

# 1997 in retrospect

*The principal feature of the year 1997 was that it was a year of recovery. The scale of this recovery shows up only indistinctly in the figure for average growth (2.4%), although this was substantially better than in 1996 (1.5%). However, it is clearly seen in the end-year year-on-year growth figure of 3.2%. The pattern of recovery was fairly traditional: an acceleration in exports, followed by a return to a positive contribution from inventories (thanks to an improvement in expectations) and finally a re-kindling of domestic demand in the form of both consumption and investment. Industry was the first to benefit, with the effect then spreading to the other sectors of the economy. However, in certain respects 1997 was also a somewhat special year.*

First, there was the strength of export growth, associated with brisk activity at world level thanks to a combination of upturn in Europe and a peaking of the cycle in the rest of the world and to an exchange-rate environment which ensured a high degree of competitiveness. All in all, foreign trade contributed more than half the 1997 growth, at 1.5 point. Above all, it provided the indispensable trigger for renewed growth at a time when there was inadequate room for manoeuvre in fiscal policy to stimulate domestic demand that had long remained flat.

The second particularity of 1997 was the long-standing hesitation of households and firms to step up their demand. In particular, investment behaviour, at a time when the corporate financial situation was good, when growth expectations were strong and when the financing conditions were improving substantially, demonstrated a high degree of caution, probably the result of the see-sawing economic conditions since 1993. In the same vein, consumption picked up again only in the summer and the rise in incomes (2.3% in 1997) was absorbed mainly through an increase in the saving ratio.

However a partial explanation can be found in the dislocation of the car purchasing cycle. It should be noted that the recovery in domestic demand coincided with a distinct improvement in the indicators of the economic climate, variables whose short-term forecasting potential, although unquantifiable, is once more demonstrated.

The year 1997 stands out clearly from previous cyclical upswings by its character as "inflation-free recovery". Whereas in 1994 growth had generated a marked increase in producer prices, the 1997 upturn merely succeeded in stabilising them at the low level of the previous year. A similar tendency was to be seen for consumer prices, which rose by only 1.1% in 1997, compared with 1.7% in 1996. Identifiable one-off factors (fall in commodity prices towards the end of the year, impact of excess capacity in the car sector) provide only a partial explanation and raise the possibility that price behaviour may in fact have changed. On the other hand, behaviour regarding employment seems to have been much the same as in recent years: the upturn rapidly generated job creation in the traded sector, revealing a relatively slight improvement in labour productivity. Above all, these job creations meant the start of an easing of unemployment.

## **The gradual spread of the upturn in industry to all the other sectors**

In 1997, industry made a significant contribution to growth in activity. Value added in manufacturing rose by 5.2%, so that, with the sector accounting for 16.5% of GDP, almost half the growth in French economic activity came from this one source. On an annual average basis, output rose by 4.3%, compared with 0.5% in 1996, while the year-on-year increase amounted to 6.5%. This strong performance from the manufacturing sector was mainly due to tendencies in foreign trade and in inventories. French exports of manufactures rose by 12.4%, compared with 5.8% in 1996. Manufacturing imports also rose, but in less marked fashion and after a certain time-lag. For the year as a whole, the increase was 8.3%. In the final analysis, foreign trade explains almost 90% of the rise in value added in manufacturing.

The steady improvement in the demand outlook, especially from abroad, led to a reversal of inventory behaviour on the part of industrial firms in Q2. Having been negative by 1.9 of a point in 1996, the contribution of

inventory changes to the evolution of manufacturing output amounted to +0.6 of a point in 1997.

The recovery gradually spread to the whole of the economy, benefiting first the business services sector before spreading to the whole of the tertiary sector. Output of traded services accordingly rose by 2.4%, compared with 1.4% in 1996. The rise in the transport and telecommunications branches was 4.2%, compared with 3.5% in 1996. The upturn in activity became visible in distribution only in the second half, helped by the acceleration in household consumption: on an annual average basis, output was stable, but there was an acceleration during the year. The only sector to record continuing flat activity in 1997 was construction. The gradual recovery in private investment was reflected initially in a continuing fall in stocks of unsold new dwellings, while corporate investment in buildings continued to fall, for the sixth year in a row. As a result, output in the building and public works sector declined by 0.6% in 1997, following a fall of 1.9% in 1996. The year-on-year figures showed no change.

### Job-rich recovery has permitted an easing of unemployment

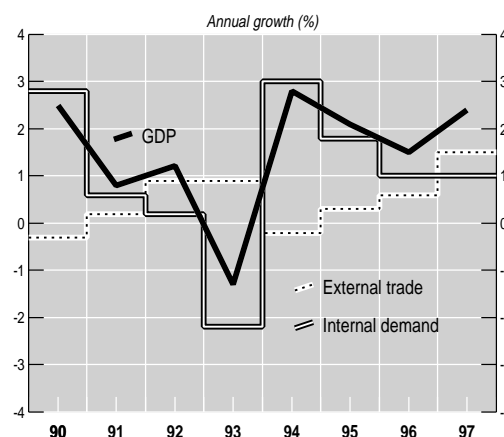
Dependent employment in the traded sector was quick to benefit from the upturn. In the non-farm traded sector, some 155,000 jobs were created, a figure which demonstrates the high job content of growth. Admittedly, employment continues to lag behind in a certain number of sectors (especially construction), but its recovery, which seemed initially to be confined to the services sector (including temporary employment agencies), has gradually become more widespread. In particular, the decline in employment in manufacturing came to a halt at the end of the year, while job losses also slowed down in construction. Overall, net job creation amounted to around 170,000. This figure includes net creations in the non-traded sector, making up for a fall in independent employment. The result of these various evolutions was that unemployment, after increasing early in 1997, levelled off in the summer before starting to fall towards the end of the year. For the year as a whole, the number of job seekers averaged 12.5% of the labour force.

### Income rises and renewed household confidence are behind a progressive revival of consumption

After stagnating in 1996, the purchasing power of household income rose by 2.3% in 1997. Part of this acceleration is explained by the growth in activity, notably through the job creations, but it also stems from a certain number of specific measures (reduction in income tax, the "nudge" given to the SMIC minimum wage, the quadrupling of the allowance for the start of the new school year). And, of course, it was also partly due to the slowdown in prices, with inflation barely exceeding 1%.

In these circumstances, the low growth in household consumption (0.9% on an annual average basis) may

CONTRIBUTIONS TO GROWTH IN GDP



seem surprising. It corresponds to a rise of almost a point and a half in the saving ratio, much more than would be explained simply by the acceleration in income growth. This rise in the saving ratio is all the more difficult to explain in that household confidence revived slightly at the end of 1996, and much more markedly in mid-1997. In reality, the movement in household consumption in 1997 is due in large part to events affecting the French car market, which collapsed with the ending of the "car-scrapping bonus" in October 1996 and then declined steadily until June 1997. For the year as a whole, car purchases fell by more than 15%. Excluding cars, on the other hand, household consumption rose by 1.6%, much the same rate as in 1996 (1.8%). The gradual recovery in registrations that began in the summer of 1997 has continued unabated since then. It has in fact gone hand in hand with a general upward tendency in purchases by households, which were 1.4% higher in second half of the year than in the first. Leaving aside energy consumption (largely determined by weather conditions), all items of consumption showed a marked revival in purchasing towards the end of the year.

### Productive investment has tracked the upturn, with a slight time-lag

There was a gradual acceleration in productive investment throughout 1997. After falling back at the beginning of the year (a decline of almost 2% between H2 1996 and H1 1997), an upturn became visible in the second part of the year, with a rise of almost 1.5% between H1 and H2. On an annual average basis, corporate investment declined very slightly (by 0.1%). This fall was concentrated on investment in buildings, whereas corporate investment in manufactured goods rose by 1.4%. The second half of the year even saw the annual rate of increase approach 5%. While this evolution shows a slight time lag compared with the pattern of acceleration in activity, it nevertheless seems somewhat meagre, given the exceptionally strong demand

and a financial environment favourable to investment (low interest rates, cash flows in excess of investment for firms in general). Excess production capacity, and a certain wait-and-see attitude, reflecting unease regarding the permanence of the recovery especially, may perhaps provide an explanation.

### **Recovery accompanied by only very moderate price rises**

In 1997, the marked acceleration in activity was not reflected in a recovery in consumer prices. On the contrary, inflation settled down at 1.1%, year on year, and 1.2% on an annual average basis, the lowest figures since 1955. This price moderation affected all sectors, but particularly manufactured goods, whose prices were virtually stable (+0.1%, year on year, at the end of

1997). At earlier stages of the production chain as well, price changes remained very moderate. After steadily rising until October, selling prices in industry fell back slightly towards the end of the year. This general moderation has several possible explanations: the stability of industrial commodity prices, the productivity gains in manufacturing, the absence of any particular pressure on productive capacity, the special situation in the car market. The Asian crisis, which rapidly produced a fall in the oil price and in those of industrial commodities, intensified the ongoing disinflation towards the end of the year. These low price increases were clearly a factor favouring the evolution of household income and consumption, but they may have held back stock-building. After providing strong support for growth in Q2 1997, inventories thereafter made only a marginal contribution to growth. ■