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LA CONJONCTURE IN FRANCE

A bi-annual short term economic report by INSEE

THE OUTLOOK FOR 1991

The Anglo-American recession which started in the summer of 1990 has had a dampening effect on the French economy, but actual recession has so far been prevented by buoyant demand from Germany. On top of this, the Gulf crisis has deepened economic uncertainties and intensified the French economic slowdown. Manufacturing production has decreased at the end of 1990 and during the first half of 1991, while the average real growth rate of household consumption was halved between 1990 I and 1990 II, before levelling out in 1991 I.

There should be a recovery in the summer months, as household consumption revives somewhat after a flat second quarter, and external demand improves as the result of US-led recovery in the OECD area. On a yearly average basis, GDP growth should be around 1.5 %. Thanks to cheap oil and easing food prices, inflation should not exceed 3.3 % in December.

Productive investment is more severely affected than household consumption. Weaker global demand and pessimistic expectations on the part of private firms will bring about a 2% annual fall of investment in real terms for the corporate sector, state-controlled public utilities excluded. In view of the high real long-term interest rates and the poor profit margins recorded since mid-1990, investment remains at a substantial level: the investment/value-added ratio will be roughly the same in 1991 as in 1989.

In order to rebuild their margins, manufacturing companies are trimming their labour costs by cutting not only temporary but also permanent jobs and curbing the growth in wage rates. This movement is expected to last until the end of the year, allowing profit margins to recover. The other outcome will be a large rise in unemployment, pushing the rate at the end of the year to about one point over its end-1990 level.

With domestic demand growing by less than GDP, net exports of goods and services should positively contribute to growth in 1991, contrary to 1990. In fact, foreign demand has been buoyed up until mid-1991 by the effects of German unification. During the second half-year, German demand could be restrained by additional tax pressure, but world trade recovery will outweigh this negative effect. In short, the French trade deficit on a customs basis (FOB-FOB), should stabilize at 55 billion FF from 50 billion in 1990.

Gross Domestic Product by Type of Expenditure

Constant 1980 prices - Percentage change, except see (1), Annual rates

	Half-year Averages						Year-on-year (H2/H2)			Annual Averages		
	89.I	89.II	90.I	90.II	91.I	91.II	1989	1990	1991	1989	1990	1991
GDP	4.6	3.1	3.1	1.9	0.8	2.8	3.8	2.5	1.8	3.9	2.8	1.5
Imports	9.9	3.4	9.0	4.2	2.0	1.9	6.6	6.6	1.9	8.2	6.4	2.5
Available resources	5.7	3.2	4.3	2.4	1.0	2.6	4.4	3.3	1.8	4.8	3.5	1.8
Households' final consumption	2.4	3.5	3.8	1.4	1.8	2.0	2.9	2.6	1.9	3.2	3.1	1.8
Gross fixed capital formation	8.1	4.9	5.3	0.8	-1.3	2.9	6.5	3.0	1.5	7.5	4.1	0.2
Of which NFCU sector (2)	*10.5*	*4.4*	*8.8*	*1.0*	*-4.2*	*3.2*	*7.4*	*4.8*	-0.5	*8.6*	*5.7*	*-1.1*
Households	*5.5*	*9.3*	*-0.9*	*-1.6*	*2.5*	*-0.3*	7.4	*-1.2*	*1.1*	7.7	*1.4*	*0.7*
Exports	16.1	4.5	6.8	2.6	1.8	7.1	10.1	4.7	4.4	10.3	5.2	3.3
Change in stocks	0.2	- 0.3	-0.2	0.5	-0.3	-0.1	-0.1	0.2	-0.5	0.0	-0.2	-0.2
Domestic demand except change in stocks	3.1	4.5	4.9	0.3	1.9	2.6	3.8	2.6	2.2	4.1	3.6	1.7
Domestic demand	3.6	3.7	4.3	1.4	1.1	2.2	3.6	2.8	1.7	4.1	3.4	1.5

(1) Change in stocks as % of previous period's GDP.

(2) Non financial corporate, quasi-corporate, and unincorporated enterprises.

THE INTERNATIONAL ENVIRONMENT: Buoyant German demand in the first half-year and OECD economic recovery in the second to moderate the slowdown in foreign demand in 1991.

The economic slowdown which began in 1989 in most of the industrialized countries, Germany and Japan excepted, turned into a moderate recession in the second half of 1990. The Gulf crisis put additional downward pressure on domestic demand within the OECD area, more as the result of the uncertainties provoked by the crisis than of the oil price increase itself. Since the end of the Gulf war, consumer and business confidence indicators have partially recovered from their low end-1990 levels. A better economic outlook, with less uncertainty and lower inflation, should lead to a revival of consumer expenditure in the second half-year. The first signs of recovery were already seen in the United States during the second quarter, following the rise in consumer confidence. Recovery should spill over into the rest of the OECD area in the second half-year, with world trade picking up moderately after having almost levelled off in the early part of 1991.

Nevertheless, French export market growth should show a slightly different pattern this year, French exporters being strongly affected by the German business cycle. German domestic demand has been boosted by the public transfers in favour of the former GDR since the implementation of economic and monetary union in July 1990. Consequently, French exporters, especially the car-makers, enjoyed buoyant demand during the first half of 1991, even though world trade was levelling off at the time. However, German demand is likely to lose steam in the second half, as higher taxes, both direct and indirect, will bite into net household and corporate income after July 1st.

On an average yearly basis, the international outlook is somewhat better for France than for the OECD in general, thanks to German demand. French export markets for manufactured products should grow at a rate of about 4.5 %, one point above the OECD average. A slight gain of competitiveness in the second half-year should not avoid a moderate loss of market share in 1991 on a yearly basis, due to the lagged effect of the EMS currencies' appreciation vis-à-vis most other currencies in 1990.

THE CORPORATE SECTOR: Squeezed profit margins and weaker demand driving firms to adjust production, investment and employment and to hold down wage increases.

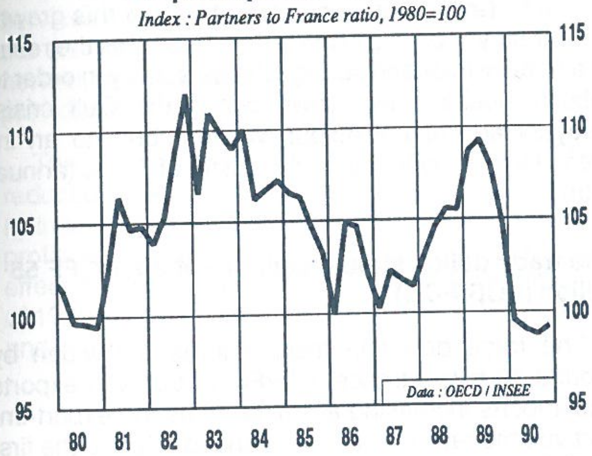
Profit margins in industry to improve at the end of 1991

Industrial firms' profits were hit in 1990 by the faster rise in prices of inputs than in their selling prices, and by the sharp slowdown in productivity, from a 4.5 % average growth rate in 1989 to 0.4 % in 1990 (manufacturing industry). Higher wage rates and larger total payrolls were the consequence of the high profits generated by the strong 1987 recovery, accompanied until 1989 by a value-added distribution that was tilted in favour of firms. The 1990 squeeze on profit margins has continued during the first half of 1991, even though commodity prices have slipped back: production is sliding down faster than employment, and the weakening of sales on the domestic market is exerting downward pressure on producer prices. Moreover, the high oil prices in 1990 II are having lagged effects on intermediate goods, which are themselves inputs for industry.

The production recovery expected in the second half-year should reverse these movements. Productivity should pick up, as stocks are not so large as to prevent production from responding to any acceleration in demand, and as the increase in the aggregate wage bill should continue to slow down. However, on a yearly average basis, productivity in manufacturing industry should record a slight decline of about one half of a percentage point.

Competitive positions - Labour costs*

Index : Partners to France ratio, 1980=100



* *Unit labour costs in FF : 7 main trade partners / France.*

Valued in French francs, unit labour costs in manufacturing industry grew faster in France than in its main trading partners, on a yearly basis, in 1990. This was mainly the result of the EMS currencies' appreciation against the dollar and the yen. This tendency will start to reverse in 1991.

On a year-on-year basis, the growth in the average hourly wage rate will slow down from 5.1 % in 1990 to 3.8 % in 1991

With productivity gains insufficient to restore profit margins, industrial firms have been turning their attention to adjustments in labour costs. Indeed, wage-rates have already slowed down. Between January and April, workers' hourly wage-rates increased by 1 %, compared with 1.6 % during the same period of 1990. However, there was active sectoral wage bargaining at the beginning of this year, as no negotiations had taken place for three years in some sectors. Negotiations concerning the lower-paid workers, under prompting from the government, have reduced the gap between the minimum wages arrived at under collective agreements and the national legal minimum wage (SMIC), which does not apply to all workers. But this reduction has had little effect on average wage rates, as skilled rates wages have been hit relatively harder by the economic slowdown than have unskilled rates. The last quarterly industrial survey carried out by INSEE shows entrepreneurs expecting no acceleration in wage rates over the forthcoming months. The balance of replies concerning wage increases is back to its 1988 level, when wage rate growth was only 0.8% on a quarterly basis.

With the SMIC being raised by 2.3 % on July 1st —the new government having honoured the undertaking made by its predecessor (1)— the hourly average wage rate should increase by 2.1 % between January and July. With no more SMIC increases expected for the rest of the year—since the consumer price rise will not exceed 2 %— the rise in wage rates between July and December should drop back to 1.7 %.

Industrial employment to fall by about 2 % by the end of the year

Employment is the most sensitive aspect of the labour cost adjustment in industry. Just as in the case of wage-rates, the latest data show payrolls also shrinking in industry, by 0.6 % in the first quarter. Overtime and non-permanent employment were the first to be hit. Moreover, firms have used temporary lay-offs, starting during the Gulf crisis, in order to adjust supply to demand. These adjustments have proved insufficient, however, and permanent employment is now being affected. As a consequence, manufacturing employment should experience a 1.4 % fall between Q4 1990 and Q2 1991. Despite the expected recovery in activity, manufacturing employment is unlikely to pick up before 1992, and a further 1.4 % fall is expected between Q2 and Q4 1991. For all industries, construction and food included, a more moderate 1.8 % fall between Q4 1990 and Q4 1991 is likely.

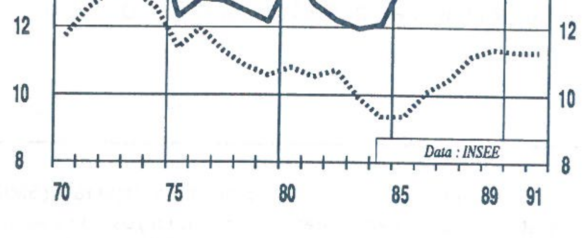
These unpalatable adjustments in labour costs, which are in fact much less marked in France than in the United States or the United Kingdom, should lead to an increase in companies' profit margins in the second half-year. A further cut in the rate of corporate profits tax, with the standard rate being trimmed from 37 % to 34 % in order to be closer to the European average, will give an added thrust in this direction.

(1) Under the present legislation, the minimum wage rate (SMIC) is adjusted on July 1st each year. The minimum year- on-year rise is equal to the latest observed year-on-year CPI rise, plus half of the year-on-year rise in the real hourly wage rate (latest available observation). In the event that consumer prices rise by more than 2 % since the last SMIC revaluation, the minimum wage is automatically aligned on this increase.
In 1988, 1989 and 1990, bonuses were granted which allowed the SMIC to grow at the same pace as hourly wage rates.

Corporate investment falling

1991 is a cutback year for investment. Productive investment is decreasing slightly, by around 1% in real terms at annual rate, and 2 % if state-controlled public utilities (2) are excluded. Indeed, the weak corporate performances at the end of 1990, the general uncertainty due to the Gulf crisis, and the demand slowdown had already brought about a reduction in the investment effort at the end of 1990 and the beginning of 1991. This evolution is consistent with a simple accelerator- effect adjustment and with the fact that capacity utilization rates had been decreasing since the middle of 1990 but now seem to be stable. But, as regards investment levels, companies are still continuing to invest strongly, the investment ratio being comparable to that of 1989, despite the fact that firms are facing numerous financial constraints: their self-financing ratio has fallen and, despite a temporary decrease in long-term real interest rates during the first quarter of 1991, the corporate debt service burden is considerable . Another aspect of the situation is that, while firms are investing strongly, this investment is being channeled into productivity rather than capacity.

In the building and public works sector, the investment growth rate will be halved between 1990 and 1991. In industry, it will be down from + 11 % in 1990 to - 6 % in 1991, while in manufacturing taken on its own, investment is stable or declining, depending on the sector, consumption goods and car industries being less affected. Only the state-controlled public utilities are continuing to increase their investment at an annual rate of about 7 %.



A distribution of value added that was in favour of firms after 1983 helped investment to revive in 1984. The international recovery in 1987, following the slide in oil prices, boosted investment growth still further until 1990. The downward correction expected this year is in fact moderate, considering the high level attained last year.

Production falling in manufacturing, but still brisk in food processing and energy

After the considerable drop at the end of 1990, manufacturing production has continued to flag in the first half of 1991, although to a smaller extent. It will start to recover in the second half, following the moderate rebound in domestic and foreign demand. According to business surveys, stocks are regarded as substantial but not so large as to postpone this positive effect. Car production will show a fall in 1991 of about 4 %, capital goods and intermediate goods falls of about 2 %, while consumer goods production will stay level. The slowdown in the construction sector is less marked, thanks to the continued buoyancy of non-residential construction, and extensive motorway and rail investment.

On the other hand, energy production will increase by 4.6 % (annual rate) in 1991. Much of this growth has already occurred in the first half-year, as the result of a harsh winter and strong refinery activity in order to rebuild stocks drawn down during the Gulf crisis. Buoyant agricultural output will contribute to an increase in activity in the food industry of 2.7 % (annual rate).

The trade deficit should stabilize at about FF 55 billion (FOB/FOB)

The trade deficit in manufactures will widen by around 10 billion francs (CIF/FOB), but with exports and imports increasing at similar rates the export-import volume ratio remains unchanged. During the first half of the year, the export-import ratio actually improved, with imports not very dynamic and exports affected by losses in price competitiveness but benefiting from Airbus deliveries. During the second half, on the other hand, imports and exports rebound in response to rising domestic and foreign demand, and despite the stronger US dollar, the export-import ratio is set to worsen.

The oil-import bill should be cut by 10 % in 1991 by comparison with 1990. With most of the rise in energy consumption taking the form of gas and electricity, the total energy import bill should be about FF 10 billion below its 1990 level. Lastly, the deterioration in the surplus on agriculture and food which began in the second half of 1990 has continued during the first quarter but should subsequently be reversed thanks to large exports of wheat and barley.

All in all, the trade deficit (FOB/FOB) should stabilize at around 0.8 % of GDP.

(2) Electricité de France, Gaz de France, Air France, Air Inter, Charbonnages de France, Poste (Post Office), France-Télécom, SNCF (State Railways), RATP (Paris Urban Transport).

After being affected by the Gulf crisis in the first half, domestic trade and services activity should revive in mid-year

Trade and services activity has also suffered from the slowdown in demand, but the adjustment to this new environment is not being made by cutting prices. In particular, the annual rate of increase for prices of services is steady at around 5 %. Therefore, job creation should be slowed to an annual growth rate of 1 %, compared with 2.4 % last year.

The slowdown in trade activity which appeared in 1990 is being seen particularly in the industrial and "clothing-leather-textile" wholesale trades, but a revival should take place in the second half. Similarly, services activity is weakening on an annual-rate basis, essentially because of low activity in transportation and services for firms (e.g. temporary employment). After the Gulf war, services activity is expected to return to normal, meaning a rate of growth similar to that of the previous year.

The external surplus on services account is being reduced in 1991 essentially because of the weak activity in air traffic and the increasing outflows of "interest, profits and dividends". The Gulf crisis has had a neutral effect on tourism, with the surplus comparable to that of 1990 because of similar decreases in both outflows and inflows.

HOUSEHOLDS : facing uncertainty about employment and income, households are not drawing on their savings.

More than 250,000 additional job-seekers by the end of the year

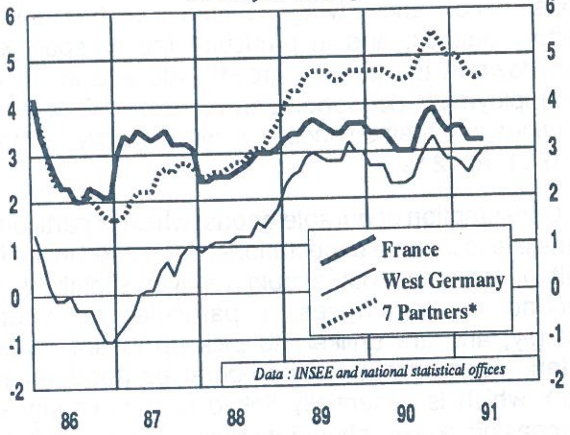
The main outcome of these developments and attitudes is rising unemployment. On the one hand, substantial lay-offs in industry; on the other, weaker job generation in the tertiary sector, some job creation in the public service and an increasing number of contracts under social programmes imply that overall employment should be stable. The addition to unemployment during the year is put at more than 250,000, meaning a rise of about one percentage point in the unemployment rate. All categories of wage- and salary-earners are being affected by this rising tide of unemployment, particularly men in the 25-to-49-year age group.

The inflation rate will level off to 3.3% in December, despite growing core inflation

Inflation is still under control and the year-on-year inflation rate could end the year at about 3.3 %, but core inflation (i.e. food and energy excluded) would then be running at 4.1 % compared with 3.2 % in December 1990. Price changes differ, depending on the sector: on the one hand, a large and steady rise in service prices and an acceleration in manufactured goods prices due in part to past increases in imported raw materials; on the other, an easing of food and energy prices.

Consumer Price Index : France and Main Partners

Year on year % change



* *West Germany, Italy, United Kingdom, Belgium, United States, Netherland, Spain, weighted by total bilateral trade.*

In West Germany, the increases in indirect taxes in July and strong growth in unit labour costs should lead to an inflation rate equal to about 4 % in December, according to German forecasters. The Franco-German inflation differential is in France's favour for the first time since 1973. Finally, with respect to the general inflationary peak in October 1990, the deceleration in prices is more marked for France's trading partners, even though the inflation differential remains in its favour.

Growth in real disposable income halved between 1990 and 1991

Another notable development is the slowdown in real disposable income. For their part, wages are growing slower in nominal terms than in 1990. In the private sector, the rise in the hourly wage rate is declining in 1991, as is the job-creation rate. Alongside this tendency, the earnings of the self-employed are suffering from slack demand. In the public sector, the growth rate in civil servants' total earnings is comparable to that of 1990. At the same time, the growth in individual tax payments and social security contributions has speeded up on account of the 1990 rise in incomes and of higher sickness insurance rates. Lastly, social transfers are making a smaller positive contribution to growth in household income than in 1990. In short, purchasing power growth is slackening appreciably. On an annual basis, it will increase by 1.8 % in 1991, compared with 3.6 % in 1990.

Durable goods the most affected

One consequence of these changes is a slowdown in household consumption. Household consumption was not very dynamic in 1990 II and 1991 I, but should accelerate slightly in 1991 II. In fact, households adjusted their consumption towards the end of 1990 in reaction to the slowdown in real disposable income. In the second half of 1991, the consumption growth rate would be in conformity with the usual trade-off between consumption and savings. Faced with this unsatisfactory outlook, and in particular the prospect of a slowdown in the income growth rate and increasing unemployment, households can be expected to remain cautious and their savings ratio will probably be stable in 1991, at 12 %.

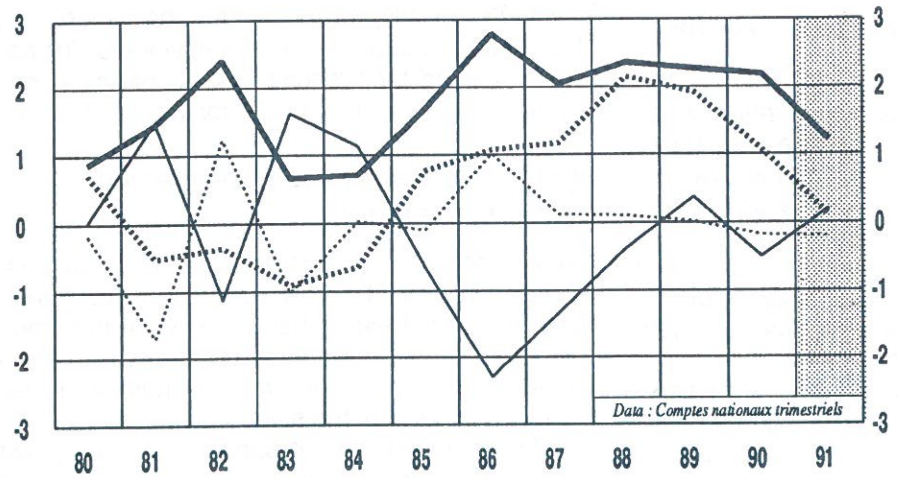
Consumption of durable goods, which is particularly sensitive to income expectations, decreased in the first half of the year, but should recover slightly in the second. Car purchases, in particular, have fallen sharply, and are unlikely to pick up to any marked extent. Consumption of non-durables (food, energy, etc.), which is essentially linked to past changes in purchasing power, should increase by around 2.5 %. Lastly, the consumption of traded services has been growing slightly more slowly during the first half of the year and should accelerate a little, but not to its previous rate. In short, growth in household consumption would be about 1.8 % at annual rate, i.e down by at least one percentage point on the 1990 figure.

GENERAL GOVERNMENT : in spite of the economic slowdown, fiscal policy unchanged.

The 1991 budget was adopted in 1990 on the assumption of a 2.7 % growth rate for the GDP in 1991. With a more modest 1.5 % rate, tax revenues are plummeting below the original expectations. However, the government is still clinging to its target of a deficit of FF 80 billion. An initial expenditure cut amounting to FF 10 billion was decided in March, and new tax measures were voted by the Parliament in June, adding FF 17 billion to revenue. But these measures may not be sufficient to keep the budget deficit on target.

On the other hand, total social security receipts have been held back by weak employment growth, while health expenditures have grown strongly. As the new "generalized social contribution" (CSG), voted in connection with the 1990 budget, was designed to be neutral as regards total revenue, an increase of 0.9 percentage points in the sickness insurance contribution rate has been decided. This will bring an additional FF 10 billion into the coffers of the Social Security.

Completed on July 4, 1990



Contributions to changes in real market GDP (%)