

CONJONCTURE IN FRANCE

MARCH 1997

First half of 1997: marked improvement in the economic climate

Steeply falling interest rates, exchange-rate movements and strong world demand have since the summer of 1996 enabled growth to pick up in France, as in most European countries. The improvement in the economic climate has been underpinned since the beginning of this year by the pronounced appreciation of the dollar.

The rally in investment is admittedly still on a very limited scale, but the factors determining the level of consumption are improving: employment is holding up better than expected, not all the benefits of the interest-rate cuts -- and possibly also of the increase in personal net worth -- have as yet been realized. Moreover, household expectations are gradually recovering. In the initial stage, however, these various positive factors are still being obscured by the impact on the timing of car purchases of the ending of the "prime qualité" (car-scrapping bonus).

The analysis in this note is based on the assumption that the effects of the recent rise in the dollar will be felt mainly in the second half of the year, leaving GDP to rise in the first half of the year at the originally expected annualized rate of around 2.5%, before later accelerating -- the impetus provided by foreign demand and by the fall in interest rates looks like being sufficiently strong and lasting to draw domestic demand progressively along in its wake.

This acceleration could come earlier than we are currently expecting, however, if the upturn in price expectations now starting to be discernible were to precipitate an inventory rebuilding movement on a scale larger than the limited one we have assumed within the time-frame of this Note.

Overview of 1996

The annual average GDP growth rate for 1996 came out at 1.3%, compared with 2.2% in 1995. This apparent slowdown, however, masks an actual upturn during the year, bringing the year-on-year growth rate up to 2.1% in the final quarter of the year from 0.8% in Q2 and 0.3% in Q4 1995.

Leaving aside the fluctuations in the quarterly growth pattern brought about by calendar effects or the see-saw movements in car purchases, the evolution of GDP can be broken down into two distinct phases. Initially, movements on the financial markets provided greater-than-expected support for private consumption. This support was not sufficient to benefit production, because firms ran down their stocks substantially in the first half, possibly in response to unfavourable price expectations. It was only when this movement began to run down, when the impact of strong foreign demand and an improved exchange-rate situation began to lend support to the high consumption level, that production really took off again.

The first half of 1996 marked by a rise in consumption

In the first half of 1996, household consumption recorded a rise of 1.5%, following a fall of 0.3% in the second half of 1995. This revival in consumption took place at a time when households were being confronted with an erosion of their purchasing power. Savings normally act as a stabilizer, and the very large decline in the saving ratio seen in the early part of 1996 -- leaving aside certain lagged effects of the December 1995 strikes -- probably has to do with the particular financial circumstances ruling at the time, notably the fall in interest rates and the strong performance of equity prices.

The unfavourable tendency in household purchasing power

Wage increases in the private sector in first half of 1996 were substantial, with the average hourly manual wage-rate showing an increase of 1.9% during the period. Part of this was a "catch-up" effect, following a second half of 1995 during which rises had been particularly small, but it was also due to certain "indexation" effects, especially for the guaranteed minimum wage. These in turn were due to the rise in the standard rate of VAT introduced in August 1995, which resulted in an acceleration in the year-on-year price rise. As against this, however, the total wage bill was held down by the stagnation of employment seen in the first half of the year. In addition, property and entrepreneurial income

dropped sharply in the first half, with the fall in interest rates having a marked effect on the level of interest earnings, although this was partly compensated by a shift towards higher-yielding assets.

As regards the payments due from them, households naturally also benefited from the lower interest rates, but at the same time were confronted with a rise in their compulsory contributions. Taxes on income and wealth rose by 4.7%, mainly as the result of the introduction of the CRDS⁽¹⁾ at the beginning of February. The burden on households was also increased by the rise in the rate of several forms of social contribution payable by retired people. And the acceleration in prices seen in the early part of the year, linked to the delayed impact of the rise in the VAT rate, dearer fresh foods and upward pressure on oil prices, all helped to diminish household purchasing power.

A sharp rise in household consumption, nonetheless

Household consumption showed a year-on-year rise of 1.5% in first half of 1996, stronger than can be explained by the postponement in purchases resulting from the December 1995 strikes. Manufactured goods posted a particularly strong rise and one that was not entirely due to the additional car purchases prompted by the car-scrapping bonus. Household purchases of mass-consumer electronic goods and professional equipment (a category which includes computers and telephonic equipment) also rose strongly, while the consumption of services was sharply up on the second half of 1995.

This rebound in consumption may have been partly a reflection of the allaying of uncertainties regarding the financing of the social security system, and hence the contributions which households would be called on to make, given that the general climate remained very listless. The decisive factor was probably the general background of falling interest rates and strong price rises on the stock market. The low yield on interest-bearing assets (money-market mutual funds, term deposits), coming on top of a tightening in their treatment for tax purposes, led to major portfolio shifts. Because the climb in the prices of bonds and equities was simultaneously giving rise to a strong spontaneous increase in personal net worth, part of the liquidity freed by the reallocation of portfolios was not reinvested in long-term securities and was therefore available for con-

(1) A levy on incomes for the purpose of repaying the social security debt.

sumption, with the fall in interest rates providing an added incentive to spend rather than save.

At the same time, households seem to have been particularly responsive to relative price movements. The acceleration seen at the level of overall prices in the early part of the year masked a distinct slowdown or even a fall in a certain number of sectors where the rise in the volume of consumption was particularly marked. The most conspicuous example was that of cars, with the producers in most cases adding their own rebates to the scrapping bonus. Spending on air travel also received a boost from the increased competition, while the demand for computers was encouraged by the continuing price falls. This responsiveness to relative prices was also to be seen in the pattern of spending over time, and especially in the concentration that occurred at the time of the sales.

The buffered impact of the stronger demand on production

Output in the distributive and services sectors naturally benefited from the upturn in household demand in the first half of 1996. On the other hand, the knock-on effects of the additional consumption of manufactures to the production stage were far from immediate.

De-stocking at wholesale level

The bi-monthly distribution surveys suggest that retailers reacted to the rise in consumption in the early part of the year by simultaneously reducing their inventory levels and stepping up their purchasing intentions. By contrast, in the wholesale sector dealing with consumer goods, despite a slight improvement in opinions regarding sales volumes (a direct reflection of the increased orders from the retail sector), a reduction in inventories was accompanied by a fall in purchasing intentions, with business leaders preferring to avoid re-stocking. There are two possible explanations: first, that the wholesalers saw the rise in consumption as a flash in the pan, a mere catching-up for December 1995; second, that their price expectations were still for a decline, providing no incentive for reconstituting stocks.

With the wholesalers preferring to run down their stocks, the producers of consumer goods found themselves receiving little or no increase in orders. Surveys carried out in the sector in the early part of the year showed order books still slim and stocks still regarded as excessive. The inevitable result was to keep output sluggish in the first half. This in turn led to limited calls on the production of intermediate goods, whose markets, many of which are highly internationalized, remained relatively depressed in general.

Decline in house construction, despite strong sales

After pausing early in the year, sales of new apartments resumed the strong growth that had begun in mid-1995. This improvement was helped by a certain number of support measures (zero-interest loans, aids for invest-

The impact of accidents of the calendar on the measurement of GDP growth rates

National accounts figures are not adjusted to take account of the number of working days. Calendar effects differ from sector to sector and are therefore difficult to evaluate with any precision.

Within the time-frame of this note, these effects are relatively important and have to be taken into account in judging the pattern of growth over time. Q3 1996 and Q2 1997 contain an exceptionally large number of working days, whereas in Q1 1997 they are relatively few in number (with Easter Monday falling on 31 March).

The orders of magnitude of the corrections needing to be made in order to eliminate these calendar effects from the published data are as follows: for Q3 1996, a reduction of one quarter of a point; for Q4 1996 and Q1 1997, an increase of one quarter of a point; for Q2 1997, a reduction of one quarter of a point.

ment in rental accommodation) as well as by the fall in interest rates. Even so, the total number of housing starts declined. This decline stemmed essentially from a drop in starts for collective housing, with the numbers for individual dwellings increasing. The run-down in unsold stocks has been very substantial, while price expectations were still headed downwards in the first half.

A drop in investment in the first half, despite lower borrowing costs

The terms on which firms were able to obtain finance improved sharply in the first half of 1996 -- the average borrowing rate for investment purposes was 1.5 points lower than in the second half of 1995, as a natural reflection of the general tendency in market rates. However, they failed to take advantage of the improvement, with investment by companies and individual proprietorships down 0.6% in the first half. This fall is explained partly by the weakness of production itself, but also by the continuing poor outlook for demand.

Growth driven by an acceleration in exports in the second half

The irregular quarterly variations in GDP in the second half of the year (a rise of 0.8% in Q3 being followed by one of only 0.2% in Q4) are explained partly by calendar effects and partly by the impact of the car-scrapping bonus. More than half the fall in manufacturing output in Q4 was in fact directly due to the fall in car production following the ending of the bonus. On a year-on-year basis, however, there was actually an acceleration in GDP growth during the half-year, to 2.1% from 0.8% in the first half.

Two phenomena dominated this period: the recovery in world demand, with its positive effects on French activity intensified by the decline in the effective exchange rate of the franc; and the ending of the de-stocking movement, reflecting an improved, but still only partial, transmission of changes in final demand to the production level.

Exports boosted by the recovery in demand and by improved competitiveness

Exports of manufactures revived in the first half of 1996, despite the merely moderate growth in world demand. This development was partly in compensation for the drop in exports caused by the December 1995 strikes, but it also reflected a sharp rise in Airbus deliveries. Growth in French export markets in the early part of 1996 was in fact still in general somewhat limited: demand was lively in Spain, the United Kingdom, the Eastern European countries, Japan and the United States, but not in the majority of the EU countries. Moreover, French exports were still being handicapped by the weakening of their price-competitiveness vis-à-vis a certain number of countries, with the marked appreciation in the franc's effective exchange rate seen in 1994 and 1995 coming to an end only in February 1996. The lagged unfavourable effects of this appreciation on French export-competitiveness were therefore still being felt.

The downward tendency in the franc's effective exchange rate since February 1996 has clearly helped to improve the price-competitiveness of French exports, which also benefited from the strength of demand from non-EU countries (United States, South-East Asia, Eastern Europe) as well as from certain countries within the EU (United Kingdom, Spain).

Exports of intermediate and capital goods were boosted by the revival of economic activity in Europe, rising sharply to Germany, Spain and the Benelux countries. Exports of consumer non-durables and cars also did well towards the end of the year.

The upturn in foreign demand only partly passed through into production

The revival in world demand and the improvement in French export-competitiveness have also been reflected

in a very distinct rise in export order-books since the summer.

This improvement was not immediately passed through into production, however, given that stocks continued to be seen as excessively high. Whereas in the first half of the year, it had been the wholesalers' disinclination to hold stocks that had hampered the transmission of final demand to production, in the second half a similar disinclination was to be seen in industry. It was only in September that opinions regarding inventory levels showed the first signs of improving. It was this de-stocking that explains the slowness of the upturn in production.

The second half of the year was marked by the divergence between strongly-rising export order-books and the much slower rise in overall orders. Movements over time in the volume of household consumption in the second half were strongly affected, first by car purchases made in the months up to October to take advantage of the last days of the car-scrapping bonus and later by the drop in purchases following its withdrawal. However, the slowdown in consumption in the second half was due to more than just the fluctuations in car purchases. Excluding cars, household consumption rose by only 0.7% in the second half, as against 1.2% in the first. While the level of household consumption at the end of 1996 was distinctly up on the 1995 average, the slowdown in the rate of progress seen in the second half may well have held back orders from the distributive sector.

Even so, and despite the absence of any pressures on productive capacity, the improvement in industrialists' expectations of future demand led them to start increasing their investment, although not at any great pace. In the second half of 1996, GFCF by companies and individual proprietorships rose by 2.1%, after falling by 0.6% in the first.

The main lines of the forecast for the first half of 1997

A buoyant international environment

The international environment turned more favourable during 1996. Demand in French export markets accelerated in the second half, thanks to the improved economic climate in Europe. In the first half of 1997, the cyclical lags between the United States and the continental European countries are expected to continue to dwindle, with growth remaining firm in the United States and becoming more entrenched in Europe as a whole, with the United Kingdom once more experiencing above-trend growth. Activity in the non-OECD countries is set to remain brisk, but only moderate in Japan, where rising productive investment and exports are unlikely to entirely offset the slackness of household demand and the decline in public spending. All told, however, demand in French export markets should continue to rise fairly strongly.

Growth firm in the United States but only moderate in Japan

Following the 1995 slowdown, the United States economy has returned to a more rapid growth rate since the beginning of 1996. In the first half of 1997, activity is expected to remain relatively strong, continuing to benefit from the robustness of both domestic and export demand. Despite the high indebtedness levels, private consumption is set to remain firm, with the labour market still exerting a positive influence on incomes and with the confidence indicators still high. Although pressures on productive capacity and the sound financial situations of American firms are still favouring productive investment, this could possibly now slow down, having been particularly brisk in the past few years. Exports, meanwhile, are benefiting from the strength of demand in American export markets, as the appreciation of the dollar in effective exchange rate terms has remained limited (stability versus the Canadian dollar, smaller appreciation versus the peso than versus the franc or the mark). Imports can be expected to go on rising strongly, in response to the firmness of domestic demand.

Growth in Japan was boosted by the government's re-stimulus packages and by a strong rally in consumption in the first half of 1996, before slowing down in the second, with private investment and exports unable fully to take up the running from slackening public demand. Growth is expected to remain moderate in the first half of 1997, despite the support from private productive investment and exports -- the latter being stimulated by the delayed impact of the depreciation of the yen and by the strength of demand in Japan's

overseas markets. The factors tending to hold back growth will be the slackness of construction investment and weak household demand, now being affected by the worsening employment situation and increased compulsory contributions.

Accelerating activity in Europe

The European economic climate, which was still relatively unfavourable at the beginning of 1996, improved sharply in the second half, as is shown by the recovery in industrialists' opinions regarding the outlook for production and demand, reported in the various business surveys. The first half of 1997 is likely to see a continuation of this improvement in the European economic climate. Exports, underpinned by the rise in the dollar, will probably go on rising rapidly. Some countries, such as Germany, will derive additional benefit from the depreciation of their currencies against certain of their trading partners, while in those countries that have seen a re-appreciation of their currencies (United Kingdom, Italy) the negative impact is likely to be offset by the acceleration in world demand. Re-stocking, although stimulated by the strength of activity, is likely to be restricted by the continuing mediocrity of price expectations. Business leaders' opinions on future prices remained depressed throughout 1996, especially in Italy and, to a smaller extent, Germany, where there was some improvement during the year, but were still hesitant at the beginning of 1997: there were signs of improvement in Italy, but a deterioration in Germany compared with the final months of 1996. At the same time, productive investment may be stepped up to a certain extent, although intentions reported at the end of 1996 remained prudent. The low level of interest rates is likely to operate in favour of higher investment, but the prospects for investment in construction, which is being held back especially by the austerity of fiscal policies, are seen as less bright. Meanwhile, private consumption, heavily influenced by tendencies on the employment market, is expected to be brisk in the United Kingdom and Spain, but slack in Italy and Germany.

The resulting boost to French exports

With activity in Europe generally firmer, French exports are set to continue to derive full benefit from the acceleration in world demand -- from Europe especially -- given the substantial productivity gains recorded by French industry since the spring of 1996. This improvement in productivity, acquired at a time when production costs were moderating not only in France but also

Gross domestic product (volume) by type of expenditure

(yearly or half-yearly averages)

| | | 1995 | | 1996 | | 1997 | 1994 | 1995 | 1996 | 1997 |
|---------------------------------------|---------------|------------|------------|------------|------------|------------|------------|------------|------------|-------------------------------------|
| | | H1 | H2 | H1 | H2 | H1 | | | | Carry-over at end Q2 ⁽²⁾ |
| GDP | (100%) | 1.1 | 0.0 | 0.9 | 0.8 | 0.9 | 2.8 | 2.2 | 1.3 | 1.6 |
| Imports | (28%) | 3.5 | -0.2 | 0.8 | 2.9 | 1.6 | 6.7 | 5.3 | 2.2 | 3.5 |
| (of which merchandise) | (25%) | 3.8 | 0.0 | 0.1 | 3.2 | 1.5 | 7.3 | 6.1 | 1.7 | 3.6 |
| Households' consumption | (60%) | 0.7 | 0.7 | 1.9 | 0.2 | 0.4 | 1.4 | 1.8 | 2.3 | 0.6 |
| General government consumption | (20%) | 0.3 | 0.6 | 0.7 | 0.8 | 0.8 | 1.1 | 0.9 | 1.5 | 1.3 |
| Total investment (GFCF) | (20%) | 0.8 | 0.2 | -1.1 | 0.6 | 0.1 | 1.3 | 2.6 | -0.6 | 0.5 |
| Corporate sector ⁽¹⁾ | (11%) | 1.9 | -0.5 | -0.8 | 1.6 | 0.1 | 1.7 | 3.8 | -0.3 | 1.1 |
| Households | (5%) | 1.3 | 0.7 | -0.3 | -0.8 | 0.6 | 2.0 | 3.0 | -0.4 | 0.2 |
| Other sectors | (4%) | -2.7 | 1.6 | -2.7 | -0.2 | -0.4 | -0.7 | -1.1 | -2.0 | -0.6 |
| Exports | (28%) | 4.9 | -2.1 | 3.0 | 3.3 | 3.2 | 6.0 | 6.0 | 3.6 | 5.5 |
| (of which merchandise) | (23%) | 5.9 | -1.8 | 2.9 | 3.6 | 3.6 | 6.5 | 7.7 | 3.8 | 6.1 |
| Domestic demand | | 0.7 | 0.6 | 0.3 | 0.7 | 0.4 | 3.0 | 2.1 | 0.9 | 1.0 |
| Contributions | | | | | | | | | | |
| Inventory changes | | 0.1 | 0.0 | -0.7 | 0.3 | 0.0 | 1.7 | 0.3 | -0.6 | |
| Trade in goods and services | | 0.4 | -0.5 | 0.6 | 0.1 | 0.5 | -0.2 | 0.2 | 0.4 | |
| Domestic demand excluding inventories | | 0.7 | 0.6 | 1.0 | 0.4 | 0.4 | 1.3 | 1.8 | 1.5 | |

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

(2) The statistical carry-over is the annual average growth rate that would result if growth were to be zero in Q3 and Q4 1997.

Forecasts

in its main trading partners, is due essentially to the appreciation in the dollar, the pound sterling and the Italian lira vis-à-vis the French franc. Exchange-rate movements since the beginning of 1997 have continued to act in favour of French export-competitiveness, with sterling continuing to rise and with the dollar standing in February 10% above its average 1996 level. The consequent weakening of foreign competition, especially on third markets, was already apparent in the second half of 1996 to French industrialists, who reported a recovery in foreign demand for intermediate and capital goods -- reflecting the strengthening of inter-industry trade within Europe -- followed by an improvement in foreign demand for consumer goods. In the first half of 1997, the intensification of inter-industry trade should be of particular benefit to French exports of intermediate goods. With the climate for productive investment in Europe still somewhat hesitant, exports of capital goods are likely to be propped up mainly by aircraft deliveries.

At the same time, imports are also likely to feel the effects of the intensification of inter-industry trade. The demand components with the highest import content, namely inventories and investment, are not likely to be particularly dynamic, however, and the rise in household demand is expected to be only moderate. All in all, with exports rising more strongly than imports, the first half of 1997 should still see the external sector making a positive contribution to growth.

Growth becoming more entrenched

In the last part of 1996, the strength shown by exports was being reflected in more positive opinions from industrialists regarding foreign demand, but much less so regarding the overall demand for manufactures. The latest industrial surveys suggest that continuing firm foreign demand is gradually finding additional support from domestic demand, especially in sectors involved in inter-industry trade. This is shown by the fact that opinions regarding overall demand are picking up, while in the case of foreign demand they are still positive but no longer improving. This is particularly true of certain intermediate goods sectors located towards the upstream end of the production process (steel, rubber and plastic materials).

In these circumstances, therefore, manufacturing output can be expected to grow more strongly in the first half of 1997, under the combined stimulus of brisk exports and firmer domestic demand, accelerating not only in the intermediate and capital goods sectors, but also, although to a smaller extent, in consumer goods. Output in the car sector is likely to recover gradually, but remain affected in the early part of the year by the ending of the car-scrapping bonus. Leaving aside technical calendar effects -- tending to reduce the figures for the first quarter and raise those for the second -- manufacturing output should show a marked acceleration compared with the second half of 1996.

The improvement in manufacturing output and in foreign trade will naturally benefit the sectors of merchandise transport, wholesale trade and services to firms. Wholesalers' purchasing intentions for intermediate and capital goods were showing a distinct improvement in the early part of the year. The prospects for prices and employment were also reported to be much improved in the case of services to firms. Recovery is likely to remain slow, on the other hand, in the case of certain other activities, especially building and public works. As regards housing, despite the reduction in unsold stocks and the upturn in sales -- partly in response to the various incentive measures introduced in 1996 and to the fall in interest rates -- activity in the residential sector is unlikely to pick up substantially, given the poor record in terms of starts and granting of permits in 1996. Non-residential construction was also slack at the end of the year, except for industrial building: commercial property construction was hit by tougher authorization conditions, while office-building maintained the decline begun several years ago. In the public works sector, despite certain large projects (the high-speed train to South-Eastern France, the motorway programme), activity remains largely dependent on spending by local authorities, which has recently been far from buoyant. Finally, the distribution sector might benefit in the event of firmer-than-expected consumption.

All told, GDP growth is expected to accelerate in the first half of 1997. Ignoring calendar effects, the annualized growth rate should be close to 2.5% for the first half of 1997, up from around 2% in the second half of 1996.

The resulting gradual improvement in employment

The last months of 1996 saw employment already starting to benefit from the upturn in growth. The time taken for employment to adjust to variations in activity seems to have been short, probably as the result of greater use of temporary staff. Job destruction, which since mid-1995 had been linked to the slowdown in activity, virtually came to a halt in Q4 1996 in the non-farm traded sectors, while the tertiary traded sector was actually creating jobs at a steady rate, compensating for losses in building and in industry. Losses are likely to decline still further in the first half of 1997, in line with the expectations for Q1 reported by building and industrial firms. Meanwhile, job creations in the tertiary traded sector, which had continued at the same rate in 1996 as in 1995, are likely to be stepped up. Services to firms can be expected to benefit from the firmer industrial activity, with firms in the sector reporting a much improved employment outlook, including the temporary agencies. The gradual consolidation of activity seen in 1996 should, in the final analysis, permit job creation to continue at the same slightly positive rate as at the end of 1996. Even so, given the continuing relatively modest rise in output, the increased recourse to temporary jobs (agency staff, fixed-term contracts) is likely to be a feature of the first half of 1997 as well.

The expansion of part-time working is also set to continue.

Employment policy, which had tended to curb labour-force growth in 1996, is likely to have slightly the opposite effect in the first half of 1997. The rise in the available manpower resources will also be swelled by the reduction in the numbers called up for national service⁽¹⁾, as part of the new programme for the armed forces. All in all, the unemployment rate on the ILO definition will probably continue to rise, but only moderately, reaching 12.9% by the end of the first half of 1997.

An improvement in the factors determining consumption

The factors that traditionally determine the level of household consumption are improving: the purchasing power of household incomes is benefiting from the cuts in personal income tax and from the moderation being shown by prices. Moreover, confidence is starting to return, the growth in unemployment is slowing down and interest rates and stock-market prices are still moving in a positive direction from the point of view of consumption.

In the first half of 1997, the compulsory contributions paid by households can be expected to fall in real terms, mainly as the result of the cuts in personal income tax. Social security contributions should also fall, thanks to the lowering of the employees' health-insurance contribution rate. In return, however, the contribution rate for the CSG⁽²⁾ has been raised by a point. The net decline in compulsory contributions provides most of the explanation for the expected acceleration in household incomes, although there will also be some acceleration in earned income, helped by the improved cash flow situation of the self-employed and by an acceleration in the total wage bill of general government due to the adjustment in the overall index of civil service pay. Wages and salaries in the private sector are expected to rise at much the same rate as in the previous half-year, with pay demands restrained by the slowdown in inflation and by the cuts in employees' social security contributions. Meanwhile, property and entrepreneurial income is likely to rise appreciably, despite the fall in interest rates, thanks to the upturn in activity and the shifts in investment portfolios undertaken in 1996. Interest payments by households, already lower as the result of a further decline in interest rates compared with the end of 1996, are not expected to change much. Social security benefits can be expected to slow down. Finally, given the moderation shown by prices, household purchasing power, after virtually stagnating in 1996, is likely to rise by 1% on average in the first half of 1997. Respondents in a household survey at the beginning of the year reported themselves to be more confident -- in particular, as regards their future stand-

(1) *Conscripts are excluded from the labour force figures.*

(2) *"Contribution Sociale Généralisée", a general levy on incomes to help finance the social security system.*

ard of living. Admittedly, the link between consumption levels and household confidence has not been particularly strong in the past. However, it was noticeable that the survey also specifically showed households to be more inclined to make major purchases.

In the first half of 1997, household consumption will still be affected by the ending of the car-scrapping bonus, as this will continue to depress purchases of private cars. The other components of consumption should move more positively, however. The rise in purchases seen in January seems to have been taken by both wholesalers and retailers as a sign of lasting strong household demand, with ordering intentions on the part of distributors of non-food consumer goods showing marked improvement. Unlike what happened at the beginning of 1996, the rise in household demand will probably be passed through to a greater extent to the production stage. Distributors seem, in particular, to be much more confident regarding the future evolution of prices. The firmness of consumption can be expected to be accompanied by a rise in the saving ratio, but only as a consequence of the ups and downs in the demand for cars.

Gradual alteration in attitudes to re-stocking and investment

In this period of growth consolidation, business leaders' attitudes towards inventories and investment are likely to remain cautious. As is customary, industrialists and distributors have tended to revise their assessments regarding inventories in line with the improvement in their demand expectations. For several months now, they have regarded their stocks of finished goods as being appropriate to their level of activity, with industrialists even judging their stocks of raw materials to be on the light side. However, the persistence in the early part of 1997 of unfavourable price expectations is holding back re-stocking, with holding costs still seen as high, even at the present low interest rates. This leaves a possible improvement in price expectations, already starting to be perceptible in the case of intermediate and consumer goods, as the sole factor liable to create a more positive attitude towards inventories. The contribution of inventory changes to growth in manufacturing output in the first half of 1997, affected by the unfavourable calendar, is likely to be small.

Furthermore, productive investment, despite the slight acceleration seen since mid-1996, is not likely to grow more than modestly in the first half of 1997. Despite the positive evolutions in financing conditions and profitability, entrepreneurs do not as yet have expectations of future demand that are sufficiently strong to induce them to step up their investment significantly. Nevertheless, the return to better-balanced exchange rates between the various European currencies and the prospect of EMU have removed part of the uncertainty concerning currency movements that hampers decision-making regarding the medium term. In industry, the low level of capacity utilization is providing no incentive to invest. Business leaders in manufacturing

The potential risks in this forecast

It has been assumed that the impact on growth of the dollar's recent appreciation will be felt only in the second half of the year. An earlier acceleration is possible, via inventory rebuilding, if price expectations were to turn up sharply in the very near future.

Conversely, the fact that the French economy seems to be more sensitive than in the past to movements on the financial markets and variations in exchange rates may have made it more vulnerable at this stage of the recovery, since it could be affected if the very favourable tendencies seen recently on these markets were suddenly to be reversed.

industry have somewhat expanded their investment intentions for 1997 but remain prudent, nonetheless. Investment in the car industry is unlikely to vary significantly, after rising substantially in 1996, while in the other branches of manufacturing industry it is likely to rise modestly, after virtually stagnating last year. Even so, substantial upward revisions in investment programmes could nevertheless be made in the course of the year in response to the improvement in the economic climate. This is especially possible in the case of the small and medium-sized firms, where investment plans were cut back in 1996.

Investment could well also be stepped up in certain tertiary sectors benefiting from the upturn in industry, but is unlikely to be more than flat in the building sector, as demonstrated by the low level of intentions for purchases of capital goods items reported by wholesalers dealing in this sector.

Consumer prices likely to rise only very moderately

The consolidation of industrial activity in Europe and the maintenance of firm activity in North America can be expected to lead in the first half of 1997 to a strengthening of commodity prices -- amplified, in the case of French industrial consumers, by the appreciation of the dollar and the pound sterling. Furthermore, despite the distinct easing of crude oil prices in dollar terms, the price in French francs can be expected to go on rising, although not as fast as in 1996. All things considered, the prices of imported inputs, after falling in the second half of 1996, are unlikely to vary much in the first half of 1997. And the decline seen since mid-1995 in the prices of intermediate goods used in industry can be expected to come to an end, so that the cost of manufacturing inputs in general is likely to stabilize, after falling throughout 1996.

Inflation at the consumer price level will probably remain weak (1.5%, year on year, by the end of the first half-year). In particular, prices of manufactures can be expected to remain constrained by producers' efforts to trim margins, especially in the car industry, and those of private services similarly affected by the intensification of competition and by the restraint shown by pay increases.