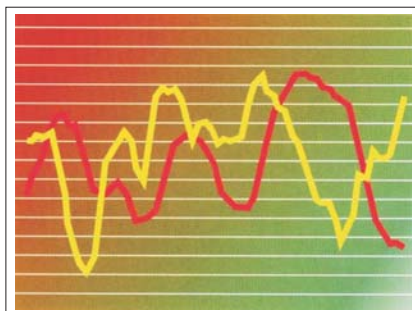


CONJONCTURE IN FRANCE

MARCH 2004



LUSTRELESS GROWTH

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LUSTRELESS GROWTH

At 0.2%, French GDP growth in 2003 was the lowest since 1993. This appreciation has to be qualified, however, by the existence of an acceleration in mid-year. After being virtually at recession levels in H1, growth picked up again in H2 to rates close to 2%. This upturn originated from the major expansion seen in the euro zone's world economic environment, which generated a revival in exports and encouraged a recovery in business leaders' expectations. However, the outcome for 2003 as a whole bears the scars of the difficult start to the year: private dependent employment fell by 50,000, bringing about a rise of 0.4 of a point in the unemployment rate; meanwhile, the slowdown in public revenues brought the public deficit to 4.1% of GDP.

The end of Q1 2004 sees euro-zone business leaders' expectations still positively headed but apparently more hesitant than in Q4 2003. The prime cause for this weakening seems to be concern over the exchange rate and the questions it raises regarding the capability of firms in the zone, now that their competitiveness has been reduced, to take advantage of world growth. Another factor is that the figures for Q4 have revived doubts concerning the capacity for rebound on the part of certain countries in the zone such as Italy. Even so, the international environment remains supportive and is generating an increase in exports from the zone. In particular, the United States is posting lively growth, of the order of 4% a year, and can be expected to maintain this rate at least until the summer, thanks to the impulses given by fiscal policy and the maintenance of a highly accommodating monetary stance.

In these circumstances, French growth, which is slightly better than that being posted for the euro zone as a whole, is expected to be close to 2% a year in H1. The fact that this growth is only moderate reflects, in part, the sluggishness of household consumption, which in turn is the result of slower growth in purchasing power and cautious purchasing behaviour resulting from continuing gloomy assessments by consumers of macroeconomic tendencies. Corporate investment, on the other hand, benefiting in particular from continuing highly favourable financing conditions, is expected to pick up and inventory behaviour should make a positive contribution to growth.

Growth in dependent employment is likely to remain slow in H1, despite the continued moderate growth, given that it had not entirely adjusted to new production levels during the cyclical downswing. Even so, the unemployment rate should remain globally stable in H1. Growth in the labour force is slowing down and the new arrangements for early retirement will produce their first effects. Inflation, in decline in Q1, is expected to be 2.1% in June, unless the oil price, which has so far remained high because of very strong world demand, falls back substantially in Q2 under the impact of the seasonal decline in demand.

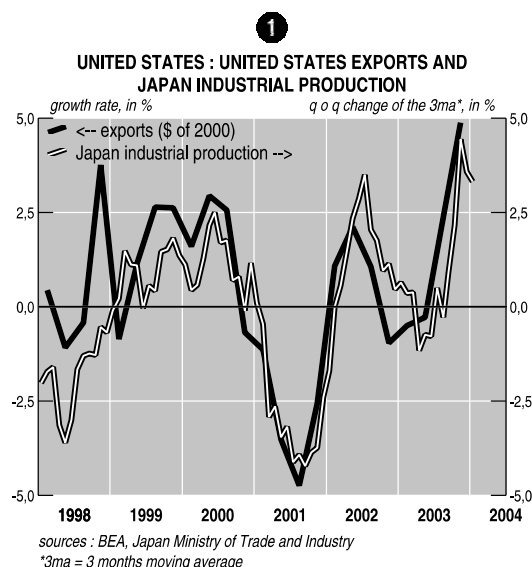
In the short term, the principal unknown factor liable to hold back euro-zone growth would be a further slide in the dollar, as the underlying structural factors for this remain unchanged. ■

The international environment and world trade both likely to remain buoyant

Within the time horizon of this forecast, the international environment can be expected to again benefit from the strength of growth in the United States and the United Kingdom, the leading trading partners for the euro zone. Surfing the American wave, Japan and China are also likely to post high growth. After a somewhat longer time-lag, the euro zone would in its turn finally profit from this tendency at world level.

In the United States, activity is likely to remain brisk until mid-year, growing by roughly 1% per quarter. Household consumption should be underpinned by tax cuts, by increasingly job-rich growth and, more marginally, by positive wealth effects. In the corporate sector, investment and stocks should continue to progress satisfactorily. The weak dollar is favouring United States exports and the prospects for foreign demand are good, with activity expected to accelerate also in the United States' trading partners (*see graph 1*). One consequence of this lively domestic demand is that growth in American imports would also be firm.

In the United Kingdom, growth is expected to remain robust but slow down slightly as the result of the tightening of monetary policy. Household consumption should continue to grow at a firm rate, although weakening from Q2 on. The reasons for this would include the strong house prices, the upturn on the stock market and the decline in unemployment, all tending to strengthen household wealth and income. In parallel, corporate investment can be expected to be underpinned by the satisfactory economic outlook. However, the tightening of mon-



etary policy is likely to curb the rises in consumption and investment. Finally, exports should be helped by the strength of world economic activity (*see graph 2*). In line with these tendencies, United Kingdom exports are expected to show strong growth in the first part of 2004.

Meanwhile, activity is also firm in Asia. In particular, Japan has returned to growth since the end of 2002, with GDP posting an exceptional growth rate of 1.6% in Q4 2003 and industrial output 3.6% (*see graph 1*). Moreover, activity revived in Q3 2003 in South Korea (up 1.1%). Finally, growth is as strong as ever in China, as demonstrated by the extremely rapid rise in imports (40%, year on year, in the early part of 2004) and by the contribution that demand from this country is making to the rise in world commodity prices, notably oil (*see section entitled «Pétrole» (French version only)*).

FRANCE: GROSS DOMESTIC PRODUCT (volume) BY TYPE OF EXPENDITURE

(at 1995 prices seasonally and working-day adjusted data, % change from previous period)

		2002				2003				2004		2002	2003	2004*
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	(100%)	0.7	0.7	0.3	-0.3	0.0	-0.4	0.4	0.5	0.5	0.6	1.2	0.2	1.4
Imports	(27%)	1.7	1.3	0.7	-1.0	0.0	0.5	0.0	2.1	1.9	2.4	0.9	0.9	5.5
Consumption	(54%)	0.2	0.5	0.5	0.3	0.7	0.0	0.5	0.3	0.5	0.3	1.4	1.6	1.2
Public consumption	(23%)	1.4	1.2	0.8	0.5	0.5	0.3	0.7	1.0	0.2	0.5	4.0	2.4	1.7
Investment	(20%)	-0.2	-0.1	-0.7	-1.2	0.1	0.3	0.1	0.7	0.9	1.1	-1.4	-0.8	2.3
<i>of which:</i>														
Non financial corporated and unincorporated enterprises	(12%)	-0.4	-1.0	-1.0	-1.9	-0.1	0.0	0.0	0.6	1.1	1.1	-2.8	-2.2	2.4
Households	(5%)	-0.1	1.1	0.2	-0.2	0.3	0.4	-0.2	0.5	1.0	1.0	0.8	0.8	2.1
Exports	(29%)	2.0	2.7	0.1	-1.4	-1.6	-1.1	0.9	1.0	1.8	2.2	1.2	-2.1	4.4
Contributions to growth														
Internal demand ex. inventory changes		0.4	0.5	0.3	0.0	0.5	0.1	0.4	0.5	0.5	0.5	1.4	1.3	1.5
Inventory changes		0.2	-0.3	0.1	-0.2	0.0	-0.1	-0.3	0.2	0.0	0.2	-0.3	-0.3	0.2
Net foreign trade		0.1	0.4	-0.2	-0.2	-0.5	-0.4	0.2	-0.3	0.0	0.0	0.1	-0.9	-0.2

Forecast
* Carry over effect at Q2.

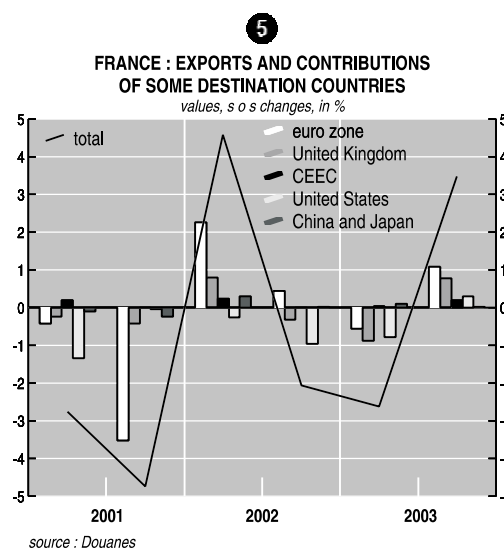
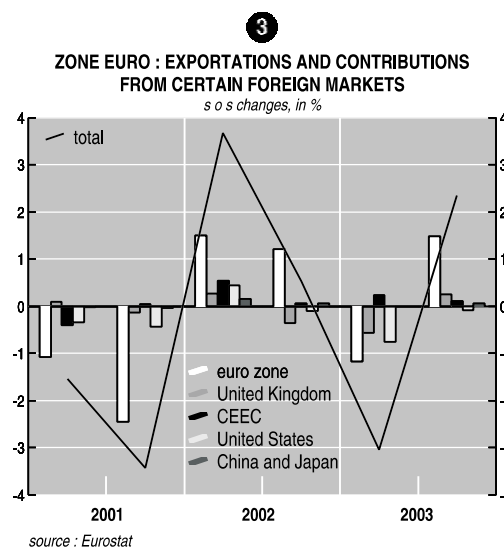
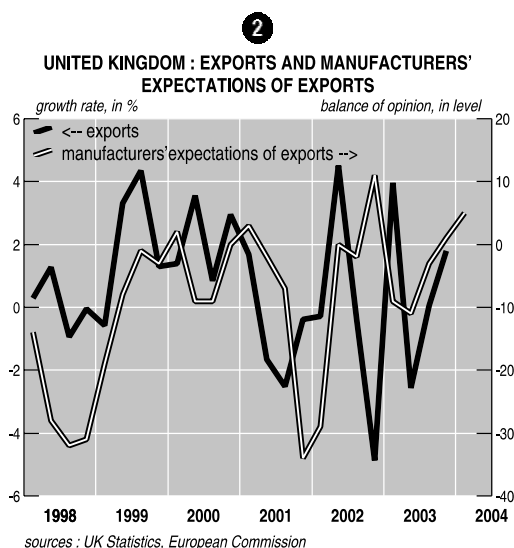
The implications for French and euro-zone trade

In H2 2003, exports from the euro zone to the United States and the United Kingdom ceased to decline, despite the appreciation of the euro. Total exports in fact rose strongly, mainly on the back of intra-zone trade (see graph 3).

In the early part of 2004, the negative impact of the appreciation of the euro on the zone's export competitiveness is still likely to be compensated by the rise in overseas demand, especially from the United States and the United Kingdom. As a result, business leaders in almost all countries of the zone are expecting a rise in export demand for their goods (see graph 4). In addition, the upturn in the European economies can be expected to encourage intra-zone

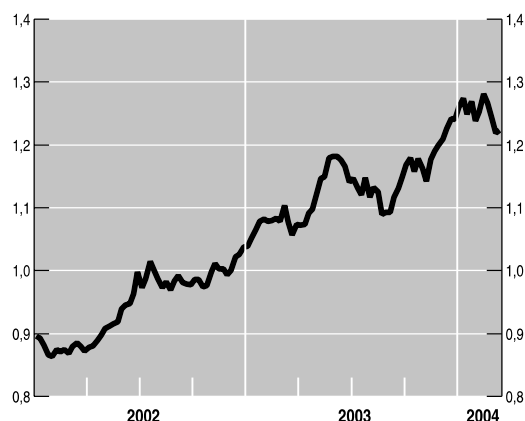
trade. All in all, total exports to countries inside and outside the zone are expected to rise by 1.4% in Q1, followed by an acceleration to 1.7% in Q2.

In France, exports returned to modest growth in H2 2003 (almost 1% per quarter on average), despite the appreciation of the euro. This recovery is related to the acceleration in demand for French goods from the United States, Germany and the United Kingdom in particular. Exports to Germany rose slightly in H2 and those to the United States and the United Kingdom ceased to decline. In particular, exports to the United Kingdom benefited from the sale of the "Queen Mary 2". With the help of a stabilisation in the dollar and firm foreign demand, notably from the United States and the euro-zone countries, French exports are expected to rise by 1.8% in Q1 2004 and then by 2.2% in Q2.



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DOLLARS BY EURO



The impact of the stabilisation of the euro against the dollar

Between December 2003 and January 2004, the euro rose from \$1.22 to \$1.26, but this tendency has since been interrupted, with the euro even falling back to around \$1.22 in the early part of March (*see graph 6*). Two main factors contributed to this evolution. First, the Asian central banks, through their massive purchases of dollars, have continued to support the American currency. Second, statements by European authorities became more and more forceful as the euro approached the \$1.30 level, foreshadowing a possible intervention.

Even so, the engagement of a new industrial upswing, driven by the outside world, is likely to be slower than expected for certain euro-zone countries

In this positive environment, foreign trade can be expected to trigger off an industrial upswing in the euro zone. However, the business climate, after improving substantially, has failed to show any further progress since February (*see graph 7*). The recovery could therefore be less clear-cut, at least initially, than was expected in December.

In France, the upturn in manufacturing output in Q1 is likely to be less vigorous than the business surveys would seem to indicate. In fact, the index for manufacturing output declined somewhat in January. When this decline is taken into account, the statistical carryover for Q1 2004 is -0.4%. According to industrial business surveys in February and March, the climate is continuing to improve but not at as firm a rate as previously (*see graph 7*).

Foreign demand for firms' products liable to stimulate investment

In order to meet export demand, firms in the euro zone can be expected to step up their investment significantly during H1 2004, with investment in the zone as a whole rising at a rate close to 0.8% during the first two quarters of the year. In Germany, the upturn was already clearly visible in Q4 2003 (+1.7%, following -0.5%). It is likely to be more delayed in Italy because of a business climate affected at the end of 2003 by fresh worries over the reliability of corporate accounts (the Parmalat affair).

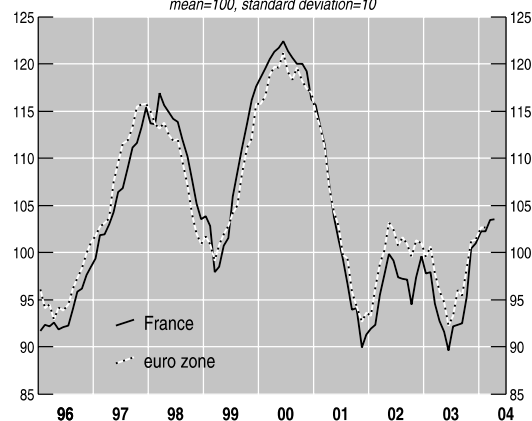
In France, industrial leaders questioned in January 2004 saw their investment during the year as being 5% higher in value than in 2003. The recovery in investment by manufacturing firms has been visible in the national accounts since the summer (+1.3% in Q4, +0.3% in Q3). It is also perceptible through the results of the January survey of wholesale distribution, showing wholesalers' intentions for orders of capital goods rising significantly. IT investment in particular is likely to rise very strongly.

Moreover, this upturn in investment would be underpinned by highly favourable financing conditions, either through borrowing or through share issues. Real interest rates are still low, favouring recourse to the bond market and to intermediated credit. At the same time, share prices rose by at least 30% between March 2003 and February 2004 on all the euro-zone stock markets, although, following the Madrid terrorist attacks, the European markets fell back in mid-March to their levels of the beginning of the year. In these circumstances, lending to firms picked up strongly in France towards the end of 2003. Lending for investment purposes showed the strongest rise, from 1.9%, quarter on quarter, annualised, in November 2003 to 3.3% in January 2004, having declined constantly throughout Q2 2003 (*see graph 8*). This tendency can be expected to extend throughout H1 2004, encouraged also by the stabilisation of corporate debt (*see graph 9*).

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BUSINESS CLIMATE

mean=100, standard deviation=10



The upturn in demand nevertheless had only a limited impact on productive capacity utilisation. In industry, spare capacity without recruitment remained virtually stable at 12.1%, slightly above the long-period average of 11.1%. This means that pressures on productive capacity are still weak and this would tend to curb investment growth.

Industrial firms prompted to limit their de-stocking

Against a background of export-triggered recovery in industrial activity, inventories should again make a positive contribution to euro-zone growth in Q1, before becoming neutral in Q2.

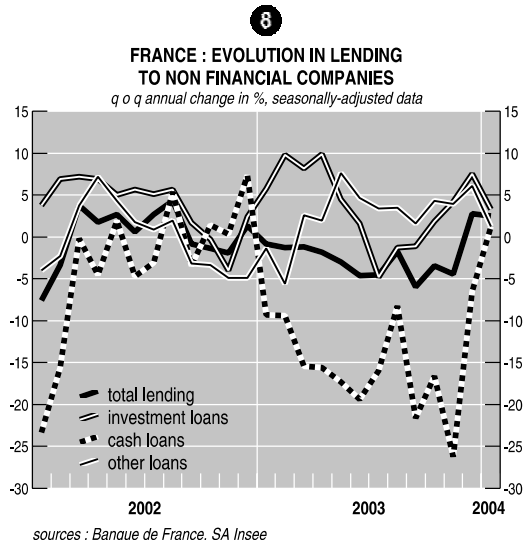
In France, because of de-stocking on a smaller scale, inventories variations made a positive contribution to growth in Q4 2003, amounting to 0.2 of a point. This tendency reflects expectations of an improvement in demand in the short term, in line with the recovery in the balance of opinion regarding the demand outlook in the latest quarterly industrial business survey (January 2004).

With demand still positively headed and with financing conditions still favourable, the slowdown in de-stocking is expected to be confirmed in Q2, following a pause in Q1. In these circumstances, the contribution of inventories to growth would be nil in Q1 and of the order of 0.2 of a point in Q2 (*see graph 10*).

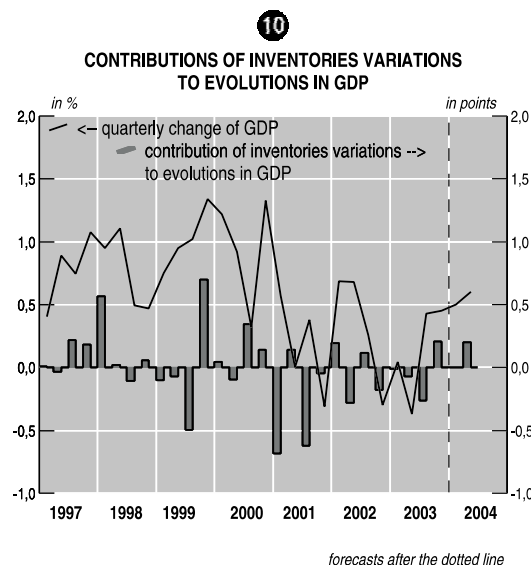
Household consumption in the euro zone likely to return to modest growth

Thanks to the acceleration in household consumption in Germany, the rise in this component of demand is likely to act as a minimum base for growth (*see graph 11*). It will in fact probably be modest but sturdy. This modest level, which corresponds to the depressed level of household confidence, is explained by an unfavourable labour market situation and by low purchasing power gains, reduced still further by the inflationary impact of the rise in the oil price. Germany is likely to stand out from the rest of the zone: after several quarters' decline, consumption in that country is liable to accelerate distinctly as the result of the planned tax cuts. Conversely, consumption in Italy would again be handicapped in Q1 by a low level of household confidence and by higher inflation than in the rest of the zone. Consumption in Spain may also be temporarily affected by the Madrid terrorist attacks, but should nevertheless accelerate in Q2.

In France, the growth rate of consumption is likely to stabilise at around 0.4% per quarter, benefiting from past rises in purchasing power. In 2003, however, these rises were limited and the latest available data



*The total domestic debt (TDD) includes all debt owed by non-financial resident companies contracted with either residents or non-residents, in the form of loans or issues of loan securities on the capital markets.



for employment and the total wage bill seem to indicate that they could be revised downwards somewhat. This would mean that H1 2004 could see a slowdown in purchasing power growth to an average of only 0.2% per quarter. In particular, inflation has been pushed up by the rise in the oil price (*see graph 12*), thus eroding purchasing power. Furthermore, household confidence is at a low ebb, having been affected, as in other countries, by the poor performance from the job market, which declined during 2003, thus contributing to a rise of the unemployment rate. However, the latest tax cuts will already be applied to the provisional payments made in H1 2004 and should therefore help to boost income and consumption.

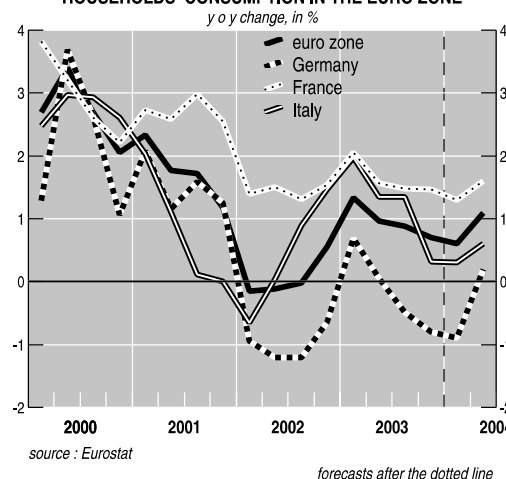
In these circumstances, production in the services sector is likely to be moderate

After slowing down in Q4 2003, activity in the market services sector is likely to accelerate slightly in the early part of 2004. In particular, output of business services should be stimulated by the upturn in investment and IT activities and would also benefit indirectly from the continued strong rise in telecom expenditures by households. In the case of services to individuals, activity in hotels and catering seems set to stabilise, as indicated by the latest business survey for services (January 2004). The sector should benefit, in particular, from the return of the foreign tourists encouraged by the pause in the appreciation of the euro.

The evolution in the output of the non-market services sector, linked in particular to that of household spending on health care, showed a steady acceleration during H2 2003. It nevertheless seems to have weakened in the early part of this year. According to the latest available statistics for the reimbursement of non-hospital care, spending on health slowed down markedly in Q1 2004.

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HOUSEHOLDS' CONSUMPTION IN THE EURO ZONE



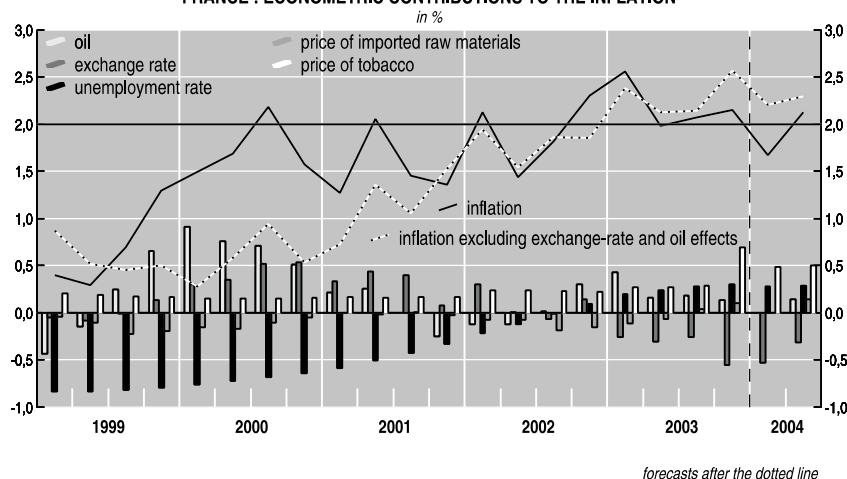
Output in construction and energy seems to have been temporarily in a trough in Q1 2004

Because of the decline in corporate demand for buildings last autumn, activity in construction is likely to have grown less rapidly in Q1 2004 (+0.3%, following +0.8%), with output still affected by the decline in non-residential starts seen in Q4 2003 (*see graph 13*). However, it should pick up again in Q2, to judge by the recent pattern of housing permits. Given the current low level of interest rates, households can be expected in fact to continue to invest in H1, so that housing investment would continue to constitute a major driving force for activity in building.

Energy production, after rising strongly in Q4 2003, seems to have declined in the early part of 2004. The last quarter of 2003 was marked by a month of Octo-

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FRANCE : ECONOMETRIC CONTRIBUTIONS TO THE INFLATION



ber that was colder than normal. The resulting rise in production made it possible to meet firm domestic demand, especially from households, at a time when imports were declining. By contrast, domestic demand seems to have declined in Q1 2004. Corporate spending on energy is likely to have remained on a modest scale, in line with the level of activity, and consumption by households even to have declined, given the fairly mild weather at the beginning of the year. Energy production seems set to recover modestly, assuming normal climatic conditions, in Q2 (+0.4%).

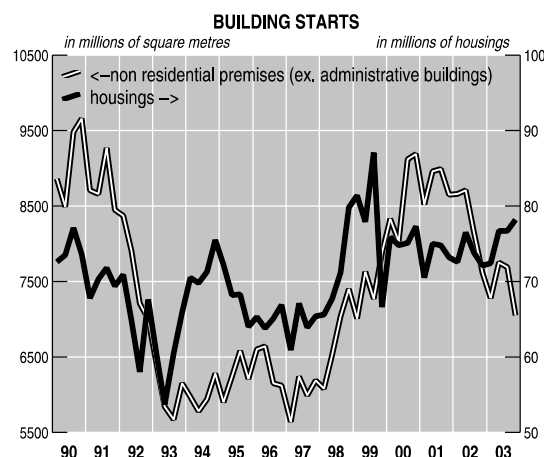
Despite the upturn in activity, the job situation is likely to be slow to improve

Against a background of slow recovery in activity, firms in the euro zone are likely to show more restraint in their hiring behaviour than in the case of investment. As a result, employment in the zone is likely to stagnate in the early part of 2004, with the unemployment rate continuing to rise.

In France, total employment is expected to continue to decline slightly in H1 2004. Job creation remains firm in the construction sector and more limited in the tertiary sector, but these gains would be virtually cancelled out by the continuing job losses in industry. In all, the rise in employment in the competitive sector seems likely to remain small, amounting to only 0.1% in H1 2004, in a prolongation of the improvement already seen in Q4 2003. Moreover, dependent employment in the non-market sector will probably show a further decline, with the rise in non-assisted employment insufficient to make up for the decline in assisted employment. The net result would be a decline of 13,000 in total employment in H1 2004.

However, the unemployment rate should finally level out, thanks to a short-term decline in the labour force. This would be partly due to the strong build-up of the impact of the new arrangements permitting workers with a long career behind them to take early retirement. This would remove 40,000 from the labour force, those in work being partly replaced.

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A slowdown in United States domestic demand could hold back European growth

The risk that foreign demand might show signs of running out of steam, especially if domestic demand in the United States were to slow down, cannot be ruled out. As a corollary, an American slowdown would probably be accompanied by a decline in the dollar. The combined negative effects would be rapidly transmitted to foreign trade and hence to industrial activity in the euro zone and in France. However, this risk probably concerns more the second half of the year. On the other hand, the Brent oil price, which has stood at more than \$30 throughout most of Q1 2004, could return to a lower level than has been assumed in this Note, especially if the uncertainties over Venezuelan output and over the cuts in OPEC quotas were to fade and if the United States were to rein back the reconstitution of the country's strategic reserves. Such a decline in the oil price would then tend to curb inflation and encourage consumption. Its impact on activity in the developed countries would nevertheless be fairly slight in terms of productive supply in the short term. ■