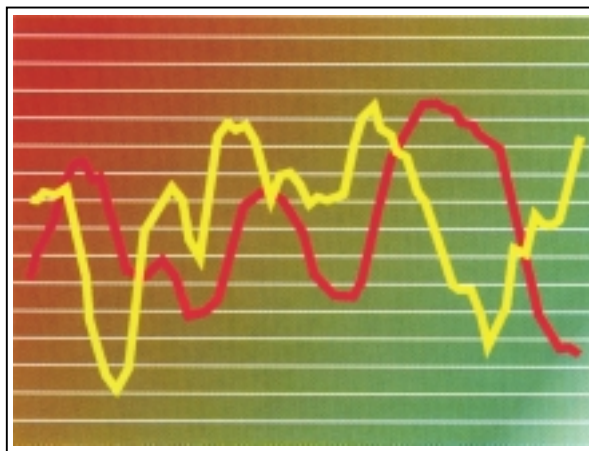


## CONJONCTURE IN FRANCE

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**MARCH 2002**



**THE CLOUDS LIFT**

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## THE CLOUDS LIFT

*The year 2001 marked a levelling-off in the expansionary phase of the French economy. Quite apart from the figure for annual average GDP growth (2.0%), the scale of the slowdown emerges from the very low year-on-year figure (0.9%). This marked slowdown in activity is explained by two specific factors: an exceptional contraction in foreign trade, associated with the simultaneous pause in the expansion of all the major economies, and the rapidity with which firms reacted to the deterioration in the world outlook, which in Europe led to a an intense de-stocking movement and an early reduction in investment spending. The only mainstay of growth in France was the rise in household consumption, which was largely the result of a record (4%) rise in purchasing power. The slowdown in activity brought a halt to the reduction in unemployment from Q2 on, although the increase in employment during the year (1.5%, or 226,000 additional jobs in the market sector) was greater than the year-on-year rise in GDP.*

*The salient feature of the world economy in the early part of 2002 is the increasing number of signs that the United States economy has passed its cyclical trough. Admittedly, the international environment of the euro zone is far from showing uniform improvement. Japan is not out of recession. Activity in the emerging regions, with the exception of certain Asian high-technology producers, is still*

*in a depressed state. However, business leaders' expectations are improving throughout Europe and this is likely to lead to less restrictive behaviour and, in particular, permit a rise in industrial output, a sector whose marked contraction accounted for the whole of the 0.2% decline in GDP in the euro zone in Q4 2001.*

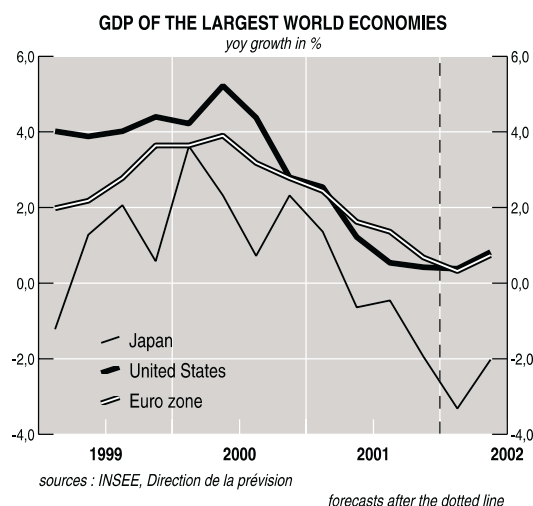
*In France, the more positive view taken by industrial leaders regarding stock levels shows that the return to more neutral corporate demand behaviour has begun. Investment is bottoming out and could return to positive growth as of the end of Q2 2002, especially if a revival in exports were to confirm the improvement in the international climate. The rise in household consumption, although less brisk than in 2001, can be expected to remain close to 2% at annual rate in H1, underpinned by the sharp rises in income towards the end of last year. French households admittedly seem somewhat less inclined to consume, but the concerns stemming from the deterioration of the labour market should be cushioned by the slowdown in the rise in unemployment, with the rate standing at close to 9.2% of the labour force in June. Growth in spending would also be based on a distinct easing of inflation. In the absence of any new external shock, the year-on-year price rise seems likely to be 1.3% in June. In these circumstances, growth should return to an annual rate of close to 2% in Q2.■*

The world economic slowdown that began in the middle of 2000 in the United States persisted throughout the past year, deepening in the second half. Both the United States and the countries making up the euro zone posted declines in activity, in Q3 for the former, Q4 for the latter. France was not spared this general tendency and its GDP showed a fall of 0.1% in Q4.

### Intense deterioration in the business climate at the end of 2001

Against a general background of falling corporate demand, the events of 11 September further worsened expectations. After giving a few faint signs of recovery at the end of the summer, American business leaders' morale slumped in Q4. In France, as in the whole of the euro zone, the worsening of the business climate intensified, to a point even below that reached in the trough of 1996, marked by a virtual stagnation of activity.

The deterioration in expectations led to the cancellation of numerous investment projects. The fall in spending on equipment in the United States persisted, reaching 8% year-on-year at the end of 2001, after having maintained an annual rate of the order of 13% up to mid-2000. Productive investment in the euro zone<sup>(1)</sup> fell less sharply, from a year-on-year change of 7% at end-2000 to -4% at end-2001. In France, the corresponding fall was of the order of ½%, whereas at the end of 2000 it had shown a rise of 11%.



Another consequence of this marked deterioration in expectations was a de-stocking movement, which was on a huge scale from the beginning of last year and persisted in the second half. By the autumn, stock changes were having a negative impact on activity in the United States for the sixth quarter in a row. In all, stock changes trimmed one percentage point off American growth in 2001 and half a point in the case of the euro zone. The contribution for France was negative by 1 point, a result whose only precedent is the 1993 recession. Moreover, leaving aside aircraft and shipbuilding<sup>(2)</sup>, the phenomenon was registered in five consecutive quarters, some-

(1) Based on corporate spending on industrial equipment in the principal countries (France, Germany, Italy and Spain), whose combined GDP accounts for 80% of the euro-zone total.  
(2) Subject to wide quarterly swings, depending on the precise timing of deliveries of ships and aircrafts.

### 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			
<b>GDP</b>	(100%)	<b>0.8</b>	<b>0.9</b>	<b>0.6</b>	<b>1.0</b>	<b>0.4</b>	<b>0.2</b>	<b>0.5</b>	<b>-0.1</b>	<b>0.3</b>	<b>0.5</b>	<b>3.6</b>	<b>2.0</b>	<b>0.8</b>
Imports	(27%)	4.7	3.7	4.0	2.9	-2.2	-1.2	-1.8	-4.7	0.7	0.6	15.4	-0.2	-3.6
(of which merchandises)	(24%)	4.9	3.9	4.4	3.0	-2.6	-1.4	-2.4	-4.8	0.7	0.9	17.0	-0.8	-3.8
Consumption	(54%)	0.6	0.5	0.5	0.4	1.4	0.3	1.1	0.2	0.5	0.6	2.9	2.9	1.6
Public consumption	(24%)	0.4	0.8	0.4	0.8	0.3	0.5	0.8	0.2	0.6	0.6	2.3	2.1	1.7
Investment	(20%)	1.9	2.0	1.3	1.6	0.5	-0.2	0.3	-0.1	0.0	0.1	6.2	2.8	0.1
of which:														
Non financial corporated and unincorporated enterprises	(11%)	1.9	2.4	2.1	2.3	0.2	0.3	0.2	-0.2	-0.2	0.1	7.2	3.8	-0.1
Households	(5%)	2.2	1.4	-0.1	-0.3	0.4	-1.2	0.5	0.0	0.3	0.0	4.6	-0.2	0.3
Exports	(29%)	3.9	4.1	2.5	3.4	-0.6	-1.7	-1.4	-3.8	-0.1	0.3	13.3	1.1	-3.9
(of which merchandises)	(24%)	4.0	4.3	2.1	3.2	-0.7	-2.7	-1.0	-4.3	-0.2	0.5	13.9	0.1	-4.3
Domestic demand		0.8	0.9	0.6	0.8	0.9	0.2	0.8	0.1	0.4	0.5	3.4	2.7	1.3
<b>Contributions to growth</b>														
Internal demand excluding inventory changes		0.8	0.9	0.6	0.8	0.9	0.2	0.8	0.1	0.4	0.5	3.3	2.6	1.3
Inventory changes		0.1	-0.2	0.3	0.1	-0.9	0.2	-0.5	-0.4	0.2	0.1	0.4	-1.0	-0.3
Net foreign trade		-0.1	0.2	-0.3	0.2	0.4	-0.2	0.1	0.1	-0.2	-0.1	-0.2	0.4	-0.2

Forecasts  
\* carry over effect at Q2

thing also not seen since 1993 in France. This persistence of the de-stocking movement throughout the world, unusual to say the least, shows the extent of the additional negative shock provided by the events of 11 September.

### Last year's spectacular decline in world trade

The decline in corporate demand led to a marked diminution in international trade, which then propagated, in intensified form, the shock wave emanating from the United States from one country to another.

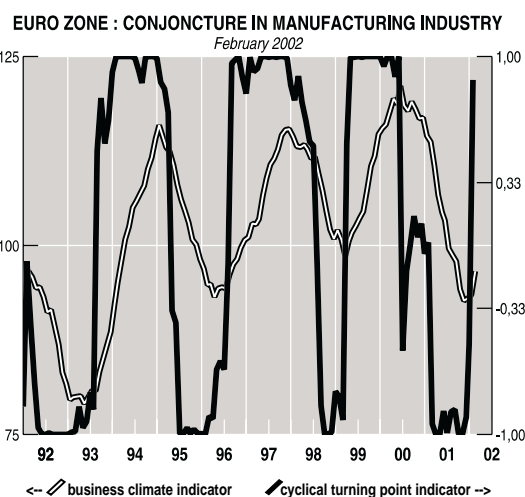
In the first place, the decline affected, as early as H2 2000, the new technologies sector and therefore had an immediate adverse effect on activity in the South-east Asian countries. In the end, however, no country in the world was entirely spared. Japan, which had still not managed to put deflation behind it during the previous upswing, again plunged into recession. The stagnation of the United States economy had a severe effect on Canada and Mexico, while Latin America was hit, in addition, by the crisis in Argentina. The Central and Eastern European countries suffered from the effects of the slowdown in Western Europe.

The decline in the trade flows for the leading euro-zone countries was all the greater in that a wait-and-see attitude on the part of European firms, coming on top of the severe shock to demand from outside the zone, led to a marked diminution in intra-European trade. Exports (including intra-zone trade) eased from year-on-year growth of 12% at end-2000 to a decline of 2% at end-2001, the corresponding figures for imports being +10% and -4%.

France took its place in this general panorama, posting an unprecedented contraction in its exports and imports at the end of last year. The import cycle was amplified by events in the new-technology sector. For example, taking French data<sup>(3)</sup>, this sector accounted for more than 40% of the slowdown in imports of manufactures seen between end-2000 and end-2001.

### Consumption strong in the United States and the United Kingdom

In response to the restrictive behaviour of firms, the economic policy reaction in the United States was highly determined. The Federal Reserve throughout 2001 carried out a policy of sweeping cuts in leading rates. In addition, following the events of 11 September, the United States government considerably stepped up its spending. Excluding general govern-



ment expenditure, GDP would have posted a further fall of 0.1% in Q4 2001, whereas in fact it rose by 0.3%.

In contrast to the sharp decline in corporate demand, private consumption remained the other pillar of United States growth towards the end of the year. Admittedly, the sharp upturn of 1.5% in Q4 is largely explained by car purchases alone, temporarily boosted by an extremely aggressive policy on the part of the carmakers (deep discounts, zero-interest loans for the purchase of new vehicles).

In the United Kingdom, too, it was the exceptional firmness of household spending that underpinned the continuing growth, albeit at a slower rate, of the economy. Private consumption in the UK rose by almost 1% a quarter throughout last year, with the continuing strong rise in incomes in H1 2001 being replaced as the principal driving force in H2 by the marked rise in house prices and the consequent positive effects on household wealth.

### France has weathered the storm better than its euro-zone partners

By comparison with these two countries, household demand in the euro zone was distinctly less dynamic in H2 2001. Following the slowdown posted in 2000, as a result of the reduction in consumer purchasing power brought about by the rise in oil prices and the depreciation of the euro, household demand nevertheless picked up in H1 2001, under the impact of tax cuts introduced in the zone's largest countries (Germany, France, Italy). Since the middle of the year, however, it has again weakened considerably. In particular, slack demand on the part of households,

(3) The calculation made here is based on a somewhat broader aggregate, corresponding to the total of the two branches "electrical and electronic equipment" and "electrical and electronic components".

bearing the full brunt of the deterioration in incomes linked to the activity, is the probable explanation for the recession in Germany.

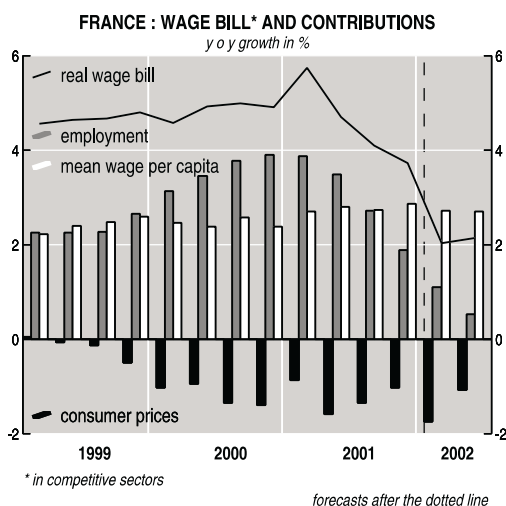
In these circumstances, the growth rate for French consumption stood out by comparison with its leading partners, remaining on an annual upward tendency of the order of 3% in both halves of 2001. This performance is explained by an unprecedented rise in household incomes in 2001, despite the deterioration on the labour market during the year.

### Slowdown in the total wage bill

In fact, dependent employment growth in the competitive sector began to slow down in Q2, following three extremely favourable years. The probable outturn for job creation in 2001 is 230,000, as against almost 570,000 the previous year. In the first place, this decline is linked to the slowdown in economic activity but it is also explained by the weakening of the impact of the reduction in working hours following the major waves of the shift to the 35-hour week by the largest firms in 2000. Taking into account the lags inherent in the productivity cycle, the gradual improvement in activity in H1 2002 is unlikely to stem this movement before next June, with dependent employment in the competitive sector continuing to slow down. Total employment would barely rise, by 0.1% in the first part of 2002, as against 0.6% in H1 2001 and 0.3% in H2.

The weakening of the employment situation has had an unfavourable impact on the tendency in the unemployment rate (ILO definition). Having declined to 8.6% in Q1, it then picked up again in Q2 before stabilising since the beginning of Q3 at 9.0%. In view of the small increase expected in employment, it seems likely to stand at 9.2% this coming June.

The slowdown in employment in the competitive sector has brought with it a decline in the total wage bill, whose growth is set to fall from an annual rate of 6% in the period up to mid-2001 to slightly over 3%



in mid-2002. Meanwhile, wage rates have remained relatively dynamic in the private sector, underpinned by earlier price rises and despite the slow rise in unemployment and the continuing wage restraint linked to the reduction in working hours. The year-on-year change in the average wage per head at the end of the year was therefore much the same as in mid-2001, slightly below 3%. It is likely to remain at this rate until mid-2002.

### Income growth still substantial following the record years 2000 and 2001

The other components of income made it possible to offset the impact of the slowdown in the total wage bill in the competitive sectors. Wages and salaries paid out by general government benefited from successive revaluations of the index applied to gross remuneration. Benefits paid to households also accelerated, as a result of the revaluation of retirement pensions and the rise in unemployment benefits. These benefits should continue to increase at a firm rate in H1 2002. In the final analysis, the slowdown in household disposable income before tax is not as great as in the case of earned income in the competitive sectors, with annual growth falling from the very high rate of around 5% at end-2000 in nominal terms to what is still a robust rate of around 4% in mid-2002.

In addition, households benefited from further tax cuts in H2 2001. The reduction in rates for all income-tax brackets, as well as the introduction of the employment premium (later doubled towards the end of the year), reduced the tax take by roughly 5.2 billion euros (equivalent to 0.6 of a point of gross disposable income).

Finally, the reduction in inflation seen in Q4 and the further reduction expected between now and the end of Q2 2002 are having a favourable effect on purchasing power. After peaking at 2.3% last May, mainly because of the rise in the prices of fresh produce, inflation eased in Q4 in line with the fall in the oil price, to stand at 1.4% at end-December. At the same time, underlying inflation has continued its slow rise, reflecting the passing on of earlier rises in the oil price and the depreciation of the euro. Between now and the end of Q2, on the assumption of a USD/EUR exchange rate of 0.88 and an oil price close to USD 22/barrel, the impact of imported inflation is likely to be limited. Underlying inflation, which reached 2.2% in February, is expected to ease slowly, to stand at 1.9% next June. Following the marked upturn recorded in the early part of 2002, mainly as a result of a further surge in the price of fresh produce<sup>(4)</sup>, the decline in overall inflation is set to resume, reaching 3% in June and benefiting in par-

(4) An initial estimate puts the impact of the changeover to the euro on the year-on-year price rise in France in January at around 0.1 of a point.



ticular from the exit from the year-on-year calculation of the price rises recorded last spring for fruit and vegetables.

Everything considered, following two years in which purchasing power rose at record rates (3.6% in 2000, 4.0% in 2001), household disposable income is likely to slow down in the early part of the year but remain on a generally favourable upward path. In mid-2002, the statistical carry-over would be 1.8%, compared with 2.9% in mid-2001.

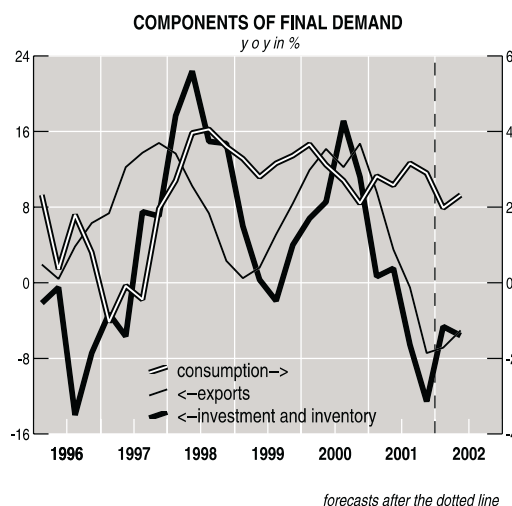
## French consumption still solid in H1 2002

This slowdown in incomes would bring with it a slowdown in consumption, likely to grow at a rate of around 2% within the time frame of this Note, compared with 3% in 2001.

Expenditure on manufactures is likely to slow down to an annual rate of about 1.5%. In particular, car purchases have weakened somewhat in the first two months of the year. Consumption of services, for its part, is likely to continue to grow at an annual rate above 3%, benefiting from a recovery in tourism-linked expenditure.

The resulting overall growth rate is compatible with a stabilisation of the saving ratio at the high average level recorded for 2001. Last year's rise of almost 1 percentage point in the saving ratio is explained in the first place by the acceleration in income growth, but the decline in household confidence and the worsening of the labour market in 2001 also probably contributed to the scale of the increase. In H1 2002, the precautionary saving imputable to the rise in unemployment is likely to be counterbalanced by traditional trade-off behaviour aimed at cushioning the slowdown in income.

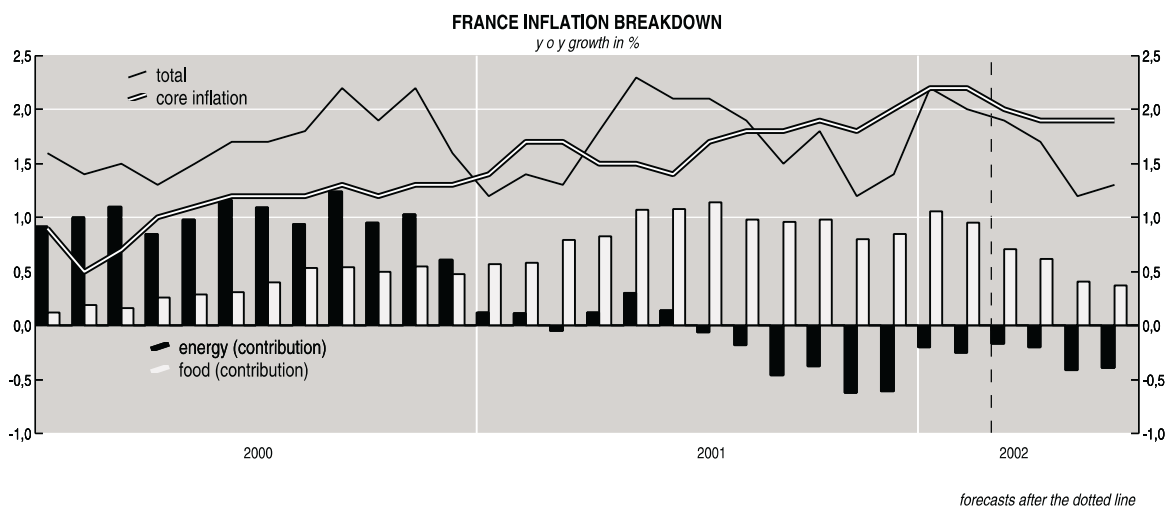
This scenario of consumption growth would also apply to the other countries of the euro zone, but in a minor key. The rise in European household demand is likely to be at an annualised rate of between 1.5%



and 2% in H1 2002. Against a background of slowdown in nominal incomes, the slight improvement would be linked to the disinflationary tendency. The consumer price rise in the euro zone fell from a peak of 3.4% in May 2001 to 2.4% in February and can be expected to be no more than 1.7% by June 2002. Meanwhile, after deteriorating in 2001, European household confidence has stabilised in the past two months, remaining slightly above its long-period average.

## Perceptible signs of recovery in activity in the early part of the year

Certain signs of recovery in the world economy have emerged in the early part of this year. Industry in Southeast Asia, a major exporter of electronic goods, is now experiencing an upturn. The figures for industrial output in January 2002 showed strong year-on-year growth in Korea (6%) and Taiwan (15%). This shows that the new technology sector, where the downturn had been the trigger for the slowdown in the world economy in 2000, seems to be regaining strength.

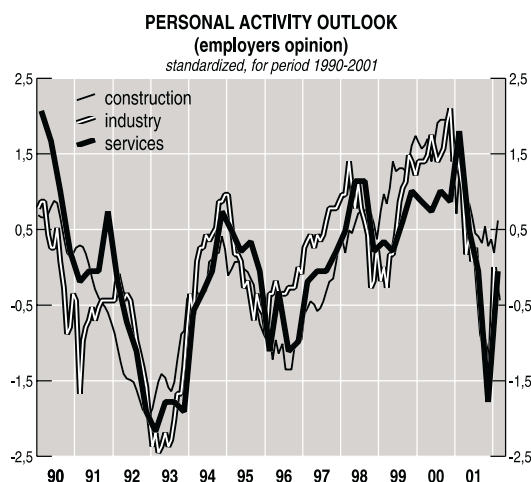
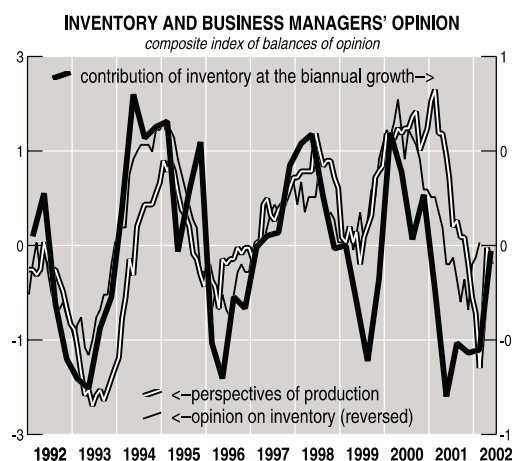


Increasing signs of a revival in activity are also to be seen in the United States. American businessmen's morale, which had been at a low point in October 2001, has picked up decidedly in recent months, returning to its Q2 2000 level. Moreover, the worst seems to be over in the United States as regards workforce adjustment. After the massive (over one million) job losses posted in 2001, the first indicators available since January are pointing to a slight improvement. The unemployment rate, which had risen from 4.0% to 5.8% between December 2000 and December 2001, fell back to 5.5% in February 2002. This suggests that GDP growth should be back on a decidedly positive tendency by Q2.

Above all, the business surveys indicate an improvement in the outlook reported by firms in the euro zone. INSEE's composite business climate index, which encapsulates the mood of surveys in European manufacturing industry, has been rising again since December. Meanwhile, our euro-zone turning-point indicator, which had been at its lowest point since April 2001, moved back into positive territory in February. While this improvement in expectations is for the time being merely a correction of the additional drop recorded in Q4, it makes it possible to expect a recovery in industrial activity in Europe in the short term. Industrial leaders had substantially run down their stocks throughout 2001 and their renewed confidence can be expected in the first place to be reflected in a perceived need to rebuild stocks, or at least apply less restrictive inventory behaviour.

France is participating in this improvement. The prospects for own-firm production reported by industrial business leaders have picked up substantially and their views regarding stock levels are more favourable. The improved outlook reported in the latest business surveys is not confined to manufacturing industry. A similar tendency is to be seen in services and, to a smaller extent, in wholesale and trade. The building and public works sector, for its part, continues to post a high level of activity, even though it is now growing only very slowly following the rapid growth in the years 1998 to 2000.

In these circumstances, whereas the contribution from stock changes had a major negative impact on French growth throughout 2001, it can now be expected, as a corollary, to be positive for activity throughout H1 2002, contributing roughly one-third of the growth. The revived momentum in inter-industry trade should set foreign trade once more on an upward path, for both France and the euro zone as a whole. With capacity utilisation rates continuing to fall until the end of 2001 and with profit margins unlikely to do better than level out in H1 2002, these



positive signs are too recent for one to be able to count on a clear-cut acceleration in investment in the very short term, in either France or the euro zone. But a levelling out is nevertheless likely by the end of Q2, with the ECB's monetary policy, which is on the accommodating side, presenting no obstacle to a subsequent upturn, once business leaders take the view that the improvement in the prospects for demand is set to last.

All in all, following a marked slowdown in French activity in 2001, with GDP actually falling slightly in Q4, it can now be expected to pick up gradually to an annualised rate of close to 2% in Q2 2002. This would match the growth pattern expected for the euro zone as a whole. ■