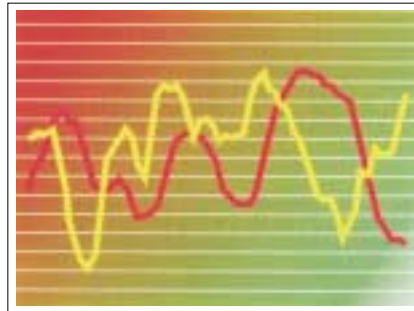


CONJONCTURE IN FRANCE

MARCH 2003



WAITING

WAITING

The recovery that was expected in 2002 following the sharp slowdown in 2001 failed to materialise. Numerous shocks (higher oil price, falling stock markets, international political uncertainties), in combination with the worries inspired by the inertness of the euro zone, and more especially Germany, kept business leaders sitting on their hands. The improvement in household consumption, thanks to a distinct rise in incomes and despite the gradual build-up of unemployment, provided the main prop for activity in France. The result was very slow growth, with the annual average rise in GDP no more than 1.2%.

In Q1 2003, the tendencies for the economy in France seem to be in line with those seen last year. Growth remains slow and the marked differences in the evolution of the various components of demand are being reflected in a dichotomy between sectors. On the one hand, industry and wholesale distribution are suffering from the slackness of exports and investment; on the other, retail distribution, services and, to a smaller extent, housing-related activities are benefiting from the rise in consumption. Similar dichotomies are to be found in the evolution of employment, where the very small overall increase masks a rise in the tertiary sector and a sharp contraction in industry, and also of unemployment, whose rise is affecting mainly males. Consumption is still underpinning growth, but, apart from an upturn in energy consumption due to fluctuations in weather conditions, is tending to slow

down. The impact of past rises in purchasing power is now fading. Moreover, households' expectations have deteriorated. Their worries are less concerned with their personal financial situations than with the overall climate and the labour market. The first quarter of 2002 is coming to an end with economic agents' confidence ebbing.

As regards the second quarter, the assumption is being made here that, on the lines of what happened in 1991, the decline in business leaders' expectations will come to a halt before mid-year. If the oil price stabilises at around 30 USD/barrel, inflation is expected to stand at 2.2% in June. Consumption is likely to grow slowly, against a background of a continuing rise in the unemployment rate, which is likely to be around 9.3% in mid-year. From then on, corporate demand would turn up again, but gradually, with business leaders still preoccupied by the need to clean up their balance sheets and to face up to the consequences of the appreciation of the euro for external demand. The result would be slight growth in the quarter. There are numerous uncertainties hanging over the evolution of the economy, mainly relating to the progress of the conflict and its consequences. A sharp depreciation in the dollar would be very costly for growth in the euro zone, but not in the short term. For the immediate future, the main threat probably lies in an additional weakening of household consumption. ■

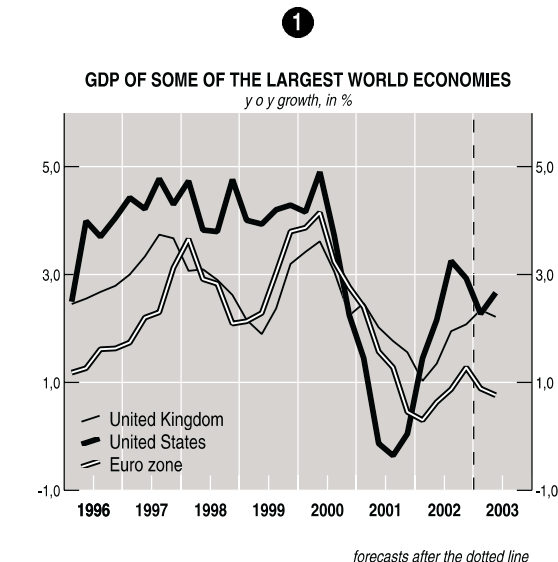
Completed on March 21, 2003

Since the end of 2002 pressures on the oil price have been affecting the world economy

The world economy has been affected since the end of last year by severe pressures on the price of oil. Between November 2002 and February this year the price per barrel has risen from 25 to 33 USD. This rise is explained mainly by domestic pressures in Venezuela and by the uncertain political climate regarding Iraq. The markets' expectation of military intervention in Iraq therefore prompted a rise in the price as of end-November, this rise then being accelerated in the early part of December following the virtually total stoppage of Venezuelan production. The combination of these different political tensions is likely to continue to affect global supply and maintain pressure on prices in coming months. It is difficult to see the present small excess productive capacity being capable of meeting a possible supply shortfall linked to a war in Iraq. This means that the oil price seems set to remain high, at around 30 USD/barrel in Q2 2003. By giving a boost to inflation, the rise in the oil price that began in November is eroding the purchasing power of household income and corporate margins and affecting expenditure in all the consumer countries.

Growth set to be below potential in the United States and the United Kingdom

This is true of households in the United States and the United Kingdom. However, in these two countries other factors are contributing to the slowdown in consumption in the early part of 2003. First of all, the negative wealth effects linked to past falls in eq-



uity prices are likely to continue to have an adverse effect. These negative effects had been compensated in 2002, notably by particularly advantageous refinancing of mortgage loans linked to the interest-rate cuts seen in 2001 and 2002. However, in 2003, the conditions for mortgage refinancing are set to stabilise and this will mean a gradual diminution in the growth of the resources derived in this way. All in all, consumption will probably slow down in the United States, with half-yearly growth falling from 1.4% in H2 2002 to 1.0% in H1 2003. In the United Kingdom, the corresponding fall would be from 1.8% to 0.8%.

With household demand slowing down, and against an uncertain international political background, business leaders' expectations remain depressed. Both in the United States and the United Kingdom investment is likely to pick up only in limp fashion and inventory behaviour to turn only slightly posi-

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	0.3	-0.3	0.7	0.4	0.3	0.2	0.3	0.3	1.8	1.2	0.9
Imports	(27%)	-2.1	-2.0	-0.7	-2.9	3.0	1.6	0.6	-0.4	0.9	1.0	0.9	1.2	2.1
Consumption	(54%)	1.1	0.4	0.9	0.2	0.3	0.4	0.6	0.4	0.7	0.3	2.7	1.8	1.7
Public consumption	(23%)	0.3	0.5	1.2	0.4	1.2	1.0	0.5	1.1	0.7	0.7	2.5	3.6	2.6
Investment	(20%)	0.7	-0.6	0.4	-0.5	0.3	-0.1	-0.7	-0.7	-0.4	-0.1	2.6	-0.6	-1.4
<i>of which:</i>														
Non financial corporated and unincorporated enterprises	(12%)	0.4	-0.3	0.3	-0.9	0.3	-0.7	-0.8	-0.7	-0.4	0.0	3.3	-1.3	-1.6
Households	(5%)	0.5	-1.6	0.3	-0.1	0.0	1.0	-0.1	-0.6	-0.4	-0.5	-0.9	0.2	-1.0
Exports	(29%)	-0.5	-2.9	-0.6	-1.8	1.9	1.8	1.6	-0.3	0.5	0.5	1.5	1.5	1.8
Contributions to growth														
Internal demand ex. inventory changes		0.8	0.2	0.8	0.1	0.5	0.5	0.3	0.3	0.5	0.3	2.6	1.7	1.2
Inventory changes		-0.8	0.0	-0.5	-0.7	0.4	-0.1	-0.3	-0.1	0.0	0.1	-1.0	-0.6	-0.3
Net foreign trade		0.5	-0.3	0.0	0.3	-0.2	0.1	0.3	0.0	-0.1	-0.1	0.2	0.1	0.0

Forecast

* Carry over effect at Q2.

tive, given that the capacity utilisation rates are also relatively low. As a consequence, the American and British economies seem set to grow in H1 2003 at annual rates slightly below their potential, by around 2 1/2% and 2% respectively.

The unsupportive external environment and the appreciation of the euro are holding back euro-zone exports

The slower growth in activity in the United States and the United Kingdom is likely to lead these countries to limit the volume of their imports in H1 2003. In the United Kingdom, imports would continue to decline in Q1 2003 and pick up only very slightly in Q2. In the case of the United States, imports would be sustained by the recovery in trade with Asia and the rest of North America.

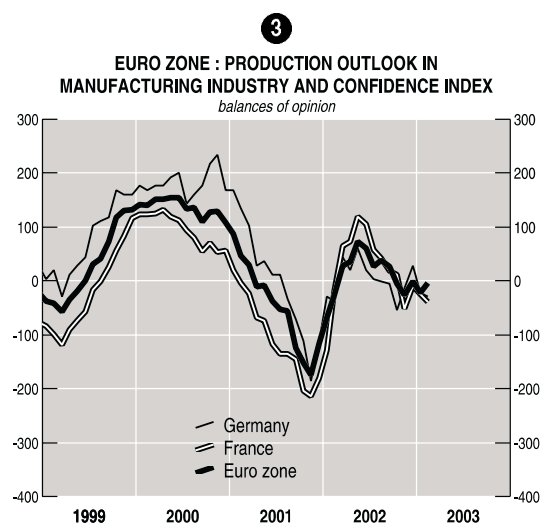
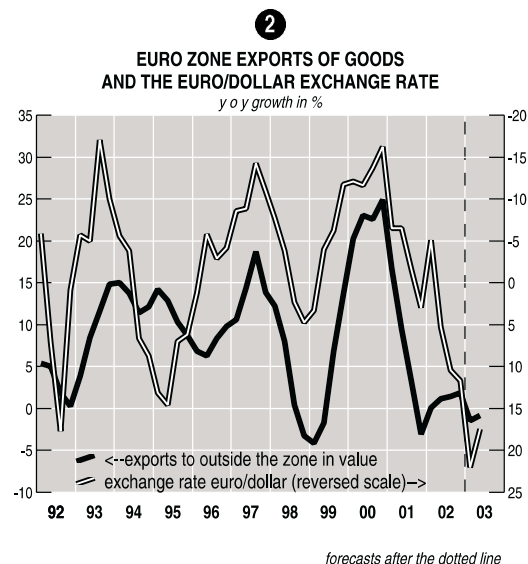
Euro-zone exports would be hit by this unsupportive external environment, especially as the recent appreciation of the euro penalises the competitiveness of firms in the zone. From a starting point of 0.90 USD at the end of 2001, the euro put on almost 14% in 2002, followed by a further 6% in the first two months of 2003, bringing the exchange rate to 1.08 USD in February. The euro's effective exchange rate has also been affected by appreciation versus the JPY and the GBP. All in all, exports from the euro zone are likely to lack vigour: having stagnated in Q4 2002, they are expected to rise by only 0.2% and 0.6% in Q1 and Q2 2003.

European activity likely to suffer from these unfavourable tendencies

Activity in the zone is likely to suffer from the low export growth and this external shock would then curb somewhat more intra-industrial trade. The prospects reported by business leaders in manufacturing industry have deteriorated slightly in the early part of the year, thus revealing the wait-and-see position adopted by business leaders. After two quarters of stagnation, industrial production in the euro zone is therefore unlikely to recover in the early part of 2003. In France, manufacturing production would also continue to stagnate during the first half of the year.

A slowdown in corporate spending in 2002 against a background of tighter financial conditions

In the final part of 2002, firms saw both their loan financing and their market financing reduced. It is the fall on the stock markets that seems to have influenced this decline, which itself reflected investor



mistrust of the reliability of corporate accounts (the Enron affair) and uncertainties regarding the international political situation.

The risk premiums required by the markets on corporate bonds accordingly rose appreciably until October, hardening the conditions for loan and market finance for firms in both the United States and the euro zone.

In 2002, the downturn in expectations in mid-year and the tightening of financial conditions during Q3 prompted firms to reduce their debt, to put their balance sheets in order and to postpone spending decisions. In France, as a result, corporate investment fell by 1.3% in 2002. Investment spending ended the year on a more negative note still, with a reduction of the order of 3% (annual rate). French firms' behaviour as regards inventories has also had a negative impact on growth virtually continuously since 2001: after lopping 1.0 point off growth in 2001, it took a further 0.6 of a point off GDP in 2002. As in 1992-1993, the contribution of inventory changes was negative throughout 2001-2002, i.e., over an exceptionally long period.

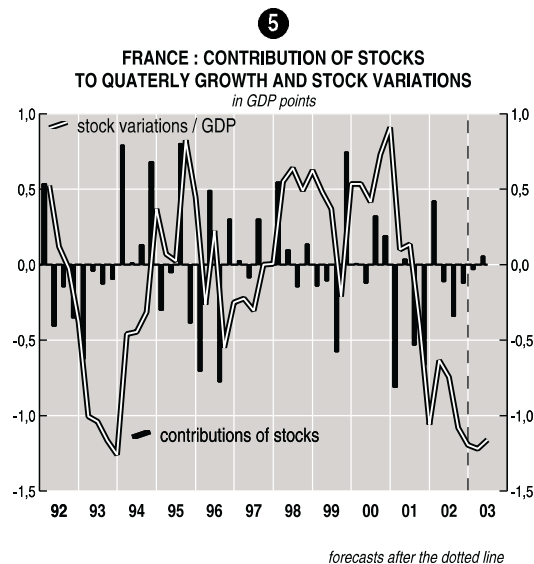
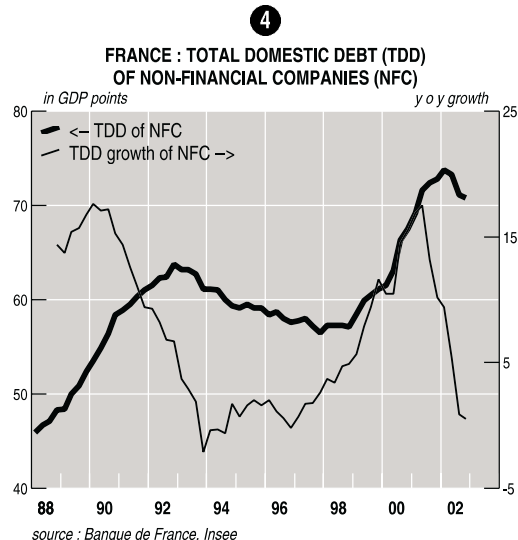
Corporate demand behaviour likely to benefit from an easing of credit conditions in the early part of 2003

Towards the end of last year, the decline in the risk premiums on private bond issues and the cuts in leading rates by the Fed and the European Central Bank (ECB) operated in the direction of an easing of money-market and loan conditions for firms. The easing of borrowing rates on the market and through intermediaries continued in parallel with the ECB's decision: Euribor rates for one to three months, but also yields on public loans for 3 and 10 years in the euro zone, declined by 50 basis points between November 2002 and February 2003. This fall in nominal yields then brought with it a similar fall in real interest rates: in France, the real long-term interest rate fell back from 3.8% in May 2002 to 1.5% in February 2003 and the real short-term rate from 2.0% in June 2002 to 0.1% in February 2003. Firms finding their finance on the bond market benefited not only from this decline but also from the narrowing of risk premiums, which amounted to roughly 50 basis points between October 2002 and January 2003.

As a result, certain leading European firms, notably in the telecom sector, have started to return to the bond market in the first months of this year. At the same time, they have cleared their balance sheets of the asset depreciation⁽¹⁾ seen in 2002 and can therefore envisage such a return to the market on a basis that is more convincing for investors.

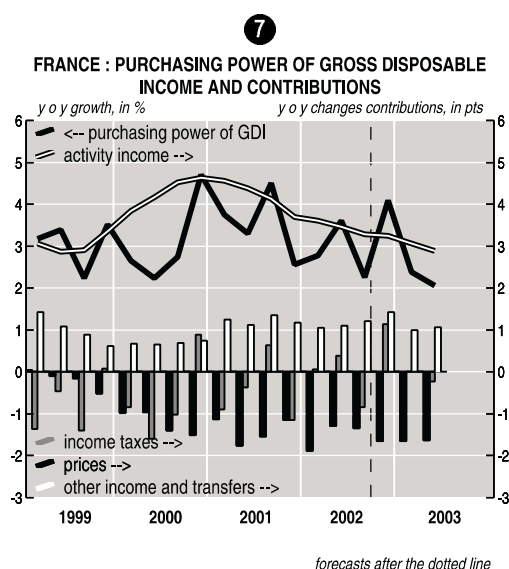
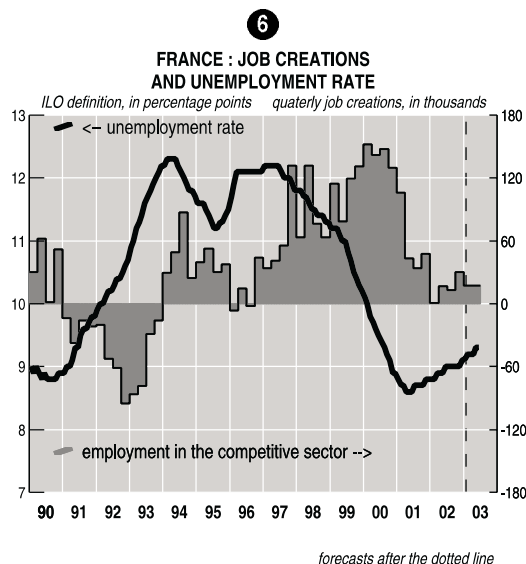
The latest cuts in ECB leading rates, by 25 basis points in March, should enable this easing to continue and contribute to an improvement in the financing conditions for firms in the euro zone. However, the improved tendency in financing conditions remains conditional on the resolution of numerous uncertainties of an economic and international political nature. For example, speculation regarding the consequences of armed intervention in Iraq has helped to produce excessive volatility in the stock-market indicators. In addition, fresh revelations of accounting frauds in Europe (Ahold) seem to have had a further depressing effect on stock markets in the early part of 2003.

At the beginning of 2003, with household demand slowing down slightly, the more accommodating credit conditions are now favouring a slight recovery in corporate demand. However, the level of productive capacity utilisation rates is not signalling any pressures on the productive system. Furthermore, the climate of extreme uncertainty is leading business leaders to be yet more cautious and to postpone investment projects. Following a smaller fall in Q1 (-0.4%) than at the end of last year (-0.7%), corporate investment can be expected to stabilise in Q2 2003. For the same reasons, the contribution of changes of inventories is likely to be neutral in the first part of the year, with firms continuing their de-stocking at the same rate as in the last months of 2002. The investment pattern in France's principal



euro-zone partners would remain similar, albeit on a smaller scale, given that domestic demand in these countries remains somewhat more depressed. In Germany, total investment fell by 5.1% in 2002, despite the expenditure committed following last summer's floods (a rise of 0.8% in Q4). In Italy, on the other hand, the expiry at the end of 2002 of incentive tax measures (the "Tremonti-bis" law) explains the substantial investment seen in H2 2002. Throughout the zone, an increasing proportion of business leaders now regard their productive capacity as adequate in relation to demand. As a result, total investment can be expected to continue to decline, by -0.5% in Q1, following -0.1% in Q4 2002 and -2.5% in 2002 as a whole.

(1) In recent years, many firms carried out external growth operations by purchasing target companies at very high prices. The capital losses resulting from the subsequent stock-market declines were provisioned by the purchasing firms so as to reflect more accurately the value of the assets held.



Consumption set to remain relatively robust in France

Economic activity in France benefited last year from more dynamic household consumption than in its principal partner countries, with a rise of 1.8% compared with 0.6% for the euro zone as a whole.

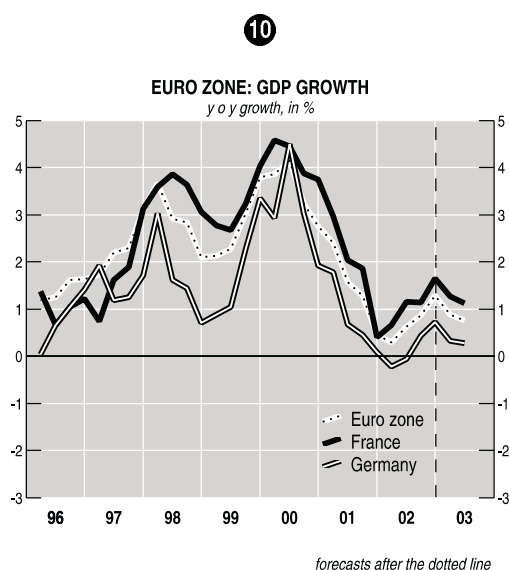
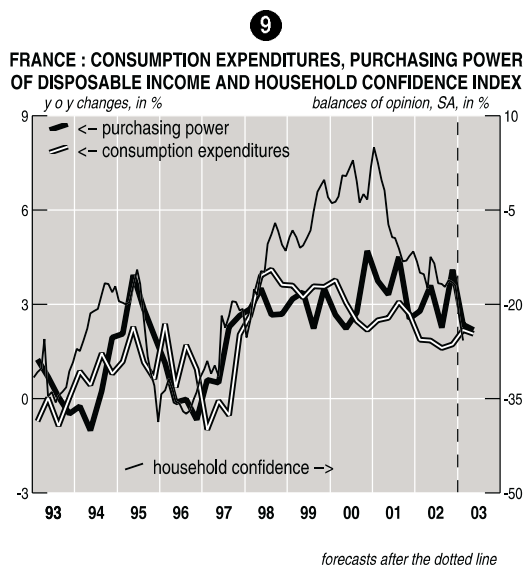
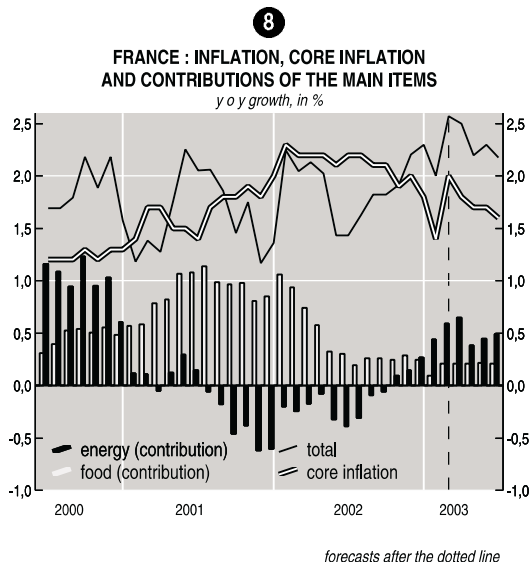
This differential in 2002 is explained by a dynamic tendency that is specific to French household income. Growth in the purchasing power of income remained high (a rise of 3.2%) as a result of fresh tax cuts and despite the slackness of the labour market.

The weakening of economic activity but also the fading out of the effects of the reduction in working hours led to a slowdown in dependent employment in the competitive sector, with 60,000 jobs created in 2002 compared with 230,000 in 2001. The slowdown in employment has adversely affected the unemployment figures since mid-2001, with the rate rising slowly throughout last year to reach 9.1% in December. The strength of the rise in incomes in 2002 was therefore due, not to the firmness of incomes, but to tax cuts, concentrated on the second half of the year and contributing as much as 0.6 of a point to income last year and permitting growth in disposable income to remain virtually unchanged (4.8%, compared with 5.0% in 2001).

In H1 2003, given the continued slackness of the labour market, earned incomes are set to continue to slow down. Employment in the competitive sector is expected to rise by roughly 0.2% and assisted employment in the non-market sector would also continue to decline, because of the virtual ending of the government-assisted schemes for young people and fewer recruits to those for the long-term unemployed. As a consequence, total employment is expected to rise only slightly in the first part of 2003. Given the appreciable slowdown in growth in the potential labour force, the unemployment rate is expected to rise steadily, reaching 9.3% in June. Despite the reduced pressures on the labour market, the wages paid in the market sector would, for their part, remain lively until mid-2003. The strength of inflation towards the end of last year, the gradual termination of wage restraint agreements and the impact on overtime earnings of the new arrangements modifying the "35-hour week" would contribute to a slight acceleration in wages in H1 2003. By June, the year-on-year rise in the basic monthly wage is expected to reach 2.7%, compared with 2.5% at the end of 2002. All in all, the total wage bill for firms in the competitive sector would cease to slow down.

By contrast, other components of income are likely to continue to slow down in the early part of 2003. In the absence of any new adjustment to the index applied to earnings in the civil service, the wage bill in the non-market sector can be expected to decelerate. Moreover, benefit payments would weaken slightly in that the revaluation of pensions would be on a smaller scale than in 2002 and because of new measures affecting the UNEDIC unemployment insurance fund aimed at curbing the growth in benefits paid out. All in all, the rise in pre-tax incomes would continue to weaken, to 1.4% in the half-year, compared with 2.0% in H2 2002.

With taxes back closer to normal levels following the cuts concentrated on the end of 2002, disposable after-tax income would show virtually zero growth in H1 2003. However, its growth over one year would remain substantial (3.7%, year on year, in mid-2003).



Furthermore, the revival in inflation associated with the higher oil price can be expected to continue to erode the purchasing power of income in the early part of 2003. After easing substantially in Q2, inflation picked up again in H2 2002, notably because of higher prices for energy and health care services (up 2.3% in December). Meanwhile, core inflation slowed down progressively in H2, falling back to 1.8% in December. In H1 2003, given the easing of domestic tensions, core inflation should continue to decline, reaching 1.6% in June, despite the gradual diffusion of the impact of the rise in the oil price. On the assumption of an exchange rate versus the dollar close to 1.08 USD and an oil price around 30 USD/barrel in Q2, total inflation, including notably the impact of the recent rises in the oil price, is expected to stand at 2.2% in June 2003.

All things considered, the purchasing power of income can be expected to continue to decelerate, while remaining brisk: the carry-over for the year is likely to be 1.2% in mid-2003, compared with 2.3% a year earlier.

In the early part of 2003, the slowdown in household purchasing power is liable to mean a similar slowdown in consumption. The deterioration in household morale has measured by the January and February surveys would also have a negative effect. In particular, the deterioration in the balance of opinion regarding the timing of major purchases is indicating additional caution on the part of consumers.

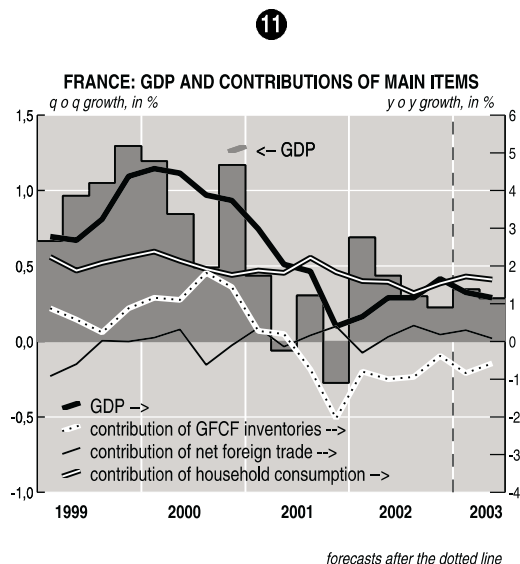
However, certain temporary favourable factors can be expected to provide an additional prop to consumption growth in Q1. First, the past tax cuts should continue to have a positive effect, since the addition to income they brought in has not been totally and immediately spent. Second, the fact that January was colder than the average will have meant an increase in the consumption of energy. Taking these effects into account, growth in total consumption is expected to have been 0.7% in Q1, before falling back to 0.3% in Q2. The saving ratio is expected to stabilise at a high level, of the order of 17%.

This positive tendency in incomes in the early part of 2003 would nevertheless be restricted to France. In the rest of the euro zone, income would be hit by a more substantial deterioration on labour markets. As a consequence, the rise in household consumption in the other countries of the zone would be less substantial, with private consumption in the zone as a whole rising by 0.1% on average in the first two quarters of 2003, compared with 0.4% in Q4 2002. In Germany in particular, the announced rises in taxes and social insurance contributions, combined with the job losses seen at the end of 2002, can be expected to depress consumer spending (down by 0.1% for the half-year) more than in the other countries of the euro zone.

Economic activity likely to post slow growth (0.3% per quarter)

The relative firmness of household consumption in France should continue to support the sectors most dependent on it: services, transport, retail distribution, especially. On the other hand, the industrial sectors would suffer from the slackness of intra-European trade, the wait-and-see attitudes on the part of firms regarding investment and the relative caution shown by consumers regarding durable goods.

All things considered, GDP growth in France, having been 1.2% in 2002, is expected to stabilise during the first half of 2003 at a rate comparable to that seen at the end of last year, namely 0.3% per quarter. This would bring the growth carry-over at mid-2003 to



0.9%. Growth in activity in the euro zone as a whole would be less lively and, in particular, is likely to have stagnated in Q1. ■

OVERVIEW BOX: THE EFFECTS OF THE 1991 GULF WAR

The impact of the military intervention in Iraq is difficult to forecast. However, it is possible to attempt to identify certain effects in the light of earlier events and at the time of the Gulf War at the beginning of 1991. There have already been a sharp rise in the oil price and increased pessimism on the part of households. However, any comparison must be made with caution. In particular, whereas in 1990-1991 there was consensus in the United Nations regarding the need for intervention in Iraq, the reaction of various countries, notably in Europe and among the main oil-producing countries, has not been the same in 2003.

By what means do the consequences of the war affect behaviour?

1. Households

The higher oil price eats into purchasing power

The oil-price rises imply a reduction in the purchasing power of households and consequently reduce their consumption. The price of Brent rose from USD 18/barrel in July 1990 to USD 35 in October following Iraq's invasion of Kuwait on 2 August. With the launching of military intervention on 17 January 1991, it fell back rapidly, reaching USD 19 in February. The rise seen since the beginning of 2002 up to February 2003 is substantial, but not on as large a scale.

Weakening confidence

In the summer of 1990, household confidence in both America and Europe deteriorated sharply immediately after Iraq's invasion of Kuwait. In January 1991, this deterioration then intensified, but confidence recovered in March following the end of the war.

Consequence for consumption

Having been in a slowdown phase since the beginning of 1990, consumer spending dropped sharply in France and in the United States in January 1991, before recovering in February and then in March 1991 to regain earlier levels.

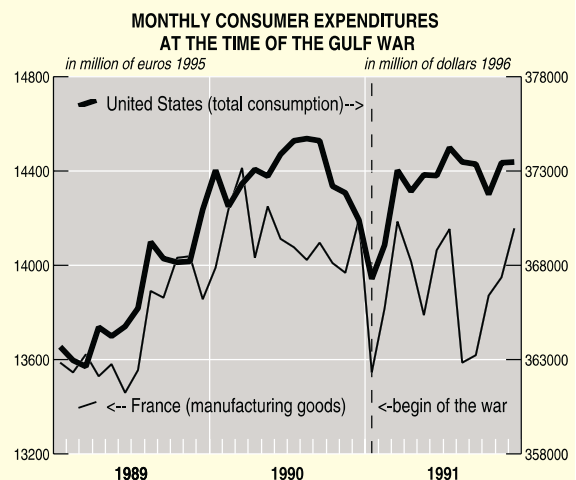
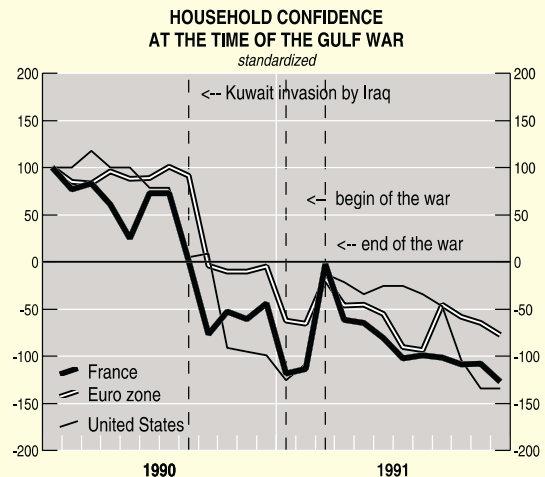
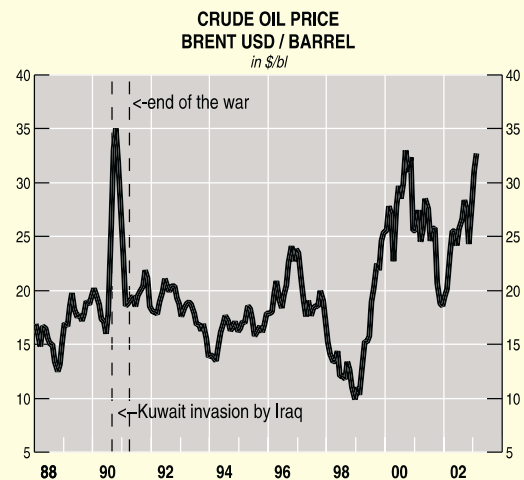
2. Firms

The business climate seems to have been little affected in the euro zone

In 1991, international political uncertainties and the war itself do not seem to have affected the unsatisfactory tendency in the summary indicators of the business climate in France and in the euro zone. In the United States, however, the start of 1991 coincided with a downturn in business leaders' confidence.

Stock prices recovered strongly following the liberation of Kuwait

Both in the United States and in France, stock-market prices dropped sharply following Iraq's invasion of Kuwait (August 1990). Prices then recovered starting in January 1991, probably because of the removal of uncertainties following the rapid liberation of Kuwait.



OVERVIEW BOX: THE EFFECTS OF THE 1991 GULF WAR

International political tensions seem to have had an unfavourable effect prior to military intervention in Iraq

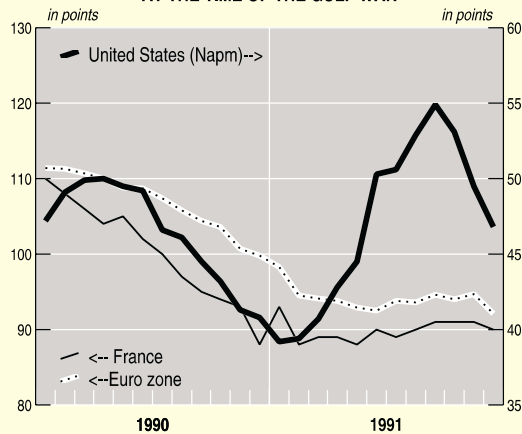
In both France and the United States, corporate demand (investment and stocks) deteriorated distinctly at the end of 1990, before recovering in Q1 1991. Iraq's invasion of Kuwait therefore seems to have had an unfavourable effect generated by rising uncertainties, which then faded once these uncertainties were lifted.

As a consequence of these evolutions in corporate and household demand, GDP growth slowed down in Q4 1990 (-0.8% in United States, 0.0% in France) prior to military intervention in Iraq. The fall was smaller in Q1 1991

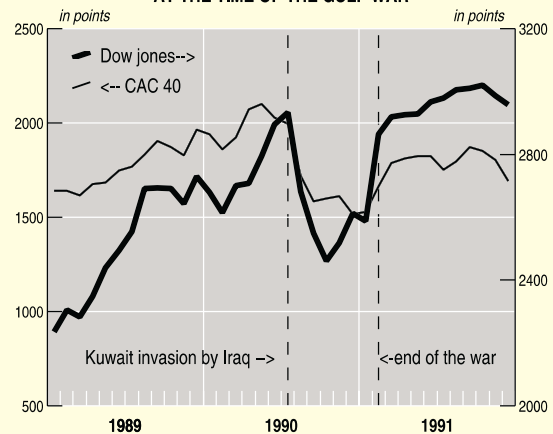
in the United States (-0.5%), with activity stagnating again in France. Subsequently, GDP growth returned to more normal levels in Q2 1991.

In conclusion, it seems that the 1991 war had little impact on the various economic determinants once hostilities actually broke out. The effects were felt mainly at the time of the uncertainties generated by Iraq's invasion of Kuwait and over the modalities of the forthcoming intervention. Once the details of the progress of the war were known (notably its relative brevity), the uncertainties were lifted and the oil price rapidly returned to its pre-summer-1990 level. ■

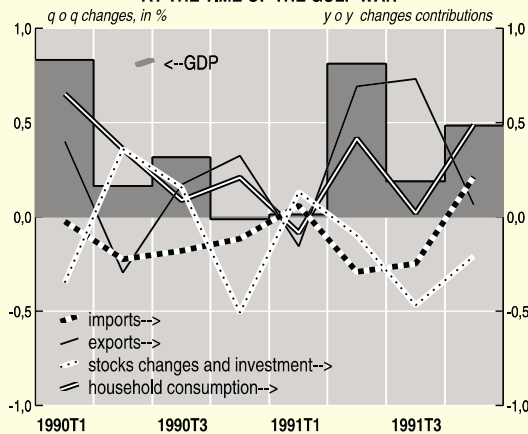
BUSINESS CLIMATE IN MANUFACTURING INDUSTRY AT THE TIME OF THE GULF WAR



STOCK EXCHANGE INDEX AT THE TIME OF THE GULF WAR



FRANCE : GDP AND MAIN CONTRIBUTIONS AT THE TIME OF THE GULF WAR



UNITED STATES : GDP AND MAIN CONTRIBUTIONS AT THE TIME OF THE GULF WAR

