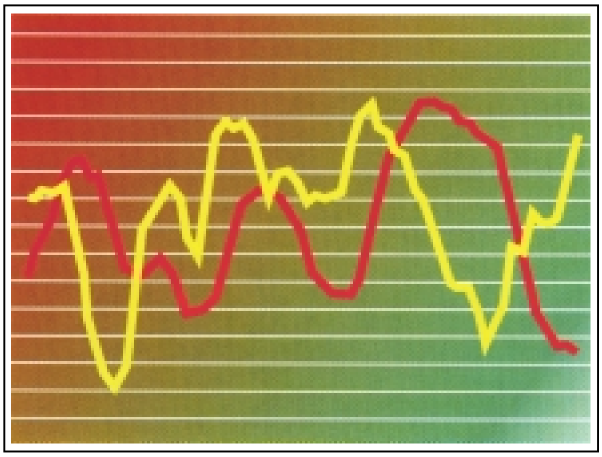
INSEE CONJONCTURE

CONJONCTURE IN FRANCE

MARCH 2000



STEADY SPEED

INSEE
FRANCE

STEADY SPEED

With the strength of the rebound observed since last spring, 1999 has demonstrated the robustness of the expansion phase in progress for the past three years. Unaffected by the "air pocket", last year's results are among the best of the decade: average growth of 2.7 percent (3.2 percent year-on-year), moderate underlying inflation, and, above all, the creation of 465,000 jobs (including 370,000 in the business sector) which led to a reduction of nearly one point in the unemployment rate. This performance reflects the stability of a sustained contribution from domestic demand (for investment as well as consumption), and the privileged role of sectors such as construction and automotive. But the acceleration in the French economy since spring is also attributable to restored strength in world demand.

At the beginning of 2000, the international environment of the euro zone is still quite promising. Exchange rate conditions are in fact quite favourable to European exports, which benefited from an 8 percent increase in world trade following the spurt registered last summer. U.S. economic growth remains buoyant as the result of sustained domestic demand, and its strong performance does not seem to be truly affected by tightened monetary policy or eroded wealth effects. However, the imbalances in the U.S. economy are substantial. In particular, there is an ever-present risk of a sharp adjustment on stock markets. The vigorous recovery continues in the UK economy—though with growing inflationary pressures. Of the major industrial countries, only Japan remains sidelined from world growth said to be nearing 4 percent this year. In the euro zone, Italy and Germany are benefiting from the world trade recovery to reduce their gap in growth rates. As economic activity is no longer accelerating in Spain and the Netherlands, growth gaps within the zone are narrowing around an average of 3.5 percent.

This growth rate has been observed in the French economy for three quarters, and the short-term economic surveys suggest that the conditions are present for this growth to continue. Ongoing expansion in investment can be expected, with a sound growth outlook and favourable monetary conditions. Job creation should remain vigorous (200,000 jobs in the business sector) during H1, leading to increased earned income and a reduction in the unemployment rate to 10 percent in mid-2000. Against this backdrop, household consumption expenditure should remain at 3 percent, with lower savings ratios offsetting the decline in purchasing power associated with higher inflation. Year on year headline inflation peaked at 1.6 percent in January. With the stabilisation of oil prices and the decrease in the value-added tax (VAT), this figure should decline to 1.2 percent by June. With the continued expansionary phase, pressures should continue to increase. However, neither their present level nor the increase in interest rates that they foster will be sufficient to dampen the growth rate in the short term.

U.S. growth with some risks

The dynamic performance of the U.S. economy is clear, with a growth rate of over 6 percent during the H2 1999. Past growth in the securities and real property markets continued to fuel robust consumption levels. Investment remained extremely vigorous despite the rise in long-term rates. Vigorous growth in economic activity can be expected to continue in H1 2000, driven by sustained domestic demand—even if some factors indicate a slight decline in household expenditure. The rise in inflation associated with the uptick in oil prices has indeed led to reduced purchasing power. Soaring high-tech securities prices are not fully offsetting the stagnation in traditional securities registered since May 1999. Securities market trends should therefore not be expected to sustain household consumption as strongly through the wealth effect.

This dynamic domestic demand performance has not yet led to increased real-sector inflationary pressures. Aside from energy and food products, inflation in January 2000 remained below 2 percent. Labour cost increases generated by a tight labour market have been offset completely by exceptional productivity gains. The production capacity utilisation rate remains close to its long-term average.

The boom in prices for certain financial assets, however, is still a wild card in this scenario of strong, regular growth. In particular, expected profits from NASDAQ securities associated with new technologies might seem excessively optimistic. The risk of a sharp adjustment said to weigh against domestic demand is therefore still present.

Technical rebound in Japan

Japan's economic activity stagnated in 1999 (up an annual average of 0.3 percent) with a net decline during H2. The outlook for H1 2000 is less pessimistic—though it is by no means outstanding. Growth in economic activity of approximately 2.5 percent might be expected, attributable subs-

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

(at 1995 prices seasonally and working-day adjusted data (1), % change from previous period)

		1998				1999				2000		1998	1999	2000*
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	**(100%)**	**0,9**	**0,9**	**0,4**	**0,7**	**0,4**	**0,8**	**1,0**	**0,9**	**0,9**	**0,9**	**3,4**	**2,7**	**3,0**
Imports	(23%)	2,9	1,3	0,5	0,2	-0,9	2,2	2,3	2,9	2,1	2,1	9,6	3,3	7,7
(of which merchandises)	(20%)	3,3	1,2	0,7	0,6	-0,3	2,0	2,6	4,0	2,1	2,2	10,4	4,6	8,7
Consumption	(54%)	0,8	1,3	0,5	0,6	0,3	0,6	0,7	0,7	0,8	0,7	3,6	2,3	2,4
Public consumption	(23%)	0,1	0,4	0,2	0,3	0,6	0,4	0,3	0,9	0,2	0,5	1,0	1,7	1,6
Investment	(19%)	1,5	1,7	1,4	1,7	2,4	1,2	1,4	1,7	1,4	1,3	6,1	7,0	4,7
of which :														
Non financial corporated and unincorporated enterprises	(10%)	*2,1*	*1,9*	*1,5*	*1,2*	*3,1*	*0,8*	*1,7*	*2,0*	*1,5*	*1,5*	*7,3*	*7,4*	*5,3*
Households	(4%)	*-0,1*	*1,6*	*0,8*	*2,8*	*1,9*	*2,7*	*0,7*	*1,3*	*1,5*	*0,9*	*3,4*	*7,8*	*4,3*
Exports	(26%)	1,0	0,8	0,7	-1,0	-0,7	2,8	4,4	0,5	2,1	2,0	6,9	3,6	7,0
(of which merchandises)	(21%)	1,7	0,6	0,9	-1,1	-0,5	3,0	5,4	1,0	2,1	2,3	7,8	4,5	8,2
Domestic demand		0,7	1,2	0,6	0,8	0,8	0,7	0,8	1,0	0,8	0,7	3,4	3,1	2,6
Contributions to growth														
Internal demand excluding inventory changes(2)		0,7	1,1	0,6	0,7	0,8	0,7	0,7	0,9	0,8	0,7	3,3	3,0	2,6
Inventory changes(2)		0,6	-0,2	-0,2	0,2	-0,4	0,0	-0,4	0,5	0,1	0,1	0,4	-0,4	0,4
Net foreign trade		-0,4	-0,1	0,1	-0,3	0,0	0,2	0,6	-0,6	0,0	0,0	-0,4	0,2	0,0

Forecasts

***** *Carry over effect at Q2*

(1) National Quarterly Accounts evaluate growth at 1995 prices. Growth rates are usually slightly different once calculated at the prices of the preceeding year.

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

tantially to a technical recovery and supplementary budgetary stimulation.

The Asian recovery is clearly the source of this partial recovery in industry, and in the confidence of Japanese entrepreneurs. However, the low degree of openess to trade and the appreciation of the yen will prevent dynamic world trade performance from driving a net recovery in growth at the beginning of 2000. Domestic demand in fact is still subdued. Household revenue has suffered from wage cuts and increased youth unemployment. Household confidence, after a rebound during H1 1999, might still be affected by the deterioration of the labour market. Enterprise demand should not be expected to perform much better, as the result of difficulties in gaining access to credit.

While monetary policy has exhausted its room for manoeuvre, the deflationary economic backdrop is forcing the new government to replace private consumption with public consumption. Although these measures should provisionally support growth, they may cause the public deficit to widen beyond 8 GDP points in 2000.

Growth and inflationary pressures in the UK

In 1999, the UK achieved a growth rate on the order of 3.5 percent, benefiting from dynamic consumption and an upturn in world trade. Growth might be expected to slow somewhat, to approximately 3 percent during H1 2000, reflecting tighter monetary policy to address the pressures observed in the economy.

Exports can be expected to remain dynamic. Foreign industrial order books should continue to be quite full despite the strong pound sterling. Sustained household demand should remain the principal source of growth during H1 2000. As the result of labour market pressures, with an unemployment rate of 4.1 percent in December 1999, dynamic real wage performance should substantially raise household purchasing power. UK consumption also benefits from household wealth gains as the result of the increase in real property prices and the past rise in shares. Enterprise investment can be expected to remain fairly dynamic during H1 2000, even if tightened interest rates dampen financing conditions.

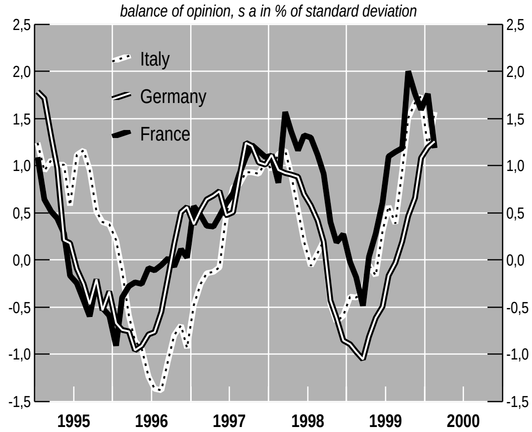
Economic recovery is accompanied by pressures. Production prices are accelerating, primarily as the result of the uptick in production costs, reflecting higher intermediate goods prices and wage accelerations. Industrial price expectations showed an upward trend in January 2000. Consumer prices in the service sector have accelerated substantially since mid-1999. Real property prices, which are partially behind the dynamic consumption performance, continues to accelerate sharply at the beginning of 2000, with the Halifax up 16 percent in January, year-on-year.

Sustained growth in the euro zone

Activity accelerated in 1999 to reach a growth rate of just under 4 percent during H2. The industry recovery evident last summer, driven by the upturn in world trade, was accompanied by a slight acceleration in domestic demand during H2—performance that can be expected to continue during H1 2000. The international environment might be slightly less promising, and the acceleration of industrial production might be expected to stop, though investment and consumption should remain vigorous. On the whole, economic activity should grow at an annualised rate of approximately 3.5 percent. Overall activity in the zone, fostered

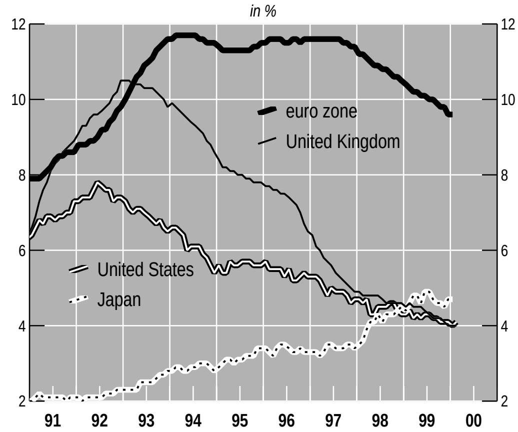
PRODUCTION PROSPECTS IN THE EURO ZONE MANUFACTURING INDUSTRY

balance of opinion, s a in % of standard deviation



UNEMPLOYMENT RATE

in %



sources : national authorities,Eurostat by still-favourable monetary conditions and reduced unemployment, seems to be situated at a sustained growth level, where inflationary pressures should remain fairly limited.

This vigorous performance is a common denominator among most countries in the zone. Germany recovered much of its lag during the H2 1999 and may achieve the overall growth rate for the euro zone during H1 2000. Italy, which remained on the sidelines at the end of last year, can be expected to step up its performance at the beginning of the year.

In a less buoyant international context, with the end of the recovery for the Asian countries and a slight shift in the UK, exports from the euro zone can be expected to slow to some extent.

In step with this slight downturn, the acceleration in industrial activity can be expected to end in early 2000. The latest short-term economic indicators suggest that the industrial recovery has peaked. After a rapid improvement in spring 1999, leading to opinions exceeding their maximum levels from the previous cycle, surveys seem to be levelling off. For the first two months of the year, the balance on production outlooks has ceased to improve, while there has been a slight decline in opinions on past production.

Dynamic investment can be expected. Pressures on the productive apparatus have been more evident for the past two quarters. The demand outlook is still quite favourable, and increasing interest rates have generated only a slight rise in financing costs.

Household consumption should be sustained with the improved employment situation. This level should increase at a rate of slightly over 3 percent during H1 2000. Job creations should sustain household purchasing power, despite some wage moderation and an uptick in inflation. The decrease in the unemployment rate from 10.4 percent at end-1998 to 9.6 percent at end-1999 helped improve consumer confidence and reduce precautionary savings.

Inflationary pressures remain moderate in the euro zone. The year on year inflation rate for the harmonised European consumer price index (IPCH) was +2.0 percent in February 2000, as against +0.8 percent a year earlier. This resurgence of inflation can be attributed substantially to the rise in oil and input prices. The impact will continue mechanically until the end of H1, when inflation may remain above 2 percent. Underlying inflation should increase only gradually, and in fact should remain limited because of wage moderation containing the "second round" effects of oil price increases, and heightened competition in several service sectors.

Regular expansion in France

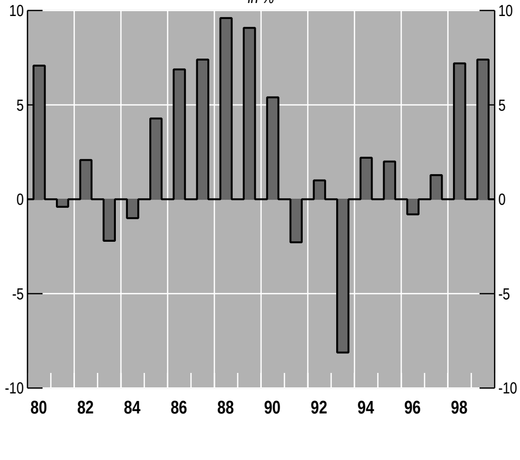
Activity accelerated somewhat earlier in France than in the rest of the euro zone in 1999. Manufacturing production began to rebound during H2 to reach a trend of approximately 6 percent, which continued throughout the year. The spill-over effects of this industrial rebound on other sectors led to regular growth in overall activity during H2 1999. Growth during this period reached an annual rate of near 4 percent.

Domestic demand will clearly stay strong during H1 2000, so that growth will remain on the same course. This phase of regular expansion, sustained by favourable monetary conditions, is supported by vigorous export and domestic demand performance. It is characterised by strong investment and employment and robust consumption levels, accompanied by increased inflationary pressures—especially in certain particularly stressed sectors such as automotive and construction. However, these pressures now only partially show in costs and prices.

French exports can be expected to remain dynamic. The lower increase registered during Q4 1999 in fact is not indicative of a substantial slowdown. Instead, it reflects an adjustment following exceptional performance during Q3. Since Q2 1999, exports have grown at an annualised rate of more than 10 percent. This level can be expected to exceed 8 percent during H1 2000. The decline in world demand should not be excessive, and its effects should be offset in part by gains in competitiveness of the euro, which has depreciated by 12.5 percent vis-à-vis the dollar since the beginning of 1999.

FRANCE : BUSINESS SECTOR INVESTMENT GROWTH

in %



Reduced working week and cost of labour per hour

N.B.: The use of a number of assumptions and approximations was required in preparing the estimates presented below. These trends should be considered with caution, as they leave scope for substantial revision. In particular, changes in the effective number of working hours are not provided by the national accounting system—they are instead estimated on the basis of the Survey on Labour Activity and Employment Status (ACEMO), for past figures, while projections are based on the flow of entries into negotiated schemes and the estimated effects of provisions under the law.

Implementation of the shorter working week is accompanied with the mechanical effect of hourly wage acceleration. A decrease in effective working time in fact entails a commensurate increase in hourly wages in order to maintain the same level of monthly remuneration (full offsetting). In this connection, a reduced working week for an employee is different than moving the employee to part-time status, which entails a decrease in monthly remuneration as well as working time (with an unchanged hourly wage). Accordingly, despite the reduction in monthly wages, provisional results from the ACEMO survey show a sharp increase in hourly wages. For blue-collar workers alone, the basic hourly earnings (SHBO) increased by more than 2 percent during H2 1999.

It is therefore a complex exercise to monitor short-term wage costs. As the shorter working week becomes more widespread, hourly wages will continue to increase at a more sustained rate than monthly wages. In other words, this process may lead to increasing labour costs. To understand these trends fully, however, our assessment should also consider supplementary relief of fees and taxes applicable to the labour factor.

This section proposes a number of factors for monitoring hourly labour costs in connection with the reduced working week. The estimates suggest that a slight acceleration can be expected in the nominal hourly cost of labour (also including a reduced business tax on wages), at a rate of +2.5 percent per annum at the beginning of 2000, as against the prior level of +2.0 percent.

Hourly labour cost (in the business sector)

(quarterly growth rate, in %)

	1998				**1999**				**2000** *(f)*	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4** *(f)*	**Q1**	**Q2**
Average monthly wage (1)	0,4	0,5	0,5	0,5	0,5	0,5	0,4	0,5	0,5	0,5
- weekly worktime change	-0,1	-0,0	-0,0	-0,0	-0,1	-0,1	-0,3	-0,4	-0,4	-0,4
= Hourly wage	0,5	0,5	0,6	0,5	0,6	0,6	0,7	0,9	0,9	0,9
+ Contribution from cuts in social contributions	0,2	0,0	-0,2	0,2	0,0	0,0	-0,2	-0,1	-0,2	-0,1
= Hourly labour cost (in terms of National Accounts) (2) (3)	0,8	0,5	0,3	0,7	0,6	0,6	0,5	0,8	0,7	0,8
+ Contribution from cuts of the "wage component" of the business tax ("taxe professionnelle") (4)	0,0	0,0	0,0	0,0	-0,3	-0,1	-0,1	-0,1	-0,1	-0,1
= consolidated hourly labour cost (incl. " taxe professionnelle")	0,8	0,5	0,4	0,7	0,3	0,5	0,4	0,8	0,6	0,7
- Hourly Productivity	0,4	0,7	-0,4	0,2	0,1	0,4	0,5	1,0	0,9	0,9
= Consolidated Unit labour Cost	0,4	-0,1	0,7	0,5	0,2	0,1	0,0	-0,2	-0,3	-0,2

(f) Forecast
(1) Average Monthly compensation per employee converted in terms of full-time job (thus corrected for the trend in part-time).
(2) (total compensation for employees + social contributions and taxes on labour) / worktime
note : the "wage component" of the "taxe professionnelle" is accounted for in "autres impôts sur la production" in the National Accounting System, and thus does not appear in the usual labour cost concept.
(3) The growth of hourly labour cost is decomposed in its main components with the following equation : $\Delta c/c=\Delta w/w-\Delta h/h+\Delta(1+t)/(1+t)$ with $\Delta c/c$=hourly labour cost growth, $\Delta w/w$=monthly wage growth, $\Delta h/h$=weekly worktime growth, and $\Delta(1+t)/(1+t)$=growth of social contributions and tax on labour
(4) The wage component of the "taxe professionnelle" is set to progressively decrease by an amount of approximately 10 billions FR up to 2003.

More specifically, this change in hourly costs is broken down as follows (see table).

- **Moderate growth (+2 percent) in average wages can be expected to prevail** at the beginning of 2000, particularly with the assumption that the price shock associated with the increase in oil prices during H2 1999 would have little effect on wages, at least in this time frame.

- **As the result of the shorter working week, a rate of increase in hourly wages of approximately 3.5 percent can be expected.** The working week should in fact decrease at an annualised rate of nearly +1.5 percent at the beginning of 2000. Projected working weeks are determined by the flow of entries into the negotiated reduced working week scheme, and, for wage-earners not covered by an agreement, reflect the application, with effect from February 2000, of the provisional legislative scheme on overtime (which provides an automatic 10 percent premium in the form of compensatory leave for overtime in the range of 35-39 hours per week).

- **Cost reductions will make it possible to limit the increase in the hourly cost of labour (as defined in the national accounting system) to approximately 3 percent.** Additional reductions in employer contributions should in fact help reduce the cost of labour by nearly 0.5 percent (on an annualised basis) at the beginning of 2000. These reductions reflect the extension of the regressive cut in social contributions (*ristourne dégressive*) in the form of a single exemption schedule—regressive to 1.8 Smic (index-linked minimum growth wage), beyond which a flat rate of F 4,000 is applied.

- **After reflecting the gradual elimination of the "wage" component of the business tax, the "consolidated" hourly wage cost (no longer a national accounting concept) would increase at a rate of approximately 2.5 percent.** The reduction in the business tax should in fact help lower wage costs by nearly 0.5 percent. All of these fee and tax reductions combined would offset two-thirds of the upward pressure associated with the reduced working week (1 percent, as against 1.5 percent).

Last, with the productivity gains accompanying the projected upturn in economic activity, unit labour costs can be expected to decline slightly at the beginning of 2000. Accordingly, with the combined effects of buoyant activity, tax reductions, and provisional application modalities for the law on the 35-hour work week, wages, and costs, the unit wage cost will not be affected during H1 2000. ■

Dynamic investment and employment

High levels of production capacity use and a favourable outlook for demand should help sustain vigorous enterprise investment. Financing conditions remain positive as the result of interest rates that are still quite moderate, despite their recent increase. The December storms can be expected to generate a slight rise in construction expenditure. Only software investments may slow somewhat during H1 2000 following the Y2K readiness effort. With an annually-adjusted growth rate of 6 percent in H1 2000, capital expenditure should continue to be consistent with the high-performance scenario that has been uninterrupted since it began in mid-1997. Enterprise investment efforts remained as strong in 1999 as during the prior year, increasing at an annual average of 7.4 percent, as against 7.3%, a level clearly higher than observed during the recovery of 1994-1995.

This capital investment effort has been accompanied by unprecedented growth in employment. With 465,000 additional jobs (as against 385,000 in 1998), exceptional levels of job creation were registered in 1999. In the business sector, the increase in dependent employment (+370,000) results from buoyant activity , labour cost reduction efforts undertaken several years ago, and the short-term effects of the reduced working week. During H1 2000, payroll job creations will continue at a sustained rate in line with economic activity. Payroll job creations can be expected to reach approximately 200,000 in the commercial sector, while total employment should increase by 1 percent.

This exceptional job creation rate led to a rapid decline in unemployment in 1999, of around 1 point per year. This fall was clearly accentuated during H2 1999, in step with accelerated economic activity. Still benefiting from sustained job creations during the coming months, the unemployment rate can be expected to fall by approximately 0.5 point to 10 percent of the active population by end-June 2000.

Against this backdrop, household confidence remains quite high. The composite consumer confidence indicator increased throughout 1999 to reach historic levels at the end of the year—which have been maintained at the beginning of 2000. This stimulated household consumption. After a slight decline at the beginning of 1999, consumption regained a fairly sustained rate of growth in line with the increase in purchasing power and revenue. This performance should continue during H1 2000. Consumption expenditure can be expected to continue to grow at an annual rate of nearly 3 percent. Accordingly, the savings ratio should decrease slightly as the result of reduced unemployment and perhaps higher stock prices.

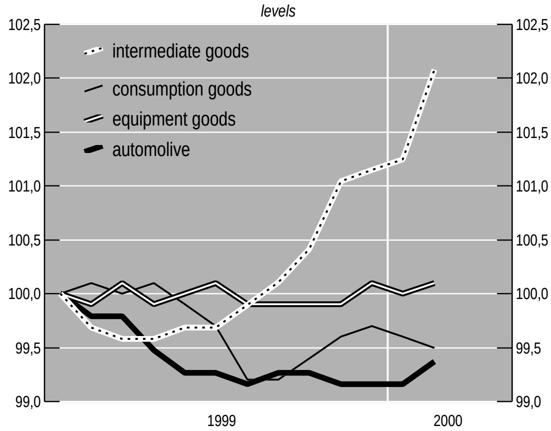
Increased real pressures, moderate rise in underlying inflation

Since the beginning of 1999, vigorous activity has been accompanied by increased pressures on the productive apparatus. These pressures are particularly acute in the automotive sector. Production bottlenecks in the construction sector have increased substantially during recent months, primarily as the result of recruitment problems.

In addition, upstream from the production line, the factors that led to reduced consumer prices at the beginning of 1999 gradually returned so that the context appears more inflationary. A clear increase was registered in imported input prices as the result of the combined effects of higher oil prices and the impact of the world recovery on the prices of other commodities. In connection with accelerated activity since last spring, this increase in input prices explains higher personal outlook on prices in industry. Industrial sales prices are now on the rise, substantially in intermediate goods.

However, inflationary tensions are still kept in check. Headline inflation reached +1.3 percent at the end of the year, as against +0.3% at end-1998. The direct effects of the increase in petroleum product prices contributed 0.9 point to the annual drift in the composite index at end-1999. These effects should peak at 1.2 points in spring and then dissipate gradually with the stabilisation of oil prices. Underlying inflation, which excludes volatile-price products, has remained near +0.7 percent throughout 1999.

PRODUCTION PRICE INDICES
levels



The ”second-round” effects induced by the increase in energy prices should be tamed as the result of intense competition in industry within the euro zone and the relative weight of less energy-intensive services, particularly in France. Most importantly, despite the resurgence of inflation, wage moderation seems to have been prevailing. The annual monthly base wage (SMB) growth rate has remained virtually stable during Q4 1999 (+1.7 percent, as against +1.6 percent during Q3), and is not expected to accelerate appreciably in the short term. Last, intensified competition, primarily in the transport and communications sector, continues to limit service price increases.

With the peaking of oil price increase effects, inflation should reach a spike at +1.6 percent at the beginning of the year, and should subsequently decline to +1.2 percent by end-June as the result of the decrease in the regular VAT rate. Underlying inflation can be expected to rise slightly to 1.0 percent in June 2000, just above the level observed at end-1999, as the result of vigorous activity and the effects of the past increase in production costs. ■

Inflationary in France

From certain standpoints, the increased pressures observed since the beginning of the recovery in 1997 are comparable to those registered during the period of intense expansion in the late 1980s. Yet, the more recent price trends and inflation expectations are still much more moderate. The resurgence of real pressures is therefore not expected to jeopardise the reduction of underlying inflation in the short term.

Increased pressures on production capacities

Since the beginning of 1999, robust economic activity has been accompanied by additional pressures on the productive apparatus. Production capacity utilisation rates in the manufacturing industry have increased by nearly 1.5 points during the past six months, now situated at more than 2 points above their average long-term level. Pressures are particularly intense in the automotive sector. Production bottlenecks in the manufacturing industry have virtually reached an historic high. There has been a substantial rise in production bottlenecks in the construction sector in recent months. Opinion levels are now comparable to (and possibly higher than) those registered at the end of the 1980s.

Increased pressures on the labour market

Improved employment levels since 1997 and vigorous economic activity are accompanied with increased recruitment problems in industry and construction. The decrease in employment at the end of the 1980s was also accompanied by labour market pressures. However, surveys show a contrasting image of the relative scope of the pressures observed today and those present during the late-1980s. Fewer recruitment problems are observed in industry at the present time than at the end of the 1980s, while the present rate of increase is less sustained. By contrast, recruitment problems in construction have regained their 1990-1991 highs. Further, while the unemployment level of the late 1980s is substantially lower than the present level, it is now declining more quickly than it did during the earlier period.

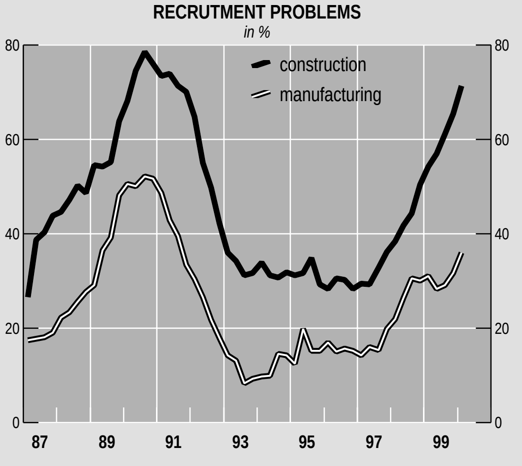
No real wage acceleration

At the end of the 1980s, there was a sharp real wage acceleration, in particular, with growth rates exceeding 3 percent at end-1989. By contrast, no real wage acceleration has been observed in connection with the present recovery. Still, real wages did accelerate by approximately 2 percent per annum between mid-1997 and early 1999. However, this acceleration resulted primarily from an unexpected decrease in inflation with the drop in oil prices. On the other hand, the increase in real wages stabilised from the beginning of 1999, with the resurgence of inflation. Assessed in connection with underlying inflation, which provides a more accurate reflection of inflation trends, real wages have been increasing at a regular rate of approximately 1 percent per annum since 1995.

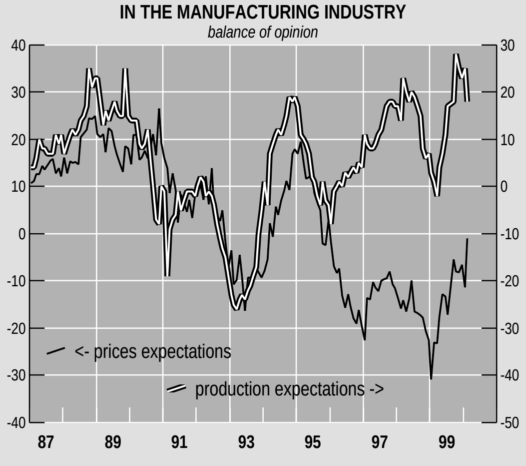
Inflation expectations remain moderate in industry

Inflation expectations are now substantially lower than those observed during the late 1980s. In fact, despite their rise since early 1999, household and industrial price outlooks remain moderate. More specifically, price expectations remain well below those observed at the end of the 1980s, while activity outlooks are comparable. In addition, there is a clear cyclical linkage between the economic activity outlook and prices.

RECRUTMENT PROBLEMS



PRICE AND PRODUCTION EXPECTATIONS IN THE MANUFACTURING INDUSTRY



This shift seems to have occurred during the mid-1990s with the unprecedented break between the increasing economic activity outlook and decreasing price trend expectations. This reflects the sustained decline in inflation expectations, which affect inflation trends and indicate a shift in the short-term Phillips curve.

This decline in inflationary expectations can be considered in light of the new European context that has been established with the increasingly credible outlook of monetary union (an end to competitive devaluations, central bank independence, and a firm commitment to meet Maastricht criteria, particularly in the area of public finance). This is suggested by the difference observed between the industry sector—which is quite open to competition; the services sector—which is more protected and characterised by a much less pronounced disconnect; and the construction and public works sector—which is even more protected, and in which the level of activity and price outlook are perfectly in step. ■

PRICE AND PRODUCTION EXPECTATIONS IN THE CONSTRUCTION SECTOR

balance of opinion