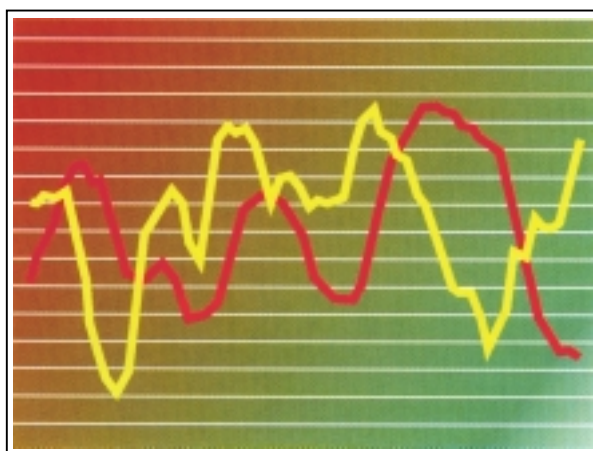


CONJONCTURE IN FRANCE

DECEMBER 2001



THE RIGOURS OF WINTER

The year 2001 has marked a turning point in the upswing in the French economy that began five years ago. GDP growth, at 2.1%, is more than a percentage point down on previous years. It is true that, with the exception of household consumption, which has remained dynamic because of strong income growth, all components of demand were headed downward from the start of the year. In line with the exceptional contraction in world trade, exports have declined steadily. Reflecting their sensitivity to the international environment, firms very rapidly cut back their investment and adjusted their inventories. As a direct consequence of the slowdown in growth, employment has grown much less rapidly (190,000 jobs created in the market sector in 2001, as against 530,000 in 2000) and the decline in unemployment that had lasted for four years came to an end in the summer.

On the eve of 2002, the euro zone's international environment is marked by recessions in the United States and Japan and by the related difficulties in the emerging zones. In this depressed economic situation that is simultaneously affecting all zones, an upturn in the American economy will be crucial. Vigorous action on the part of the authorities, notably through an unprecedented series of cuts in interest rates, has established the conditions for recovery in the United States. But household demand, affected by the deterioration on the labour market, could weaken just when investment, whose fall has had a lot to do with the slowdown, is about to have a less negative effect on activity. This means that the American economy would not post any substantial growth before mid-2002. In these circumstances, the euro zone would stagnate in coming months, with growth based solely on the

rise in household demand. The performance of Germany would be below the European average, those of Italy and France somewhat above.

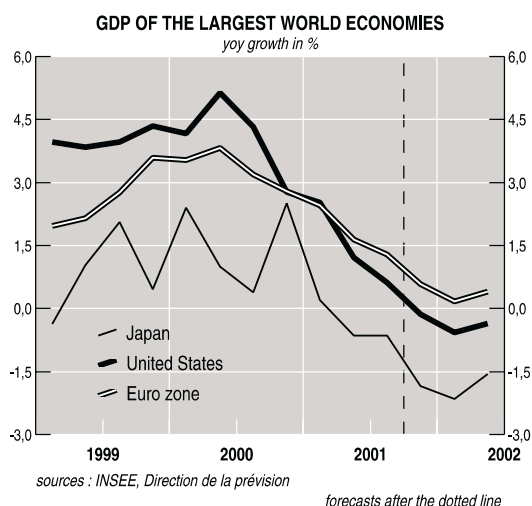
In France, the 11 September events have added to the uncertainty. Just when the economy was posting signs that domestic demand was holding up well, this tragedy produced an additional shock that intensified the downturn in corporate spending. The climate of uncertainty and a configuration in which the various demand components are showing divergent evolutions undoubtedly make any forecasting exercise more problematical than usual. The key element is that the rise in incomes, which has accelerated distinctly in H2 2001, is expected to keep consumption rising at the beginning of 2002 at a rate of 2%, with the easing of inflation back to a year-on-year rise of around 1% in June 2002, adding to the increase in purchasing power. The rise in the unemployment rate linked to the stagnation of employment would remain sufficiently modest not to lead to a build-up in precautionary saving. With a return to more neutral behaviour on the part of corporate demand, especially as regards inventories, and an improvement in foreign trade, the growth rate would again rise above 1% in the spring, after stagnating for two quarters. The signals now visible mean that it is necessary to remain prudent regarding the possibility of an upturn within the time-horizon of this note. Conversely, firms' capacity to react could come into play just as much on the upside as the downside, and with the general conditions surrounding activity, especially in the monetary field, remaining favourable, there is nothing to prevent a strong upturn in growth once business leaders see tangible signs of an acceleration in the United States economy.

A world-wide economic downturn

The hard landing for the United States economy that began in Q3 2000 was triggered off by a downturn in investment, itself brought on by the sudden downward revision in profit expectations linked to the surge in high-technology and by the worsening in US companies' financial accounts. This downturn rapidly spread to the whole of the world. The impact of the levelling off in world trade was then amplified in that firms throughout the world reacted strongly by cutting stocks and cancelling a large number of investment projects as of the winter of 2000-2001. Concerns raised by the consequences of the terrorist attacks in the United States constituted an additional shock and led to a short-term acceleration in the decline in expectations.

Stabilisation of the American economy by the spring

After slowing down substantially, United States GDP actually began to fall in Q3 2001 and this fall is expected to continue until Q1 2002. The severe deterioration on the employment market is now adversely affecting both incomes and household confidence. Consumption by American households, which showed its first real signs of weakness in Q3, is expected to touch bottom early next year. Conversely, the very low level of inventories held by US firms gives reason to hope that the major de-stocking recorded this year could come to an end. It is now a



year since the Fed began easing its monetary stance. The relaxation of fiscal policy was launched in Q3 and a further set of tax cuts is planned for 2002, although the amount and timing have still not been decided. This means that an upturn in American activity could take place by next spring, although it is impossible to be certain about either the date or the amplitude. Meanwhile, Japan, which had not managed to rid itself of deflation in the previous upswing, formally entered recession in Q2 2001, with slack consumption and a very fragile financial system.

This means that two of the three largest economies are currently in recession and have brought down the emerging zones with them. South-East Asian coun-

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			
GDP	(100%)	0.8	0.9	0.7	0.9	0.4	0.2	0.5	0.0	0.1	0.4	3.5	2.1	0.7
Imports	(27%)	4.9	3.9	4.4	2.0	-1.7	-1.0	-1.5	-0.8	-0.2	0.3	15.2	1.1	-1.5
(of which merchandises)	(24%)	5.1	4.1	4.8	2.0	-2.1	-1.2	-1.8	-0.4	-0.4	0.5	16.8	0.7	-1.6
Consumption	(54%)	0.6	0.6	0.6	0.2	1.3	0.3	1.2	0.4	0.6	0.5	2.8	2.9	2.0
Public consumption	(24%)	0.4	0.8	0.4	0.8	0.4	0.6	0.8	0.5	0.6	0.6	2.4	2.4	2.0
Investment	(20%)	1.9	2.0	1.2	1.7	0.6	-0.3	0.1	-0.3	-0.1	-0.1	6.2	2.7	-0.5
of which:														
Non financial corporated and unincorporated enterprises	(11%)	1.8	2.3	2.1	2.4	0.4	0.1	-0.2	-0.5	-0.3	-0.1	7.1	3.6	-0.9
Households	(5%)	2.3	1.3	-0.2	-0.1	0.4	-1.3	0.1	0.3	0.4	-0.1	4.6	-0.3	0.2
Exports	(29%)	4.3	4.3	2.6	2.8	-0.3	-1.5	-1.5	-1.7	-0.7	0.1	13.4	1.8	-3.0
(of which merchandises)	(24%)	4.4	4.5	2.4	2.3	-0.2	-2.5	-0.6	-1.7	-0.8	0.2	14.0	1.2	-2.8
Domestic demand		0.8	0.9	0.7	0.6	0.9	0.3	0.9	0.3	0.4	0.4	3.4	2.7	1.4
Contributions to growth														
Internal demand excluding inventory changes		0.8	0.9	0.7	0.6	0.9	0.2	0.9	0.3	0.4	0.4	3.3	2.6	1.4
Inventory changes		0.0	-0.2	0.4	-0.1	-0.8	0.2	-0.4	0.0	-0.1	0.0	0.3	-0.8	-0.3
Net foreign trade		0.0	0.2	-0.4	0.3	0.4	-0.2	0.0	-0.3	-0.2	0.0	-0.1	0.2	-0.5

Forecasts
* carry over effect at Q2

tries specialising in output based on new technologies (Taiwan, Hong Kong, Singapore) saw a decline in their activity as far back as the beginning of this year and the others, whose exports had previously been somewhat spared, are now likely to suffer more from the fall in commodity prices and the weakening of United States private consumption. Latin America is being subjected to the combined effects of the Argentinian debt crisis and the American recession. Russia, which had benefited from a positive income shock thanks to the rise in oil prices in 1999 and 2000, seems for the time being to be holding up well, on the back of dynamic domestic demand. The central and eastern European countries, although contaminated by the market slowdown in the euro zone, are also being buoyed up by relatively robust private consumption.

Finally, the United Kingdom is showing resistance to the downturn in the world economic situation. Although gradually weakening, activity should be underpinned by continuing growth in private consumption and by an accommodating fiscal policy.

The weakening in European corporate demand that began in early 2001

With hindsight, 2001 will be noted for the collapse in international trade. For the first time in more than 20 years, world demand for euro-zone countries' exports is likely to have shown at least four consecutive quarterly falls.

The euro zone as a whole was unable to resist this external demand shock, despite its relatively low degree of openness⁽¹⁾, as this was accompanied by a reversal in business leaders' expectations. Although faced with European household demand that was accelerating again — after absorbing the impact of the higher oil price — firms in fact reacted very rapidly to the rising uncertainty by shelving numerous investment projects and by massive de-stocking. The resulting downturn in European inter-industry trade, especially in the intermediate goods branch, aggravated the decline in exports of each European country taken individually, while at the same time leading to corresponding declines in their imports.

The rising uncertainty linked to the terrorist attacks on United States merely amplified this tendency.

All in all, activity in the euro zone has been dragged down by the sharp decline in corporate demand. After rising by around 9%, productive investment seems to have been on a downward path of 4% throughout 2001⁽²⁾. In addition, de-stocking is thought to have lopped ½ a point off euro-zone GDP.

The French experience matches this tendency at European level. In particular, the contribution of stocks is estimated to have held back activity by 0.8 of a point.

Moreover, after rising at a rate of 10% in 2000, investment by French firms slowed down sharply, returning to an annual growth rate of the order of 1% in H1 2001 before declining since Q3 at a rate of between 1% and 2%.

Admittedly, French firms had to face the downturn in the world economic situation in a less sound financial situation. In 2000, under the impact of the higher oil price, and then in 2001 under the impact of the deterioration in productivity, corporate profit ratios were reduced, impairing firms' capacity to finance investment out of their own resources. In addition, the halt imposed on issues of equity capital following the fall on the stock market beginning in Q2 2000 meant that the source of almost half their external financing dried up.

In 2001, the downturn in the momentum of French imports reflected the very severe adjustment in corporate demand. Imports in H1 fell even more than exports, with the drop particularly marked in the intermediate goods branch as the result of the de-stocking tendency. Moreover, just as new-technology products had pushed up French imports in 2000, the marked decline since then is contributing to the scale of the present fall.

Stocking tendencies likely to have a more neutral impact on activity in H1 2002

In France and in the euro zone as a whole, the present outlook for demand, especially from abroad, gives no reason to expect a rapid recovery in corporate investment, which is likely to continue to decline in H1 2002, as suggested by the initial estimates derived from the investment survey of French industry carried out last October.

On the other hand, following the marked de-stocking tendency in H1 2001 and its continuation brought on by the additional shock which the events of 11 September have produced on expectations, corporate demand could benefit in H1 2002 from a return to more neutral stocking tendencies.

(1) Exports and imports are each equivalent to 14% of euro-zone GDP.

(2) Eurostat does not publish figures for corporate investment in the euro zone. The figures given here are orders of magnitude, obtained by adding together corporate investment ex construction for the principal countries.

This would diminish the decline in imports. The situation is likely to be much the same in the other countries, so that exports would also cease to decline by next spring.

Slight rise in unemployment

Following the record level of job creation (530,000) posted in the competitive sectors in 2000, 2001 has been marked by a distinct weakening in Q2 in tendencies on the labour market. 160,000 market-sector jobs were created in the first half but probably no more than 30,000 in the second. Allowing for lags in the adjustment of employment to activity and the fact that the impact of the reduction in working hours will be substantially smaller than in the past, dependent employment in the competitive sectors is likely to post a slight decline in H1 2002. However, when the non-market sector is taken into account, total employment is likely to show a smaller slowdown, notably thanks to new jobs expected to be created as part of the “contrats-emplois-solidarité” arrangements. This would mean a stable level of employment in the first half of next year.

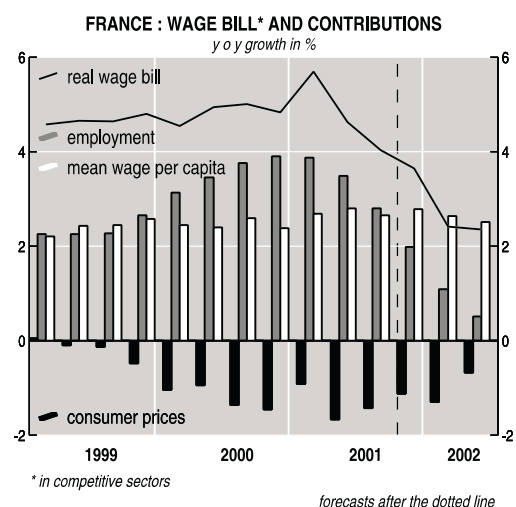
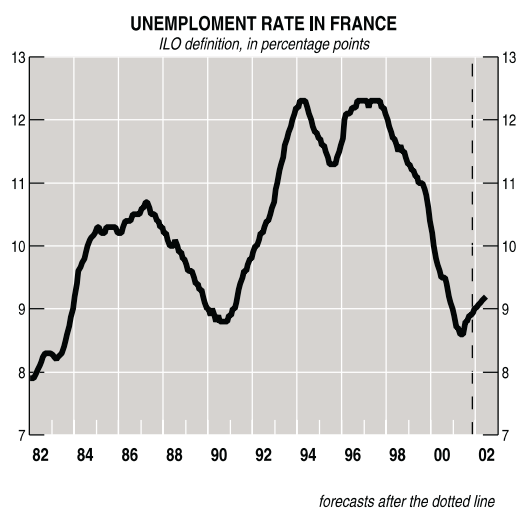
In these circumstances, the slight rise in the unemployment rate can be expected to continue, to around 9 ¼% in June 2002, compared with 9.0% in December 2001, returning to its October 2000 level.

Household incomes still robust, despite slowing down

The slowdown in employment is leaving its mark on the evolutions in the total wage bill and in household disposable income.

Other components of income remain dynamic, however, and the rise in wages in the competitive sectors remains relatively firm, although still somewhat attenuated by the wage restraint linked to the reduction in working hours. Under the combined impact of the sharp fall in unemployment in 2000 and the wage adjustments linked to past rises in inflation, growth in the average wage in fact accelerated in H1 2001, to a year-on-year rate of 2.8%, as against 2.4% a year earlier. Under the impact of the present disinflation and the increasing unemployment, wages are expected to slow down slightly by next spring.

All in all, under the impact of the slowdown in employment, the wage bill in the competitive sectors is also likely to slow down considerably, from an annual rate of more than 6% until mid-2001 to a rate of just above 3% in mid-2002. The total amount of wages received by households is likely to stand up somewhat better, thanks to the acceleration in wages and salaries paid out by general government.



Household incomes enjoyed the benefit of further tax cuts in H2 2001. The cuts in rates for all income-tax brackets, as well as the introduction of the PPE (employment premium), reduced taxes by 4.3 billion euros. The renewal of this premium for a sum of 1.2 million euros, announced by the government as part of its consolidation package, will again boost income growth this winter.

Finally, 2001 has been marked by an acceleration in benefits paid out to households through the adjustment of pensions and the rise in unemployment benefit (increased allowances, ending of the degressive nature of benefits in the framework of the PARE⁽³⁾ and the rise in the number of unemployed since Q3).

This means that gross household disposable income growth will have slowed down in 2002 under the impact of the slowdown in earned income, but, given that it was still rising at a very rapid rate in the early part of 2001, its growth rate can be expected to continue to be relatively robust. In addition, the ongoing decline in inflation is expected to last and would provide support for purchasing power gains. After peaking at 2.3% in May, inflation has eased in H2

(3) “Plan d’Aide au Retour à l’Emploi”, a joint public-private conditional package to help those who are out of work.

2001 under the impact of the decline in prices of petroleum products. At the same time, underlying inflation has continued its slow growth, reflecting the diffusion of past rises in the oil price and the depreciation of the euro.

On the assumption that the euro exchange rate stabilises at USD 0.90 and that the oil price is around USD 20 per barrel in the spring, the tendency in energy prices would continue to be negative. Moreover, food prices should return to normal after the exceptional events that affected them in 2001, leading to a favourable base effect on the year-on-year figures recorded in mid-2002. Besides, by this horizon, underlying inflation is likely to ease back to around 1.5%. The diffusion of imported inflation should be coming to an end, while the deterioration in the economic climate will mean a distinct reduction in pressures on the productive system. As a result, overall inflation should be at 1.1% in June 2002⁽⁴⁾.

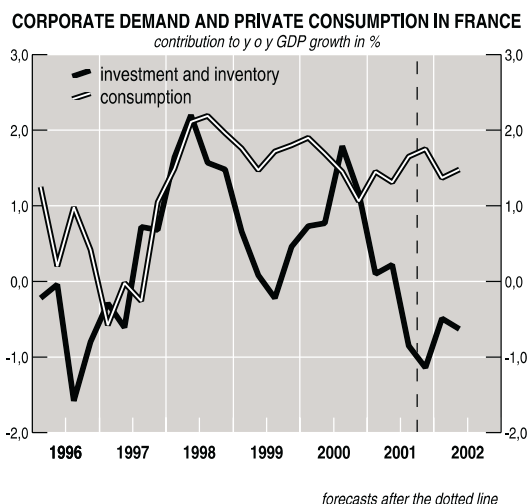
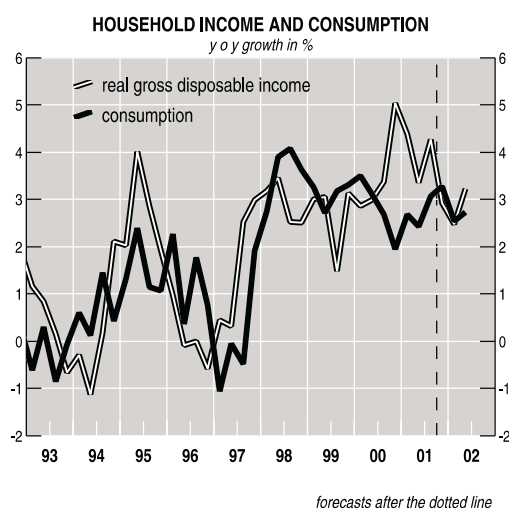
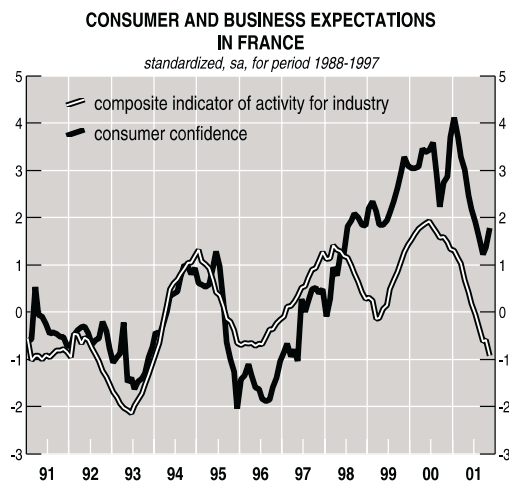
All things considered, following a record rise of 3.7% in H1, household purchasing power can be expected to slow down under the impact of the deterioration on the labour market, although still growing relatively favourably. In the middle of next year, its growth carry-over is likely to be of the order of 2% (by comparison, it amounted to 2.7% in mid-2001).

Robust consumption

This year, the sharp rise in purchasing power has enabled household consumption to rise continually at a firm annual rate, of the order of 3%. It is likely to ease back in H1 2002 under the impact of the slowdown in income growth, returning to a rate of slightly better than 2%⁽⁵⁾.

This being so, households are expected to reduce their saving in the early part of 2002. This tendency, like the corresponding increase in 2001, would be due to classic trade-off behaviour aimed at smoothing out variations in income. It would also be encouraged by the stabilisation in household confidence at what continues to be a relatively high level. In fact, after being exceptionally high in the early part of 2001, its fall during the rest of year has already largely incorporated the deterioration in outlook for the labour market, and unemployment is not expected to rise other than very gradually between now and next June.

Purchases of manufactures are expected to weaken in H1 2002. In particular, the tendency in car purchases, which had been very brisk in 2001, is likely to be less favourable. Consumption of services is likely to have been curbed in Q4 2001 by the slowdown in tourism-linked expenditure, as a consequence of the terrorist attacks in the United States, but it should return to an annual rate of slightly better than 3% at the beginning of next year, in other words to a path slightly less steep than in recent years.



(4) This scenario makes no allowance for the specific effect on prices of the changeover to the euro. The first conclusions of a review of the impact of the change in currency (see special article) lend support to this assumption.

(5) No significant impact of the changeover to euro on consumption growth is assumed here.

Households' investment in housing is likely to remain lacklustre, now that the major impact of the incentive measures has been exhausted (Perissol and Besson legislation, cut in VAT to 5.5% early in 2000). Property prices have already begun to level off. Residential housing starts, especially for collective housing, are nevertheless not pointing to a fall in investment in the coming half-year.

This scenario for household demand applies also to other countries in the euro zone, although not as intensely. Having marked time in H2 2000 under the impact of the higher oil price, European consumption consolidated in H1 2001 thanks to the acceleration in incomes brought about by cuts in taxes and compulsory contributions applied in the leading countries (Germany, France, Italy). It seems to have maintained a moderate growth rate in the second half of the year, suffering from the slowdown in job creation but profiting from the disinflation. In H1 2002, the year-on-year growth rate is likely to weaken a little more, coming out at 1.4%. Here too, the slowdown in the total wage bill can be expected to leave its mark on income. Moreover, the tax cuts that had boosted it in H1 2001 will no doubt be less substantial for the zone as a whole, with only France introducing further cuts in the second half of the year, while the measures planned for 2002 in Germany and Italy will be on a smaller scale than in 2001.

However the slowdown in European household purchasing power is likely to be cushioned by the continuing disinflation. The consumer price rise in the

euro zone, after peaking at 3.4% in May 2001, looks like being 2.0% at the end of this year and fall to 1.6% in June 2002.

The end of 2001 finds the French economy close to stagnation

All things considered, the French economy will probably post growth of 2.1% for 2001. After being close to stagnation in Q4 2001 and Q1 2002, growth is likely to remain modest in the spring. At the beginning of next year, like its European partners, it should benefit from a return to more neutral corporate stocking behaviour, as well as the continuing robust, albeit slower, growth in consumption.

This scenario reflects the caution imposed by the current absence of any tangible sign of a genuine recovery in world trade and the uncertainty surrounding the exact date of the upturn in expectations. American household consumption could yet provide a nasty surprise. In the other direction, an upturn in expectations in Europe in the spring could, against a background of an easing of the monetary stance in the euro zone, lead to a more rapid and more distinct improvement through a reversal of corporate behaviour, involving re-stocking and a revival of investment. ■