CONJONCTURE IN FRANCE

Second half of 1998: consumption sheltering growth

The dominant feature of the French economy since the beginning of the year has been the strength of domestic demand. Corporate investment, motivated by a return to more intensive capacity utilisation, rose in the first half of the year at an annual rate of almost 10%. At the same time, household consumption has maintained the sharp recovery that began in mid-1997, making it now the principal growth motor, with year-on-year growth approaching 4%. In this, it is being underpinned by the expansion of employment in the traded sector, with job creation (170,000 in H1) adding to total earned incomes and favouring a fall in the saving ratio. The increase in domestic demand has come at a good moment in that it offsets the negative impact from the foreign trade sector. Exports have stagnated since the beginning of the year, while imports have continued to rise. As a result, GDP growth, although down on the rate seen at the end of 1997, has remained close to 3% in H1 1998.

Since the middle of the year, continental Europe has had to face up to an international environment that is lastingly more restrictive: deepening of the Asian crisis, collapse of Russia, difficulties in Latin America, the stock-market slide, a falling dollar. Even within the euro zone, despite the protection it provides from external turbulence, assured currency stability and low interest rates, the outlook is starting to be eroded.

While the external contribution to GDP is now negative, the momentum of domestic demand remains intact: the latest figures show that household consumption in France is still rising strongly and that corporate investment, although not increasing as fast as in H1, remains firm. The latest industrial surveys in fact show contrasts between individual sectors, with a decline in the intermediate goods sector bringing about a gradual slowdown in industrial output. Following a third quarter continuing on much the same lines as the first half of the year -- and with the figure raised by a quarter of a point as the result of the number of working days -- GDP growth is likely to return to around 2.5% in Q4. Job creations are expected to remain positive, bringing the unemployment rate down to around 11.6% by the end of the year. Against a background of restraint in wage costs, the low prices of raw materials and oil are likely to keep the year-on-year consumer price rise below 1%.

INSEE

An international environment marked by financial crises

In the first half of 1998, the world economy suffered the consequences of the financial crisis that had broken out in Asia in the second half of 1997. All economies have been affected, showing more or less resistance to the shock depending on their degree of exposure to Asia and the solidity of their domestic situation.

Asia is still the zone most affected. In the worst-hit countries, domestic demand has collapsed, with the difficulties of the banking sector impeding the provision of financing for the exports that are alone capable of triggering off recovery. The deterioration in the Japanese situation has been amplified by the crisis in neighbouring emerging countries, the result being a virtually uninterrupted contraction in activity that has lasted for more than a year. The timetable for recovery depends upon the introduction and the effectiveness of the measures announced by the government, especially as regards the banking sector, and above all on whether and when Japanese economic agents regain their confidence.

The summer of 1998 saw the financial crisis spread to other countries, with Russia one of the most affected. After having stabilised in 1997, the Russian economy has plunged back into recession and inflation has built up rapidly, with August seeing a monthly price rise of more than 15%. The Russian crisis has sparked off fresh turbulence on the financial markets and thus amplified the risks of contagion.

The American and European financial markets benefited throughout the first half of the year from the return of capital to safer investments, a move which, among other things, led to substantial falls in interest rates. The decline in prices for industrial raw materials and energy also tended to ward off the inflationary pressures that might have emerged here or there. Even so, the Western economies have not been spared by the Asian crisis. The contraction of domestic demand in Asia has resulted in a distinct slowdown in Western exports, which had previously been highly dynamic. Already in Q1 1998, the external contribution to growth had begun to show a marked deterioration in all countries. In consequence, the capital goods and intermediate goods sectors, whose markets are world-wide, saw their prospects deteriorate.

In the United Kingdom, this tendency has widened the gap between a manufacturing sector already suffering from the high level of sterling and a domestic sector which until the summer was benefiting from firm domestic demand. The Bank of England's monetary stance, which had been steadily tightened until the spring of 1998, inevit-

GROSS DOMESTIC PRODUCT (AT 1980 PRICES)[1] BY TYPE OF EXPENDITURE

(% change from previous period)

		1997				1998				1996	1997	1998
		Q1	Q2	Q3	Q4	Q1	Q2	Q3[2]	Q4			
GDP	(100%)	**0.2**	**1.1**	**0.9**	**0.8**	**0.7**	**0.6**	**0.9**	**0.6**	**1.6**	**2.3**	**3.1**
Imports	(29%)	-0.4	4.5	3.2	1.4	2.5	0.5	**1.5**	**1.3**	3.0	7.7	**7.9**
(of which merchandise)	(26%)	-0.4	4.6	3.1	1.6	2.8	0.6	**1.5**	**1.3**	2.5	7.8	**8.5**
Households' consumption	(60%)	0.1	0.0	1.4	1.0	0.7	1.1	**1.1**	**0.7**	2.0	0.9	**3.7**
General government consumption	(19%)	0.1	0.2	0.2	0.3	0.3	0.4	**0.4**	**0.4**	2.6	1.2	**1.4**
Total investment (GFCF)	(20%)	-1.1	1.1	0.7	0.2	2.0	0.8	**1.1**	**0.7**	-0.5	0.0	**4.2**
Corporate sector[3]	(11%)	-2.5	1.4	1.1	0.6	3.2	1.7	**1.6**	**1.0**	0.6	-0.4	**7.0**
Households	(5%)	-0.6	0.2	0.3	-0.3	0.1	1.6	**0.0**	**0.2**	-1.0	-0.6	**1.4**
Others	(4%)	2.2	1.5	-0.3	-0.2	0.8	-2.4	**1.1**	**0.7**	-2.9	2.1	**-0.2**
Exports	(29%)	1.8	6.2	3.2	1.5	0.8	-0.4	**1.0**	**0.8**	5.2	12.5	**5.4**
(of which merchandise)	(24%)	2.2	6.9	2.3	2.5	1.0	-0.6	**1.1**	**0.9**	5.1	12.9	**6.1**
Domestic demand		-0.6	0.6	1.0	0.8	1.5	1.0	**1.2**	**0.8**	0.6	0.8	**4.3**
Contributions to the growth of GDP												
Inventory changes		-0.4	0.2	-0.1	0.0	0.4	0.0	**0.1**	**0.1**	-0.7	0.0	**0.5**
Trade in goods and services		0.7	0.6	0.0	0.1	-0.5	-0.3	**-0.2**	**-0.1**	0.6	1.5	**-0.6**
Domestic demand excluding inventories		-0.1	0.3	1.0	0.7	0.8	0.9	**1.0**	**0.6**	1.6	0.8	**3.3**

Forecasts

(1) National quartely Accounts evaluate growth at 1980 prices. Growth rates are usually slightly lower once calculated at the prices of the preceeding year.
(2) Calendar effects account for 1/4 point of GDP growth in 1998 Q3.
(3) Corporate and quasi-corporate enterprises (including unincorporated enterprises)

INSEE

ably accentuated the slowdown in the economy, with the services sector now affected.

The United States has stood up better than the United Kingdom to the worsening international environment. Although exports have fallen appreciably, domestic demand excluding inventory changes rose in H1 at an annual rate of more than 6%. Household consumption, which until the summer had benefited from a steady decline in the saving ratio and from positive wealth effects, is now nevertheless likely to slow down in the aftermath of the correction seen on the stock markets. Meanwhile, the outlook for American exports remains depressed as a result of the extension of the financial crisis to markets that are important for American exporters.

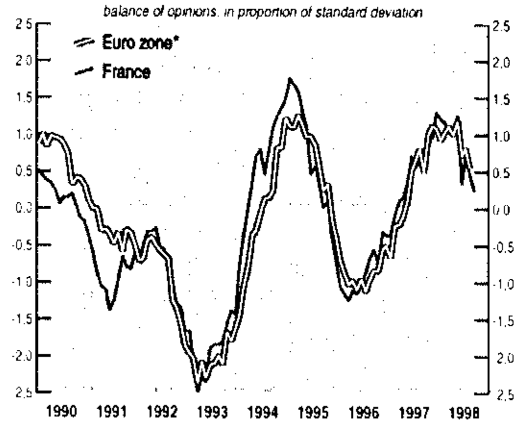
Since the end of 1997, exports have no longer been the principal growth motor in the euro zone. Business surveys in industry show a generalised slowdown in activity and deteriorating export prospects, especially in the most highly internationalised branches. Growth is now being fuelled by the progress of domestic demand. Productive investment has been stimulated by a favourable demand outlook and easy financing conditions. In coming months, the strength of investment will depend on whether firms continue to hold satisfactory views regarding the demand outlook. The deterioration in the international environment and doubts following the fall on the stock markets could well lead firms to postpone some investment projects. As for household consumption, its strength varies from country to country in the light of employment prospects. Consumption remains robust in the Netherlands and Spain, but its recovery still remains to be confirmed in the case of Germany and Italy. Even so, it seems likely to continue to progress everywhere between now and the end of the year.

France has not been spared the consequences

The general pattern seen in the euro zone can be broadly transposed to the French economy, which since the beginning of 1998 has felt the effect of the Asian crisis via a fall in exports. Compared to its partners, domestic demand in France has been particularly strong. World demand has slowed down considerably and is now growing at an annual rate of close to 5%. With exporters no longer enjoying the competitiveness gains built up in 1997, French sales abroad are unlikely to rise to any great extent between now and the end of the year.

While imports remain dynamic, the slowdown in French exports is having an adverse effect on

OUTPUT IN INTERMEDIATE GOODS



Sources : INSEE, IFO, ISCO

* Based on three main countries

activity. GDP growth, which had been at an annual rate of over 3% towards the end of 1997, is thought to have remained close to 3% until the summer and is likely to revert to 2.5% in Q4. Average growth for the year is expected to be 3.1%.

Manufacturing is being hit by the slowdown in exports. According to business surveys, industrial activity slowed down in the summer, hit by the levelling-off in export order books. Although production of cars and capital goods remains lively, there has been a slowdown in the consumer goods industry and especially in intermediate goods. In the latter sector, the slowdown in activity could soon have consequences on factor demand. All in all, after growing at the exceptionally high annual rate of 6% in 1997, and then by 4% in H1 1998, manufacturing output is likely to post a growth rate of close to 3% at the end of the year. Meanwhile, the domestic sectors remain dynamic, with activity in services rising at an annual rate of roughly 4% since mid-1997 and liable to continue at this rate until the end of 1998. As for the construction sector, the recovery took longer to materialise but all the available indicators show it to be solid.

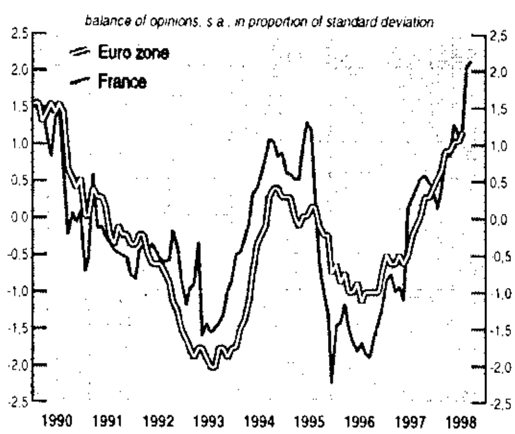
Strong domestic demand ensuring French growth

The continuation of growth in France despite a less buoyant international environment owes much to the strength of earned incomes and of economic agents' confidence. Over the recent past, expectations on the part of both firms and households have remained positive. As regards firms, the prospect of depressed sales prices has somewhat limited stock re-building. On the other hand, business leaders' improved expectations for demand, coupled with a favourable financial environment, have led them to launch investment projects in 1998 that had long been postponed. Already perceptible in the summer of 1997, the upturn in corporate investment intensified in the early part of 1998, bringing the annual growth rate to around 10%. In the summer of 1998, capacity utilisation rates were still well above the long-period average and, despite a slight levelling-off, demand expectations remain favourable. Following the sharp acceleration in the early part of the year, investment seems set to remain firm in H2. Despite the extreme restraint shown by producer prices, companies' financial situations have remained satisfactory as the result of cost-cutting.

While corporate demand has made a distinct contribution to the growth momentum seen since the summer of 1997, the upturn in household demand is perhaps even more conspicuous. Since the spring of 1997, households' expectations have steadily improved. This continuous rise in household confidence is linked to the improvement on the labour market. For the year 1997 as a whole, almost 190,000 dependent jobs were created in the non-farm traded sector. Following a further acceleration in job creation in H1 -- 170,000 on comparable coverage -- 1998 is likely to see total job creations in the non-farm traded sector close to 285,000, a figure not seen since 1989. This figure is before taking account of youth-employment jobs, which would bring the total growth in employment to almost 360,000 for the year. In these circumstances, the decline in unemployment that began in 1997 is set to continue, bringing the unemployment rate down to around 11.6% by the end of 1998.

This notable improvement in the job situation has prompted households to adopt a saving behaviour that is more favourable to consumption. Whereas the household saving ratio had risen by 1.3 of a point in 1997, in the second half of the year it had already begun a decline which seems likely to continue until the end of 1998. Purchases of durable goods have been the first to benefit from this fall in the saving ratio. In the first nine months of 1998, car registrations rose by more than 14% compared with the same period of 1997. In August 1998, purchases of household durables were also 6% up on a year previously.

HOUSEHOLD CONFIDENCE INDEX



Sources: INSEE, European Commission (DGII)

This fall in the saving ratio has been taking place at a time when earned incomes were rising strongly. Total pay received by households is rising at a rate of almost 4%. This rise stems mainly from the improvement in employment, with wage rates themselves remaining restrained. The upturn has been accompanied by a slight increase in underlying inflation, now slightly above 1%. The fall in prices of petroleum products is keeping the year-on-year rise in the overall index below 1%. This continued moderation in inflation should keep the rise in real wage rates above 1% for the year. All in all, household purchasing power can be expected to rise by roughly 3% in 1998. This employment-generated rise in incomes continues to provide the principal growth motor. In coming months, continued growth in consumption will bring its rise for the year as a whole to 3.7%, higher than at any time since the second half of the 1980. ■

Completed on 1st october 1998

Editors: Michel Devilliers, Roland Lescure - **Lay out:** Geneviève Bouyoux - **Translated by:** Francis Wells

INSTITUT NATIONAL DE LA STATISTIQUE ET DES ÉTUDES ÉCONOMIQUES
Headquarters: 18, boulevard Adolphe Pinard 75675 PARIS CEDEX 14 - FRANCE
Publication manager: Paul CHAMPSAUR