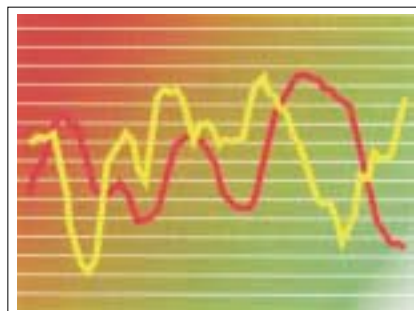


CONJONCTURE IN FRANCE

DECEMBER 2003



IN STEP WITH WORLD RECOVERY

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IN STEP WITH WORLD RECOVERY

The first half of 2003 turned out to be the low point for activity in the euro zone. European growth, after stagnating in the first half, accelerated from the third quarter on. On similar lines, the very low growth for France in 2003 (0.2%) would include a GDP rise of 0.6% in Q4, following 0.4% in Q3. Much of the recovery is explained by the improvement in the international environment, as French exports have started to grow again since the middle of the year. Interest rates remain low and this is encouraging house purchases in particular. Consumption is rising but at a modest rate. Purchasing power growth has in fact been slowing down for the past two years, as a result of the slowdown in earned income due to the decline in employment. Total payrolls in the private sector are thought to have fallen by 40,000 in 2003, the result being a steady rise in the unemployment rate (to 9.8% in December) and this has prompted cautious consumption behaviour. Meanwhile, inflation has remained above 2% in 2003.

In the final run-up to 2004, growth in the United States, still being stimulated by official policies, appears to be particularly brisk and should remain so in coming quarters. The revival in job creation should enable earned income to take up the running from tax cuts in ensuring growth in consumption. Meanwhile, the improvement in companies' financial situations as a result of the substantial productivity gains should keep investment rising. Growth is also very strong in Asia, notably in China, which has now become a front-rank force in international trade.

In the euro zone, expectations continue to improve. The new feature in these final months of the year is that industrial output, which had

been slack until September, has bounced back in Q4. Even though it does not enjoy the same fiscal support as in the United States and even though the benefits derived from the world upturn in terms of exports have been curbed by the appreciation of the euro, growth in the euro zone is expected to be on a trend rate of more than 2% in 2004, thanks to a strengthening of domestic demand.

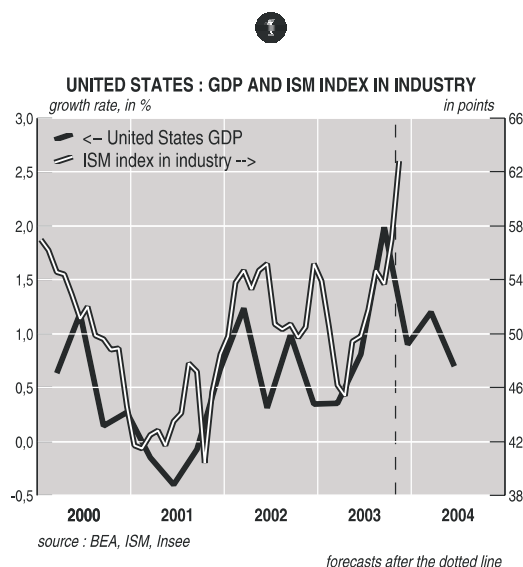
France is likely to move roughly in line with the euro-zone average, returning to a growth rate close to its long-term trend (2% to 2.5%). This acceleration in activity would be the result of more rapid export growth and a return to a positive contribution by inventories, while investment is expected to pick up gradually and consumption to maintain its moderate rise. Purchasing power, for its part, is expected to slow down in H1 2004, despite a slight easing of inflation (to 1.9% in June). Consumers, while still cautious, should nevertheless be positively influenced by the leveling out in unemployment due to a gradual return to net job creation.

In the short term, two elements could possibly hold back growth in the euro zone. The first and less likely of these would be an accelerated rise in long rates on both sides of the Atlantic. The second and distinctly more probable influence would be a lasting upward tendency in the euro versus the dollar, following the relative pause seen this past summer during the period when doubts regarding recovery in Europe were tending to favour financial investment in the United States. A possible element operating in the other direction would be a strong wave of investment, as often occurs in an upswing phase. ■

Confirmation of world recovery...

GDP growth in the United States was exceptionally strong in Q3 2003 (8% at annualised rate). Between now and mid-2004, the American economy is expected to post near-potential growth (between 3 and 4% at annualised rate). The slowdown compared with Q3 2003 would mainly be the result of the fading of the effects of the tax cuts introduced in the summer. It seems that American households spent virtually all of the proceeds from these on consumption in Q3. Household spending is likely also to have been held back to some extent by the recent rise in long rates, notably because of the resulting decline in the attraction of mortgage refinancing. Even so, consumption is expected to continue to grow at a robust rate (between 2.5% and 3.5%, annualised), with the expected improvement in earned income resulting from a higher job content of growth. Recent productivity gains generated in the American economy are unlikely to be sustainable and firms can be expected to continue to hire workers in order to meet the demand for their products. This means that the upturn in employment that began last August is likely to be confirmed in coming quarters. Another factor boosting growth would be corporate demand. Business leaders' expectations are at historically high levels (see graph 1) and financial conditions remain favourable. As a result, the upturn in investment that began in Q2 2003 can be expected to continue and firms would make a lasting reversal in their inventory behaviour starting in Q4. Finally, United States exports should accelerate, helped by the liveliness of activity in several partner countries (Canada, Japan and the United Kingdom, notably), as well as by the past depreciation of the dollar.

In the United Kingdom, GDP has been growing strongly since Q2 2003. This tendency is likely to accelerate somewhat in the final part of this year and



the beginning of 2004 (annualised rates of between 2.5% and 3.0%), with growth therefore remaining slightly above potential. Consumption would remain the main growth motor, although slowing down somewhat in response to the tighter monetary stance. Exports, on the other hand, can be expected to accelerate as a result of the recovery in world trade. Finally, corporate investment would remain firm thanks to business leaders' positive demand expectations.

Activity is also strong in several of the euro zone's trading partners in Asia. Growth is particularly strong in China (see graph 2). It is also firm in Japan, where year-on-year growth has been between 2 and 3% since the end of 2002, as well as in South Korea, where industrial output picked up strongly in the summer.

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

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

		2002				2003				2004		2002	2003	2004*
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	(100%)	0.7	0.7	0.2	-0.3	0.1	-0.3	0.4	0.6	0.7	0.5	1.2	0.2	1.7
Imports	(27%)	1.6	1.3	0.7	-0.6	0.0	0.2	-0.1	2.6	2.0	1.8	0.8	1.0	5.4
Consumption	(54%)	0.3	0.5	0.4	0.2	0.7	0.1	0.4	0.3	0.4	0.3	1.4	1.6	1.1
Public consumption	(23%)	1.4	1.2	0.7	0.6	0.3	0.2	0.7	0.9	0.5	0.6	4.0	2.1	2.0
Investment	(20%)	-0.2	0.0	-0.8	-1.2	0.1	0.3	0.3	0.5	0.6	0.7	-1.4	-0.6	1.8
<i>of which:</i>														
<i>Non financial corporated and unincorporated enterprises</i>	(12%)	-0.5	-0.9	-1.0	-1.9	0.0	0.2	0.3	0.5	0.6	0.9	-2.8	-1.8	1.9
<i>Households</i>	(5%)	0.0	1.1	0.1	-0.2	0.3	0.4	0.4	0.2	0.5	0.2	0.8	1.0	1.2
Exports	(29%)	1.8	2.6	0.1	-0.8	-2.1	-0.8	1.1	1.6	2.4	1.8	1.3	-1.6	5.4
Contributions to growth														
Internal demand ex. inventory changes		0.4	0.5	0.2	0.0	0.5	0.1	0.5	0.5	0.5	0.5	1.4	1.2	1.4
Inventory changes		0.2	-0.3	0.1	-0.2	0.2	-0.2	-0.4	0.4	0.1	0.1	-0.4	-0.3	0.2
Net foreign trade		0.1	0.4	-0.2	-0.1	-0.6	-0.3	0.3	-0.2	0.1	0.0	0.2	-0.8	0.1

Forecast
* Carry over effect at Q2.

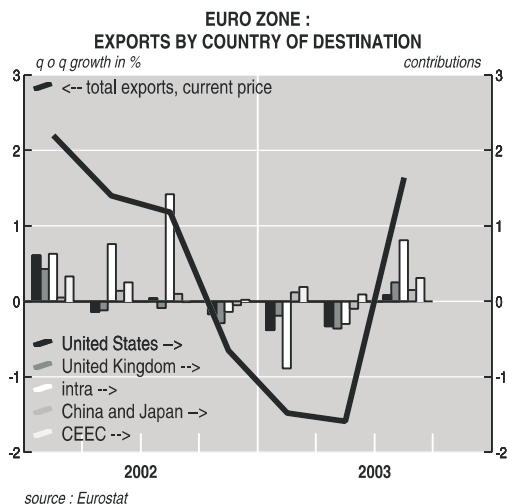
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... with immediately visible effects on euro-zone trade

The euro zone has benefited since Q3 2003 from the liveliness of activity in its principal partners. Exports to non-euro-zone countries picked up strongly in the case of the Asian countries, the United Kingdom, the United States and the CEEC (see graph 3) and are likely to continue to accelerate in coming quarters on the back of world economic recovery. Exports within the zone, for their part, have also accelerated strongly since Q3 and should continue to grow at a firm rate until mid-2004, also helped by the upturn in world trade. All things considered, total exports from euro-zone countries can be expected to show an acceleration in year-on-year growth from 4% to 8% between mid-2003 and mid-2004.

3



In France, the upturn in exports in Q3 (1.1% over the previous quarter, compared with a quarterly decline of 0.8% in Q2) is explained by the impetus given to world trade by the recovery in the American economy and by the exceptional strength of Chinese demand. Merchandise exports to the United States reversed five successive quarters of decline. At the same time, despite their small share of French exports (1.8%), sales to China made an appreciable contribution to the export recovery because of an exceptionally high growth rate (40.6% in value in Q3), partly the result of the exceptional delivery of six Airbus aircraft. In 2004, French exports should continue to be bolstered by purchases made by the United States, as well as by a recovery in orders from euro-zone countries, notably Germany, Spain and Italy. All in all, the acceleration in foreign demand would have a major impact on exports, which can be expected to grow at quarterly rates of between 1.5% and 2.5% until mid-2004.

... despite unfavourable evolutions in exchange rates

After rising steadily since the beginning of 2002, the euro/dollar exchange rate fluctuated around \$1.17 from end-May 2003 on, before breaking through the \$1.20 level at the beginning of December. On the assumption that the rate stabilises at around \$1.20, the past appreciation of the euro is likely to hamper French exports and, more generally, those of the euro zone as a whole. However, the impact is likely to fade at the beginning of 2004 and would to a great extent be eclipsed by the acceleration in activity in trading-partner countries (see graph 4).

4



The start of a new industrial upswing, driven by the external sector...

In the wake of the recovery in world trade, industrial output in the euro-zone countries is thought to have picked up again in Q4. Furthermore, business leaders' assessments of past output have also been positively headed since October. The discrepancy seen for several months between assessments of future production, which have risen sharply since July, and past production can be expected to narrow (see graph 5) and the strong tendency in exports should trigger off a new industrial upswing in the euro zone.

Industrial output in France seems to have recovered appreciably in Q4, following four consecutive quarterly declines, as indicated by the upturn in the composite business climate index in October and November (see graph 6).

... breathing new life into corporate demand

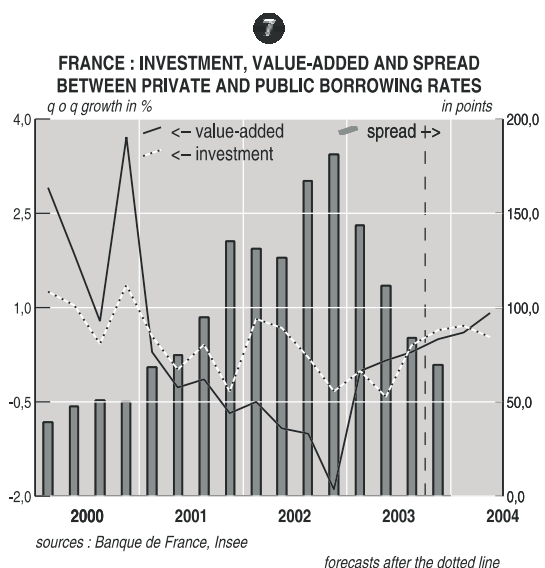
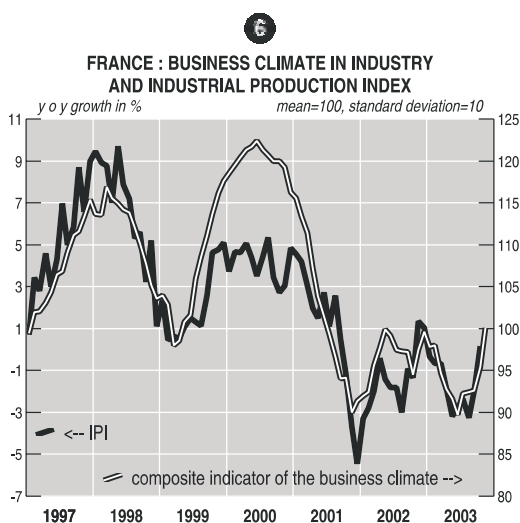
Investment barely rose in France during the first three quarters of 2003 (see graph 7), while it fell sharply in Italy and Germany. Because of the weakness of demand for companies' products, investment programmes have been thin, despite generally favourable financing conditions.

In Q4 2003 and in the early part of 2004, the recovery in the demand expected by business leaders, combined with continuing favourable financing conditions, should permit a gradual upturn in spending on capital investment. Initially, the recovery in demand would emanate essentially from abroad. As regards the financing conditions, the narrowing in the public/private interest-rate spread and the rise in



stock-market prices are confirming the decline in investors' aversion to risk. This suggests that corporate investment is set to gather speed in most countries in the zone. In the case of France, investment growth is likely to accelerate from an annualised rate of 1% to almost 4% by mid-2004.

Inventory changes, another major component of corporate demand, have continued to hold back growth in Q3 2003. Even so, a turning point in the inventory cycle has probably been reached. In November 2003, the principal determinants of inventory behaviour were once more favourable. For example, business leaders in industry, notably the producers of intermediate goods, now judge their inventories to be on the low side, while production prospects have climbed steadily back from the low point reached in June 2003. With demand once more lively as of the



end of the year, inventory changes are likely to have again made a positive contribution to growth starting in Q4 2003.

Starting already in Q1, employment is likely to be stimulated by the upturn in activity

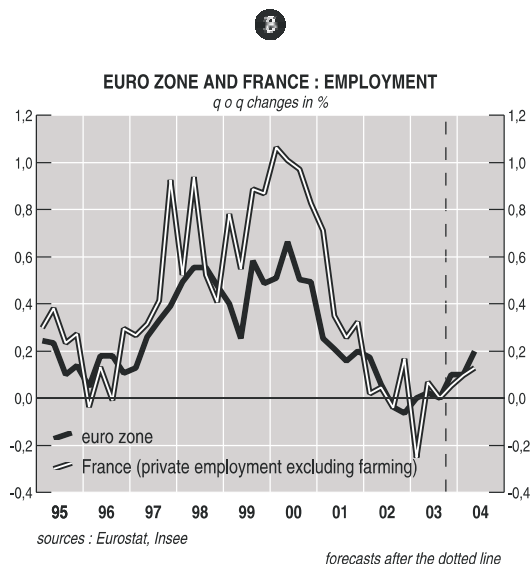
In parallel with an improvement in the tendency for corporate demand in terms of investment and inventories, the employment situation in the euro zone should also improve. Taking the zone as a whole, employment is expected to grow by 0.1% in Q1 and Q2 2004 (*see graph 8*).

In France, employment in the tertiary sector, which had already been rising since Q2 2003, seems set to accelerate gradually to growth rates of the order of 0.4% per quarter in the first part of next year. In particular, temporary agency employment, which is highly sensitive to the economic situation, should benefit to the full from the upturn in industrial output. In the case of employment in industry excluding temporary agencies, there would from now on be a slower decline: business leaders' opinions regarding the outlook for employment are in fact recovering under the influence of the upturn in demand.

In addition, the expansion of employment in the competitive sector in France would be facilitated by employment policies directed towards the private sector. The numbers newly affected by the specific arrangements in favour of employment in the market sector should have a visible impact: «sandwich» contracts should start to rise again, those for «young people in companies» continue to build up, people affected by the «employment initiative contracts» should rise and the new «minimum income from activity» gradually start to be applied. At the same time, however, certain earlier measures would no longer be contributing to evolutions in employment. The overall impact of exonerations from social insurance contributions for the lower-paid, taken a stage further by the «Fillon» law, would be countered by the rise in the cost of labour resulting from the harmonisation of the various monthly minimum wages.

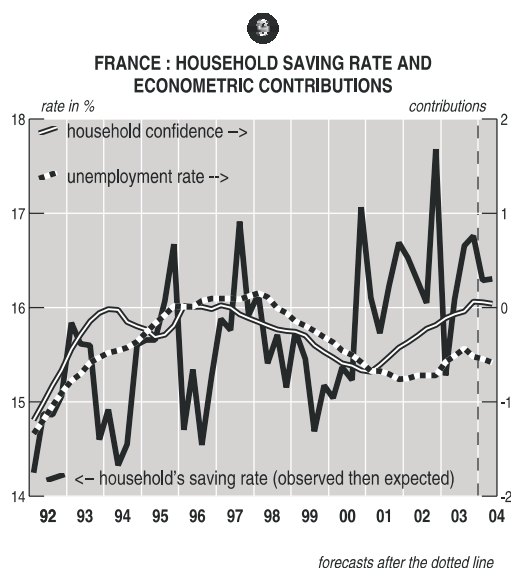
The reversal in the tendencies of the unemployment rate and inflation should allay households' nervousness and hence reduce the saving ratio...

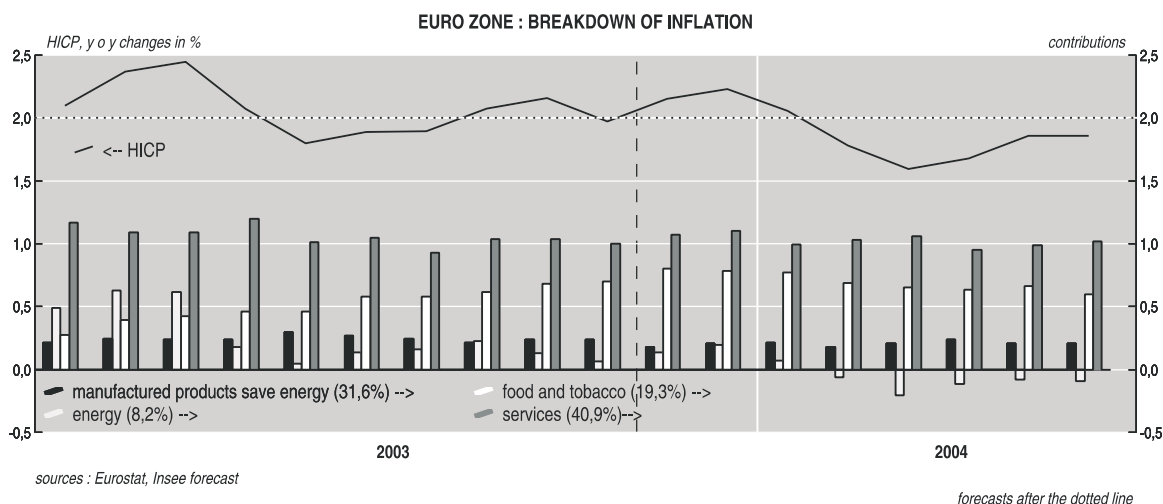
Starting in Q1, European households can be expected to take on board the change in the economic environment, notably the revival in employment, accompanied by a gradual reversal of the unemployment curve and a slowdown in inflation. As a result, households would feel able to reduce their past precautionary savings (*see graph 9*).



The resumption in employment growth would have a favourable impact on household confidence. In France, this would be linked in particular to a turning point in the unemployment rate. At the end of H1 2004, the rate is expected to be 9.8%, as at the end of 2003, since the impact of the rise in employment would be compounded by the measure about to come into force enabling workers who began their careers at a very early age to take retirement sooner than previously possible, the result being slower growth in the labour force and an additional downward influence on unemployment numbers.

The slowdown in inflation is liable to have a positive effect on household confidence, especially as it would be due to a slowdown in energy prices, to which households are particularly sensitive. Inflation in the euro zone would then be at a slower rate in H1 2004. Having still been above 2.0%, year on year, in the final part of 2003, it would fall below this threshold in Q1 2004 (*see graph 10*). Core inflation,





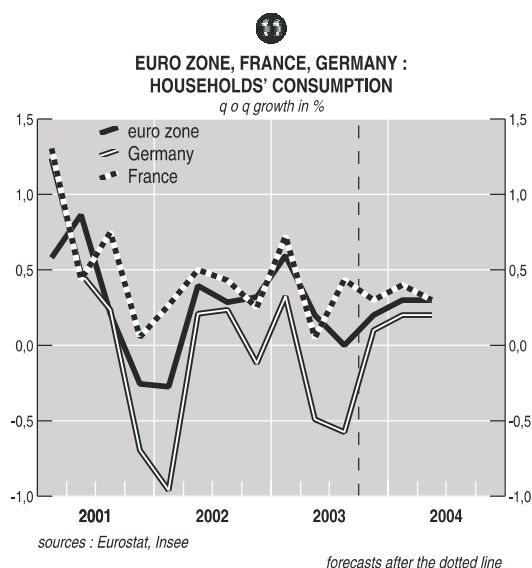
for its part, would remain stable, influenced notably by the continuing rise in prices of services. On the assumption that the exchange rate versus the dollar stabilises at \$1.20 and that the price of Brent falls gradually to \$25 at the end of H1 2004, the past rises in energy prices, which were particularly marked in Q1 2003, would drop out of the inflation calculation for the euro zone, traditionally measured on a year-on-year basis. Apart from its impact on household confidence, this slowdown in inflation would permit certain purchasing power gains.

... but consumption growth is likely to remain moderate because of low purchasing power gains

After stagnating in Q3 2003, consumption by European households can be expected to pick up again starting in Q1, rising by 0.3% in Q1 and Q2, following 0.2% in Q4 2003 (see graph 11). Previously, the decline in spending by German households in Q2 and Q3 2003 had had a particularly severe negative impact on spending by households in the euro zone as a whole. French household consumption, for its part, had slowed down distinctly in Q2 before picking up again in Q3.

Nor is consumption in France likely to accelerate to any greater extent between now and mid-2004, given the lacklustre state of household income. The purchasing power of gross disposable income is thought to have increased by 1.8% in H2 2003 compared with the previous half-year before stagnating in H1 2004. Wages and salaries received by households will probably slow down very slightly in H1 2004, despite the rise in employment. This is because of the moderate scale of wage increases: in the civil service, only a very small adjustment in the index will occur in 2004, while in the private sector the basic monthly wage is likely to continue to grow at the same rate (around 2.6%, year on year), after benefit-

ing on a one-off basis from the rise in the «social minima» on 1 July 2003 under the law relating to the harmonisation of minimum wages and guaranteed monthly remuneration levels. Furthermore, cash benefits received by households are likely to continue to slow down, notably because of the stabilisation of unemployment and the adoption of a new convention for the Unédic unemployment insurance scheme that reduces the duration of benefit entitlement and lengthens the minimum duration of contributions needed in order to be indemnified. The number of beneficiaries of unemployment benefit could fall by 13% as of January and the proportion of jobseekers in receipt of benefit decline from 53% to roughly 45%. Finally, compulsory payments by households can be expected to accelerate in H1 2004, given the time pattern of tax cuts. The earlier cuts applicable to the income tax payable in 2003 were felt in H2 2003, at the time when households paid their third annual instalment or were informed of an adjustment in their monthly instalments. As a result, despite the government's decision to imple-



ment the next round of tax cuts in the first instalments payable in 2004, payments due from households would show an apparent increase in H1 2004.

However, the purchasing power slowdown would not be sufficient to reverse the renewed moderate increase in French household spending between now and the end of H1 2004. For one thing, the past rises in purchasing power, which were strong in the period to mid-2003, would continue to stimulate consumption; for another, the improvement in the economic climate would act as an incentive to households to limit their precautionary savings. In the case of France, therefore, household consumption is expected to grow at a steady rate of between 0.3% and 0.4% per quarter. This growth in consumption would occur without eroding investment in housing, which, as shown by the latest figures for construction permits, is likely to grow at a steady rate following a slight slowdown in Q4 2003.

Activity likely to find support from all components of domestic demand, being already lively in services and distribution

Domestic demand should provide lasting support for activity in the euro zone: the steady growth in consumption, the acceleration of investment under the impact of external demand and the favourable financing conditions, as well as a more pro-active attitude to inventories in the light of the recovery in demand expectations, is liable to underpin activity throughout the zone during H1 2004. Euro-zone GDP growth would then accelerate, from 0.5% in Q4 2003 to 0.6% and 0.5%, respectively, in the next two quarters.

In France, the acceleration would occur somewhat in advance of the zone as a whole: 0.6% already in Q4 2003, followed by 0.7% and 0.5%. The statistical carryover for growth in 2004 would then be 1.7% in midyear. Growth in the case of services, already strong in Q3 2003, will probably continue, stimu-

lated particularly by healthcare spending. The dynamism of the services sector would then become generalised under the impact of domestic demand. In the case of retail distribution, the general outlook for activity already showed considerable improvement in the November business survey, a sign of expectations of firm household demand. The November survey for wholesale distribution also showed respondents judging the outlook for activity to have improved. At some stage, demand tendencies will lead to a rise in industrial output, as confirmed by the upturn in the business climate (*see graph 6*). Following several consecutive quarters of decline, manufacturing output is thought to have increased by 1.1% in Q4 2003 before slowing only slightly in Q2 2004 as result of the slowdown in world trade. In the construction sector, underpinned by firm investment in building on the part of both households and firms, output is set to rise at quarterly rates of between 0.5% and 0.6%. The energy and transport branches, for their part, buoyed up by household demand and by an increased need for inputs on the part of firms, are likely to track movements in activity for the economy as a whole.

The euro exchange rate still an element of uncertainty

Should the euro continue to appreciate in coming months, this would have an impact on the scenario described above. Additional appreciation of the European currency would impair export price-competitiveness and lead to a downward revision in industrial leaders' demand expectations. Conversely, however, it is possible that the scenario underestimates corporate demand. Demand in the form of investment may be stronger than business leaders are currently expecting, given the backlog that may have accumulated since 2002 and inasmuch as investment growth rates in upswing periods are often higher than those posited here. ■