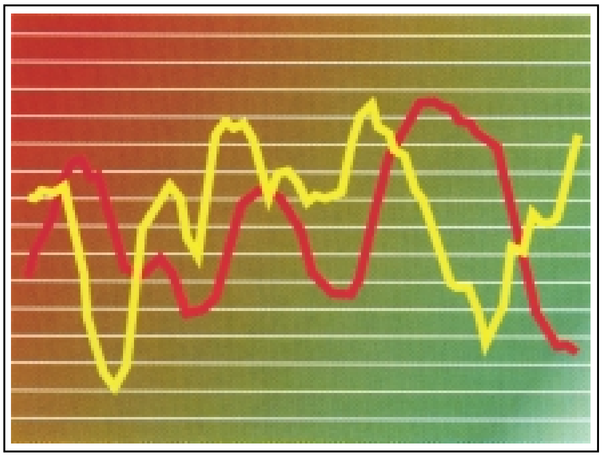
INSEE CONJONCTURE

CONJONCTURE IN FRANCE

JUNE 2000



FULL SPEED

INSEE

FRANCE

FULL SPEED

The most striking feature of the present French economic situation is the persistent strength of domestic demand, reflecting very optimistic expectations on the part of both firms and households. Exports, too, are dynamic, having grown at an annual rate of 10% since Q2 1999.

However, it seems highly probable that activity in the euro zone's international environment has passed its peak, in view of the gradual tightening of monetary policies. The American economy has begun to slow down, although it is not sure that the recent downturn in demand will not be followed by signals indicating the contrary. A hard landing is still possible. On the other hand, growth in the euro zone itself is tending, if anything, to strengthen still further, with acceleration in Germany and perhaps in Italy, two countries where household consumption may be returning to more robust growth. The re-balancing of European and American growth is therefore under way.

In France, GDP growth in Q1 seems to have been more the reflection of a temporary shortfall in supply at the turn of the year than of any change in the underlying growth tendency, which is in fact now well above 3%. The French economy now finds itself in the fourth year of an upswing whose end is not yet in sight. The monetary and fiscal context remains favourable. The increase in earned income means that consumption continues to grow despite the slight upturn in inflation. Stock re-building, normal in this phase of the cycle, should make a positive contribution to growth. The same can probably not be said of foreign trade, with both imports and exports showing similar vigour. The contribution from investment, however, is tending to increase. One of the characteristics of the present upturn is the strengthening of the supply side through a sharp increase in productive resources in response to the strength of demand expectations. In particular, the investment ratio, which has recovered sharply since mid-1997, will by the end of this year regain the record level reached ten years earlier at the peak of the previous cycle. Employment is expected to post an equally exceptional performance, with more than 500,000 jobs created in 2000, meaning that the unemployment rate should be only slightly above 9% at the end of this year.

The counterpart of the present GDP growth, which should come to 3.5% this year on an annual average basis, is a build-up of pressures on the economy. However, except in a few branches such as construction, these are not expected to impose a brake on activity this year. In industry, for example, the capacity utilisation rate is likely in the coming winter to be still one percentage point below its peak of the end-1980s. Underlying inflation is slowly picking up again. The year-on-year rise in consumer prices, mainly reflecting increased imported inflation, is likely to remain above 1.5% for most of the year. On the assumption that the oil price stabilises at $25/barrel, the rate should then ease to 1.2% in December.

Exceptional world growth

The middle of the year 2000 is bringing confirmation of the improvement in the world economy. Growth is becoming general to all regions, with recovery in the emerging countries and intensification of the upswing in Europe, while the United States continues along its strong growth path. For the year as a whole, world growth is expected to amount to almost 4.5%. This very firm rate of expansion could nevertheless weaken somewhat towards the end of the year under the combined impact of the monetary tightening seen since last autumn, the maturing of the industrial cycle in the euro zone, the gradual slowdown in the American economy and the petering out of the catch-up effect in the emerging countries.

Slowdown in the United States

Growth remains very strong in the United States. In Q1 2000, in particular, activity rose at an exceptional rate and for the year as a whole American growth could well exceed 4% on an annual average basis. However, activity is likely to slow down in the second half of the year to a rate more compatible with the American economy's growth potential. A weakening of activity is all the more likely in that the Fed has since last autumn been substantially tightening its monetary policy stance. Indeed, signs of this slowdown are already perceptible. On the supply side, business surveys are indicating a gradual decline in business leaders' optimism, while on the demand side retail sales have levelled off and this could be heralding a slowdown in consumption, which nevertheless remains very brisk the moment. Meanwhile, housing investment has turned down since last autumn.

In these circumstances, inflationary pressures seem to give less cause for concern. Pressures on the labour market can be expected to ease in response to the downturn in the growth rate. Moreover, real earnings are still rising less fast than productivity and this is reducing the risk of a rise in producer prices. Such price pressure as there is therefore remains mainly confined to the energy sector. A particular feature is that the strength of the dollar is tending to limit the transmission of the higher commodity prices to the intermediate goods sector.

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

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

		1998				1999				2000				1998	1999	2000
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	**(100%)**	0.9	**0.9**	**0.5**	**0.8**	**0.5**	0.8	1.0	**0.9**	**0.7**	**1.0**	0.9	0.9	3.2	2.9	3.5
Imports	(23%)	3.7	2.3	0.6	0.0	-1.1	2.5	2.4	3.3	2.8	1.5	2.0	2.0	11.3	3.8	10.2
(of which merchandises)	(20%)	4.0	2.4	1.0	0.4	-1.0	2.6	2.9	3.6	3.6	1.6	2.2	2.2	12.3	4.7	11.6
Consumption	(54%)	0.8	1.3	0.6	0.6	0.3	0.4	0.9	0.6	0.9	0.8	0.6	0.6	3.5	2.3	3.0
Public consumption	(23%)	-0.4	0.1	0.3	0.6	1.0	0.7	0.5	0.7	0.2	0.5	0.4	0.5	0.3	2.5	1.8
Investment	(19%)	1.5	2.0	1.6	1.8	2.3	1.5	1.4	1.3	1.7	1.8	1.7	1.7	6.6	7.3	6.5
of which :																
Non financial corporated and unincorporated enterprises	(10%)	*2.5*	*2.2*	*1.8*	*1.5*	*2.8*	*0.9*	*2.1*	*1.5*	*1.3*	*2.1*	*2.2*	*2.1*	*8.3*	*7.7*	*7.0*
Households	(4%)	*-0.8*	*2.0*	*0.8*	*3.0*	*1.8*	*3.5*	*0.3*	*1.0*	*2.5*	*1.1*	*0.4*	*0.6*	*3.6*	*8.2*	*5.4*
Exports	(26%)	2.2	1.0	0.3	-1.4	-0.2	2.7	4.5	1.6	2.6	1.0	2.0	2.0	7.7	3.8	9.1
(of which merchandises)	(21%)	2.9	1.1	0.4	-1.8	-0.3	2.7	5.4	1.3	3.6	1.0	2.2	2.2	8.8	3.9	10.7
Domestic demand		0.6	1.1	0.7	0.8	0.9	0.7	0.9	0.8	0.9	0.9	0.8	0.8	3.3	3.3	3.4
Contributions to growth																
Internal demand excluding inventory changes		0.6	1.1	0.7	0.8	0.8	0.7	0.9	0.7	0.8	0.9	0.8	0.8	3.2	3.2	3.3
Inventory changes		0.5	0.1	-0.1	0.3	-0.5	0.0	-0.5	0.5	-0.1	0.2	0.1	0.1	0.7	-0.4	0.2
Net foreign trade		-0.3	-0.3	-0.1	-0.4	0.2	0.1	0.6	-0.4	0.0	-0.1	0.0	0.0	-0.6	0.1	0.0

Forecasts

The main uncertainty hanging over the scenario of a gradual slowdown in the American economy remains the threat of a sharp stock-market correction. In this respect, the American economy seems more vulnerable today than previously. The proportion of US households' assets invested in equities has never been as high as at present. Moreover, private agents, and especially households, are heavily in debt. This means that a stock-market crisis could turn out to be more difficult to handle via monetary policy. In such an event, the United States would have difficulty in avoiding a hard landing.

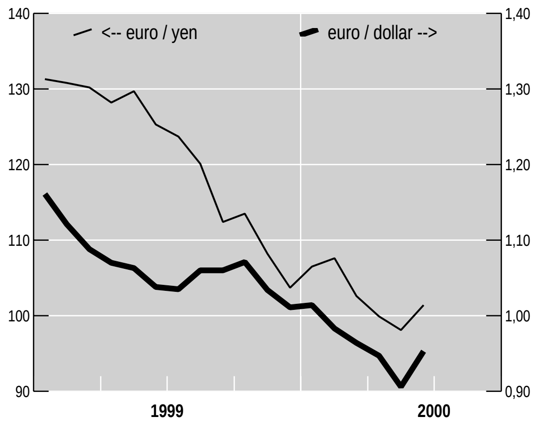
Monetary tightening in the United Kingdom

The British economy slowed down in Q1, to an annualised growth rate of 2%. This downturn in the rate of activity is in large part the reflection of the tightening of monetary conditions seen since last autumn resulting, in part, from a tightening of the Bank of England's monetary policy aimed at countering the emergence of inflationary pressures. But it is also the result of the marked appreciation in sterling seen since 1996, which has itself been partially accentuated by recent monetary policy decisions. In these circumstances, growth is not expected to exceed 2% in coming quarters. Domestic demand remains fairly firm but exports are being hampered by the continuing strength of sterling. As a consequence, activity in industry, the sector most exposed, is likely to remain subdued, with growth continuing to be based mainly on the buoyancy of the services sector. All in all, the economy is expected to slow down significantly in 2000, with a year-on-year growth rate of 2.4% at the end of the year, compared with 2.9% in 1999.

Very gradual export-driven upturn in Japan

Japanese economic activity apparently took a turn for the better in Q1 2000. However, part of the strong growth recorded (10% at annualised rate) was the result of technical and statistical factors. Looking beyond these, the ending of the recession is mostly explained by external demand and, more particularly, by the upturn in the emerging Asian economies. It is therefore the exposed sectors, and above all industry, which have been at the centre of this revival in activity. On the other hand, the upturn in domestic demand has still not begun: consumption is weak at a time of falling earnings and rising unemployment; investment remains apathetic, still suffering from the gradual reabsorption of excess capacity. All things considered, growth is likely to come out at 1.5% on an annual average basis.

EXCHANGE RATE



source : Banque de France

Buoyancy in the euro zone

Growth in the euro zone has bounced back strongly since Q2 1999 and the outlook for activity remains very positive. Demand in the zone's export markets is in fact growing very strongly, the exchange rate situation is helpful to the competitiveness of exports, and the policy mix has become generally more expansionary by reason of the tax cuts planned in several countries, with expectations of both business leaders and households stabilising at peak levels. This means that growth is on a path of around 3.5% at annualised rate and this should enable the euro zone to record annual average growth rates of 3 1/4% or thereabouts in 2000.

For several quarters now, the strength of activity has been mainly based on the robustness of domestic demand. Investment remains very dynamic: the market outlook is highly favourable, financing conditions are still on the accommodating side and productive investment is being boosted by certain incentive measures introduced in several countries in the zone; investment in construction could also improve somewhat in countries where it was previously slack, like Germany. Meanwhile, consumption is continuing its gradual recovery thanks to the brisk rise in employment. Finally, the upturn in industrial activity has continued to benefit from the impact on exports of the exchange-rate situation. However, this stimulus coming from outside

THE IMPACT OF MOVEMENTS IN THE EURO EXCHANGE RATE

Since the euro came into being on 1 January 1999, its nominal effective exchange rate has declined by 20%. In theory, this depreciation is reflected first of all in an increase in European producers' competitiveness, with exports being pushed upward and imports downwards, stimulating growth in the short term. In parallel, the imported inflation adds to the rise in consumer prices. The price-wage loop comes into action and this not only reduces the external competitiveness gains but affects investment by squeezing margins and consumption through a decline in real gross disposable income (GDI). In the long term, a purely nominal depreciation in the exchange rate has only inflationary effects as long as it does not correspond to a re-adjustment in the direction of the currency's equilibrium value. The cumulative addition to inflation is in fact 10%, so that the real exchange rate is unaltered and the impact on activity is nil. In the short term, there are first-round effects: a depreciation of 10% in the euro's effective exchange rate is liable to raise inflation by 3/4 of a point in the first year. If monetary policy reacts to this rise, the impact can be brought down to roughly half a point in France and in the euro zone as a whole.

A mechanistic approach to the first-round impact on inflation

Leaving aside, initially, the macroeconomic knock-on effects (dearer inputs, price-wage loop, etc.) as well as the substitution effects between domestic and imported goods, the impact of the depreciation of the euro on consumer prices mainly takes the form of dearer imports from countries outside the euro zone.

The share of imports in the euro zone's resources is roughly 10%. A fall of 10% in the euro's effective exchange rate therefore adds 1% to the total price of resources. In total, therefore, the impact on consumer prices could be of the order of 1%.

In the case of France, 50% of total imports (roughly 20% of resources) come from outside the euro zone. A fall of 10% in the euro's effective exchange rate would therefore also mean an acceleration of 1 point in prices.

This mechanistic calculation tends to overstate the impact in the very short term, by assuming total and complete transmission of the depreciation into import prices. In practice, importers compress their margins so that the effect is less marked. The following simulations offer a complete estimate taking account of importers' margin behaviour.

Simulation of a 10% depreciation in the euro's exchange rate

The NIGEM multi-national model makes it possible to take account of macroeconomic knock-on effects. A simulation is made of a 10% depreciation in the euro's effective exchange rate. The euro zone then benefits from additional growth of 1.4% the first year, while inflation rises by 0.8 of a point in the same period. In the case of France, the growth rate is raised by 0.9% and inflation rises by 0.7 of a point.

This first variant nevertheless assumes that monetary policy does not react to the imported inflation. A second variant is carried out including a simulation of the reaction of the ECB, using a standard Taylor's rule. A rise of 140 basis points in the first year in this case brings the impact of depreciation on activity down to 0.4% and on inflation in the euro zone down to 0.7%.

The impact of recent variations in the euro's exchange rate

The steep depreciation in the euro recorded since the beginning of 1999 followed a substantial rise of nearly 6% in the component currencies between Q4 1997 and the winter of 1998-99. This rise resulted, in particular, from the steep devaluations seen in Asia. This succession of appreciation and sharp depreciation had significant consequences for activity and inflation in the euro zone.

According to the simulations made using the NIGEM model, the appreciation of the European currencies reduced activity by almost one percentage point of GDP in 1998, while the depreciation is thought to have stimulated growth by around 0.5 a point of GDP in 1999 and by more than 1 point in 2000.

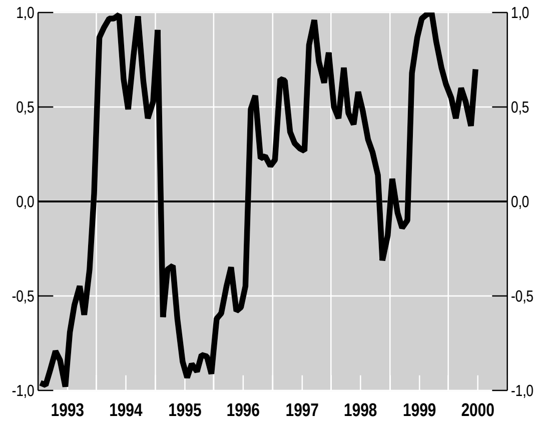
As regards prices, the currency movements are estimated to have reduced inflation by around half a point in 1998 and 1999 and produced additional inflation of the order of 0.8 of a point in 2000. ■

THE INDUSTRIAL SITUATION AS PORTRAYED BY TWO COMPOSITE INDICATORS

Following an insignificant dip early in the year, the turning-point indicator is now back in a zone indicating a favourable cyclical phase for industry.

Interpretation: the cyclical turning point indicator is calculated using balances of opinion drawn from the monthly survey of activity in industry. It is constructed on the following principles: the overall tendency of the balances is assumed to depend on the phase of the cycle; this tendency, whether favourable or unfavourable, is represented by a qualitative variable that is not directly observed. An estimation is made, through the evolution in opinion balances, of the probability that this unobservable variable is to be found in one position or the other (favourable or unfavourable economic situation). The results obtained are represented in the form of a curve, showing for each date the difference between the likelihood that the cyclical phase is favourable and the likelihood that it is unfavourable. The indicator therefore moves between +1 and -1.

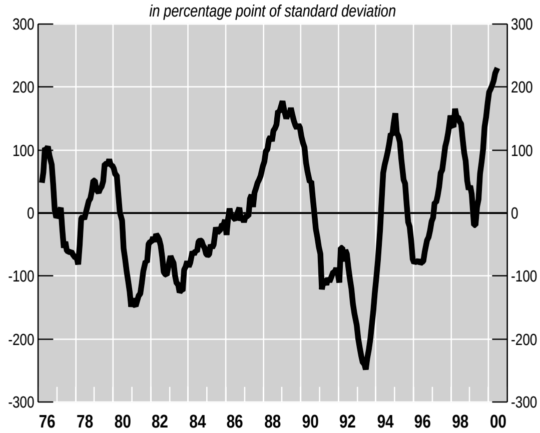
LEADING INDICATOR FOR MANUFACTURING INDUSTRY
June 2000



In June 2000, the composite business climate indicator continused the upward tendency begun in Q2 1999. Its very high level shows the extremely favourable climate revealed by business surveys in recent months.

Interpretation: the composite business climate indicator is a summary variable representing the common component of the six opinion balances reported in the survey of the industrial situation -- past and expected tendency in output, order books (overall and export), inventories and general outlook -- used to give a picture of the industrial activity cycle. Statistical tests show that a single variable -- the composite business climate indicator shown here -- is sufficient to portray the common behaviour underlying the opinion balances. In this way, the evolution in the composite business climate indicator summarises the cyclical phase that is influencing all the various opinion balances in the survey. This indicator is obtained by factor analysis (or analysis into common and specific factors), a statistical technique making it possible to summarise the concomitant evolution in several variables whose movements are highly correlated. ■

COMMON FACTOR
in percentage point of standard deviation



INSEE

the euro zone is expected to fade somewhat under the impact of the foreseeable slowdown in world activity expected in the course of the year.

This generally highly positive scenario is not yet completely visible in Germany and Italy, where domestic demand remains less lively than in the rest of the euro zone. Given the considerable wage restraint and the low level of household confidence, the strong rebound in consumption seen in Italy in Q1 still needs confirmation. A revival in job creation as well as more favourable saving behaviour will be needed to underpin any lasting recovery in Italian households' consumption. In Germany, job creation is still on too small a scale to ensure brisk consumption. As yet, there is no real improvement in household confidence, although the outlook should improve under the impact of the cuts in income tax planned for 2001.

French growth underpinned by the strength of domestic demand

French growth is expected to come out at 3.5% on an annual average basis in 2000. The bout of weakness shown by activity at the turn of the year seems not to have been signalling a lasting downturn in the growth rate but rather to have been due largely to exceptional factors that are liable to have been compensated as early as Q2, enabling the expansion to continue at a rate of around 3.5%.

This buoyancy is based on a general context that is highly favourable to demand. The international environment is vigorous; monetary conditions remain accommodating; fiscal policy, involving cuts in taxes affecting households, is favourable to growth. In addition, job creation remains exceptionally strong, permitting a rapid fall in the unemployment rate. In these circumstances, domestic demand excluding inventory changes is still the cornerstone of the upswing seen since mid-1997. The strength of demand is being accompanied by a gradual build-up of pressures on productive capacity, as is normal at this stage of the cycle. For the time being, however, these are not generating inflationary pressures, the only reasons for the acceleration in prices still being the imported inflation.

Massive job creation and tax cuts stimulating household demand

Since 1997, dependent employment in the market sector has shown a sharp acceleration. Underpinned in the first instance by the strength of activity, it has also benefited from policies in favour of employment, in particular the positive short-term effects of the reduction in working hours. The impact of these measures is likely to be concentrated especially on the first half the year, as is already shown by the marked fall in working hours reported by the Survey on Labour Activity and Employment Status (Acemo). For the year as a whole, total employment is expected to show the same exceptional progress as in 1999, with 520,000 jobs created, a rise of 2.2%, year on year by the year-end. This means that the unemployment rate could fall to just above 9% by the end of the year.

As a result, the purchasing power of income can be expected to go on rising very strongly. On top of the rapid growth in total compensation, there will be the impact of the cuts in income tax and local taxes, so that household disposable income would rise by 4.1% in nominal terms, compared with 3.1% in 1999. The acceleration in inflation of around 3/4 of a point would not be sufficient to cancel out this acceleration, leaving the purchasing power of income rising by 2.7% in 2000, up from 2.4% in 1999.

The strong growth in income opens the way for household consumer spending to remain dynamic, having grown at an annualised rate of 3.5% in the early part of the year. The purchasing power gains and the fall in the unemployment rate brought about by the growth in employment have helped to improve household confidence, still shown to be very positive in the economic surveys, even reaching historic highs in the first part of the year. Consumer spending can therefore be expected to remain strong in the second half, even though the gradual rise in interest rates could induce a slight weakening, notably in the consumption of durables. All in all, consumer spending can be expected to rise by 3% on an annual average basis. The saving ratio, for its part, would fall very slightly, by the order of 0.2 of a point -- further proof of the buoyancy of household confidence.

Finally, investment by households should have another good year, with a sharp rise already seen in the first half. In particular, maintenance and renovation work has increased substantially, in the aftermath of the December gales. The upturn in the housing sector is being confirmed, following the ending of the impact of the abolition of the Périssol arrangements (offering tax advantages to purchasers of housing for rent). This tendency should continue in the second half, against a backdrop of highly favourable financing conditions.

Corporate demand very strong

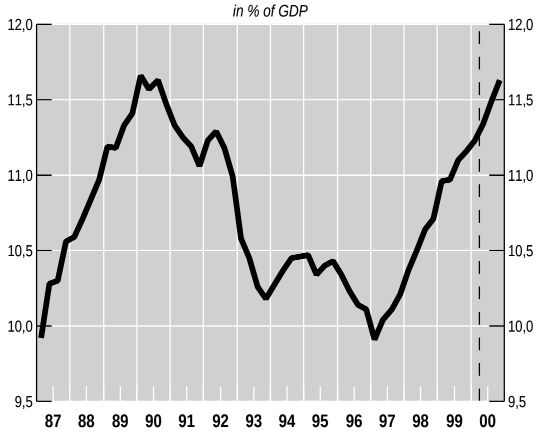
Corporate investment remains very lively, being thought to have risen at an annualised rate of 6% in H1, to be followed by 9% in H2. This means that the annual average growth in 2000 should reach 7%. In industry, this strength is to be seen in the investment surveys, with business leaders expecting a rise in investment in value terms of 12% for the year as a whole, with a distinct acceleration in the second half. Investment in building continues to benefit from the steep rise in non-residential starts. The prospects as recorded by business leaders in the construction sector and the tendency in licences granted in all sectors point to continuing strong growth for the rest of the year. This strength of investment is a response to the exceptional level of demand addressed to industry and is in line with the upswing in investment that began in 1997 aimed at substantially raising productive capacity. At the same time, the financing conditions are favouring the continuation of this tendency: firms' self-financing capacity has recovered slightly following the sharp fall recorded in 1999, as the result of improved mark-ups; long rates, although higher, do not constitute a brake. Companies are therefore still spending large sums on investment, and the investment ratio in 2000 will exceed the maximum recorded at the end of the 1980s.

Inventory changes should once more make a positive contribution to growth. Firm demand expectations and improved price prospects are prompting firms to rebuild their stocks -- the latest surveys show that levels are regarded as very low, historically low in fact in virtually all branches. While the strength of demand has for the moment slowed down the stock re-building, the contribution should turn positive in the second half.

Competitiveness gains prolonging the strength of foreign trade

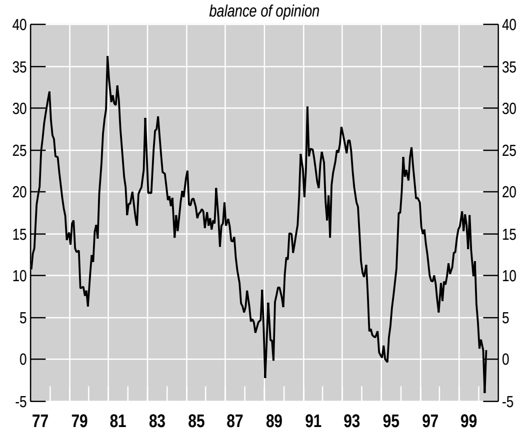
The first half of the year saw exports remaining particularly strong in response to the liveliness of world demand and they can be expected to remain firm, with the competitiveness gains associated with the depreciation of the euro compensating for the slowdown in world growth in the second half. Imports are also likely to go on rising strongly, by around 10% at annualised rate, by reason of the very dynamic domestic demand. All in all, exchange-rate conditions are enabling the French economy to grow faster than its trading partners

BUSINESS INVESTMENT IN FRANCE
in % of GDP

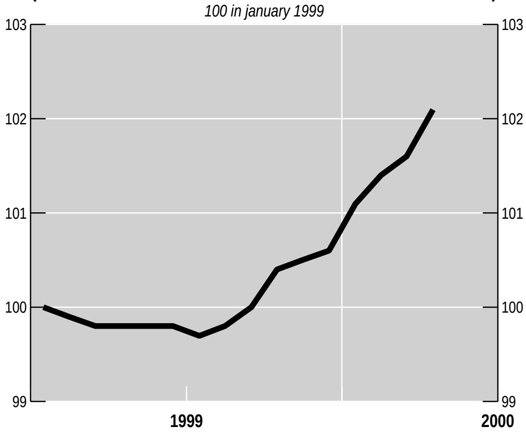


forecasts after the dotted line

OPINION ON THE LEVEL OF INVENTORIES IN MANUFACTURING INDUSTRY
balance of opinion



PRODUCTION PRICE INDICES (EXCLUDING ENERGY AND FOOD PROCESSING INDUSTRY)
100 in january 1999



REDUCTION IN WORKING HOURS AND LABOUR COSTS

Caution: the calculations of evolutions presented here have necessitated numerous assumptions and approximations. The estimates have to be handled with caution, as they are liable to substantial revision. In particular, the evolutions in working hours are not derived from national accounts but estimated on the basis of the Acemo survey as regards the past and, for the forecasts, using the numbers joining the negotiated arrangements for reduction in working hours and an estimate of the impact of the statutory arrangements.

The implementation of the arrangements for reduction in working hours is automatically accompanied by an acceleration in hourly wages. Keeping monthly remuneration at the same level at a time when the hours actually worked are declining leads to a corresponding rise in the hourly wage. The provisional results of the Acemo survey for Q1 2000 in fact show a very rapid rise (2.3%) in the hourly working wage compared with the previous quarter that can be directly related to the sharp decline in working hours over the same period (2.1%). For the whole of the competitive sector (i.e., including the firms with fewer than ten employees that are not included in the Acemo survey), the reduction in working hours in Q1 comes out at 1.6%.

However, for a correct evaluation of the foreseeable evolution in corporate wage costs in 2000, it is necessary to take into account the additional easing of employers' labour-related costs: reduction in employers' contributions and gradual elimination of wages from the base used for calculating business tax. At the same time, the transitory overtime regime is, for the year 2000, reducing the additional costs associated with the cuts in the legal working hours for firms that have not yet moved to 35 hours.

It is also preferable to think in terms of average annual rates. The information available on the numbers of employees concerned by the reduction in working hours suggests that the change seen in Q1 was exceptional and that similar figures are not

Hourly labour cost (in the business sector)

(quarterly growth rate, in %)

	1998				1999				2000				Annual average		
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2** *(f)*	**Q3** *(f)*	**Q4** *(f)*	**1998**	**1999**	**2000** ***(f)***
Average monthly wage (1)	0.4	0.5	0.5	0.5	0.5	0.4	0.4	0.6	0.3	0.4	0.7	0.7	2.1	2.0	1.9
- weekly worktime change	-0.1	-0.1	-0.1	0.0	-0.1	-0.2	-0.4	-0.4	-1.6	-0.4	-0.1	-0.1	-0.2	-0.5	-2.5
= Hourly wage	0.5	0.6	0.6	0.5	0.6	0.6	0.8	1.0	1.9	0.08	0.8	0.8	2.3	2.5	4.4
+ Contribution from cuts in social contributions	0.0	0.1	0.0	0.1	0.0	-0.1	-0.1	0.1	-0.4	-0.6	0.0	0.1	-0.1	0.0	-0.9
= Hourly labour cost (in terms of National Accounts) (2) (3)	0.4	0.7	0.6	0.5	0.5	0.6	0.7	1.1	1.5	0.2	0.8	0.9	2.1	2.5	3.6
+ Contribution from cuts of the "wage component" of the business tax ("taxe professionnelle") (4)	0.0	0.0	0.0	0.0	-0.4	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	-0.5	-0.3
= consolidated hourly labour cost (incl. " taxe professionnelle")	0.4	0.7	0.6	0.5	0.2	0.5	0.6	1.0	1.4	0.2	0.7	0.8	2.1	2.0	3.3
Value added (+)	1.0	1.0	0.5	0.6	0.5	0.8	1.0	0.9	0.7	1.1	1.0	1.0	4.0	2.8	3.7
Employment (-)	0.5	0.6	0.5	0.4	0.6	0.6	0.6	0.7	1.0	0.9	0.7	0.7	1.8	2.2	3.2
Weekly worktime change (-)	-0.1	-0.1	-0.1	0.0	-0.1	-0.2	-0.4	-0.4	-1.6	-0.4	-0.1	-0.1	-0.2	-0.5	-2.5
- Hourly Productivity	0.6	0.4	0.0	0.2	0.0	0.4	0.8	0.6	1.3	0.7	0.4	0.4	2.3	1.1	3.1
= Consolidated Unit labour Cost	-0.1	0.2	0.6	0.3	0.1	0.2	-0.2	0.4	0.1	-0.5	0.3	0.4	-0.2	0.9	0.2
													-0,2		

(f) Forecast
(1) Average monthly wage per person on a full-time-equivalent basis (and therfore corrected for the increase in part-time working).
(2) (Wage-earners'remuneration + taxes on labor)/(volume of hours worked)
remark: in the national accounts, the burden of the business tax on wages is included under "others taxes linked to production".
(3) The breakdown of the hourly cost has been approached through a combinaison of its various components.
The breakdown is carried out using the following approximation formula: $\Delta c/c = \Delta w/w - \Delta h/h + \Delta(1+t)/(1+t)$
where $\Delta c/c$ *=the evolution in the hourly cost,* $\Delta w/w$ *=evolution in the average monthly wage,* $\Delta h/h$ *=evolution in the working week, and* $\Delta(1+t)/(1+t)$ *=evolution in the rate of taxation of labour.*
(4) The wage component of the "taxe professionnelle" is set to progressively decrease by an amount of approximately 10 billions FR up to 2003.

to be expected in following quarters. Moreover, the full-scale implementation of the easing of employers' contributions accompanying the second law on working hours (Aubry II) could be delayed by two months for administrative reasons.

Once these elements have been taken into account, the estimates suggest that the nominal hourly labour cost, allowing for the easing in social contributions and business tax, can be expected to rise by 3% at annual rate in 2000, as against 2% previously.

- The average monthly wage is expected to show an annualised growth rate in the range 2-2.5% in 2000. The impact of the acceleration in inflation and the steep fall in unemployment are cushioned by the wage restraint written into many of the work-time agreements. Indirectly, the reduction in working hours has an impact on average earnings in Q3, because of the rise in the guaranteed minimum wage which is itself partially indexed on the rise in the hourly wage.

- Because of the reduction in hours worked, the hourly wage can be expected to rise at a rate of 4.5%. The reduction was particularly marked in Q1 (1.6% for all wage-earners in the competitive sectors, more than 2.5% year on year). Forecasts for the reduction in the working week over the rest of the year take account of this initial shock, of the numbers joining the arrangements for negotiated reduction in hours worked and the application, as regards wage-earners not covered by agreements, of the provisional statutory arrangements regarding overtime (bonus of 10% allocated by default in the form of weekly compensatory time off amounting to 24 minutes for the overtime between 35 and 39 hours a week). For the year as a whole, the rate of reduction in hours worked is therefore close to 2.5%.

- Thanks to the easing of employers' compulsory contributions, the hourly labour cost as defined for the purposes of the national accounts is expected to rise by 3.5%. These additional easings of employers' contributions are associated with the reduction in hours worked. Because of the two-month time lag mentioned earlier, their full impact will be spread over Q1 and Q2. Being of the order of 25 billion francs in 2000, they will help to reduce by 1% the evolution in the hourly wage costs, making up for slightly over one-third of the impact of the reduction in hours worked.

- Taking into account the gradual elimination of the wage-bill element in the calculation of the business tax, the consolidated hourly wage cost is estimated to rise at a rate of 3%. The planned elimination over five years of this business tax element brings wage costs down by 0.5% a year until 2003.

Given the hourly productivity gains accompanying the upturn, the unit wage cost is likely to rise only to a very small extent in 2000. The economic situation, the cuts in employers' contributions and the transitory implementation modalities (notably regarding overtime) contained in the second law regarding the 35 hours combine in such a way as to avoid a major shock on labour costs in 2000. ■

but without modifying the equilibrium in volume terms, so that the external contribution to growth is expected to be neutral in 2000. On the other hand, the terms of trade losses due to the higher oil price and the depreciation of the euro are likely to produce a deterioration of the trade balance in value terms.

Heavy calls on the productive system

With demand as strong as it has been for the past three years, productive capacity must rise very significantly in order to avoid too rapid a build-up of pressures. A number of indicators have suggested that the productive system was encountering certain difficulties in meeting demand in the early part of the year. Industrial production has grown relatively slowly, with demand therefore being met either by substantial de-stocking or by higher imports.

The weakness of industrial activity in Q1 should nevertheless turn out to be short-lived. The month-to-month pattern of the IPI was particularly uneven around the turn of the year, showing sharp falls in December and January that were later made up. Such a bout of weakness is not in fact confined to France, being visible also in the other large euro-zone countries: Germany, Italy, Spain.

Meanwhile, other supply-side indicators have continued to show a positive tendency. Employment grew at an exceptional rate in Q1, involving all branches and reflecting the strength of temporary agency employment. Nor have business surveys shown any real weakening in the situation, at most a levelling off. The balance of business leaders' opinions on the outlook for their production are today at historic highs in all sectors of industry. The dip seen at the start of the new millennium seems therefore to have been mainly a reflection of precautionary behaviour on industrialists' part and did not affect their expectations of future production. Output should therefore once more rise briskly in all branches, especially manufacturing industry, which should return to an annualised rate of 6% in the second half.

Pressures on productive capacity still subdued

As is normal at this stage of the cycle, the strong growth is being accompanied by a build-up of pressures on the productive system. The capacity utilisation rate, for example, has risen appreciably and now stands 2.5 points above its long-term average. Even so, this leaves it almost 2 points below the historic peak seen at the end of the 1980s. The rise in the rate has even weakened slightly, according to the April survey. This relative moderation by comparison with the levels recorded at the end of the 1980s is in fact being seen at a time when the demand-side indicators (order books, for example) are at record levels.

Nor is this gradual build-up of pressures likely to intensify in coming quarters. The capacity utilisation rate (CUR) may continue to rise during the year 2000 but by no more than one percentage point between now and the end of the year. Capital productivity gains, as well as the substantial investment effort being made by firms, should bring about a strong rise in productive capacity.

Pressures have also been building up on the labour market. The rise in employment since 1997 and the strength of activity are in fact being accompanied by an increase in recruitment difficulties, although these are still not on the scale seen at the end of the 1980s except for the building and car sectors. In any case, the unemployment rate is still sufficiently high for firms to be able to recruit without putting pressure on the general wage level.

Underlying inflation still moderate

At 1.5% in May, inflation continues to rise. This is the result of the depreciation of the euro and the rise in the oil price, compensated to some extent by the cuts in the VAT rate in April, whose impact is put at 0.2 of a point for the overall index.

The rest of the year 2000 should see a stabilisation of inflation. The direct impact of the rise in the oil price should gradually fade, but underlying inflation is expected to rise from 1.1% in June to 1.4% in December because of the depreciation of the euro and the rise in commodity prices in general. This should mean a stabilisation of the year-on-year rise in the overall index at around 1.6% until November, followed in December by a possible decline to around 1.2%, brought about by the exit from the year-on-year calculation of the very sharp rise in oil products recorded in December 1999. However, this drop at the end of the year is heavily dependent on the assumption that the oil price gradually returns to $25 by the end of the year.

In the short term, therefore, the main source of inflation comes from the outside world. Neither the upturn in activity, nor the marked improvement in the labour market situation seems as yet to be producing any significant domestic pressures. This favourable climate is in large part due to the moderation shown by wage growth. The monthly basic wage is in fact expected to rise in 2000 at the same rate as in the previous year, i.e. by around 2%. The rise in underlying inflation and the fall in the unemployment rate are not producing any acceleration in monthly earnings. This restraint is the result of a reduction in wage-earners' reactions to very short-term changes in the inflation rate but also of the general climate created by the introduction of the cuts in working hours. Negotiated agreements on this point have in fact often included clauses limiting wage increases.

The cuts in working hours are nevertheless being accompanied by a sharp increase in hourly wages, as shown by the leap in the basic hourly wage (SHBO) recorded in Q1: a year-on-year rise of 5.2% in March according to the Acemo survey. The impact on unit wage costs has been cushioned by an easing of the burden on employers and the substantial gains in hourly productivity made possible by the upswing (see box). For the year 2000, unit wage costs can therefore be expected to remain restrained. At some stage, however, the marked improvement in the situation on the labour market and the moves to reduce working hours could lead to an acceleration in wage costs and rekindle inflation.

All in all, the economic situation appears extremely favourable from the standpoint of demand but this strength requires in return a significant adjustment on the supply side. In the short term, the upturn in investment that began as far back as 1997, as well as the massive job creations now being enjoyed by the French economy, should permit a sufficient increase in productive capacity. Looking further ahead, whether inflationary pressures can be kept under control will depend on the continuation of this investment effort and the prolongation of the wage restraint. ■