

CONJONCTURE IN FRANCE

MARCH 1999

SECTORAL CONTRASTS

This document is available on the INSEE Website <http://www.insee.fr>



Sectoral contrasts

In 1998 the French economy maintained the upswing that began in mid-1996. The out-turn for the year was the best so far this decade, with growth of 3.2%, inflation at an historically low level and 400,000 job creations (including 300,000 in the market sector) accompanied by a decline of almost one point in the unemployment rate. The results would have been better still without the Asian crisis, whose impact gradually emerged during the year, marked by slowdowns in both activity and job creation, reflecting the appreciable loss of momentum in industry.

The early part of 1999 has in fact seen industrial output stagnate, still being held back by depressed world demand and since the autumn also feeling the effects of the deterioration in industrial leaders' expectations. These have led to a slowdown in investment, following the marked acceleration in Q2 1998, and a de-stocking tendency, although on only a limited scale, as the previous inventory build-up had also been small because of the rapid deterioration in the price outlook. Meanwhile, consumption has remained lively, thanks to the purchasing power gains generated by job creation and disinflation and to households' continuing highly favourable expectations. Demand for housing continues to rise, benefiting from very low nominal interest rates. All in all, it is household demand that is underpinning growth in numerous non-manufacturing sectors and especially those which traditionally create a large number of jobs. The result has been to set in train a virtuous spiral providing an underpinning to growth, while at the same time industry is marking time.

The international environment for France is still clouded. As the latest victim of the "Asian" crisis, Brazil has now lapsed into recession and is dragging the rest of Latin America with it. Japan is struggling to get out of the rut, although other Asian countries, like Korea, are showing signs of recovery. The United States, which showed surprising strength towards the end of the year, is continuing along its growth path based on domestic demand. The situations of France's euro-zone partners, which posted low growth in Q4, show wide contrasts. Consumption continues to strengthen, but industrial leaders' expectations are still deteriorating. All things considered, however, demand in French overseas markets should now cease to contract.

Combined with the rise in the dollar, this tendency, apart from its impact on French exports, is of a kind to favour a recovery in industrial leaders' expectations and so bring to a halt by mid-1999 the adjustments they have been making in investment and inventories. This could mean a reinvigoration of the upswing phase, although probably not to the same rapid rate as in 1998, given that household purchasing power will no longer be feeling the benefits of disinflation. Indeed, the bottoming out of commodity prices means that the year-on-year price change is now rising very gradually. In these circumstances, after weakening in the early part of the year, the annual growth rate can be expected to move back above 2% in Q2. Net job creation (90,000 in the market sector in H1) would then enable the unemployment rate to continue falling, reaching 11.3% in mid-1999.

Euro-zone growth in 1998 affected by the e-merging-countries crisis

Despite the high growth rate recorded in 1998 (3% on average), activity in the euro zone showed the impact of the emerging-countries crisis in the time-pattern over the year, with a sharp slowdown in industry.

South-East Asia last year found itself plunged into a deep recession, with the average growth rate falling from more than 5% before the crisis to -5% in 1998. This shock produced a marked deterioration in demand in the euro zone's overseas markets. France is not the most affected of the euro-zone countries, since its overall trade with South-East Asia is less important than for others, in particular Italy and Germany, and its principal export niches are less subject to competition from Asian products than those of some other countries, like Italy, with its specialisation in textiles and leather goods. This has meant that the crisis affected industrial activity in Italy and Germany sooner and more strongly than in France. At the end of Q3, with the financial crisis spreading to Russia and, to some extent, to Latin America, world demand weakened further. Germany, the euro-zone country with the closest trade links with Russia, was particularly affected by the extension of the

crisis, which also towards the end of Q3 triggered off a drop in equity prices on all the Western markets. This in turn was followed by an appreciable easing of monetary policies and the correction was short-lived.

From Q4 on, expectations on the part of European industrial leaders were lastingly affected by the fallout from the financial crisis, as shown by the business surveys carried out since then. The downward revision of their demand prospects led them to draw down stocks, seen as increasingly burdensome. As a result, the contribution of inventories to GDP growth in the euro zone fell from +0.8 of a point in H1 1998 to -0.3 in H2. Exports of intermediate and capital goods within the zone suffered from the slowdown in activity. For all the countries, export growth fell from an annual rate of roughly 10% in H1 to virtual stagnation in H2. Meanwhile, growth in industrial output weakened from an annual rate of 5% in H1 to 2% in H2.

The overall result was a slowdown in euro-zone GDP growth from an annual rate of 3% in H1 to 2% in H2, with the recovery in household demand the mainstay of growth towards the end of the year, although to differing degrees in different countries. The most recent

Gross domestic product (volume) by type of expenditure

(at 1980⁽¹⁾ prices, % change from previous period)

		1997				1998				1999		1997	1998	1999 Carry over ⁽²⁾
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	(100%)	0.1	1.2	0.9	0.8	0.8	0.9	0.4	0.7	0.3	0.6	2.3	3.2	1.7
Imports	(29%)	-0.2	4.6	3.7	0.9	2.4	1.1	2.3	-1.0	0.0	1.1	8.0	8.0	1.4
(of which merchandise)	(26%)	-0.4	4.9	3.5	1.2	2.6	1.3	2.6	-0.7	-0.2	1.0	8.1	8.7	1.5
Households' consumption	(60%)	0.1	0.2	1.1	1.1	0.9	1.2	0.7	0.7	0.7	0.6	0.8	3.8	2.2
General government consumption	(19%)	0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.3	0.4	0.2	1.2	1.1	1.0
Total investment (GFCF)	(20%)	-1.4	1.4	0.7	0.4	1.3	1.3	0.8	1.4	0.5	0.8	0.3	4.1	2.9
Corporate sector ⁽³⁾	(11%)	-2.6	1.8	0.9	0.8	2.2	1.9	0.8	1.2	0.2	0.7	0.1	6.0	2.6
Households	(5%)	-0.8	0.1	1.0	-0.6	-0.3	1.4	-0.1	2.4	1.2	1.6	-0.6	1.3	4.6
Others	(4%)	1.4	1.8	-0.3	0.4	0.8	-0.6	1.9	0.7	0.2	0.3	2.1	2.1	1.7
Exports	(30%)	2.0	6.4	3.4	0.9	1.0	0.5	2.9	-1.7	0.6	0.6	12.6	6.3	1.4
(of which merchandise)	(25%)	2.3	7.3	2.6	1.7	1.1	0.1	3.5	-2.1	0.5	0.5	13.0	6.7	1.0
Domestic demand		-0.6	0.6	0.9	0.8	1.2	1.1	0.2	1.0	0.0	0.8	0.9	3.7	1.7
Contributions to the growth of GDP														
Inventory changes		-0.4	0.2	0.1	0.0	0.4	0.1	-0.5	0.2	-0.5	0.2	0.1	0.4	-0.4
Trade in goods and services		0.7	0.6	0.0	0.0	-0.4	-0.2	0.2	-0.2	0.2	-0.1	1.4	-0.4	0.0
Domestic demand excluding inventories		-0.2	0.4	0.8	0.8	0.8	1.0	0.7	0.7	0.6	0.5	0.8	3.2	2.1

(1) National Quarterly Accounts evaluate growth at 1980 prices. Growth rates are usually slightly lower once calculated at the prices of the preceeding year.

(2) The statistical carry-over is the annual average growth rate that would result if growth were to be zero in Q3 and Q4 1999.

(3) Corporate and quasi-corporate enterprises (including unincorporated enterprises).

Forecasts

economic indicators show manufacturing output contracting in the early part of 1999, hit by more rapid de-stocking and by a slowdown in investment.

The early part of 1999 nevertheless finds the euro zone's international environment no longer deteriorating

The economic situation in South-East Asia began to stabilise in 1998. The timing of the exit from the crisis varies appreciably from one country to another. Some, like Indonesia, are still seriously affected by the crisis but it would seem that for most of the others the worst is now over. Exchange rates have been stable for the past year and industrial output is either no longer declining or starting to improve. Following the drop in imports resulting from the crisis, countries' trade balances are now substantially in surplus. The supply-side constraints are gradually easing (ending of credit restrictions, cuts in interest rates, etc.) and Asian industrialists are going to benefit from the competitiveness gains accumulated over recent quarters. They will be obliged to re-build the inventories they had run down considerably last year. The on-going restructuring of banking organs in certain countries, such as Korea, is also tending to re-build financial investors' confidence.

Japan could well benefit from this greater tranquility in its neighbour countries. The exceptional firmness of United States demand is also boosting Japanese exports. The domestic demand situation, on the other hand, remains worrying. The purchasing-power falls generated by the unprecedented rise in unemployment and the wage deflation mean that it is difficult to see any marked recovery in consumption occurring in the near future. The lack of outlets, the deflationary climate and the difficulties encountered in rehabilitating the banking sector are having a depressive impact on corporate investment. In these circumstances, the only positive contribution to growth in domestic demand is coming from public investment. As a result, Japan is now in its second consecutive year of recession. However, the rate of the decline in GDP is tending to diminish: -4% at annual rate in H1 1998, -2% in H2, while the figure for H1 1999 could be held down to -1%.

Given that Russia accounts for only a very small share (0.7%) of French trade, the contraction in activity in that country a year after the outbreak of the Asian crisis should not have any notable impact on French exports. Nor is the Russian crisis having any great knock-on effect on the Central and Eastern European countries, which, for the time being, are standing up well to the emerging-countries crisis. In Brazil, on the other hand, the recession looks like being a deep one in 1999 and, in particular, liable to have a considerable impact on activity in the other Latin American countries.

In the United Kingdom, the euro zone's principal trade partner, the economy has been stagnating since last summer and will not pick up again before the summer of this year. The external contribution is now strongly negative. Household consumption is no longer en-

joying the windfall proceeds of the transformation of several "building societies" into joint-stock companies and the recession in industry is at last being felt in slower employment growth. The fall in the unemployment rate has been partly based on a long-term tendency for the labour force to decline and it could well start to increase again in the early part of year. All things considered, and despite the marked monetary easing, private demand is likely to be flat in H1 1999, with strong public spending the only positive element in favour of growth.

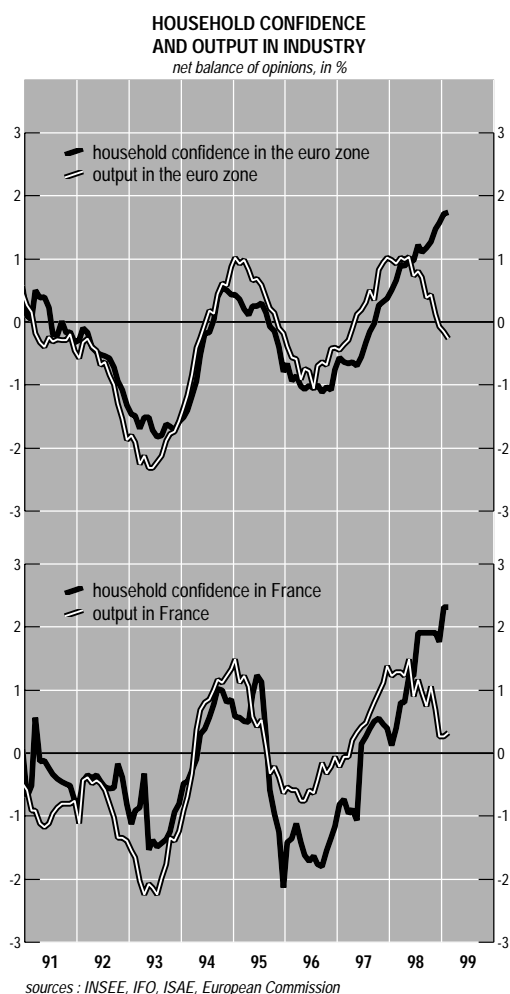
In the United States, domestic demand could now gradually slow down. The decline in exports, due to the drop in overseas demand and to the competitiveness losses following the appreciation of the dollar in the period up to mid-1998, has begun to affect industrial activity, now clearly slowing down. The fall in the capacity utilisation rate and the less favourable tendency in the demand outlook, both internal and external, can be expected to start to have an effect on corporate behaviour, with investment, which had been particularly strong in recent years, now likely to slow down. The saving ratio, after declining steeply in 1998 (probably because of the strong wealth effects), is not likely to fall further this year, meaning that household demand can be expected to slow down but remain firm. H1 1999 should see growth of the order of 2% at annual rate, compared with 4% last year.

All in all, demand in the euro zone's overseas markets should no longer be slowing down significantly in H1 1999, with stabilization in Asia offsetting slowdown in Latin America. Following growth of roughly 10% in 1997 and 5% in 1998, the euro zone's export demand should now grow at an annual rate of the order of 4% in H1 1999, marking the end of the deterioration. Continuing buoyant household consumption in countries where the upturn is well established and confirmation of its recovery in the others should provide a growth platform of close to 2% in the euro zone.

In the circumstances, demand in French overseas markets should continue to grow by close to 3%, as it did towards the end of last year. Exports would then grow in line with world demand.

The slowdown in French manufacturing is leading to less lively growth in employment

The workforce in the market sectors rose by more than 300,000 in 1998, more than in any year since 1990. Job creations remained strong in H2, despite a slight slowdown. Industry, the sector most affected, saw numbers employed stabilise in H2. The rise in temporary employment, mainly in industry, levelled off at the end of last year. Despite this slowdown in temporary employment, numbers employed in the tertiary sector (in which temporary-agency workers are classified) rose at a firm rate throughout the year, benefiting from the strength of household consumption and the buoyancy of services to businesses. Following three years' uninter-



ted decline, numbers employed in construction levelled out, thanks to an upturn in activity that was particularly visible in the second half of the year.

The continuing slowdown in industrial activity is likely in coming months to mean a reduction in numbers employed in industry. Especially through its impact on temporary-agency employment, it should also be felt in the tertiary sector, where employment is liable to grow more slowly than in 1998. However, the construction sector is still expanding and is expected to increase its workforce. All things considered, in H1 1999 employment in the non-farm market sectors is likely to rise by around 90,000, with the progressive application of the statutory 35-hour week cushioning the impact of the slowdown in activity. In addition, the extension of the public employment programmes, which were largely responsible for the increase in employment in the non-market sector in 1998 (100,000, approximately), should also help to bring about a further significant rise this year. As a consequence, total employment is expected to increase by around 140,000 in H1 1999.

The sharp rise in numbers employed in 1998 has affected the unemployment rate, bringing the ILO-definition figure down from 12.3% in December 1997 to 11.5% in December 1998. This fall is likely to continue through

out H1 1999, but at a slower rate than last year: roughly 0.2 of a point, compared with 0.3 in H2 1998 and 0.5 in H1 1998. By June 1999 the unemployment rate is expected to stand at around 11.3%.

Gradual upturn in prices

Partly as a result of the collapse in prices of oil and raw materials, which was directly passed on into energy and food prices, consumer prices slowed down appreciably in 1998, giving a year-on-year rise of 0.3% at the end of the year, compared with 1.1% at the end of 1997. Since the beginning of 1999, oil and commodity prices appear to have stabilised. In these circumstances, production costs are unlikely to show much change and the rise in wage costs would itself be moderate. Following the marked decline seen last year, the year-on-year consumer price rise could accelerate slightly in coming months, although still remaining below 0.5%. Underlying inflation is likely to stay slightly below 1%.

A less rapid rise in household purchasing power

Nominal wages are expected to rise in H1 1999 at much the same rate as last year. The year-on-year rise in the basic hourly wage for manual workers is expected to reach 1.8% by June, compared with 2% at the end of 1998. This slight slowdown in wage growth would be associated, in particular, with the low level of inflation. Despite this, the purchasing power of wages in the private sector should continue to grow at an annual rate of almost 1.5%, while the low inflation and the periodical adjustments already agreed will keep real wages rising in the civil service. It is the slowdown in employment growth that can be expected to bring about a similar slowdown in earned income. Moreover, given the target for the limitation of health care spending, social insurance benefits are also likely to rise less strongly. In all, the purchasing power of households' gross disposable income, which rose particularly strongly last year because of the rise in employment and the fall in inflation, is likely to ease back to a more modest annual rate (2.5%, compared with 3.5% in 1998).

Household demand still underpinning growth

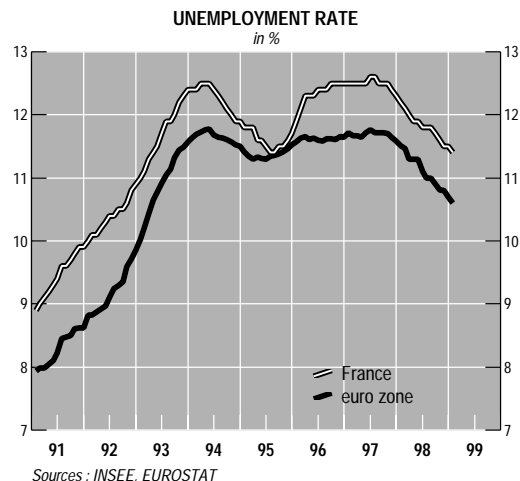
Household consumption, boosted by the rise in incomes and the fall in the saving ratio linked to the improvement on the employment market, rose strongly last year. On an annual average basis, the increase was close to 4% and contributed more than 2 percentage points to GDP growth. This average for the year was made up of a very steep rise in H1, followed by a slight slowdown in H2, with consumption growth easing from an annual rate of more than 4% to roughly 3%, a tendency similar to that shown by the purchasing power of incomes. In H1 1998, household spending was no doubt boosted by purchases of "brown goods" ahead of the World Football Cup. Car purchases were buoyant in 1998 and have remained so in the first part of this year. Consumption of services remained very firm throughout last year, stimulated, in particular, by the rise in spending on leisure and tourism and by the

consumption of telecommunications services accompanying the expansion of mobile telephones. It is likely to remain firm in H1 this year and this, combined with the strength of other components of consumption, should contribute to growth in the tertiary sector, which is relatively better sheltered than industry from external shocks. In circumstances that are slightly less favourable to employment, the saving ratio is likely to remain stable, with consumption increasing in H1 1999 in parallel with purchasing power, giving roughly 2.5% growth at annual rate.

In the second half of 1998, private investment in housing showed a marked upturn, from an annual growth rate of 2% in H1 to as much as 4.5% in H2. This upturn, driven by the rise in incomes and the low level of interest rates, as well as by highly favourable legislation, came as a breath of fresh air to the building sector, where activity accelerated sharply in H2 1998. Given the substantial rise in housing starts at the end of last year, this tendency is set to continue in H1 1999.

The adjustment in industry coming to an end

Confronted with the deterioration in the international environment, manufacturing firms last year changed their attitudes to inventories and investment. The contribution of inventories to GDP growth fell from +0.4 of a point in H1 1998 to -0.4 in H2, while the annual growth rate for corporate spending on capital equipment fell from 10% to below 4%. While this adjustment has continued in the early part of 1999, the



conditions are now in place that will bring it to an end. Household demand remains firm and is underpinning growth in the sheltered sectors (tertiary and building). Moreover, the international environment is now stabilising, while the dollar, after a downward phase at the end of last year, is tending to appreciate. In these circumstances, after weakening early in the year, the annual GDP growth rate can be expected to move up again above 2% in Q2. ■