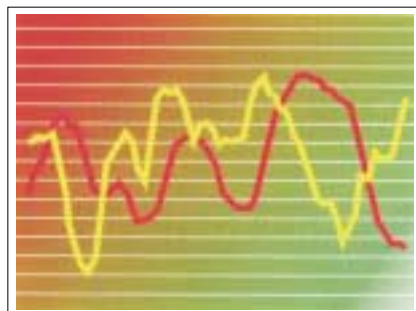


CONJONCTURE IN FRANCE

DECEMBER 2002



STEP-BY-STEP GROWTH

This document is available on the INSEE Webservice <http://www.insee.fr>

STEP-BY-STEP GROWTH

With 0.7% growth in the euro zone (1.0% in France), the year 2002 failed to realise the hopes of an upturn in Europe following the sharp world slowdown in 2001. Three main conclusions seem to emerge from this: a high degree of sensitivity on the part of the European economies to an increasing number of external shocks, a lack of internal driving forces in the euro zone and a particular weakness on the part of Germany, its principal economy. In France, while corporate demand remained depressed throughout the year, household consumption continuously increased, constituting the principal growth motor. Admittedly, purchasing power again rose strongly, thanks mainly to tax cuts. Moreover, the rise in unemployment linked to the marked slowdown in employment growth (50,000 jobs created in the competitive sector in 2002, as against 230,000 the previous year) remained just slow enough not to produce any marked modification in households' saving behaviour.

At the start of 2003, two factors that had severely impacted Western business leaders' expectations from Q3 on are moving more favourably. Oil prices have eased back and the stock markets have got some colour back in their cheeks. Moreover, monetary policy has again been relaxed. Following strong growth in Q3 (1.0%) and probably more modest growth in Q4, the American economy, given the progress in companies' situations, now seems capable of returning to a GDP growth rate of the order of 3% in H1 2003. This would contribute to an expansion of world trade that would benefit the euro zone.

Business leaders' expectations in the euro zone are tending to improve, but the outlook for the very short term is penalised by the adverse tendencies in the German economic situation. In France, conversely, activity is still enjoying the benefits of a steady increase in consumption. The rise in incomes linked to the tax cuts in the latter part of 2002 can be expected further to bolster household spending in H1 2003, but the effect is likely gradually to wear off. However, the purchasing power of earned income would be maintained by a steady slowdown in inflation and a continuation of wage growth. Core inflation, which was above 2% in the first three quarters of 2002, is expected to fall back towards 1.6% in mid-2003 and the year-on-year rise in consumer prices is likely to be 1.7% in June 2003, compared with 2.3% in December 2002. In these circumstances, household consumption would gradually slow down, against a background of a slowly rising unemployment rate (9.3% in June 2003).

Firms are only at the start of the recovery in their profit margins and are therefore likely to remain cautious as regards job creation. Even so, the easing of the climate of uncertainty and the strengthening of the world economic situation would permit a more neutral stance as regards stocks and investment. The net result would be a steady acceleration in French growth, bringing the average for H1 2003 to around 2% (at annual rate). This evolution obviously assumes that there will be no significant new external shock, in which case the tendency for growth to accelerate would be postponed yet again. ■

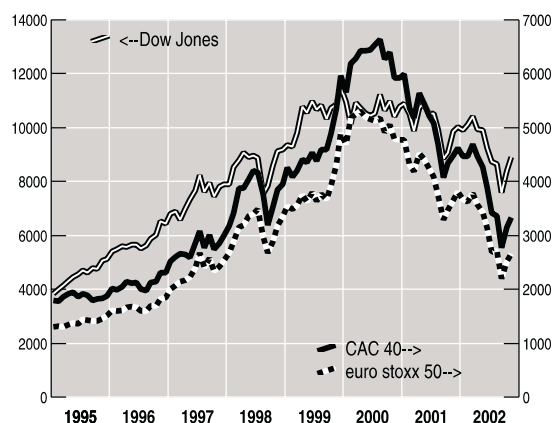
The spring of 2002 saw increased uncertainty and a deterioration in the financial situation...

In a climate of uncertainty as to the robustness of the revival in American activity and with the stagnation in euro-zone domestic demand persisting, the business climate worsened sharply during the summer, following the improvement seen between December and May. This tendency coincided with the fall on the stock markets, also influenced by investors' mistrust of the reliability of company accounts, as well as by uncertainties over the international political situation.

The risk premiums being demanded by the markets on corporate bonds then increased substantially on both sides of the Atlantic, hardening the financing conditions of loans and of market finance. The larger firms found their short-term financing particularly affected, especially in sectors related to telecommunications and the new technologies, where debt was already high.

As a result, despite the diffusion of central-bank cuts in leading rates to all risk-free interest rates, corporate demand for loans declined. In addition, firms had borrowed heavily to finance the steady level of investment between 1998 and 2000. Faced with their repayment obligations, and at a time of uncertain prospects, they made great efforts to reduce their debt. In France, the debt of non-financial firms expressed as a percentage of GDP stabilised, after rising sharply in previous years. In Germany, the downturn in borrowing was intensified by the problems of the banking system.

STOCK EXCHANGE INDEX OF THE UNITED STATES AND THE EURO ZONE



... with a negative impact on corporate demand and activity

The economic slowdown led to a steady fall in corporate investment in 2001, both in the United States (a decline of 9.3%, year-on-year by the year-end) and in the euro zone, where productive investment fell back by 4.8%. For similar reasons, firms had adopted a very strict policy regarding their inventories. In 2001, this behaviour had lopped 1.2 of a point off growth in the United States, 0.4 of a point in the euro zone and 1.0 point in France. In H1 2002, business leaders' expectations started to recover and the de-stocking was reversed.

However, in the euro zone the downturn in expectations starting in June and the tight financing conditions prompted a further postponement of investment decisions and increased de-stocking. In

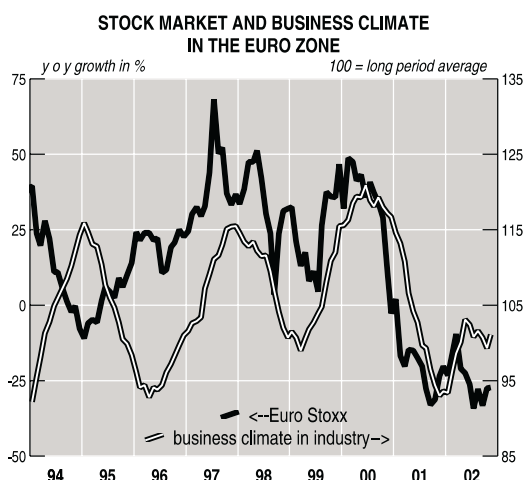
FRANCE : GROSS DOMESTIC PRODUCT (volume) BY TYPE OF EXPENDITURE

(at 1995 prices seasonally and working-day adjusted data. % change from previous period)

| | | 2001 | | | | 2002 | | | | 2003 | | 2001 | 2002 | 2003* |
|---|--------|------|------|------|------|------|------|------|------|------|------|------|------|-------|
| | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | | |
| GDP | (100%) | 0.4 | -0.1 | 0.4 | -0.4 | 0.6 | 0.4 | 0.2 | 0.3 | 0.4 | 0.6 | 1.8 | 1.0 | 1.3 |
| Imports | (27%) | -2.0 | -1.9 | -0.6 | -3.1 | 2.9 | 1.4 | 0.2 | 0.8 | 1.8 | 1.6 | 0.8 | 1.1 | 4.1 |
| Consumption | (54%) | 1.1 | 0.4 | 0.9 | 0.2 | 0.3 | 0.4 | 0.7 | 0.6 | 0.6 | 0.4 | 2.7 | 1.8 | 1.9 |
| Public consumption | (23%) | 0.3 | 0.5 | 1.0 | 0.6 | 0.9 | 0.8 | 0.3 | 0.9 | 0.8 | 0.8 | 2.5 | 3.0 | 2.4 |
| Investment | (20%) | 0.6 | -0.6 | 0.3 | -0.4 | 0.3 | 0.1 | -0.9 | -0.4 | -0.2 | 0.3 | 2.6 | -0.4 | -0.7 |
| of which: | | | | | | | | | | | | | | |
| Non financial corporated and unincorporated enterprises | (12%) | 0.4 | -0.2 | 0.1 | -0.7 | 0.5 | -0.5 | -0.8 | -0.4 | 0.0 | 0.5 | 3.3 | -0.9 | -0.5 |
| Households | (5%) | 0.4 | -1.5 | 0.2 | -0.1 | -0.1 | 1.1 | -0.7 | -0.3 | -1.0 | -0.8 | -0.9 | 0.0 | -1.9 |
| Exports | (29%) | -0.1 | -2.9 | -0.6 | -2.3 | 2.3 | 1.7 | 1.2 | 0.9 | 0.9 | 1.4 | 1.5 | 1.6 | 3.6 |
| Contributions to growth | | | | | | | | | | | | | | |
| Internal demand ex. inventory changes | | 0.8 | 0.2 | 0.8 | 0.2 | 0.4 | 0.4 | 0.2 | 0.5 | 0.5 | 0.5 | 2.6 | 1.6 | 1.5 |
| Inventory changes | | -0.9 | 0.0 | -0.4 | -0.7 | 0.3 | -0.1 | -0.3 | -0.2 | 0.2 | 0.1 | -1.0 | -0.8 | -0.1 |
| Net foreign trade | | 0.5 | -0.3 | 0.0 | 0.2 | -0.1 | 0.1 | 0.3 | 0.0 | -0.2 | 0.0 | 0.2 | 0.2 | -0.1 |

Forecast

* Carry over effect at Q2.



France, firms' inventory behaviour had a virtually continuous negative impact on growth from the start of 2001. The recovery in the early part of 2002 was very shortlived, with inventory investment again making a negative contribution to growth as of Q2 in France (-0.1, followed by -0.3 of a point in Q3), but at the same time total investment in France rose by 0.1% in Q2 before falling by 0.9% in Q3 (the corresponding figures for the corporate sector being -0.5% and -0.8%). Similarly, in Germany total investment fell by 3.0% and 0.5% in the same two quarters.

More favourable conditions for investment emerging towards the end of the year

However, the halt to the stock-market slide that occurred in October has improved firms' financing conditions, with, in particular, a diminution in the risk premiums for equities and bonds beginning in November. Moreover, the Fed and the ECB each in turn made 50-basis-point cuts in their leading rates in the final months of 2002 and this should make financing conditions even more favourable.

The deterioration in the business climate as seen by industrial firms in the euro zone came to an end in November. The cyclical turning-point indicator in industry moved out of an unfavourable zone into a neutral zone. Germany was alone in not benefiting from this positive change. In France, the ending of the deterioration in the industrial business climate was also to be seen in the other sectors, heralding less restrictive corporate demand. In particular, the contribution from inventory changes is expected to turn positive again from the start of 2003.

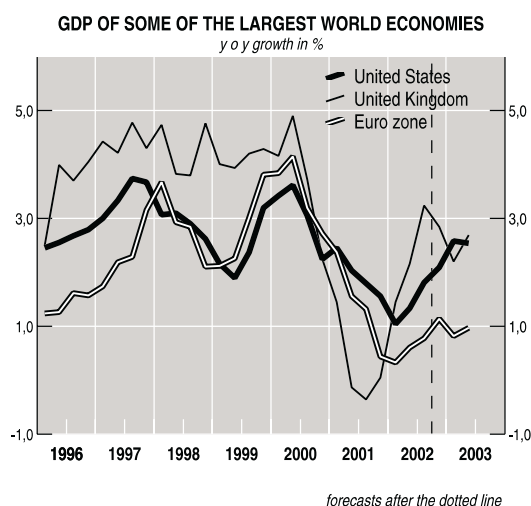
With French domestic demand meanwhile remaining strong, the conditions are now in place for a gradual recovery in investment once firms have closed their books for 2002. The monetary stance is more accommodating, the conditions for market finance are less uncertain and the growth in borrowing has

now been brought under control. However, the positive signs of an upturn are too recent and too tenuous and the capacity utilisation rate is not indicating pressures on the productive system, so that the upturn in spending suggested in the latest survey of industrial investment is therefore unlikely to come through before the spring. The investment pattern in the euro zone is likely to be similar, although less marked because of the situation in Germany. The outlook for domestic demand in that country remains depressed at the end of 2002, despite the support from the spending that has been launched following last summer's floods.

The annual growth rate in the United States should be close to 3% in the early part of 2003

In the United States, domestic demand has been much livelier. Despite the negative wealth effects, consumption has been the mainstay of growth since the end of last year. It received a further boost from a proactive fiscal policy, from an injection of liquidity into household budgets through the refinancing of their mortgage-backed loans, as well as from the advantageous hire-purchase terms offered by the car-makers. With this last factor no longer having as great a favourable effect towards the end of the year, consumption is likely to weaken in Q4 2002, before returning to an annual growth rate of 3% in H1 2003.

In this context of firm household demand, the improvement in stock prices that began towards the end of 2002 and easier access to borrowing can be expected to re-boost US corporate investment in the coming half-year. Corporate capital spending, which has already been stable since Q2, would then take up the running from the re-stocking behaviour that had made a major contribution in the early part of 2002 to the upturn in activity. Growth in United States activity can then be expected to be close to an annualised rate of 3% in H1 2003, compared with 0.3% in 2001 and 2.4% in 2002.



World trade likely to revive gradually

The strength of American demand can be expected to give a fresh impetus to industrial production in Asia. The Asian countries are in fact closely dependent on the level of American activity, notably through their exports of high-tech products. Latin America should also benefit from the upturn in trade launched in the United States.

Similarly, in the United Kingdom external demand should gradually take up the running from household consumption. Against a background of relatively fast-rising income, mortgage-backed loans, bolstered by the steep rise in house prices, have hitherto enabled private consumption to rise rapidly. However, consumption is likely to weaken to an annual rate of the order of 2 to 2½% with the slowdown in house prices and the heavy interest burden borne by households. Having recovered in the spring (rises of 0.6% and 0.8% in Q2 and Q3 2002), GDP growth should nevertheless remain at an annualised rate of the order of 2½%. Corporate demand as well as government spending would make an increasing contribution to this firm growth.

All in all, the euro zone's international environment is likely to be better oriented in 2003 and to favour the revival of trade

In France, employment in the competitive sector would go on rising slowly

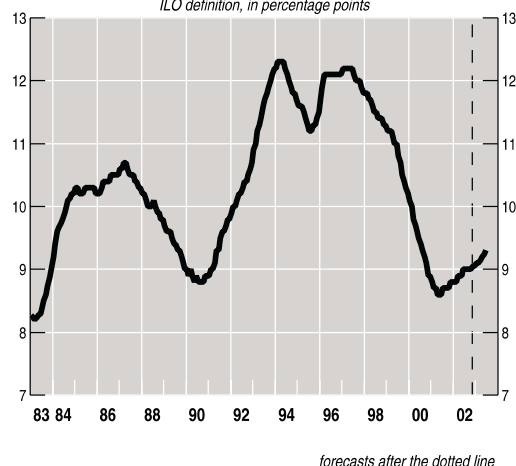
Since 2001, the deterioration in economic activity has been a factor in the marked slowdown in job creation. In France, the slowdown in employment that began last year continued in 2002: following 570,000 job creations in 2000 and 230,000 in 2001, employment in the competitive sector is expected to show a rise of only 50,000 in 2002. Reacting belatedly to the upturn in the early part of 2002, employment in the competitive sector ceased slowing down in H2, and is likely to continue to grow at a similar rate in H1 2003 (+0.2%). As a result, the economy would once more show gains in apparent labour productivity, with firms coping with the need to restore their margins. Following their marked deterioration since 2001, profit margins are likely to recover slightly in the early part of next year.

In view of the expected decline in the number of beneficiaries of state-assisted posts in the non-market sector, total employment is set to stabilise in H1 2003. Employment is likely to move somewhat less favourably in the rest of the euro zone, notably in Germany, where it has already started to decline, in line with the gloomy economic environment.

The weakening of employment explains the rise in unemployment begun since Q3 2001. In France, the unemployment rate rose substantially in Q2, before

UNEMPLOYMENT RATE IN FRANCE

ILO definition, in percentage points



stabilising at 9.0% until October (compared with 8.7% a year earlier). Given the slow rise in employment, the slowdown in the labour supply should not prevent a further rise in unemployment in coming months, bringing the rate to 9.1% of the labour force by the end of the year, and later to 9.3% in June 2003. The rise in the unemployment rate for the euro zone is likely to remain similar, amounting to 8.4% of the labour force in October 2002, as against 8.1% a year earlier, and this upward tendency is set to continue.

French household income growth likely to remain firm

Past increases in the unemployment rate have held back wage growth. However, three factors are contributing in France to a slight increase in wage growth in the coming half-year: the past acceleration in prices, the gradual ending of the wage-restraint agreements in firms having moved to the 35-hour week and the new regulations concerning overtime. After slowing down in 2002, the rise in average earnings per head is likely to return to an annual rate slightly below 3% in the coming half-year. With employment weakening, the total wage bill in firms in the competitive sector had slowed down substantially in 2002 (an annual rise of 2.9%, compared with 5.0% in 2001), but should now cease to do so.

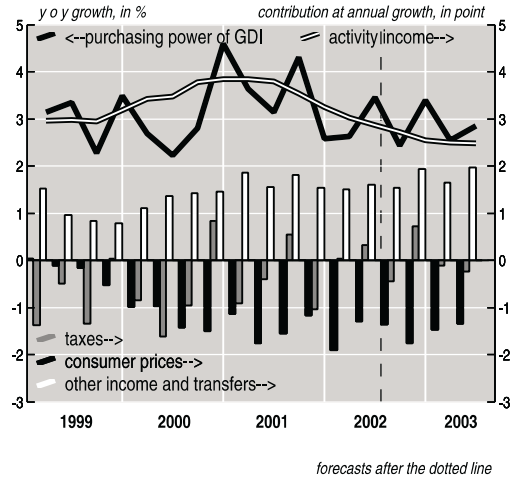
The other components of income are likely to slow down slightly in the early part of next year. Following the successive changes to the civil service salaries index in 2002, the growth in the total general government wage bill is likely to ease back in the coming half-year. Social insurance benefits can also be expected to weaken in the early part of 2003, after accelerating in 2002. In total, the rise in pre-tax income is likely to stabilise at a fairly firm annual rate; as in 2002, it would be slightly below 4% in the early part of next year, barely half a point less than the performance in 2000 and 2001.

Purchasing power to be bolstered by the tax cuts at the end of 2002 and the easing of inflation in the early part of 2003

Following the acceleration seen in the early part of 2002, mainly attributable to the impact of the weather conditions on the prices of fresh produce, inflation declined slightly in the spring, notably because of favourable base effects (a year-on-year figure of 1.4% in June 2002, compared with 2.2% in January). Subsequently, with the rise in the price of crude oil, prices accelerated again and inflation reached 2.2% in November. After two years of slow increase, core inflation reached a plateau at 2.2% during H1 2002, before starting a slight decline in the autumn. On the assumption that the price of crude oil stabilises at around USD 25/barrel and that the euro-dollar exchange rate remains close to parity in the coming half-year, imported inflation would be limited. Favourable base effects in food and the gradual easing of core inflation (1.6% next spring) would then enable prices to slow down, with a year-on-year rise of 1.7% in June 2003. This slowdown would mean purchasing power gains for households.

Following two years of sharp rises (3.1% in 2000 and 3.4% in 2001), the purchasing power of household gross disposable income began to slow down in 2002 (3.0%). The pattern over time within the year for growth in the purchasing power of income was yet again marked this year by the timing of tax cuts. These took effect mainly in the second half and involved a sum of 5 billion euros, equivalent to 0.5% of annual gross disposable income, 2.3 billion having been provided for in the original Finance Act for 2002 and 2.55 billion as part of the additional 5% cut. As a corollary, income growth will be low in H1 2003. However, the statistical carry-over of income growth would remain high, being 1.9% in mid-2003 compared with 2.1% a year earlier. This strong income momentum would be peculiar to France. In the euro zone in general, the total wage bill is likely to

FRANCE: PURCHASING POWER OF GROSS DISPOSABLE INCOME - BREAKDOWN

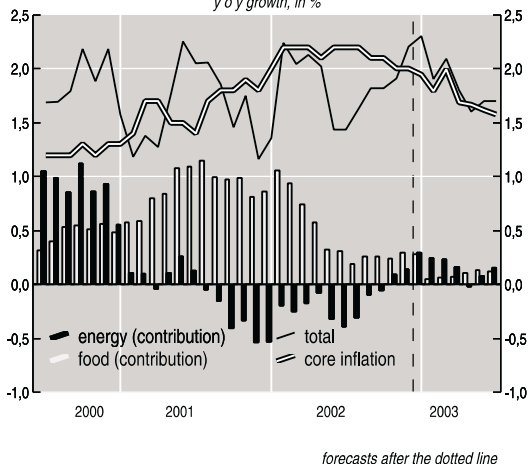


continue to slow down because of the deterioration in the employment market. The announced rises in taxes and social insurance contributions in Germany can be expected further to widen the disparity in income growth.

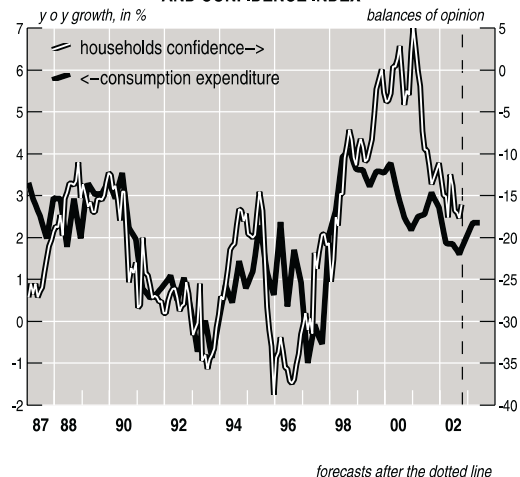
Consumption in France set to remain solid again in the early part of next year

The slowdown in growth of household purchasing power has led to a similar slowdown in household consumption. French household consumer expenditure is thought to have increased by slightly less than 2% in 2002, compared with a rise of 2.7% in 2001. In line with the decline in household confidence, private spending slowed down distinctly at the very end of last year and the early part of this. It later picked up again in Q2 and Q3, and is expected to remain at an annualised growth rate of slightly above 2% until next spring. At the same time, the rise in the saving ratio is likely to come to a halt. After standing at 15.4% in 2000 and 16.0% in 2001, it is expected to be 17.0% in 2002 before later stabilising. This sta-

INFLATION, CORE INFLATION CONTRIBUTION OF THE MAIN ITEMS



HOUSEHOLD: CONSUMPTION EXPENDITURE AND CONFIDENCE INDEX



bilisation is probably due to «smoothing» behaviour aimed at compensating for fluctuations in income, despite the rise in precautionary saving linked to the increase in unemployment.

Slack consumption in the rest of the euro zone

With incomes showing less lively growth, the consumption pattern in the other euro-zone countries is likely to be markedly different, notably in Germany. Admittedly, consumption by German households picked up substantially in Q3 (by 0.5%). However, this improvement is likely to be only temporary, being explained in part by exceptional payments of family benefits, and income growth is likely to have been sluggish thereafter.

The deterioration in household confidence since mid-2002, much more marked in the other euro-zone countries than in France, reflects households' worries over the deterioration on the labour market. This decline can therefore be expected to continue to hold down household consumption in the euro zone in the

final months of 2002 and the early part of next year, despite the purchasing power gains emanating from the decline in consumer-price inflation in the euro zone. The consumer price rise in the euro zone, from a low of 1.8% in June 2002, is expected to reach 2.4% in December before easing back to 2.0% in mid-2003. On average, private consumption in the euro zone is expected to rise by 0.5% in 2002, in other words 1½ point less than the rate in France, before returning to an annualised rate of below 1% in the coming half-year.

Activity in France set to accelerate slightly and return to a rate of the order of 2% in the first half

Household demand, despite slowing down, is expected to continue to be the main driving force for French growth. Inasmuch as corporate behaviour is likely to become less restrictive, activity could pick up again as of the end of 2002. Following annual growth of 1.8% in 2001 and 1.0% in 2002, activity in France seems set to return to an annual growth rate of 2% in H1 2003 (the statistical carry-over for growth in mid-2003 would then be 1.3%). Over the same period, notably because of the erosion in the growth of German consumption, growth in the euro zone as a whole would be distinctly less lively, at an annualised rate of between 1% and 1½%, following 0.7% in 2002 (annual average basis).

This scenario is based on the assumption of no change in the international political situation. However, mere speculation regarding military intervention in Iraq could result in sharp rises in the price of oil, leading to a draw down of income in the consumer countries. Conversely, a rapid solution to the Iraqi question would bring oil prices down. At the same time, consumption by French households could be looking slightly more dynamic by the spring, in view of the historically high level reached by the saving ratio. ■

