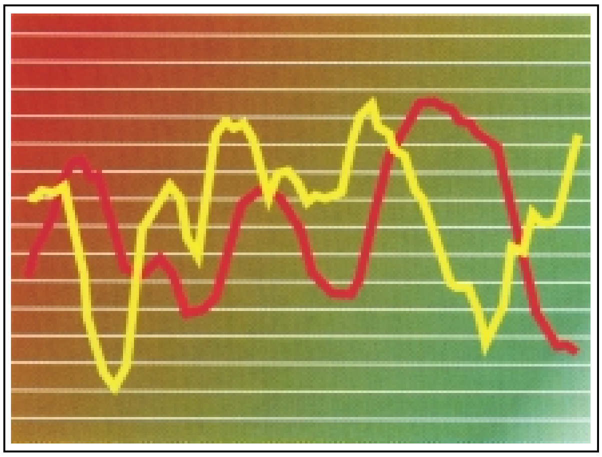
CONJONCTURE IN FRANCE

JUNE 1998



STABILISED GROWTH

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STABILISED GROWTH

For both firms and households, the return to growth is now an established fact and expectations are still strongly positive. Consumption is rising, manufacturing output remains lively. The relatively modest increase in GDP in Q1 (0.6%), bearing the imprint of the Asian crisis, gave a somewhat pessimistic impression of the tendency in GDP in H1, which is in fact of the order of 3% at annual rate.

This is somewhat slower than in H2 1997 (3.5%). At that time, growth was being bolstered by both the continuing strength of exports and the revival of domestic demand. Since the end of 1997, however, exports have been slowing down while imports have continued to be buoyed up by the increase in domestic demand. As a consequence, the contribution of foreign trade to growth, which had been strong in 1997, has been wiped out and is even tending to turn negative.

The slowdown in exports reflects a decline in the competitiveness gains that had been building up until mid-1997 and, especially, a less supportive international environment. Given the marked weakening of activity in the United Kingdom and a buildup of factors indicating a slowdown in the United States, growth in the euro zone is now the principal prop for French exports, faced with the impact of the Asian crisis : not only declining sales to the hard-hit emerging countries but also increasing competitive pressures, both from these countries and from Japan.

This leaves French growth mainly dependent on the expansion of domestic demand. In H2, all demand components are expected to improve. Household consumption should continue to rise at a rate of the order of 2.5%, making it the principal contributor to growth. Investment, in a context still highly favourable for its financing, is expected to continue to accelerate given the continuing strong demand outlook and the pressures on productive capacity. Changes in inventories should continue to make a positive contribution to growth, but not as much as in the previous upturn, because of the stagnation of producer prices. All in all, and assuming no aggravation of the Asian crisis -- always a possibility -- GDP growth is expected to approach 3% in H2. The Q3 figure will in any case be raised by a quarter of a point because of the number of working days. Given the substantial statistical carry-over at end-1997, GDP is expected to rise in 1998 by an annual average of 3.2%.

The rise in employment in the private sector is central to the new growth dynamic. The substantial numbers of jobs generated by the upturn since 1997, which in fact accelerated in Q1 1998, are providing a dual lift to consumption. They increase purchasing power, via earned income, especially as inflation remains moderate (despite a slight upturn in underlying inflation, the consumer price rise is not likely to exceed 1% at end-1998). At the same time, they are encouraging a downward shift in the saving ratio. Taking 1998 as a whole, almost 300,000 jobs in the traded sector are likely to be created, bringing the unemployment rate down to 11.5% by the end of the year.

A less dynamic world environment

The Asian financial crisis which erupted in the summer of 1997 had already by last winter begun to spread to the real economies of the countries concerned. Collapsing exchange rates led to a surge in import prices and, as a consequence, in producer and consumer prices. Meanwhile, the monetary squeeze and the difficulties experienced by the banking sector produced a fall in the credit supply. Domestic demand and output folded and the unemployment rate suddenly soared. Given the scale of the slump in domestic demand, activity in these countries can this year count only on demand from abroad. Their exports could indeed benefit from the steep drop in their currencies, but on condition that their firms are not totally asphyxiated by their financial problems.

For Japan, the Asian crisis has aggravated an ailing economic situation. In particular, it has intensified the already substantial difficulties facing the banking sector, leading to bankruptcies, wage cuts and redundancies. The rise in unemployment has badly dented household confidence, and consumption had in fact already been depressed since the hike in the VAT rate in April 1997. GDP fell in Q4 1997 and then even more steeply in Q1 1998. The package of exceptional measures decided by the Japanese government in the spring may help activity to pick up again, but only very gradually. In any case, it is unlikely to prevent the Japanese economy from posting a fall in GDP for the year 1998.

The fall in Asian demand is also adversely affecting the United States economy. Admittedly, activity continued to rise very strongly in Q1 1998, thanks to firm domestic demand. However, it is now likely to slow down progressively. Industrial output, which had been lacklustre early in the year, is likely to continue to be affected by the fall in foreign demand and by the decline in United States competitiveness. The deterioration in the outlook as seen by industrial business leaders could start to affect investment. Moreover, while the factors that are currently restraining inflation (weak commodity prices, disinflationary effects of the Asian crisis) are fading, the possibility of a tightening of monetary policy cannot be ruled out.

Activity in the United Kingdom began to slow down towards the end of last year, led by a deterioration in exports associated with the weakening of United Kingdom price-competitiveness. The slowdown has begun to have an impact on employment tendencies. Despite

Gross domestic product (volume) by type of expenditure

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

		1996				1997				1998				1996	1997	1998
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3(2)	Q4			
GDP	(100%)	**1.3**	**-0.1**	**0.8**	**0.3**	**0.2**	**1.1**	**0.9**	**0.8**	**0.6**	**0.8**	**1.0**	**0.7**	**1.6**	**2.3**	**3.2**
Imports	(29%)	3.2	-1.0	1.7	2.4	-0.1	4.3	3.6	1.0	2.7	1.3	1.7	1.6	3.0	7.8	8.7
(of which merchandise)	(26%)	2.5	-1.2	2.4	1.9	-0.2	4.7	3.4	1.2	2.8	1.2	1.7	1.7	2.5	7.8	9.0
Households' consumption	(60%)	2.4	-0.9	0.9	-0.6	0.1	0.3	1.2	0.9	0.6	0.6	0.6	0.6	2.0	0.9	2.9
General government consumption	(19%)	1.0	0.7	0.6	0.4	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.2	2.6	1.2	0.9
Total investment (GFCF)	(20%)	-0.4	0.3	0.0	-0.1	-0.9	1.3	0.6	-0.1	1.1	1.4	1.5	1.6	-0.5	0.3	3.8
Corporate sector(3)	(11%)	-0.1	1.1	1.0	-0.4	-2.0	1.5	1.2	0.0	1.9	2.1	2.3	2.5	0.6	0.1	6.4
Households	(5%)	-0.8	1.6	-2.9	1.0	-0.7	0.5	0.2	-0.3	0.0	0.5	0.4	0.4	-1.0	-0.6	0.7
Others	(4%)	-0.5	-3.5	0.8	-0.7	2.2	1.5	-0.3	-0.2	0.0	0.2	0.3	0.5	-2.9	2.1	0.5
Exports	(30%)	5.3	-1.9	3.7	3.0	1.4	6.0	3.4	1.9	0.7	1.5	1.3	1.3	5.2	12.2	7.5
(of which merchandise)	(25%)	5.0	-2.4	4.6	2.1	1.7	6.6	2.6	3.0	0.6	1.6	1.3	1.5	5.1	12.5	8.1
Domestic demand		0.7	0.2	0.2	0.1	-0.2	0.6	0.9	0.5	1.2	0.8	1.1	0.8	0.9	1.0	3.5
Contributions to the growth of GDP																
Inventory changes		-0.8	0.5	-0.5	0.4	-0.2	0.1	0.0	-0.1	0.5	0.1	0.4	0.0	-0.7	0.1	0.8
Trade in goods and services		0.6	-0.3	0.6	0.2	0.4	0.6	0.0	0.3	-0.6	0.1	-0.1	-0.1	0.6	1.4	-0.2
Domestic demand excluding inventories		1.6	-0.4	0.7	-0.3	-0.1	0.5	0.9	0.6	0.6	0.7	0.7	0.7	1.6	0.9	2.7

(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) Calendar effects account for 1/4 point of GDP growth in 1998 Q3.
(3) Corporate and quasi-corporate enterprises (including unincorporated enterprises).
Forecasts

continuing substantial wage increases, growth in earned income is liable to slow down substantially. All in all, the growth in household income is likely to be distinctly less brisk this year and to lead to a fairly marked deceleration in private consumption. As for investment, this is likely to be affected by the monetary tightening seen over the past 12 months and by the deterioration in the outlook for production.

More autonomous growth in continental Europe

Growth in the future euro zone is likely to be firm this year, despite a distinctly less dynamic world environment than in 1997. All the economies in the zone either began or continued recovering last year, under the impact of the strength of external domestic demand and the fall in their exchange rates versus the dollar. The upturn in activity is being accompanied by an improvement in employment, which should generate substantial additional earned income virtually everywhere. It could also encourage less cautious saving behaviour. Household confidence, which picked up in virtually all countries in the middle of last year -- in Germany, only in the autumn -- has continued to improve in the early months of 1998. Household demand is also benefiting throughout the euro zone from a relative relaxation of economic policy, exemplified by the abolition of the euro-tax in Italy and the reduction in the solidarity surtax in Germany. Finally, in Italy until June and in Spain, car-purchase bonuses have been providing specific support for the sector.

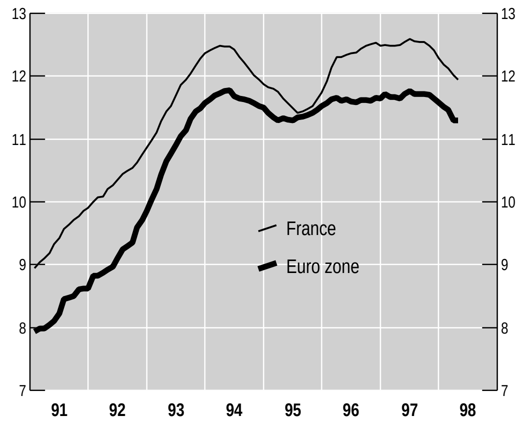
According to European opinion surveys, business leaders continue to see the demand outlook as good, despite the fact that export order-books are not as full as at the end of last year. All these factors point to a fairly high level of investment this year, in a climate of growing pressure on productive capacity and low interest rates. Taken together, these factors are signalling the likelihood of strong domestic demand in all the countries of the euro zone.

As in other European countries, French growth has led to an improvement in employment ...

Employment in France, responding rapidly to the upturn in activity, began to improve in 1997. In the non-farm traded sectors, there was a net increase of around 160,000 jobs. The acceleration seen towards the end of the year reflects business leaders' confidence in the robustness of the growth. In sectors where employment had deteriorated in 1996 (manufacturing, construction), job losses slowed down. In private services, job creation picked up, while in public services there was also progress in 1997 as the result of an active employment policy. In all, net job creations amounted to 180,000 in 1997.

The strengthening of activity at the end of 1997 led to a further improvement in employment in the first half of the current year. In 1998, employment is expected to progress in virtually all sectors. As a corollary, the unemployment rate has continued the decline begun at the end of 1997, falling from 12.3% last December to 11.9% in May. The continuing strong outlook for activity is likely to lead to a further improvement in the job situation in H2, allowing the unemployment rate to fall back to around 11.5% by the end of the year.

UNEMPLOYMENT RATE (ILO)
in the euro zone



Sources : INSEE, EUROSTAT

... and hence in earned incomes ...

Total wages and salaries, which had already risen strongly in 1997, are expected to rise even faster this year, thanks to the recovery in employment. However, wage rates are set to rise slightly less than last year, having been held back at the beginning of the year by the low level of wage settlements and the allowance made for the weak inflation. The second half of the year should see wage increases picking up slightly. As a result, growth in the total private-sector wage-bill is likely to accelerate throughout the year, reaching an annual growth rate of 4.5% in the second half. The increase on an annual average basis would be 4%, compared with 3.3% in 1997. Wages and salaries in the public sector are likely to feel the benefit of the introduction of the government's youth employment programme as well as the adjustments in the index governing civil service pay.

In 1998, compulsory contributions from households can be expected to rise at roughly the same rate as earned incomes. Social benefits are likely to slow down compared with last year (an average annual increase of 2.8%, as against 3.4%). All in all, thanks to the acceleration in earned income and the moderation shown by inflation, the purchasing power of household income is likely to continue to rise strongly, by about 3% on an annual average basis (2.5% in 1997).

... bolstering private consumption and household investment

In the second half of 1997, consumption had already begun to rally, reflecting the improvement in purchasing power linked to the slowdown in income tax payments and the growth in social benefits. It was possibly also responding to the first signs of the improvement in employment. This not only provides a direct encouragement for consumption, through the induced increase in purchasing power, but also more indirectly through the downturn in the unemployment rate, which has contributed to the improvement in household confidence shown over the past year in the opinion surveys, the corollary being a decline in the precautionary motive as an influence on saving behaviour. After last year's rise, the saving ratio is thought to be tending to decline, although on an annual average basis it is expected to remain around 14.5%.

All in all, after being particularly lively towards the end of 1997, household consumption has returned to an annual growth rate close to 2.5% and this is likely to persist throughout the year. On an annual average basis, the increase would be around 3%.

At the same time, investment by households is picking up again. After stabilising in the early part of 1997, sales of new apartments have since risen substantially. A large number of building permits for individual houses were issued in the first four months of the year. The rise in average rents can be expected to encourage investment for letting purposes, while investment in general is also being favoured by the low level of interest rates. Finally, expectations of a continuation of the firm trend in selling prices that began towards the end of last year are liable to stimulate plans to purchase.

HOUSEHOLDS' CONFIDENCE INDEX

(opinions - s.a. : quartely moving average)

Source : INSEE

Price rises still moderate

Having touched bottom in Q3 1997, underlying inflation has stabilised at slightly below 1%, year on year, and is likely to rise slightly in the course of 1998. This tendency would be partly linked to the recovery in prices in manufacturing, where the strength of consumption has somewhat eased competitive pressures (notably in the automobile sector). However, the slight rise in underlying inflation will not be reflected in the general index because of the sharp fall in energy prices. All things considered, the year-on-year consumer price rise is expected to be in the neighbourhood of 1% by the end of the year.

A propitious economic climate for corporate investment

After the recovery that began in the summer of 1997, purchases of plant and machinery by firms and individual businesses are thought to have risen by around 4% between H2 1997 and H1 1998. This increase is in line with the reported intentions of industrial leaders, who are expecting to increase their investment by around 10% for the year as a whole. Surveys of capital goods producers and wholesalers also indicate this upturn in purchases: their opinion on their activity has been very positive for the past six months or so, whereas demand from abroad has levelled off.

The factors determining investment spending remain positive. First of all, demand for companies' products is either brisk or improving markedly, depending on the sector. In manufacturing, against a background of a continuing low level of renewal of productive capital, this has led to a rise in the capacity utilisation rate, which in April stood at around 87%, well above the long-period average of 84.4%. Secondly, financial conditions are favourable. Long-term interest rates are low, meaning that investment can be financed by low-cost borrowing. Thanks to the growth in operating earnings, firms may also be in a position to finance their investment out of their own resources.

Investment in construction has remained slack in H1 1998 (up 0.8% on the previous half-year). However, the second half should see investment expenditure starting to shift towards the acquisition of buildings as well. It is probable that the high fixed costs connected with investment in building -- higher than for purchases of equipment -- have prompted businesses not to launch out in this direction until the upturn was confirmed. The marked increase in permits for industrial buildings, seen in the early part of year, indicates that the recovery is now under way.

Stock re-building

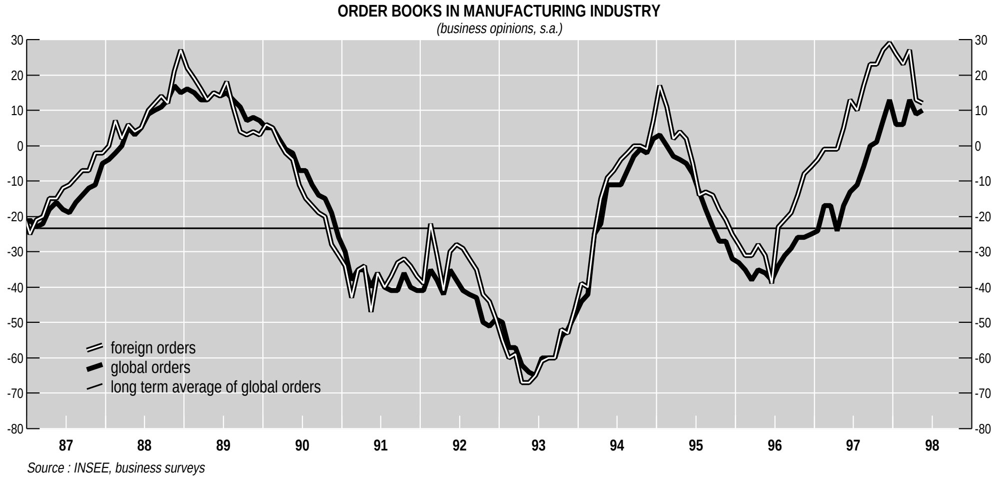
Inventory changes are expected once more to make a positive contribution to growth for the year 1998 as a whole. This tendency would be mainly due to expectations concerning demand, as business leaders' opinions on the price outlook are still relatively pessimistic. The actual level of inventories, still seen as low in industry both in France and in the rest of Europe, should prompt producers into a partial rebuilding of stocks, but it is mainly in distribution that the movement would take on substantial proportions, with the rise in order books and in sales prompting distributors to increase their buffer stocks to cope with continuing lively demand.

Imports stimulated by the rise in domestic demand

The strength of imports, which was particularly marked in mid-1997, has so far shown no signs of weakening. In coming months, growth in merchandise exports is expected to settle down at an annualised rate of around 7%. Productive investment and inventories, with their structurally high import content, would be the main driving-forces. By bolstering activity, domestic demand would therefore also indirectly stimulate imports of intermediate goods and industrial raw materials, whose prices seem to have stopped falling.

Exports underpinned by the European market

French exports have slowed down in the early part of the year, but this tendency has to be placed in perspective by remembering the exceptional growth rates attained last year (over 12%, year on year, at the end of 1997). The slowdown is explained by the gradual fading of the competitiveness gains built up last year, but especially by the slowdown in demand in French export markets as a result of the fall in activity in Asia and the slowdown in the United Kingdom. After being almost 10% in 1997, growth in world demand has slackened appreciably, with the annual growth rate now no more than around 6%. On top of this, in the second half there will be the probability of a slowdown in activity in the United States. Demand in French export markets would then have European growth as its main prop. Exports are likely to move in parallel, with



growth in the second half not exceeding an annualised rate of 5%. The sectors mainly benefiting from the demand would be capital goods and consumer goods, with food and beverages more severely affected by the Asian crisis.

All things considered, the contribution of foreign trade to GDP growth is weakening appreciably and is expected to be slightly negative on an annual average basis in 1998. As in the case of France's European partners, it is domestic demand that can be expected to take up the running from the external sector in underpinning activity.

Growth in activity levelling off at a rate of 3% a year

The upturn has now spread to all sectors. The weakening in manufacturing activity in the early part of the year -- here again, following very substantial growth in 1997 -- is thought to have been followed by a slight rebound in the spring, to judge by business surveys. The favourable outlook for demand from firms and households is pointing to continuing dynamic output in the second half. In manufacturing industry, the annualised growth rate is expected to be of the order of 6%. The strong demand would also be reflected in an acceleration in activity in wholesale and retail distribution, where sales have already risen considerably. The revival of investment in housing and other building should enable the construction sector to return to growth in 1998. Finally, services should feel the full benefit of the demand emanating from both households and firms and rise at a firm rate. This tendency would particularly affect the more modern types of services (computers, telecommunications, television, consultancy, etc).

GDP growth, after reaching an annualised rate of 3.5% in H2 1997, slowed down in the early part of 1998, under the impact of the Asian crisis. It is now at an annualised rate of close to 3%, and this is likely to be maintained in the second half. A calendar effect will in any case raise growth in Q3 by a quarter of a point. On an annual average basis, GDP growth is expected to reach 3.2%. ■