

**DECEMBER 1997**

## **BETTER-BALANCED GROWTH**

***T**his autumn's figures have confirmed the acceleration in French economic activity. The international environment, which has been behind the recovery seen since mid-1996, was as supportive as ever, while the revival in all the main components of domestic demand has been confirmed. After being initially concentrated on manufacturing industry, the upturn has now spread to the tertiary and construction sectors.*

*Inventory behaviour turned positive in the spring and is expected to remain so, given the positive orientation of demand. However, the contribution to growth from stock-building is likely to be less than in past upswings because of weaker price expectations. Consumption seems set for a durable increase. Purchasing power, after distinctly recovering in 1997, is expected to rise in the first half of 1998 thanks to higher earned incomes, while households' expectations have shown a marked improvement since the summer. Investment has picked up since mid-1997. Its gradual increase reflects business caution and it can be expected to continue to track the rise in output. The corollary of the gradual increase in domestic demand has been an upturn in imports. At the same time, the international environment, although remain-*

*ing buoyant because of the dynamic context in Europe, is being affected by the South-East Asian crisis and its various repercussions, notably on Japan. Less lively growth in world demand and an easing of the impact of the competitiveness gains built up until last summer are likely to bring year-on-year export growth down from 13% in mid-1997 to 8% in mid-1998. All in all, the positive contribution from external trade to growth is expected to dwindle in the next few months.*

*GDP growth, after accelerating steadily since mid-1996, is thought to have peaked at an annualised rate of almost 3.5% in the second half of 1997. With less support from the external sector and from inventories, it looks set to level out in H1 1998 at around 3% a year. The growth in activity is unlikely to have a significant impact on inflation, which is expected to remain very moderate, with the year-on-year consumer price rise likely to be around 1.4% in June 1998. On the other hand, the growth will probably enable the positive job creation to continue. As a result, the unemployment rate, after stabilising in 1997, could ease by around a quarter of a point by mid-1998.*

# Better-balanced growth

## **The international environment still fairly buoyant, thanks to Europe**

World growth in 1997 was buoyed by the exceptional strength of the United States economy, as it had been in 1996. However, the upturn in European activity has given a broader underpinning to world demand, which has, however, been affected by the slowdown in Japan and, from the autumn on, by the South-East Asian financial crisis. In the first half of 1998, the strong growth in continental Europe, now driven more by domestic demand, should cushion the impact of the expected weakening of the United States economy and the slowdown in Asia. All things considered, activity at world level, while continuing to grow at a firm rate, is likely to slow down between now and the middle of 1998.

After six years of expansion, the United States economy again managed to accelerate in 1997, driven by continuing exceptionally firm domestic demand. Private consumption is being boosted by a sustained rise in purchasing power. The steady climb in stock-market prices until October 1997, by generating strong wealth effects, may have contributed to a reduction in the household saving ratio. These tendencies have led firms to step up investment, which was in any case being encouraged by the continuing low interest rates, the high cash flows and the fall in capital goods prices. While the positive orientation of domestic demand is unlikely to weaken much, if at all, in the first half of 1998, a downturn in activity related to the outside world is now expected and the competitiveness losses induced by the steady appreciation of the dollar and the fall in demand from Asia are likely to result in a slowdown in United States exports.

The South-East Asian financial crisis, which began in the emerging economies before spreading at the end of 1997 to the more industrialised countries of the region (Hong Kong, Singapore and Korea), has now led to a substantial depreciation in their currencies and tighter domestic economic policies. As a result, competitiveness has improved and domestic demand has been reduced in these countries. Moreover, the short-term effects of the crisis could well be amplified by the structural malfunctioning of the financial systems of some of these economies, which has now been cruelly exposed. It is also having a debilitating knock-on effect on all the emerging economies in Eastern Europe and Latin America. Another country likely to be especially affected is Japan, where domestic demand was already suffering from the tight fiscal stance. This partly took the form of cuts in public investment, which had previously, along with the external sector, been a substantial prop for growth in 1996. It has also produced a

distinct fall in private consumption, hit by the rise in indirect taxes.

However, continued growth in Western Europe, driven by a positive tendency in domestic demand, should partly offset the repercussions on France of the slowdown in activity outside Europe. This prediction is made on the assumption that the move to the third stage of Economic and Monetary Union takes place smoothly at the planned date. In the unlikely event that this assumption is unfounded, the scenario would probably be thrown somewhat off course by the resulting adjustments in interest and exchange rates. Conversely, the markets' present confidence that monetary union will be achieved without difficulty is contributing to the stability of intra-European exchange rates and the maintenance of low interest rates, and in so doing has probably helped to contain the impact of the Asian crisis on the European financial markets.

Ever since 1996, exports have provided the principal prop for growth -- in continental Europe, at least. In this, they have benefited from the marked improvement in demand from outside Europe. In addition, for the continental European countries, the depreciation of all their currencies vis-à-vis the dollar has enabled exporters to achieve substantial competitiveness gains. However, the driving force provided by external demand has begun to weaken in the second half of 1997, in favour of an expansion of domestic demand, first seen in Spain and the Netherlands. Households began to show improved confidence during the summer in all the European countries, partly because of the improvement in the employment situation, which seems set to last. In a certain number of European countries it is accompanying a revival of consumption. Furthermore, the higher capital utilisation rates (already well above average in the German case), at a time of low borrowing costs and substantial cash flows, have led to a gradual upturn in investment.

## **French exports slightly less dynamic**

Boosted by the steady rise in world demand and by the substantial competitiveness gains generated by the depreciation of the franc against the dollar, French exports rose strongly until the summer of 1997. In coming months, however, the positive impact of the decline in the franc's effective exchange-rate, which had been interrupted in the summer of 1997, will start to fade. French exports will continue to profit from the strength of domestic demand in Europe, but will feel the impact of the weakening of demand from other regions and especially from the fallout of the Asian crisis. This is now affecting countries whose demand made an appreciable contribution to the strength of French exports

earlier this year. At the same time, the depreciation of the currencies involved is affecting the competitiveness of French products. The negative impact of the Asian crisis on French export growth could be of the order of 3 percentage points. All things considered, year-on-year export growth, after reaching almost 13% in the summer of 1997, is expected to stabilise at around 8%.

### **The 1997 upturn in manufacturing output**

The upturn in economic activity that began in mid-1996 initially took the form of a revival of manufacturing output. This was partly due to traditional factors -- manufacturing output is highly cyclical, notably because of the role played by inventories -- but also to the predominant role played in 1997 by external demand in getting the economy moving again. There was a distinct acceleration in manufacturing output throughout the year, with year-on-year growth close to 6.5% at the end of 1997, compared with 1.7% a year earlier. The first sector to record a substantial upturn was that of intermediate goods, following the decline seen in 1996. This was stimulated by lively external demand and by stock re-building in domestic industry. Activity in the capital goods sector, despite the slackness of corporate investment in the early part of the year, also showed marked progress thanks to exports, which were particularly well maintained in the aircraft sector. It later benefited from the renewed purchases of capital goods. On similar lines, activity in the car sector initially rose in response to the strength of external demand, with the impact of the upturn in domestic demand felt only in mid-year. The consumer goods branch has continued to lag behind the rest of manufacturing industry.

### **Growth now stabilising on a broader sectoral base**

The forward momentum in the manufacturing sector has gradually spread to other branches of the economy. It had already resulted in strong demand for temporary employment services in the first half of 1997 and later brought in its wake an improvement in activity in other services to firms, especially consultancy and assistance services. Wholesale distribution also recorded an upturn in activity at a fairly early stage, first for intermediate goods and then in the summer for capital goods. Retail distribution has tended to lag behind in 1997, as a result of the flatness of consumption in the first half of the year. In the construction sector, activity levelled out following the deterioration seen in 1996.

In 1998, industrial activity is likely to slow down slightly, mainly because of the weaker export growth. In addition, the role played by corporate inventory policy, after providing substantial support to the rise in output in 1997 -- as is usual in an upswing -- is likely to fade progressively. Growth in manufacturing output, after exceeding 6% on a year-on-year basis at the end of 1997, is likely to fall back to around 5%. Activity is expected to remain firm in the other branches, with the building sector showing particular progress. All in all, GDP growth, after steadily accelerating since mid-

1996 and reaching a peak in the summer of 1997, will probably level out at around 3% in the first half of 1998.

### **Strong job creation**

In line with the upturn in production, dependent employment in the traded sector has been rising since Q4 1996. This rise has been confirmed in 1997 and should continue in 1998. The number of dependent workers in the non-farm traded sector is expected to rise by 130,000 between the beginning and end of 1997 and by 120,000 during the first half of 1998. Having been until now largely confined to the services sector, net job creation should start to involve the industrial branches, too, as of early 1998. Total employment is likely to rise even more, as the government's new youth-employment measures take their full effect. At the same time, the decline in the number of independent workers has eased in 1997 and this tendency is expected to continue in the first part of 1998. During this period, the impact of the measures in support of the reduction in working hours is likely to remain limited.

With the labour force growing at close to its long-period trend rate, job creation will permit a slight fall in the unemployment rate, possibly by around a quarter of a point between now and the end of H1 1998.

### **The resulting growth in incomes**

In 1997, the purchasing power of household income showed a marked acceleration (with a rise of 2.3% on an annual average basis, following +0.2% in 1996). This improvement was based mainly on two factors which will not be repeated in 1998: the cuts in personal income tax and the marked slowdown in prices. During the past year, however, the acceleration in earned income has been unmistakable. The improved tendency in employment already seen in mid-year and the rise in real wages have produced a slight acceleration in wage income in the private sector. Independent workers' earnings from activity have also accelerated during the year. In 1998, continuing growth in earned income is likely to ensure that purchasing power continues to rise.

### **Household consumption still rising**

In 1997 household consumption is unlikely to increase by more than 0.7% on an annual average basis, compared with 2.1% in 1996, despite the strength shown by gross disposable income. Consumption was particularly affected by the uneven time pattern in car purchases, which fell sharply in the first half in reaction to the ending of the "car-scrapping" bonus in October 1996. For many products, including innovative household durables, consumption has in fact been rising steadily throughout 1997. Car sales have picked up again since the summer and household purchases as a whole are now looking stronger. This tendency is likely to continue in coming months, underpinned by the low cost of borrowing, the income rises and household confidence. Households' expectations have in fact remained positive after their substantial improvement in June.

## Investment now tracking activity

In 1997, productive investment by firms <sup>(1)</sup> appears to have risen only slightly (by 0.4% in volume terms compared with 1996). The small size of this increase in fact masks an acceleration as the year went on, signalled by several indicators. Capital goods imports rose by more than 10% in Q3, and a survey of wholesalers showed that sales and orders addressed to wholesalers of capital goods picked up substantially from July on. Moreover, industrial building starts began to rise in the middle of the year.

Productive investment is likely to show continued progress in H1 1998. Helped by continuing strong demand and by a generally favourable financial situation, companies' investment expectations for 1998 are looking better. Although still only moderate, they could well be revised upwards at a time of accelerating activity.

## The strength of domestic demand reflected in imports

Imports have accelerated substantially in the upturn phase that began in 1996. Until mid-1997, however, their rise was slower than that of exports, with the result that the external contribution to growth remained substantially positive. Q3 1997 was marked by a surge in imports, in reaction to the strength of domestic demand. Thereafter, in combination with the slowdown in exports, the strength of imports is liable to mean a gradual dwindling of the external contribution to growth between now and mid-1998.

(1) "SQS-EI" (corporations and quasi-corporations, unincorporated enterprises)

## Growth unlikely to be accompanied by inflationary pressures

In 1997, several factors might have been expected to combine to generate an upturn in producer prices that would have gradually fed through to consumer prices: the depreciation of the franc, the upturn in industrial activity and, especially in the services sector, the rise in wages. In the event, underlying inflation was at a minimum in the summer (0.5% in July) and has risen only very moderately since then. The end of 1997 is likely to see it at a year-on-year level of 1%.

Producer prices were probably held back by the relative moderation shown by import prices, reflecting the more generalised tendency at international level. However, in industry they also benefited from the restraint shown by unit wage costs, made possible by the productivity gains achieved in an upswing phase. Substantial price reductions on innovative products, drawing on significant technical progress, partly explained the moderation shown by prices of manufactures. On top of this, there was in the French case a fall in car prices linked to the weakness of consumption in this sector.

Between now and the end of the first half of 1998, prices are likely to show moderate increases. Producer prices can be expected to move in line with the upturn, with a further push from the gradual acceleration in production costs. The consolidation on the demand side is also likely to exert an upward influence. Prices of services to households can be expected to move upwards as a delayed result of the wage increases granted in 1997. All things considered, consumer prices are likely to show a year-on-year rise of 1.4% at the end of H1 1998, with underlying inflation at 1.2%. ■

## Gross domestic product (volume) by type of expenditure

(at 1980 <sup>(1)</sup> prices, % change from previous period)

		1996				1997				1998		1996	1997	1998 Carry-over <sup>(2)</sup>
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
<b>GDP</b>	(100%)	<b>1.3</b>	<b>-0.1</b>	<b>0.8</b>	<b>0.3</b>	<b>0.3</b>	<b>1.1</b>	<b>0.9</b>	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>1.5</b>	<b>2.5</b>	<b>2.6</b>
Imports	(29%)	2.9	-1.3	2.7	1.2	-0.1	3.4	3.7	1.7	1.6	1.7	2.8	6.8	6.9
(of which merchandise)	(26%)	2.3	-1.7	3.8	1.1	-0.2	3.6	4.1	1.6	1.7	1.8	2.5	7.4	7.3
Households' consumption	(60%)	2.4	-0.9	0.9	-0.5	0.2	0.1	1.1	0.2	0.5	0.6	2.1	0.7	1.7
General government consumption	(19%)	0.7	0.4	0.5	0.5	0.4	0.3	0.3	0.1	0.2	0.2	1.7	1.5	0.7
Total investment (GFCF)	(20%)	-1.1	-0.2	1.5	0.2	-1.3	0.5	1.7	0.3	0.6	0.7	-0.5	0.7	2.3
Corporate sector <sup>(3)</sup>	(11%)	-1.2	0.2	2.3	0.0	-1.9	0.4	1.9	0.1	0.7	0.7	-0.8	0.5	2.3
Households	(5%)	-2.5	1.2	0.0	1.1	-2.5	-0.2	2.8	0.3	0.4	0.5	-0.2	-0.1	2.3
Other sectors	(4%)	0.7	-2.9	1.1	-0.2	1.8	1.3	-0.2	0.7	0.8	0.8	-0.4	2.5	2.1
Exports	(29%)	4.8	-1.9	3.3	2.0	2.2	5.3	2.4	2.4	1.8	1.7	4.8	11.1	7.5
(of which merchandise)	(24%)	4.2	-2.2	4.3	1.8	2.2	6.0	2.6	2.7	2.0	1.8	5.1	12.0	8.3
Domestic demand		0.7	0.1	0.7	0.1	-0.4	0.5	1.2	0.5	0.7	0.7	1.0	1.1	2.3
<b>Contributions to the growth of GDP</b>														
Inventory changes		-0.6	0.6	-0.3	0.2	-0.3	0.3	0.2	0.3	0.2	0.2	-0.5	0.3	0.7
Trade in goods and services		0.6	-0.2	0.2	0.2	0.7	0.6	-0.3	0.3	0.1	0.1	0.6	1.3	0.3
Domestic demand excluding inventories		1.3	-0.5	0.9	-0.2	0.0	0.2	1.0	0.2	0.5	0.5	1.5	0.9	1.6

(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 1998.

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

Forecasts