

CONJONCTURE IN FRANCE

JUNE 1997

CONFIRMATION OF THE RECOVERY

In an increasingly favourable international environment, the acceleration seen since last summer in French economic growth is likely to be maintained in the second half of 1997. The industrial sector, helped by brisk foreign demand, by the competitiveness gains accumulated in the recent past and by firmer prices, is making a strong contribution to the acceleration: first, through a change in stock-building behaviour and second, by stepping up investment. With household incomes benefiting from the upturn in activity, the boost this will give to consumption can be

expected to provide consolidation for growth. Even with job creation accelerating throughout the year, however, unemployment is not expected to do more than stabilize in the second half, because of above-trend growth in the labour force.

The maintenance of positive expectations on the part of business leaders is crucial to this scenario. On this assumption, GDP growth in 1997 should be 2.3% on an annual average basis, with the annualized rate exceeding 3% in the second half of the year.

FOREWORD

The circumstances at the time this Note was being drafted were somewhat particular, coinciding with a change of parliamentary majority and the announcement by the new government of "new measures". Just what these measures would be and, especially, their timing were not known at the time of drafting. Rather than make what would inevitably be speculative assumptions, it seemed preferable not to take them into account at this stage.

In these circumstances, the Note makes more use of conventional assumptions than usual. But this does not necessarily mean any great loss of reliability, given the importance of the role played by the European economy as a whole. It is a known fact that the individual European economies are moving increasingly in phase with one another and that the current industrial upturn is not confined to France. Its causes and characteristics are largely shared by all the continental European countries: accelerating world demand, favourable tendencies in interest and exchange rates and a cyclical upswing in intermediate goods that is largely an international phenomenon.

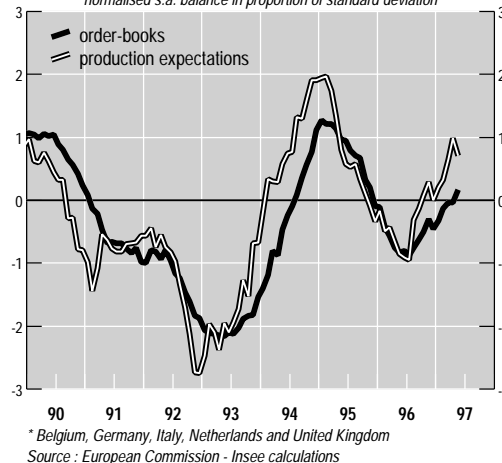
A favourable international environment

Economic growth at world level was already lively in 1996 and should be even livelier in 1997, spreading to regions that had tended to lag behind last year. Most of the impetus is likely again to come from the rapidly-developing countries. In particular, China and the South-East Asian countries can be expected to conserve a growth rate of 8% and the Latin American countries to do better than in 1996, with 4%.

The upswing in the United States has now lasted for more than six years and so far shows no signs of losing momentum -- quite the opposite in fact, as activity has again accelerated towards the end of last year and in the first quarter of 1997. United States GDP rose by around 2.5% in 1996 and is expected to rise this year by close to 3.5%, with private consumption likely to remain the main driving-force for the whole of the year. Households are currently enjoying a high level of purchasing power, stemming from a combination of strong wage growth and especially a steep rise in employment -- the unemployment rate fell to 4.8% in May, the lowest figure since the first oil-price shock. As measured by the composite confidence index, consumer confidence has been steadily rising since the beginning of 1996 and is now at a very high level. Overall investment is also expected to rise strongly, although it could possibly slow down somewhat in the second half, with the construction sector starting to feel the impact of the rise in long-term interest rates that occurred last year. On the whole, domestic demand, excluding inventory changes, should make an even greater contribution to GDP growth than it did last year. Conversely, the external contribution is likely to be slightly smaller, with imports boosted by the strong domestic demand, especially as the strength of the USD is having an adverse impact on domestic producers' competitiveness. The same is naturally true of export competitiveness, but in this case the handicap should be partially compensated by the rising demand from a number of the country's main trading partners.

In the case of Japan, while the rate of growth of activity in 1997 will appear to be slower than last year, this will in fact represent a consolidation. This is because the strong rise in GDP (3.7%) seen in 1996 was largely explained by an exceptional first quarter, marked by the impact of the fiscal re-stimulus package and the reconstruction efforts following the Kobe earthquake. The Japanese economy later slowed down. This year, however, Japan should be reaping the full benefit of the delayed impact of the currency depreciation seen throughout last year, further intensified by the acceleration in demand in all the main trading partners (the United States, in particular). As a result, the external contribution can be expected to turn positive again in 1997. In addition, private consumption, despite a rise in compulsory contributions -- and ignoring the artificial quarterly swings in the first half (sharp rise in Q1, sharp fall in Q2), due to the effects of the 2-point VAT rise that took effect on 1 April -- is expected to show continuing moderate progress, with incomes bolstered by progressively-rising employment. Private invest-

ORDER-BOOKS AND PRODUCTION EXPECTATIONS
(net balance of european* industrial managers' opinions)
normalised s.a. balance in proportion of standard deviation



ment can also be expected to remain dynamic, underpinned by the improvement in demand and the very low level of real interest rates.

Accelerating activity in Western Europe

After slowing down in 1995 and in the early part of 1996, activity in Western Europe began to pick up in the middle of 1996, under the impact of an acceleration in demand from the rest of the world. As business surveys in all the EU countries are now substantiating, this acceleration has been confirmed in the first half of 1997 and should be maintained in the second, being more marked in certain countries of continental Europe (Germany, Belgium and, as regards the second half, Italy), which had been more severely affected by the earlier slowdown.

Several factors can be expected to bolster the acceleration of activity in Europe, building successively on the platform constituted by the strength of demand in the EU's export markets, notably the United States and the rapidly-developing countries (South-East Asia, Latin America and the countries of Central and Eastern Europe, even though some of the latter, such as the Czech Republic, seem to be having to cope with increasing financial disequilibria). In the first place, exports to the rest of the world should be further increased by the recent sharp rise in the USD, whose delayed effects should enable European countries to gain market share throughout 1997. Second, the prices of industrial commodities (other than fuels) have started rising again since the end of last year and this, combined with the appreciation of the USD, will mean a gradual rise in import prices. In these circumstances, we are likely to see, at least in the case of intermediate goods, the start of a change in price expectations which, combined with the improvement in expectations of demand, can be expected to modify producers' inventory behaviour. The distinct revival in inter-industry trade in Europe that has been a feature of the first half of 1997 was in fact due not only to the acceleration in external demand but also to reduced de-stocking. With expectations regarding prices and demand now headed firmly up-

wards, this same tendency can be expected to continue in the second half. Third, this upturn in activity, which has now lasted almost a year, should permit a gradual pick-up in productive investment between now and the end of the year. This already seems to be happening in Germany. In total, the end of the year should see a major reduction in the cyclical lag that had opened up between Europe and the rest of the industrialized world.

Looking beyond this general acceleration, the main EU countries are displaying differences as regards the strength of private consumption. In Germany and Italy, the worsening employment situation and rises in compulsory contributions can be expected to hold back consumption. In certain other countries, conversely, household spending should be boosted by rises in purchasing power: in Spain, thanks to a fall in unemployment and a marked slowdown in consumer prices; in the United Kingdom, because of strongly-rising wages and employment. The United Kingdom will also continue to stand out from the rest of Europe by being at a more advanced stage in the growth cycle, involving strong domestic demand and a negative external contribution, which is likely to deteriorate still further in the second half of 1997 under the delayed impact of the steep rise in the GBP.

French exports boosted by competitiveness gains

France is engaged in much the same acceleration of activity as its main continental European partners. French exports had in fact already begun to accelerate early in 1996, helped first by demand from non-EU countries and later by the dissipation of the adverse effects of the appreciation of the FRF's real effective exchange rate in the period up to end-1995. French exports have remained constantly strong since then, as is shown by the rapid and lasting recovery in French business leaders' opinions of their foreign order-books. From mid-1996 on, there was added support in the shape of the upturn in inter-industry trade within Europe, on top of the demand from outside the EU and from certain more dynamic EU members (United Kingdom, Spain, Netherlands). In the first half of 1997, this tendency was confirmed, thanks to the positive direction taken by demand expectations, but also to a turnaround in price expectations. Moreover, at a time of relative stability in cost-competitiveness, French exports can be expected to benefit between now and the end of the year from the delayed effects of the marked decline in the nominal effective exchange rate of the FRF since the end of 1995 (which now amounts to 3.5%, year on year). According to the results of the May survey of foreign competition, this currency advantage seems to have been large enough to enable French producers to relax to some extent their efforts to trim their export margins, while still keeping a competitive edge. The year-on-year change in prices of manufacturing exports is likely to move from -1.1% at the end of 1996 to +1.7% a year later. All sectors are showing great export dynamism, but this is especially true of intermediate and capital goods. Car exports are

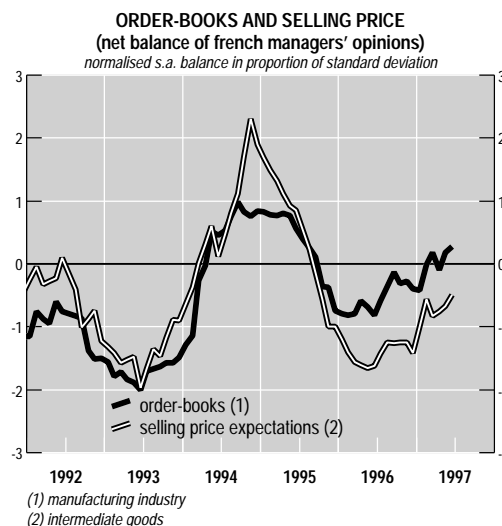
being led mainly by sales to the United Kingdom, Spain and Italy (being helped in the last two cases by the existence of a governmental car-scrapping bonus).

The recovery in expectations of demand and prices ...

In 1996, part of the slowdown in French growth stemmed from a substantial de-stocking movement affecting manufactures, which was itself caused by a downturn of expectations of future demand and prices. 1997 looks like being characterized by the reverse process. While the improvement in demand expectations dates back to mid-1996, business surveys at both manufacturing and wholesale level continued to produce discouraging results regarding price expectations right up to the early part of this year. However, a recovery in expectations, although admittedly still on a limited scale, now seems to be under way. The price index for industrial commodities (other than fuels) imported by France, expressed in foreign currencies, turned upwards at the end of last year. Moreover, this tendency has been considerably increased by the parallel rises in the USD and the GBP. A related tendency, in diluted form and with a certain time-lag, can now be expected in the import prices of manufactures and in the prices of goods produced at the upstream end of the production process. The index of industrial sales prices in the intermediate goods branch, seems now to be moving up again, after stabilizing in Q1 1997.

... is likely to help growth by provoking a favourable movement in inventories

All the conditions now seem to be in place for a reversal of inventory behaviour. The latest business surveys have in fact been showing a marked shift in opinions regarding inventory levels, with the balance now slightly on the side of those who consider them to be below normal. This tendency for an easing of the de-stocking movement was probably obscured in Q1 1997 by the adverse impact on industrial production of the exceptionally reduced number of working days in the quarter, obliging distributors and manufacturers to



draw on their inventories to meet part of the demand addressed to them. However, the second quarter will probably have seen the reverse phenomenon (perhaps on an even larger scale), so that, taking the first half of the year as a whole, inventory changes probably contributed 0.3 of a point to growth in industrial output, a figure that is likely to be doubled in the second half of 1997.

Productive investment set to accelerate in the second half

Despite annual figures showing a small fall in 1996, productive investment had already begun to recover in the middle of the year, in line with the positive turnaround in expectations of demand and at a time of low interest rates. Looking beyond the sometimes erratic quarterly movements, this as yet modest improvement seems to have continued in the first half of 1997. Industrial firms were probably still being fairly cautious at the beginning of the year, concentrating their investment mainly on replacement and modernization. There is in fact no discernible pressure on productive capacity at present: the capacity utilization rate, although rising slightly, was still below its historical average in April.

But investment seems set to accelerate in the second half of 1997, as demand expectations continue their expected improvement. The lead would be taken by the industrial firms with a large export business and, to a smaller degree, by business services, with distribution and other services tending to lag behind. Firms are still in a very strong financial situation, with cash flows positive and interest rates very low. Capital goods sales are likely to be the most dynamic driving-force. Opinions regarding future production levels, as revealed by business surveys, are extremely positive, and it is unlikely that this can be explained solely by the strength of exports. Registrations of heavy goods and other commercial vehicles, after marking time around the end of 1996 and in the early part of this year, have been headed upwards since April. The intensification, not only of international freight traffic, but also of domestic traffic, in the second half of the year will necessitate an increase in the vehicle fleet. Lastly, the decline in corporate investment in buildings should slow down, now that office construction has stopped falling.

In total, corporate investment is expected to rise by 1.6% this year, with an acceleration coming in the second half, giving year-on-year growth for the half-year of 3.7%, still a relatively modest rate.

Imports boosted by stronger domestic demand

Imports of manufactures began rising again in the middle of last year, in response to the upturn in activity. This tendency is likely to gather pace as the year goes on, especially as the demand components showing the strongest growth -- exports, and especially inventories and investment -- have a high import-content.

This tendency for an acceleration has been cushioned in the first half of the year by the competitiveness gains

made by domestic producers on the home market, thanks to the decline in the real effective exchange rate of the FRF. This decline in fact had a relatively large impact on import price growth, despite the efforts made by certain foreign competitors to trim margins. These price-competitiveness gains are likely to diminish in the second half of the year, as producer prices accelerate, with the result that import growth is likely to pick up considerably in the second half of 1997, to the benefit of France's usual European trading partners.

In total, manufacturing imports are expected to rise by 5.3% in 1997, compared with 2.2% in 1996. The sharpness of the acceleration is shown in the fact that the end of 1997 should see the year-on-year growth rate close to 7%.

Output growth being led by a lively industrial sector

A process in which a revival of external demand is followed by an acceleration in demand from domestic firms (inventories and investment) has gradually been taking shape since mid-1996 in France, on the lines of events seen in the leading continental European countries. This explains why output growth in 1997 will in the first place be led by the industrial sector. After putting on barely 1% last year (annual average), manufacturing output is expected to rise this year by almost 4%, with the year-on-year rise even reaching 6% by the end -- a very high rate, although still below the 10% seen in the 1994 upswing. As is so often the case, the intermediate and capital goods sectors are likely to be the main driving-forces behind the acceleration. However, growth in French household spending broadly matching the increase in household purchasing power should permit an improvement in the consumer goods sector as well. The car sector, whose domestic market is still suffering from the backlash of the ending of the car-scrapping bonus in October 1996, should nevertheless benefit from the strength of markets in the United Kingdom, Spain and Italy.

While they appear not to be doing as well as the manufacturing sector, most other branches can also be expected to contribute to the overall acceleration in production. Activity in business services, led mainly in the early part of the year by the temporary employment agencies, should strengthen and spread to the whole sector. Wholesale trade is likely to see a similar improvement. Despite showing a slight slowdown on an annual average basis, household services and retail distribution are also likely to benefit from the acceleration in private consumption in the second half of the year. Activity in building and public works, still fairly slack, should now be due for an acceleration, according to the professional opinions recorded in the latest business surveys. Two sectors stand out in contrast to this generally positive growth picture: agriculture (following the exceptional harvests of 1996); and energy, because of the exceptionally mild weather in the first half of the year.

Gross domestic product (volume) by type of expenditure

		(% change from previous period)										
		1996				1997				1995	1996	1997
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	(100%)	1.3	-0.2	0.8	0.2	0.2	1.2	0.7	1.0	2.1	1.5	2.3
Imports	(29%)	2.8	-0.9	2.7	1.0	-0.6	2.2	1.9	2.0	5.1	2.6	4.4
(of which merchandise)	(26%)	2.3	-1.2	3.6	0.5	-0.6	2.2	1.9	2.0	5.8	2.3	4.5
Households' consumption	(60%)	2.4	-1.0	0.8	-0.5	0.4	0.4	0.7	0.7	1.7	2.1	1.0
General government consumption	(19%)	0.5	0.2	0.3	0.3	0.2	0.3	0.5	0.4	0.0	1.2	1.3
Total investment (GFCF)	(20%)	-0.8	-1.4	1.6	0.0	-1.3	1.3	0.8	1.0	2.5	-0.5	0.8
Corporate sector ⁽¹⁾	(11%)	-0.5	-1.8	2.4	-0.1	-1.4	2.3	0.6	1.2	3.3	-0.7	1.6
Households	(5%)	-2.7	1.4	0.3	0.8	-2.8	0.2	1.6	0.9	2.3	-0.2	-0.6
Other sectors	(4%)	0.9	-3.6	0.9	-0.4	0.8	-0.1	0.1	0.3	0.4	-0.3	0.0
Exports	(29%)	4.3	-0.7	3.2	1.5	1.1	2.2	2.0	1.9	6.3	4.8	7.0
(of which merchandise)	(24%)	3.7	-0.9	4.0	1.1	1.5	2.2	1.9	1.9	7.9	5.1	7.4
Domestic demand		0.8	-0.2	0.6	0.0	-0.3	1.2	0.7	1.0	1.8	0.9	1.4
Contributions to the growth of GDP												
Inventory changes		-0.5	0.6	-0.3	0.2	-0.3	0.6	0.0	0.3	0.3	-0.5	0.4
Trade in goods and services		0.5	0.1	0.2	0.2	0.5	0.1	0.0	0.0	0.3	0.6	0.8
Domestic demand excluding inventories		1.4	-0.9	0.9	-0.2	0.0	0.6	0.7	0.7	1.5	1.4	1.0

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

Forecasts

More numerous job-creations in the second half ...

As a consequence of the upturn in output since the second half of 1996, net job-creations are expected to accelerate as the year wears on, in a climate of improving expectations and accelerating growth. But the improvement will be at a slower rate than that of activity, as is usual at this stage of the productivity cycle. Dependent employment in the non-farm market sectors is therefore likely to show a rise of 0.8%, year on year, by next December (an average of 0.2% for the year as a whole), after falling in 1996 (by 0.3% for the year). There is visible improvement in the recruitment outlook in all sectors, according to the latest surveys. Services, especially temporary employment, are likely to remain in general the most dynamic sector in terms of job creation, despite a downward trend in the banking and insurance sector. In building and public works, the rate of job losses, which was rapid in 1996, should now slow down considerably, under the impact of the gradual improvement in the situation in the public works and residential housing branches.

Employment in industry will probably show a further decline, taking the year as a whole, but with an upturn taking place in the second half. In the first part of 1997, the manufacturing sector is thought to have continued to cut its work-force. The improvement in industrial activity and the gradual recovery in expectations initially led to increased use of staff from temporary employment agencies and to a fall in the number of days declared as short-term unemployment, a device that had

helped to curb the deterioration on the labour market in 1996 and which had enabled firms to adjust their use of labour in a manner that was not irreversible. In the second half of 1997, job creation in industry should pick up slightly, to a rate compatible with the acceleration in productivity gains. These gains in manufacturing industry, which are traditionally greater than in the other branches of the economy, are expected to amount to 7%, year on year, by the year's end, the highest rate seen since the 1994 recovery.

... permitting unemployment to stabilize

The improvement in dependent employment will probably be accompanied by a continuing fall in the number of independent workers, although not quite as rapid as the one seen last year. The long-term tendency of employment to fall in the agricultural sector would in fact be partly offset by the impact of the improvement in the building and traded tertiary sectors. Non-traded tertiary employment can be expected to benefit from the fact that the so-called "emplois Ville" (publicly-financed jobs for local authorities and non-profit-making associations) will be getting up to speed. Moreover, the underlying growth tendency in the labour force will be reinforced by changes in employment policy. This movement, combined with the planned reduction in the numbers called up for national service, will produce a marked increase this year in available man-power resources.

Figures presently available indicate a stabilization of unemployment between mid-1996 and Q1 1997. How-

ever, it seems more likely that it in fact went on rising until Q2. In these circumstances, the accelerated job creation should enable the unemployment rate in the second half of the year to level off at around 12.5%.

Higher-than-expected wage rises

The strength of the rise in the average hourly wage in the early part of the year was somewhat unexpected, given the tendencies in its usual determinants (prices and unemployment level).

It would seem that wage negotiations, which are traditionally bunched in the early part of the year, may have taken into account, with a certain time-lag, the acceleration in consumer prices on an annual average basis seen in 1996, which was in turn due mainly to the delayed effects of the VAT increase which took effect in July 1995.

In the second half of 1997, firms are likely to curb the growth in their production costs, given the rising costs of inputs. At the same time, the moderation shown by consumer prices should ensure that purchasing power gains are appreciable. As a result, wage rises can be expected to continue, but at a slower rate than at the beginning of the year⁽¹⁾.

On an annual average basis, the rise in the hourly wage rate is expected to accelerate slightly in 1997 (by an annual average of 2.6%, compared with last year's 2.5%). The increase in real terms would show a greater acceleration (to 1.4% from 0.5%).

Another probable feature of the labour market this year is a continuation of the tendency for part-time employment to account for a larger share of the total (adding 0.8 of a percentage point between March 1996 and March 1997, according to the Employment survey). This would help to curb the growth in average wages per head, which is likely to be 2.3% on an annual average basis, compared with 2.6% in 1996.

The consumer-price rise has probably touched bottom

Price rises, generally speaking, were surprisingly small in the first half, given the marked depreciation of the FRF. Even leaving aside the sharp fall in energy prices due to the drop in the world oil price, prices of manufactures slowed down considerably (to -0.1%, year on year). This evolution was due mainly to the fall in car prices in Q1, reflecting the slump in the market following the ending of the car-scrapping bonus in October 1996. For the other manufactures the slowdown was only slight. This result at retail level reflects the low growth in upstream prices in other sectors of the economy.

But there are a number of reasons for thinking that the price rise, after bottoming out in Q2, could accelerate again in the second half of the year. First of all, the stabilization during Q2 and the later renewed rise in

industrial producer prices can be expected to be gradually passed on into consumer prices. Second, the rise in the prices of imported consumer goods will benefit French domestic producers, giving them a certain degree of leeway to relax their efforts to squeeze margins. Finally, private consumption is likely to be brisker in the second half.

Prices of private services are likely to follow this general tendency, ceasing to slow down in the second half and incorporating, at least partially, the acceleration in the hourly wage rate seen in the early part of the year. All things considered, underlying inflation (excluding public-service charges and energy) can be expected to accelerate by 0.4 of a point in the second half, from 0.8% to 1.2% by the year-end. The December year-on-year rate for global inflation would be 1.1%.

The improvement in the corporate financial situation

Firms are likely to see a recovery in their operating earnings, following the slight fall seen in 1996, with a 2.8% rise in their gross operating surplus, a slightly slower rate than for nominal GDP. The stability of the profit ratio for the non-financial firms as a group in 1997 nevertheless masks contrasting movements, depending on the individual positionings on foreign markets, the improvement in operating results being greater in the case of manufacturing industry, with its stronger presence on these markets.

The recovery in industrial producer prices would in the first place be linked to the rise in the price of inputs. Higher commodity prices and dearer imports as the result of the depreciation of the FRF are likely to be passed on into industrial firms' selling prices from Q2 on, although the acceleration in productivity gains should cushion the impact on unit costs. At the same time, the acceleration in inter-industry trade and the competitiveness gains made by the export sector should permit a slight relaxation during the second half of the year of the efforts to trim export margins.

On the other hand, for firms concentrating mainly on the home market (in the tertiary sector, especially), the improvement in earnings is likely to be more limited. Admittedly, the acceleration expected in household demand in the second half should encourage the restoration of margins, but the effects will be relatively slight, for two main reasons. For one thing, in the services sector unit costs will be adversely affected by the low level of productivity gains (of the order of 1.5%, year on year) and by the relatively large wage increases. For another, the perception of fierce competition and the extreme sensitivity of consumers to prices will incite firms to restrain their price increases.

But other factors are likely to have a positive impact on the re-constitution of operating margins in 1997. Just as in 1996, the apparent rate of employers' social security contributions will diminish because of the sharp rise early this year in the exemptions granted under the RBS and CIE programmes (in favour of the lower-paid and the long-term unemployed, respectively). More-

(1) On the conventional assumption of a rise in the SMIC (minimum wage) kept to the legal minimum (1.7%).

over, financial charges should continue to fall in 1997, as a consequence of the sharp decline in interest rates seen throughout 1996.

Companies' financial situations should therefore improve in 1997. After rising sharply last year, corporate tax revenues are likely to level off, in large part because of the tax breaks for which this will be the first full year. The reduced tax payments should add one point to the corporate saving ratio. Despite a small (1.6%) rise in corporate investment in 1997, the self-financing ratio should rise again, reaching around 117%.

Growth in the purchasing power of household incomes set to accelerate ...

The nominal value of household incomes is set to rise this year, mainly by reason of the reduction in income tax adopted in the Finance Act for 1997 and the slowdown in taxable income that occurred in 1996.

Total wages and salaries received by households are likely to rise at approximately the same pace as in 1996. Payments by non-financial firms (other than the nine large public companies) are accelerating (rising by 2.8% this year, compared with 2.6% in 1996), reflecting the wage-rate acceleration and the recovery in employment on an annual average basis. The growth of total civil service pay, however, would be around 2%, the relatively slow growth rate being explained by that of staff numbers.

Moreover, the impact on incomes of the one-point rise in the rate of CSG (levy on all incomes to help fund the social security system) was broadly compensated by the fall at the beginning of the year in the sickness insurance contribution rates for dependent and independent workers. The growth in work-derived incomes of the self-employed is expected to remain unchanged on an annual average basis, in line with the modest growth in activity in retail distribution and in agriculture. On the other hand, social security benefits are expected to slow down sharply, contributing only 0.3 of a point to the rise in purchasing power. This slowdown is due mainly to the gradual introduction of the measures adopted as part of the plans to restore order to the social security accounts. As illustration, the benefits paid out of the general social security régime are expected to rise by 2.7% in 1997, compared with 3.7% in 1996.

The acceleration in income growth is likely to be more marked in real terms, as the result of the slowdown in inflation. The end of 1997 should see year-on-year growth in the purchasing power of income at around 2.4%, compared with -0.1% at end-1996. The increase on an annual average basis would be 1.6%.

... bolstering both consumption and household investment

After being fairly slack in the second half of 1996 and the first half of 1997, household consumption seems set to accelerate in the second half and, in so doing, underpin growth. The expected increase for the year as a whole (1%) is admittedly smaller than for the purchasing power of incomes, so that the saving ratio would be

The potential risks

As the mechanisms responsible for the current upturn mainly involve the corporate sector, the principal potential risks in this forecast relate to the behaviour of firms.

At this stage of the recovery, business leaders' expectations play a crucial role. It has been assumed here that their views of the future outlook will show steady improvement, along with the start of a re-stocking movement and a gradual revival in investment.

Business surveys in the past three months have been showing a gradual deterioration in the overall outlook as seen by industrialists, but this contrasts with a steady improvement in views regarding the own-firm outlook. If the uncertainties reflected in the global outlook were to lead in the end to a turnaround in individual expectations, the impact on activity could be very rapid, as was seen in 1992 and 1995. The initial phase of such a reaction would be a reversal of inventory behaviour, which could already make a serious impact this year. Because investment decisions are not as immediately responsive as those regarding inventories, the impact of any deterioration in expectations is likely to be felt in the final months of the year, the period when firms will be deciding on their programmes for 1998.

The impact would be all the greater if all the European economies were affected.

If, on the other hand, uncertainties over profitability and European integration were to be dispelled, growth could be faster than is foreseen here.

Other potential risks should be mentioned. The financial markets, quite apart from the influence of uncertainties over European integration, could undergo largely unpredictable swings, and it is known that these can have a substantial impact on the real economy. The obvious example of such a factor is the USD, conventionally assumed in this Note to remain stable, but which, if it were to fall, could have a substantial effect on the current upturn. Meanwhile, the balance-of-payments difficulties being experienced by certain Central and Eastern European countries could have an impact on the economies of the region, which have in the recent past been providing significant support for both German and French exports.

0.4 of a point higher than in 1996, at 13.3%. However, the evolution of total consumption in 1997 is being affected by exceptional factors that distort the analysis of the consumption/saving trade-off.

First of all, the sharp drop in purchases of new cars is probably reducing the annual growth in total consumption by 0.6 of a point. Special support measures for the car sector in the past three years brought replacement purchases forward in time and this probably had an adverse effect on saving during the years in question. This tendency seems likely to be reversed in 1997. The ending of the car-scrapping bonus in October 1996 produced a sharp drop in purchases, with the overall situation returning to normal only gradually in the course of 1997.

The mild weather of the first half of the year was a second exceptional factor, leading to a fall in energy consumption on an annual average basis.

Apart from cars and energy, the main items of consumption have all been rising strongly, in line with the improvement in purchasing power. Consumption of durable goods other than cars, which is very sensitive to expectations of future income, is expected to rise at much the same rate as in 1996 (3.1%). Consumption of traded services, after accelerating in Q1, is also likely to rise at a substantial rate, in line with the average growth seen in recent upswings. Food consumption is also headed upwards, with households shifting their purchases towards higher-value-added products.

Although likely to show a slight fall for 1997 as a whole, household investment looks set to accelerate as the year goes on. Investment demand from households should show a marked positive tendency, thanks to rising incomes, low interest rates and attractive prices. In addition, the measures taken to support the housing sector -- zero-interest loans, the "Perissol amendment" giving tax breaks for purchases of rental housing -- can be expected to continue to boost the sector. Meanwhile, maintenance and renovation expenditure (which accounts for almost 45% of household investment in housing) is expected to rise at a firm rate, in view of the

satisfactory evolution since the end of 1996 in the market for existing housing. An additional stimulus will be provided by the tax incentives relating to the purchase of dwellings needing substantial work done on them.

GDP set to go on accelerating

On an annual average basis, GDP growth will probably be 2.3% in 1997. In a dynamic international environment, the external sector will probably turn out to have made the strongest contribution to growth in the early part of the year, before slowing down somewhat as the growth differential between France and its main trading partners gradually narrows. Demand from the corporate sector would then take up the running in the second half, through a reversal of the de-stocking process in manufacturing and a gradual acceleration in investment. Finally, household consumption can be expected to provide additional support for overall demand. The year-on-year GDP growth figures are likely to show a steady acceleration, reaching 3.2% by the year-end, compared with 2.4% at the end of the first half and 2.1% at the end of 1996.■