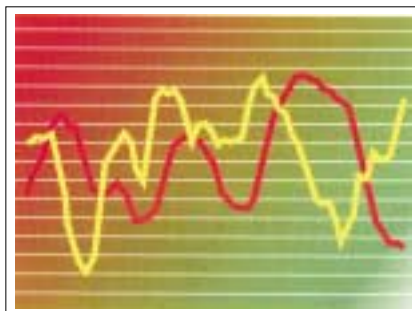


CONJONCTURE IN FRANCE



Recovery deferred

The upturn that began in Europe towards the end of last year failed to last beyond the second quarter of 2002. The weakness of internal driving forces in the euro zone, characterised by the stagnation in domestic demand ex stocks seen in the past year, has reduced the European economies' capacity to cope with external shocks. Business leaders' expectations have suddenly turned downwards, with the realisation of the fragile nature of the American upturn, the spectacular collapse of the stock markets and the rise in the oil price. The expected re-stocking has not materialised and corporate demand has remained slack. As a result, GDP growth stabilised in France in H1 at a rate of 2%, underpinned by domestic demand whose capacity for resistance has enabled the country to post slightly better growth than in the rest of the euro zone. In particular, the German economy has shown surprising slackness, due to the absence of any revival in consumption.

The end of the summer finds the American economy, which recorded appreciable growth in Q3, vulnerable to the risk of a decline in household demand, due to the negative wealth effect and the deterioration on the labour market. The stock markets remain depressed. In the euro zone, business leaders' expectations are generally continuing to weaken.

In this environment holding out little hope of external support, French growth in H2 would again be underpinned by household consumption, which has been rising in Q3 but is being hampered by the deterioration in households' expectations, reflecting worries inspired by the steady rise in unemployment. With employment continuing to stagnate, the unemployment rate looks set to be around 9.3% in December. However, the sharp rise in disposable income linked to the "employment premium"⁽¹⁾ and the income tax cuts will boost purchasing power towards the end of the year, against a background of continuing moderate inflation. The temporary spurt in the year-on-year price rise (2.3% in December) would tend to mask a gradual levelling off in underlying inflation.

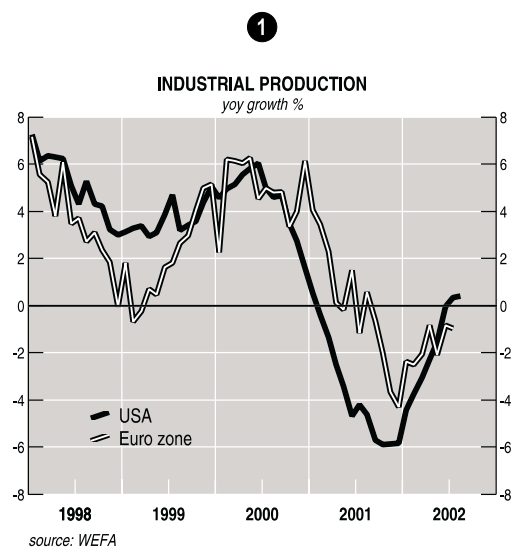
Demand from firms confronted with the need to put their accounts in order is likely to continue to stagnate. As a result, year-on-year growth is likely to be slower in H2 than in H1, being of the order of 1.5%. On an annual average basis, growth in 2002 would be 1%. This figure, the lowest in nine years, is a consequence of the instability of the environment in the past 18 months and of the persistent uncertainty, due to possible unforeseeable downside influences, at a time when many of the fundamentals are still positive for growth.

(1) A tax bonus for lower-income workers in, or about to join, the employed labour force.

An international climate marked by the collapse of the equity markets and the rise in the oil price

In the spring of this year, the accounting scandals in the United States triggered off a substantial wave of mistrust vis-à-vis equity markets in the industrialised countries. The Enron affair revealed the shortcomings of the American system of accounting controls. Since then, other major American firms, whose names had often been associated with the successes of recent years (WorldCom, QWest, among others), have been singled out for criticism by the auditors and by the Securities and Exchange Commission. These scandals came to light at a time when there were still numerous uncertainties regarding the robustness of the upturn in American growth in Q1 (1.2%, preceded by 0.7% in Q4 2001 and followed by 0.3% in Q2 2002) and when in the euro zone domestic demand ex stocks had been stagnant for a year (*see graph 3*). There followed a substantial decline on equity markets in the United States, which then spread to the other industrialised countries. Since May, the Dow Jones in the United States has dropped by 20%, the Eurostoxx in Europe by more than 30% and the CAC 40 in France by more than 30%.

For the large firms in the industrialised countries, this decline on the stock market has meant a severe tightening of financial conditions. In certain sectors, notably those involved in the new information and communication technologies, firms had borrowed heavily and are having difficulty in meeting their ob-



ligations. In the end, all sectors have in fact been affected, including the banking sector, which has seen a substantial drop in the value of its assets.

The repercussions on the real economy are clearly visible in the corporate sector. In the English-speaking countries, investment fell in Q2 in the United States for the seventh quarter in a row and remained stable in the United Kingdom, following the falls in the five previous quarters. At the same time, business leaders' expectations in the United States have deteriorated: the ISM business climate index for American manufacturing industry levelled off in March at what was still a high level, before later falling substantially in July and August; the ISM index for the service sector has also declined in recent months. To judge by the outlook being reported by

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

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

		2000				2001				2002				2000	2001	2002
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	(100%)	1.1	0.8	0.5	1.3	0.3	-0.1	0.5	-0.5	0.5	0.5	0.4	0.4	4.2	1.8	1.0
Imports	(27%)	3.8	3.7	4.1	3.3	-2.0	-1.7	-0.7	-3.1	2.2	0.6	0.9	1.1	15.0	0.8	0.2
Consumption	(54%)	0.8	0.3	0.4	0.6	1.1	0.4	0.9	0.2	0.3	0.5	0.5	0.5	2.9	2.7	1.8
Public consumption ⁽¹⁾	(24%)	0.5	0.9	0.5	1.0	0.3	0.5	1.0	0.5	0.8	0.9	0.8	0.6	2.8	2.5	3.1
Investment	(20%)	3.0	1.8	0.7	2.1	0.6	-0.5	0.4	-0.6	0.4	0.1	-0.2	-0.3	8.3	2.7	-0.1
of which:																
Non financial corporated and unincorporated enterprises	(11%)	3.0	1.8	1.0	3.0	0.3	-0.2	0.4	-0.9	0.5	-0.4	-0.4	-0.4	8.9	3.3	-0.6
Households	(5%)	2.3	1.2	-0.3	-0.5	0.4	-1.4	0.2	-0.1	-0.2	1.0	0.0	0.0	4.1	-0.8	0.2
Exports	(29%)	3.5	4.1	2.6	3.4	-0.3	-2.8	-0.6	-2.2	1.4	1.5	1.4	1.3	13.6	1.5	0.8
Contributions to growth																
Internal demand excluding inventory changes ⁽²⁾		1.2	0.8	0.5	1.0	0.8	0.2	0.8	0.1	0.4	0.5	0.4	0.3	3.8	2.6	1.7
Inventory changes ⁽²⁾		0.0	-0.1	0.3	0.2	-0.9	0.1	-0.4	-0.8	0.2	-0.3	-0.2	-0.1	0.4	-1.0	-0.9
Net foreign trade		0.0	0.2	-0.3	0.1	0.5	-0.4	0.0	0.2	-0.2	0.3	0.2	0.1	-0.1	0.2	0.2

Forecasts

(1) General government and NPISH's consumption expenditures.

(2) Inventory changes include acquisitions net of sales of valuable.

business leaders, there can be little hope of any notable upturn in investment in the United States in the rest of the year.

In the household sector, the repercussions have not yet been felt, but the situation could well change between now and the end of the year. In the United States and the United Kingdom, the negative wealth effect of the stock-market decline has until now been offset by several phenomena: the surge in house prices and the cuts in interest rates have enabled households to obtain cash by refinancing their mortgages; in the United States, the tax cuts made last year continued to boost disposable income in H1; retail price inflation remains at reasonable levels (1.8% in the United States and 2.0% in the United Kingdom in August). As a result, household consumption continued to grow robustly in H1: by 0.65% in the United States and 0.85% in the United Kingdom (quarterly averages). On the basis of the retail sales data available for July and August, there is reason to expect that growth will have remained lively in United States in Q3. However, it is hard to see this rate being maintained. In Q3, households benefited from very attractive financing arrangements proposed by car dealers, but this effect could well fade in Q4. Growth in retail sales excluding cars had already been very slow since May. Moreover, household morale has been tending to weaken and the recent rise in the number of unemployment benefit claimants is not conducive to any improvement in morale. Similarly, the rise in house prices that had underpinned household spending in the United Kingdom could easily run out of steam and lead to a slowdown in consumption.

Another factor tending to worsen the prospects for world growth is the rise in the oil price since the summer (from USD 24/barrel in June to more than USD 27 since September). The resulting reduction in purchasing power is likely to have a rapid impact on household spending.

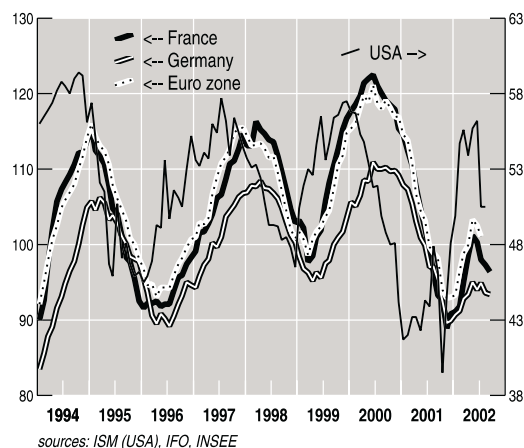
The impact on corporate spending in the euro zone

The decline in business leaders' expectations in the United States is being matched in the three largest countries of the euro zone (see graph 2) and is acting to prolong the stagnation in corporate investment seen since 2001. The composite business climate indicator for euro-zone manufacturing industry levelled off in May and tended to decline slightly during the summer. At the same time, investment in Germany dropped by 2.5% in Q2 and in Italy by 0.6%.

French firms are no exception to this general behaviour of tighter spending and this tendency is likely to continue for the rest of the year. In Q2, both the 0.4% drop in corporate investment and the de-stocking (making a negative contribution of 0.3% to GDP growth) came as a surprise, in view of the strength of

2

INDICATORS OF THE SHORT-TERM ECONOMIC CLIMATE IN INDUSTRY



expectations in industry until May. As in the rest of the euro zone, the business climate in France has since the summer been headed distinctly downwards in manufacturing industry and this could lead to a fall in investment and an intensification of de-stocking in Q3 and Q4 in this branch. Business leaders in the service sector were still optimistic in July about the demand outlook, but are likely to start to show signs of concern, in parallel with the past tendency in demand, which remains unfavourable in this sector.

French firms also imposed a freeze on job creation in H1 and can be expected to do so in H2 as well, given the tendencies in the demand outlook. Moreover, net job creations (excluding state-aided jobs) in the non-competitive sector would be offset by a decline in independent employment. The number of state-aided jobs in the non-competitive sector (CES, CEC⁽¹⁾) would, for its part, fall slightly. As a result, total employment is likely to show a slight decline in H2. Given the upward trend in the labour force, the unemployment rate, which had already been rising slightly since the beginning of the year, could well reach 9.3% by December.

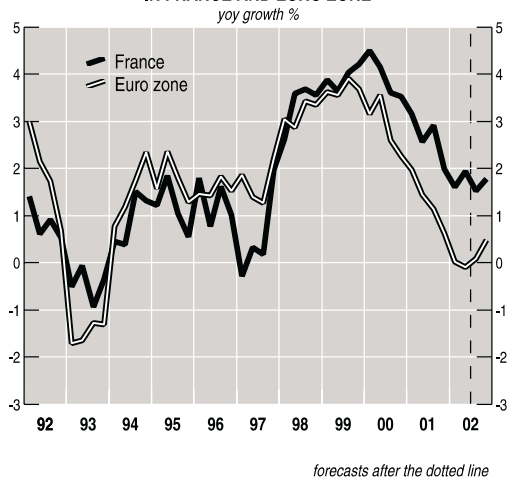
Household spending set to remain a strong feature in France

In the competitive sector, the rise in the unemployment rate is likely to continue to hold back wage growth. In the non-competitive sector, wages can be expected to slow down in H2, given that the next increase in civil service wages and salaries is due in December (0.7%, compared with 0.6% in March and 0.7% in November 2001).

(1) "Contrats-emploi-solidarité", "contrats emploi consolidés" : state-funded or state-aided contracts, mainly in the non-market sector, for job seekers in particularly difficult circumstances.

3

DOMESTIC DEMAND (EX. STOCKS) IN FRANCE AND EURO ZONE



The overall result is slower growth in the total wage bill. At the same time, the year-on-year consumer price rise has increased slightly in Q3, notably as a result of the acceleration in energy and health-care prices. The rise will reach 2.3% in December. The tendency in real income would then weaken in the final part of the year.

In Q4, the cuts in personal income tax can be expected to boost household income. These tax cuts are estimated to amount to almost 5 billion euros, equivalent to roughly 2% of household income in Q4. Past experience with tax cuts, both in France and in other industrialised countries, suggests that households have a strong tendency to smooth out these sporadic additions to income. As a result, only a relatively small part of the tax cuts is likely to be consumed in H2, the result being a substantial and probably temporary rise in the saving ratio.

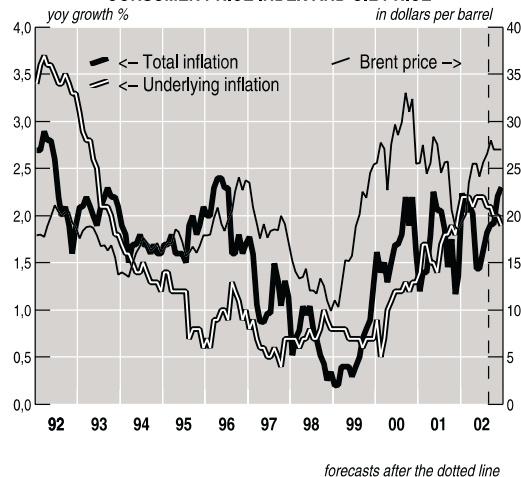
The overall result would be that household consumption would continue to rise at an annual rate of 2.0% in the last part of the year.

The slowdown in world trade likely to have an adverse effect on French activity in the latter part of the year

The slowdown in world demand can be expected to mean a corresponding slowdown in French exports, notably in Q4, given that household spending in the

4

CONSUMER PRICE INDEX AND OIL PRICE



English-speaking countries would no longer be compensating for the persistent slackness of domestic demand in the euro zone.

All things considered, growth in activity in France is likely to remain below potential, but be higher than in the rest of the euro zone

GDP growth in Q2 is likely to be slightly slower than in H1: 0.4% on a quarterly average basis, compared with 0.5% in H1. This would be the reflection of a slowdown in numerous branches, and especially in manufacturing.

There are substantial imponderables in this prediction. Consumption could turn out to be brisker in Q4, given the historically high level reached by the saving ratio. Conversely, exports could be hit by a more substantial deterioration than expected in the international environment, notably in the case of a more appreciable slowdown in the United States. In the event of heightened tension with Iraq, the assumption of an oil price of USD 27/barrel would have to be revised upwards, affecting consumer spending in France and the industrialised countries in general. ■