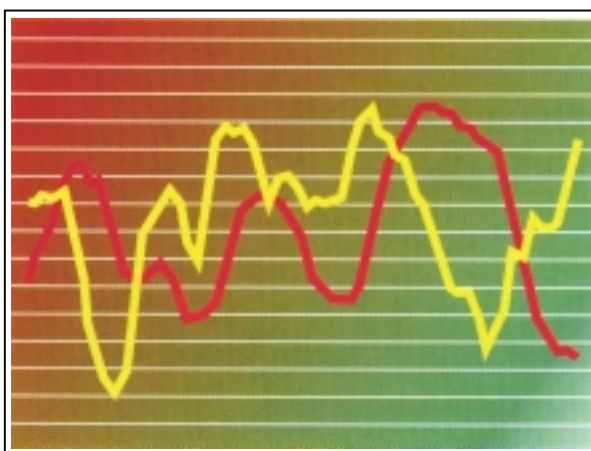


## CONJONCTURE IN FRANCE

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**JUNE 2002**



**PICKING UP AGAIN**

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## PICKING UP AGAIN

*Following the marked slowdown in growth in 2001, the French economy has got some colour back in its cheeks since the beginning of the year. In symmetry with what was seen towards the end of last year, there has been a recovery in business leaders' expectations, a halt to the de-stocking behaviour and a revival in exports. Even so, while household consumption continues to make progress, investment is still sluggish.*

*The end of the spring finds the euro zone's international environment apparently buoyant. In the United States, growth was boosted in the early part of the year by massive fiscal support and is now set to persist, although at a more moderate pace. In the short term, the curb on the development of a new upswing phase lies not so much in the very large external deficit as in the need for companies to put their accounts in order. In the wake of the American economy, emerging Asia is experiencing a recovery and the Japanese economy is reviving, although with no guarantee that it has definitely emerged from recession. The Latin American economies remain handicapped by the Argentinian crisis.*

*Growth in the euro zone turned positive again in Q1, thanks to the recovery in external trade. This, coupled with major re-stocking this spring, has meant a recovery for the industrial sector. However, domestic demand is picking up only gradually, notably in Germany. The continuing steep rise in prices in the early part of the year has held back household consumption. However, inflation in the euro zone is now easing off and the rise in the European currency should provide further support for this tendency. With a better tone*

*on the employment market due to the return to growth, the conditions are now in place for the strengthening of consumption that is probably indispensable if investment is to get going again.*

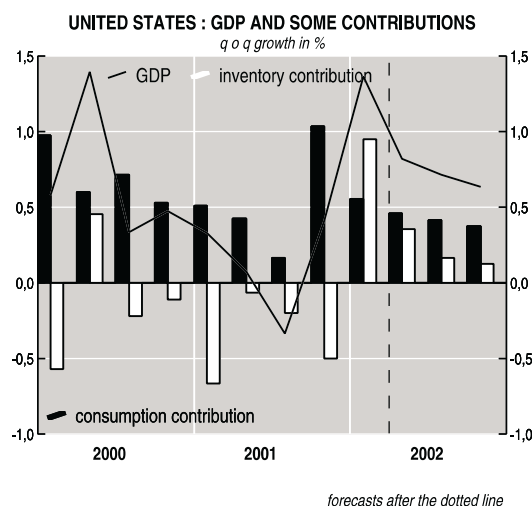
*Household consumption in France has been more dynamic than in its partner countries in the recent past because of stronger income growth. It has also provided backing for growth. Having weakened towards the end of last year, the GDP growth rate rose to 0.4% in Q1 and should be better still in Q2, benefiting from the rebound effect related to the reversal of inventory behaviour. This improvement in activity should gradually have repercussions for employment, although firms are likely in the short term to be cautious about hiring, in view of the need to rehabilitate their accounts, which had substantially deteriorated in 2001. As a result, the unemployment rate is likely to stabilise only during H2. Household consumption seems set to rise at a steady rate of 2%, against a background of continuing robust income growth — although not as fast as last year — and the slow return of underlying inflation to below 2%. The year-on-year price rise, which has now fallen back to around 1.5%, can be expected to rise at the very end of the year as the result of an adverse base effect. With investment gradually picking up again, growth would be installed on a path of slightly better than 2.5%. On an annual average basis, GDP is expected to rise in 2002 by 1.4% in France and 1% in the euro zone. The principal uncertainty surrounding this prediction lies in the evolution of the dollar. If its depreciation were to gather pace this could end by having an impact on European business leaders' expectations. ■*

## Slower growth in the United States following the upturn at the start of the year

The slowdown in the American economy that had begun in mid-2000 came to an end at the beginning of this year. Having been virtually stagnant throughout 2001, economic activity rallied strongly in Q1 2002. Two factors explain the strength of this recovery: a highly expansionary fiscal policy and the reversal of inventory behaviour. The first of these took the form of accelerated growth in public spending and especially sharp tax cuts in favour of households, permitting a sharp re-acceleration in private consumption at the end of last year. The resumption of stock building, which reflects the recovery in American firms' expectations, made a contribution that was all the greater because of the massive scale of last year's de-stocking, accentuated following the 11 September terrorist attacks.

However, these two upturn factors, which have made it possible to trigger off the recovery, are likely to see their effects fade rapidly. In these circumstances, United States growth can be expected to be at a more modest rate in the second part of the year. The rise in household spending would return more in line with that of earned incomes, which have slowed down distinctly in the past year as a result of the deterioration in employment and are now likely to stabilise in view of the slow improvement on the employment market. Productive investment, meanwhile, at a time when monetary policy is still highly accommodating, should return to an upward path. After falling continuously for two years, it would benefit from the improvement in the corporate financial situation and from the relatively favourable demand outlook.

All things considered, growth in the United States should be at an annual rate of 2.5%-3% in H2, having been more than 4% in H1.



## More dynamic world trade

Recovery in the United States has also led to an upturn in imports and this has breathed new life into world trade.

The Asian economies were the first to benefit from the recovery in demand for high-tech products and from the strength of consumption by American households. Economic recovery in these countries accordingly took place at an early stage. On the other hand, Latin America continues to suffer the consequences of the crisis in Argentina. A concern to maintain monetary stability has led central banks to raise interest rates sharply and this is holding back domestic demand. The Central and Eastern European countries, highly dependent on their exports to the euro zone, are gradually seeing their prospects improve. The United Kingdom is in the same situa-

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

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

		2000				2001				2002				2000	2001	2002
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<b>GDP</b>	(100%)	1.1	0.9	0.5	1.3	0.3	-0.1	0.5	-0.4	0.4	0.8	0.7	0.7	4.1	1.8	1.4
Imports	(27%)	3.8	3.7	4.0	3.1	-2.3	-1.8	-1.0	-3.2	2.3	2.3	2.8	1.9	15.1	0.1	2.4
(of which merchandises)	(24%)	3.6	3.4	4.2	3.6	-2.5	-1.6	-0.9	-3.9	2.8	2.6	3.2	2.2	15.5	0.3	3.1
Consumption	(54%)	0.8	0.3	0.5	0.6	1.2	0.2	1.0	0.3	0.2	0.6	0.6	0.5	2.9	2.7	1.8
Public consumption	(23%)	0.5	0.9	0.5	1.1	0.3	0.5	0.9	0.3	0.7	0.8	0.6	0.6	2.8	2.5	2.5
Investment	(20%)	2.8	1.5	1.9	1.9	-0.1	-0.3	0.3	0.2	0.2	0.0	0.2	0.4	8.3	2.6	0.6
of which:																
Non financial corporated and unincorporated enterprises	(12%)	2.8	1.2	3.1	2.8	-0.8	0.1	0.0	0.3	0.1	0.0	0.3	0.6	8.9	3.3	0.6
Households	(5%)	2.2	1.2	-0.3	-0.5	0.2	-1.3	0.3	-0.1	0.1	-0.1	0.0	-0.1	4.1	-0.8	-0.2
Exports	(29%)	3.5	4.2	2.4	3.1	-0.4	-2.7	-0.8	-2.4	2.1	1.0	1.2	2.5	13.6	1.0	1.1
(of which merchandises)	(24%)	3.4	3.9	2.3	3.4	-0.3	-2.5	-0.5	-2.9	2.8	1.3	1.5	2.9	13.3	1.5	2.1
Domestic demand		1.2	0.7	0.8	1.0	0.7	0.2	0.8	0.3	0.3	0.5	0.5	0.5	3.9	2.6	1.7
<b>Contributions to growth</b>																
Internal demand ex. inventory changes		1.1	0.7	0.8	1.0	0.7	0.2	0.8	0.3	0.3	0.5	0.5	0.5	3.8	2.6	1.7
Inventory changes		0.0	0.0	0.1	0.3	-0.9	0.1	-0.3	-0.9	0.1	0.7	0.5	0.0	0.4	-1.0	0.0
Net foreign trade		0.0	0.2	-0.4	0.1	0.5	-0.3	0.0	0.2	0.0	-0.3	-0.4	0.2	-0.1	0.3	-0.3

Forecast

tion: a recovery in the industrial sector has taken shape in Q2, helped on by the revival in European inter-industrial trade, but at the same time household consumption, hitherto highly dynamic, is likely to slow down. However, an expansionary policy with regard to public spending should bolster the return to growth.

### The euro zone likely to benefit from the upturn in the inventory cycle

After declining towards the end of 2001, euro-zone GDP returned to modest growth in Q1 2002, thanks to the upturn in world activity and the resulting increase in external demand. In this improved climate, European industrial leaders' expectations, as reported in business surveys, have shown a marked upturn since February. The improvement in the demand outlook, the improvement — more recent and more modest — in the price outlook and the fact that stocks are now regarded as being on the slim side are all indicators that inventory behaviour is being reversed this spring throughout the euro zone. Activity in Europe would thus benefit from a similar tendency to that seen in the United States, but with a slight delay.

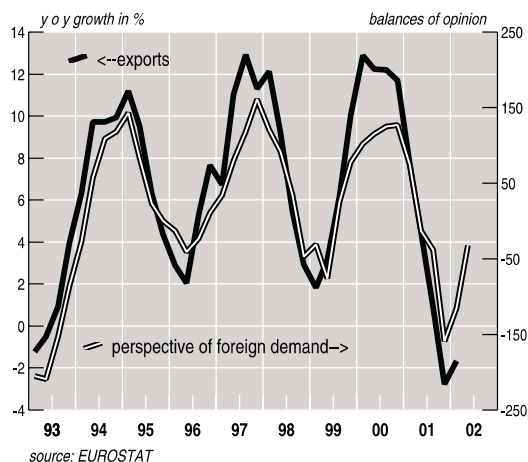
France has participated in this movement. Already in Q1 2002 stock movements, by returning to neutral after being distinctly adverse towards the end of last year, have contributed to the upturn in French activity. This neutrality should now be replaced by a more markedly positive contribution, providing a supplement to growth in both Q2 and Q3.

### Stabilisation on the labour market by the end of the year

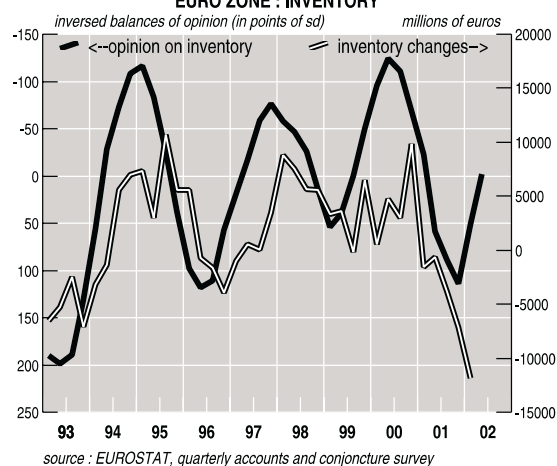
After three years of very strong growth, total employment began to slow down last year in France, under the impact of the downturn in the economic situation. Allowing for the usual lags inherent in the productivity cycle, this slowdown can be expected to last throughout H1 2002. After that, the first effects of the current upturn in activity should be felt on the labour market, but the impact is likely to remain modest between now and the end of the year, as firms will initially be coping with the need to rebuild profit margins, which had narrowed sharply in 2001. Growth in dependent employment in the private sector is likely to be no more than 0.2% in H1 2002, before recovering slightly to 0.3% in H2. Total employment would rise by 95,000 in 2002, compared with 240,000 in 2001.

In these circumstances, unemployment, which has tended to rise slightly since the beginning of year, could level off in H2, with the employment rate standing at around 9.1% next December.

EURO ZONE: FOREIGN DEMAND



EURO ZONE: INVENTORY



### Less dynamic growth in household incomes in France

The marked slowdown in employment is liable to be accompanied by a slightly smaller slowdown in average earnings per head. For one thing, the recent deterioration on the labour market is likely to have an impact on wage negotiations. For another, the statutory adjustment in the minimum wage and the monthly remuneration guarantees will be smaller than last year. On the other hand, even though inflation has eased in Q2, the spurt in the early part of the year will probably have had a delayed braking impact on the slowdown in wage growth, as will the ending of the wage freezes or wage restraint provided for in many of the agreements concerning the reduction in working hours signed at the end of 1999 and during 2000.

All things considered, households' earned income is likely to slow down distinctly this year. This tendency would be partly compensated by the continuing strong rise in social benefits and by further cuts in taxes and compulsory contributions. The initial Finance Act for 2002 provides for a further reduction in personal income tax brackets, as well as a prolon-

gation of the «employment premium» for a total sum not far off the cost of its creation in September 2001 and its repetition at the end of last year.

### Inflation to ease in mid-year

On top of the slowdown in nominal incomes, allowance also has to be made for a slight deceleration in prices on an annual average basis, the result being that the purchasing power of household incomes is expected to rise by 1.9% in 2002, meaning still robust growth, but down on the historic peak of 3.5% recorded in 2001.

In fact, inflation picked up in France in January and remained above 2% until April. The January spurt was due to unfavourable base effects in the case of energy and housing services, to a steep increase in prices of fresh produce, and to a small «euro effect» (0.1 of a point). Other contributing factors were the rise in the oil price at the end of Q1 and the revision in doctors' consultation fees, the initial impact of which was visible in February and whose impact on overall inflation (allowing for the agreements reached recently) can be expected to amount to 0.2 of a point by the end of 2002. However, inflation has ebbed in May, on the back of a return to normal in the case of prices of fresh produce. On the assumption of a stabilisation of the oil price at USD 25/barrel and the EUR/USD rate at 0.94, imported inflation should continue to move favourably. Overall inflation is likely to be slightly above 1.5% in the summer and early autumn, before rising temporarily at the very end of the year to 2.1%, as the result of an adverse base effect in the case of energy.

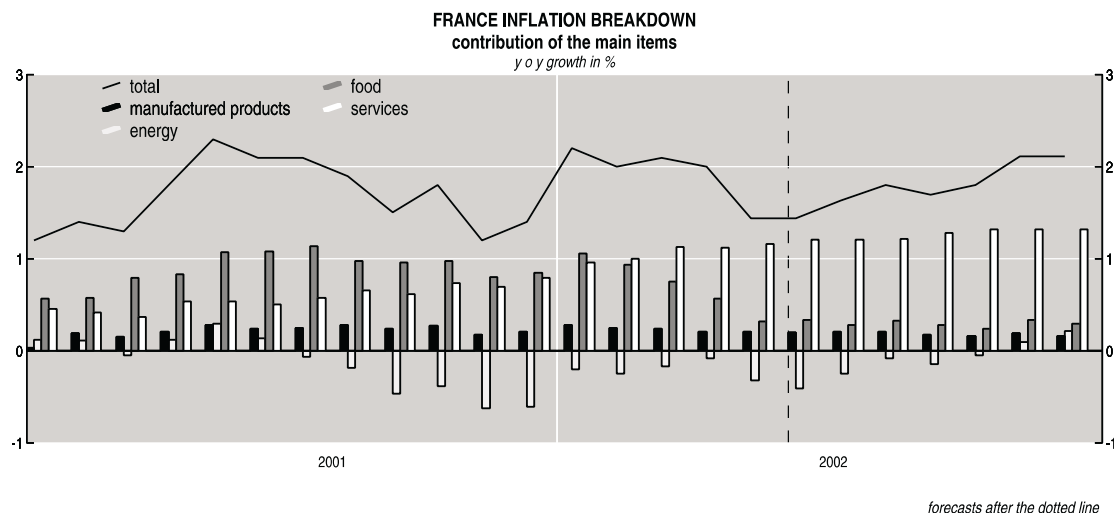
Meanwhile, underlying inflation, which had risen steadily in the past two years, stabilised in H1 2002 at a somewhat higher level than expected (slightly above 2%), under the impact of the sharp rise in unit wage costs and, to a more marginal extent, the changeover to the euro. However, the second-round effects of the earlier rise in the oil price and the depreciation of the euro are now coming to an end.

Given the gradual diffusion of the fall in industrial selling prices that took place in 2001 and the expected stabilisation of unit wage costs, underlying inflation should now decline very gradually, returning to slightly below 2% next December.

### Recovery in household consumption in H2

Having been the sole remaining mainstay of French growth in 2001, consumption began to lose momentum towards the end of last year under the impact of the slowdown in incomes. It has remained lacklustre in the early part of the year, although the sharp drop in spending on energy, most probably linked to the mild winter, tends to conceal a slightly more positive underlying tendency.

This development means that France has merely fallen into line with a tendency currently operating in the euro zone as a whole, but with a slight timelag and in more moderate fashion, because the growth momentum in purchasing power had been comparatively more favourable than elsewhere, thanks to tax cuts. Taking Europe as a whole, household consumption in fact levelled off in mid-2001 and stagnated in Q1 2002. The principal explanations are the same everywhere: a slowdown in earned incomes as a result of the deterioration of labour markets, but also an upturn in inflation in the early part of the year (with a peak for the euro zone at 2.7% in January). Quite apart from the direct impact on purchasing power, these two factors seem also to have prompted a rise in European households' saving. In addition, their purchasing behaviour may also have been temporarily affected by the changeover to the euro, since the impact of this on the overall price level, even though it has remained limited to a few tenths of a point at most, generated fears of inflation. This in turn is probably explained by the fact that the prices of those products and services most affected by rounding practices are among those with high purchase frequencies. Finally, more limited room for





manoeuvre in fiscal policy in the euro zone meant that it was not possible to boost household income to the same extent as in the United States.

However, purchasing behaviour can be expected to relax with the help of this spring's decline in inflation and later thanks to the stabilisation in employment. Consumption would then return to an annual growth rate of close to 2% in H2 2002, both in France and in the zone as a whole. In the case of France, this tendency would mean that households would reduce their saving in order to cushion fluctuations in purchasing power.

### Gradual recovery in investment

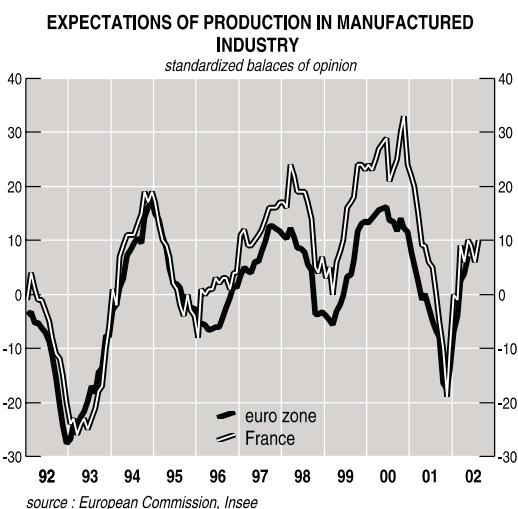
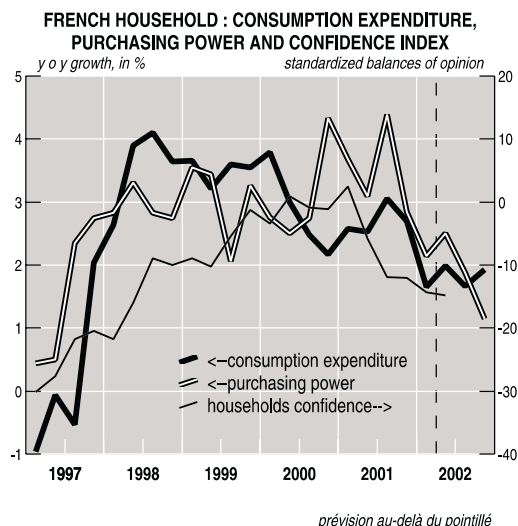
Firmer consumption growth would be a key element in the revival in activity in the euro zone in that, by underpinning the present tendency for business leaders' expectations to improve, it would permit a gradual upturn in investment in H2. In general, European firms are now enjoying favourable financing conditions. Although the cost of long-term borrowing has recently risen somewhat with the prospect of a gradual tightening of monetary policy, it remains relatively low. In addition, the possibilities for firms to finance investment out of their own resources are set to improve. An additional factor in France is that corporate accounts should benefit in 2002 from a continuation of the suppression of the supplementary 10% contribution and the ending of the exceptional contribution demanded of oil firms.

Investment growth could accelerate beyond the end of the year, once the final uncertainties concerning the durability of growth in the world economy have been lifted.

French exports should continue to rise during 2002, with the impact of the acceleration in world demand for French products barely curbed by the recent appreciation in the exchange rate, especially as this acceleration to a large extent involves trade within the euro zone. Imports would recover even more during the year, being traditionally more affected by any marked changes in the inventory cycle. Last year, they seem to have dropped sharply at the time of de-stocking; now that this movement has been reversed, their recovery should also be spectacular.

### GDP to rise by almost 1.5% in 2002

The upturn in French economic activity in 2002 would be reflected above all in a recovery in industrial output. Intermediate goods are likely to benefit from less restrictive inventory behaviour on the part of industrial firms and from the revival in inter-industry trade in the euro zone. Production of consumer goods would be stimulated by robust household consumption and by the acceleration in



exports. Activity in the services sector, after slowing down in 2001, should settle at a fairly brisk rate. Transport would benefit particularly from a recovery in air transport, following the steep drop recorded in the aftermath of 11 September. On the other hand, the construction branch, after several years of strong growth, is likely to continue the slowdown that began last year. Activity in the public works sector will still bear the traces of the post-municipal-election context, while residential housing will probably tend to level off.

All things considered, GDP is likely to grow by 1.4% on average in 2002. This figure would be roughly one half-point higher than growth in the euro zone as a whole, given that the slowdown in consumption has taken place later and been more modest than elsewhere. A particularly strong force for growth this spring would be dynamic inventory behaviour. In H2, growth should be at an annual rate of slightly above 2.5%, on the back of a steady improvement in consumption and a gradual recovery in investment. However, this scenario is based on the assumption that changes in exchange rates will be relatively limited. In the event of a sharp depreciation in the dollar, especially if it were to weaken business leaders' expectations, the growth rate might be somewhat less favourable by the end of the year. ■