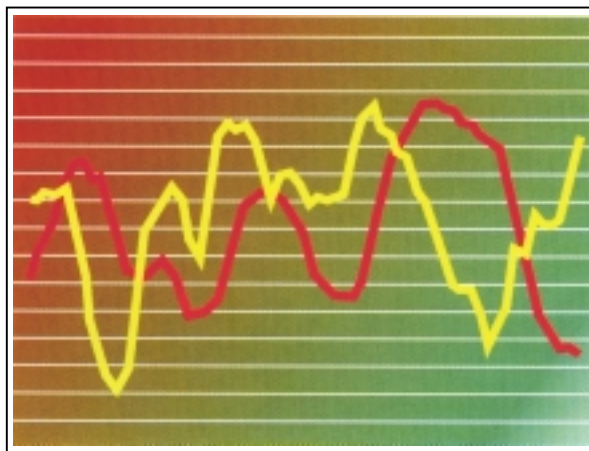


## CONJONCTURE IN FRANCE

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**DECEMBER 1999**



**UPSWING PHASE**

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## UPSWING PHASE

*In the end, the Asian crisis put only a temporary damper on the recovery posted by the French economy in the past three years. Activity accelerated distinctly in Q2 1999, with the H2 growth rate (4%) comparable to that of end-1997. The most visible consequence of this was a sharp increase in employment. Dependent job creations in the market sector are now expected to total 320,000 in 1999, implying a fall of three-quarters of a point in the unemployment rate during the year. Growth in 1999 is principally explained by continuing firm domestic demand excluding stock changes. Both corporate investment and household consumption made steady progress. Household demand was also very vigorous in the housing sector. However, the acceleration in activity from Q2 on is mainly due to the stepping up of world growth.*

*The end of 1999 finds the international environment of the euro zone looking highly supportive. The world economy is posting strong growth, accompanied by a rise in commodity prices that is gradually leading to the progressive return of inflation and to tighter monetary policies. The sharp rally in emerging Asia is helping Japan to pull out of recession. The United States remains on a growth path of close to 4%, although factors tending to slow down domestic demand are becoming more apparent. There has been a marked upturn in the British economy. Industrial output in the euro zone, stimulated by the recovery in world trade at a time when the exchange rate is*

*particularly favourable, is gathering pace, especially as domestic demand is improving in response to the confidence shown by both households and firms.*

*In France, the constituent elements for a continuation of the upswing phase are in place, even though the growth rate is liable to ease slightly following last summer's sharp upturn. The climb in numbers employed made possible by the growth is expected to intensify in H1 2000. This would mean the creation of 215,000 jobs in the market sector, bringing the unemployment rate sharply down to 10.3% by mid-2000. The consequences of this would be continuing strength of earned incomes despite the impact on inflation, and hence on purchasing power, of the rise in energy prices. On the assumption that the oil price will now stabilise, the year-on-year price rise would be around 1.2% in June 2000. Underlying inflation would remain below 1%, with productive capacity pressures remaining concentrated on the building sector. In these circumstances, and given the exceptional strength of households' expectations, consumption would again rise strongly. Import growth, linked to the strength of domestic demand, would then reduce the external contribution to growth. In all, following a scissors effect at the turn of the year, French GDP growth, still stronger than in the euro zone as a whole, can be expected to return to a rate slightly above 3%.*

## Brisk upturn in growth in the emerging Asian countries

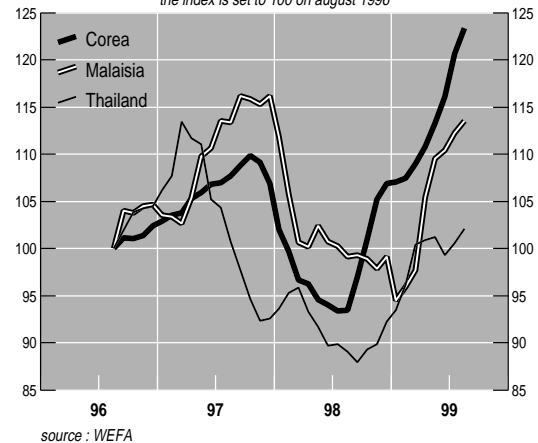
The upturn in the countries of emerging Asia has become more firmly entrenched in recent months. On top of the recovery in exports, helped on by the depreciation of the currencies in the region, domestic demand is now reviving as well. With employment rising and inflation falling to pre-crisis levels, consumption is now increasing again. South Korea is showing particular dynamism, with the growth statistical carry-over in Q3 as high as 7.6%. Following a sharp decline of 6% in 1998, the region's GDP is expected to show a rise of roughly 4% in 1999. This recovery should be confirmed in the early part of next year, even though the momentum created by recovery from the effects of the crisis is liable to diminish.

## Japanese recovery still conditional on what happens to consumption

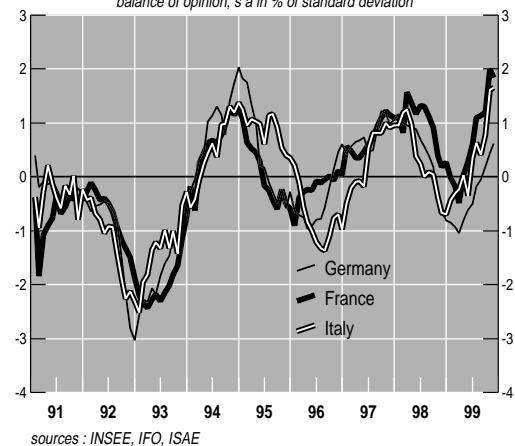
The Japanese situation remains uncertain. Activity bounced back substantially in the first half of this year (annualised rate of 5%), but much of this rally was due to a fiscal stimulus. Preliminary estimates show a distinct decline in GDP in Q3 (-1%). Although the government has already announced this past autumn the introduction of a new fiscal stimulus package in 2000, the extremely weak situation of public finances probably rules out keeping budget support going on any major scale. The strength of external demand, notably from Asia, has boosted exports, but the appreciation of the yen is likely to limit the external contribution to growth. Private investment will probably remain depressed by reason, first, of the weakness of the supply of credit linked to the continuing rehabilitation of the banking system and, second, of the persistence of excess productive capacity.

Whether the Japanese upturn can be maintained therefore depends on what happens to consumption and this in turn is subject to a number of doubts, with the rise in unemployment and the wage austerity likely to continue to hold back domestic demand. A lasting upturn in consumer expenditure depends on a diminution in precautionary behaviour in the shape of a fall in the saving ratio. This tendency, which seemed well engaged in the early part of 1999, was no longer visible in Q3. The second half of 1999 is therefore likely to show a decline in activity, with growth then possibly settling at a rate of 1%.

INDUSTRIAL OUTPUT  
IN THREE ASIAN COUNTRIES  
the index is set to 100 on august 1996



PRODUCTION PROSPECTS IN THE EURO ZONE  
manufacturing business leaders' opinions  
balance of opinion, s a in % of standard deviation



## Growth still brisk in the United States

The growth momentum in the United States remains very firm, thanks to a combination of very strong domestic demand and a more marked recovery in external demand. In all, GDP is expected to show an annualised growth rate of around 4.5% in H2 1999. Thereafter, United States growth is expected to ease back to a more modest rate, in line with its long-term trend figure of around 3%. One reason for this is that domestic demand can be expected to slow down, mainly under the impact of the gradual rise in interest rates. The steep rise in long rates since the beginning of the year is having an impact on housing investment and could also affect corporate investment. Meanwhile, the fall in the saving ratio will probably be halted as the result of the high level of household debt. This weakening of domestic demand could nevertheless see its impact on growth cushioned by external demand. Growth is still marked by major disequi-

libria: a wide current-account deficit, a high level of private debt and a possible overvaluation of the stock market.

## The renewed strength of the United Kingdom economy

The sharp upturn in activity has been confirmed in the United Kingdom. This tendency could ease slightly in coming months, however. The policy mix is now somewhat more restrictive, with a slight tightening of monetary policy since September and the maintenance of a tight fiscal policy. The strength of the pound, fuelled by the rise in interest rates, can be expected sooner or later to hold back foreign trade, which has been one of the driving-forces between the recovery in activity. Investment remains slack at a time when corporate margins are being squeezed by the combination of a strong pound and rising wage costs. Consumption, on the other hand, despite a temporary weakening, is expected to remain robust. One of the

consequences of its present dynamism has been a very marked decline in the saving ratio, and it is now being boosted by a wealth effect that is stimulating increased borrowing. The rise in house prices has in fact provided a stimulus for mortgage-based consumer credit (equity withdrawal). In all, the annualised growth rate of the order of 3.5% in H2 1999 is likely to be followed by a rate of 3% in H1 2000.

## Industrial activity recovering in the euro zone

Following a lacklustre first half, activity in the euro zone has bounced back under the impact of the revival in industrial activity. Industrial output could well be rising at a rate close to 8% (annualised) by the end of the year. This recovery has been brought about by the strong improvement in the international environment but also by the ending of the negative contribution from stock changes. Moreover, household consumption is likely

## GROSS DOMESTIC PRODUCT (volume) BY TYPE OF EXPENDITURE

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

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

Forecasts

\* Carry over effect at Q2

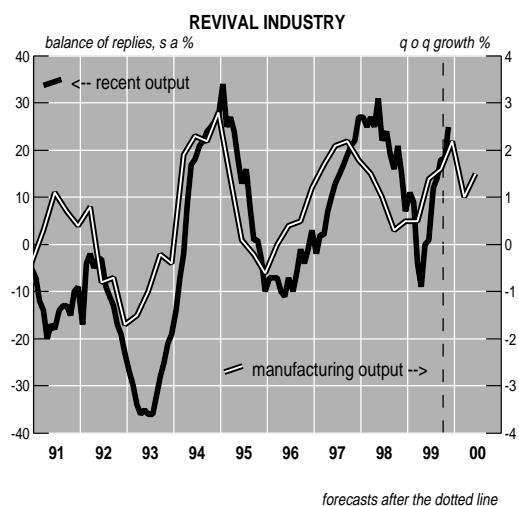
(1) National Quarterly Accounts evaluate growth at 1995 prices. Growth rates are usually slightly different once calculated at the prices of the preceeding year.

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

to remain robust, although its progress could be somewhat curbed by rising inflation and higher interest rates. Job creation is boosting household disposable income, with the unemployment rate continuing the decline that began two years ago and falling below 10% in October, compared with 11.5% in September 1997. In these circumstances, consumer confidence has stabilised at a very high level and this could generate a further fall in the saving ratio that would give an additional boost to consumption. All things considered, growth in the euro zone is seen as being brisk at the end of 1999, with an annualised growth rate of close to 3.5%. It is nevertheless likely to ease in the early part of 2000 as a reflection of the slowdown in world demand and the weakening of the contribution from inventories, settling down at an annualised growth rate of slightly below 3%.

Between now and mid-2000, the sharp disparities between countries of the euro zone are likely to narrow. Italy should be able to take full advantage of the upturn to make up its growth backlog. Job creation is at a high level and consumption is steadily recovering. On the other hand, uncertainties remain greater in Germany, where industrial output is recovering only gradually and consumption is having difficulty in reviving. The very small fall in the unemployment rate in the past six months and the austerity programme announced for 2000 are adversely affecting households' spending behaviour, while the wage rises resulting from the spring bargaining round have been slow in coming through. By contrast, the dynamic countries (Spain, Portugal, Ireland, Netherlands) continue to post growth rates that are substantially higher than the euro-zone average (3.5% in 1999, as against slightly below 2% for the zone as a whole). This dynamism is based, in particular, on strong domestic demand. The reverse of the coin is that these countries have for several months been experiencing significantly higher inflation than elsewhere in the zone.

There has in fact been a modest increase in inflation in the zone as a whole, with the year-on-year price increase rising to 1.4% in October from last winter's low point of 0.8%. This acceleration in prices is mainly due to the rise in the oil price since last March. Inflation is likely to continue to accelerate slightly in coming months, as the impact of the rise in energy prices spreads through the economy. The inflation differential between the euro zone and France, now slightly over half a percentage point, is unlikely to change substantially. Inflation in the euro zone as a whole is expected to be around 1.8% by mid-2000.



### Sharp upturn in French activity in H2 1999

Stimulated by a strongly improving international environment, activity in France accelerated sharply in H2 1999. Having been at an annualised rate of 2% until the second quarter, growth in the final months of the year is expected to turn out to be over 4%. The bulk of the growth in H2 stems from domestic demand excluding inventories. The slight slowdown in households' consumer spending in the early part of the year has given way to firmer growth. Meanwhile, firms have continued to step up their investment considerably. Having withstood the industrial slowdown in the winter of 1998/1999, investment seems set to show an annual growth rate of the order of 8% for the year as a whole. Substantial deliveries of aircraft already on order to Air France helped to maintain capital spending in the early part of the year, but in the second half the strength of investment has more to do with the upturn in activity. It is also partly the result of the renovation of computer equipment in the run-up to the year 2000, as is indicated by the sharp rise in software investment, shown by the high level of activity recorded by firms supplying IT advice and assistance.

On top of this firm growth in domestic demand excluding inventories, the second half of 1999 found foreign trade strong as well. The sharp upturn in world demand and the competitiveness gains consequent on the depreciation of the euro are in fact bringing about a substantial improvement on external account, despite the strength of domestic demand. Foreign trade is therefore likely to have made a significant contribution to growth in H2, of the order of 0.2 of a point each quarter, bringing the quarterly GDP growth rates to over 1%.

These half-year figures mask unevenness between quarters, however, as the result of the unexpected strength of exports in Q3 (up 4.4%). The external contribution to growth was in fact 0.6 of a point in Q3. More broadly, the strength of all elements of final demand has forced firms to draw heavily on their stocks, the result being the highly negative contribution from stock changes seen in this quarter. Stock re-building, combined with precautionary behaviour in the run-up to 2000, is likely to make a significant contribution to growth in Q4. Meanwhile, exports are likely to show a slowdown following the previous quarter's exceptional rise.

## Revival in industry

Industry, which had been the sector most affected by the short-term slowdown in the autumn of 1998, has seen its activity revive strongly during the year. This is confirmed by business surveys. The balance of business leaders' opinions on past activity slumped between mid-1998 and early

1999, falling from what was virtually its historic maximum to a level identical with that of the low point in 1996. This slump was followed by a recovery of comparable scale in the space of a single half-year. The current very high level of business opinion seen in all branches of industry is in line with the cyclical recovery in Europe and especially in inter-industry exchanges, as indicated by the steady improvement in business leaders' opinions in the intermediate goods branch. The quarterly national accounts nevertheless show growth in manufacturing output to have been smoother than the surveys would seem to indicate: following an annualised rate of almost 4% in the first half, growth in the second could come close to 8% by the end of the year.

At the same time, other sectors have remained dynamic. The building sector, riding on firm household and corporate investment, has seen its activity growing at a firm rate since its upturn first began at the end of 1997. It is by no means impossible that the existence of substantial recruitment difficulties will act as a constraint on this sector. Transport activity remains firm, despite a slight slowdown in road goods traffic last winter due to the deterioration in the European economic

## The qualitative impact of the "Y2K bug"

The transition to the year 2000 is raising problems for the functioning of computer systems, generally lumped together under the term "Y2K bug".

From an economic standpoint, the consequences of the Y2K bug can be assimilated to those of a natural catastrophe, a commodity-price shock, or any other event capable of destroying productive capacity. It can therefore be regarded as a supply-side shock and be expected in time to lead to a combination of falling output and rising prices. However, unlike a natural catastrophe, the Y2K bug was predictable. In the industrialised countries, efforts to adapt have been made some time in advance, so that the shock has been smoothed out, in the sense that its impact on output and prices is not concentrated at a single moment in time, but has been gradually incorporated into the tendencies shown by activity and inflation.

The "Théry report" on the IT transition to the year 2000 estimates that spending on adapting IT systems to meet the needs of the year 2000, will be roughly 90 billion francs, or roughly one GDP percentage point, spread over the three preceding years. In addition, preparation to deal with the bug may have been the occasion for bringing forward IT investment programmes. On the other hand, in developing countries unable to carry out this kind of

adaptation on a preventive basis, it has to be expected that some production units will come to a halt. According to estimates by the IMF<sup>(1)</sup>, the result next year could be a negative impact of almost 2 percentage points on GDP growth and additional inflation of the order of 1.2 points. As a result, these countries' imports are also likely to decline, having a slight adverse effect on world demand for goods produced in the euro zone and in France.

More immediately, the Y2K bug is leading to precautionary behaviour aimed at avoiding any disruption of output or supply on 1 January 2000. The level of inventories can be expected to rise at the end of the year before falling back to the previous situation in Q1 2000. These movements would mean stock-building towards the end of this year and de-stocking in the following quarter. To evaluate their contribution to growth, these changes have to be examined in terms of acceleration: the contribution of stock changes to growth would be positive in Q4 1999, negative in Q1 2000, positive again in Q2 2000.

(1) *World Economic Outlook, International Monetary Fund, September 1999, p.34-40.*

situation. Activity in the distribution sector is strong at a time of firm household consumption. Lastly, services, driven by household demand and corporate investment, are experiencing a very good period. The fact is that growth is now being experienced by all sectors of the economy.

### The fall in unemployment gathering pace

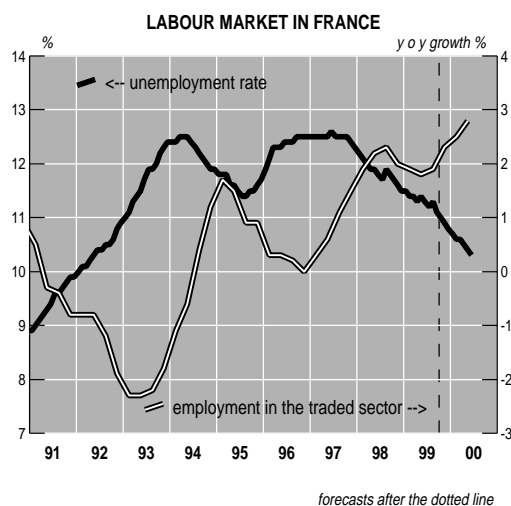
In the competitive sectors, dependent employment had slowed down during the winter in line with the economic situation. It then began to post firmer growth in Q2, with its six-monthly growth rate rising from 0.8% in December 1998 to 1.0% in June of this year. Given the upturn in activity, its growth should continue to accelerate, reaching 1.3% by the end of the year. In all, this would mean the creation of almost 320,000 dependent jobs this year in the competitive sectors, to which should be added more than 110,000 jobs in the non-market sector (essentially through the youth employment scheme). The total rise in numbers employed this year is likely to amount to 420,000, well above last year's figure of 370,000.

In services and construction, job creation has remained strong throughout the year. Numbers employed in industry, which had been falling early in the year, recovered in Q3 and are likely to continue on this upward path. Finally, as the usual result of industrial recovery, temporary-agency employment, after stagnating since the autumn of 1998, has been rising strongly since September.

Still benefiting from the strong growth seen in H2 1999, dependent employment in the competitive sector is expected to rise by roughly 1.5% in H1 2000, giving an additional 210,000 jobs, to which should be added 30,000 in the non-market sector. The steady pick-up in job creation has accelerated the decline in unemployment, especially youth unemployment. From 11.3% at the end of H1 1999, the unemployment rate is in fact expected to be down to 10.8% by the end of the year and to 10.3% at the end of H1 2000.

### Modest pick-up in inflation

Inflation rose slightly in the second half of this year as the result of the higher oil price, with the year-on-year consumer price rise amounting to 0.9% in November, compared with 0.3% in June. Even if energy prices stabilise, inflation is liable to continue to rise in H1 2000. This is because the



rise in prices of industrial raw materials in parallel with the upturn in world activity can be expected to feed through into production costs and hence into selling prices -- as already seems to be the case in the intermediate goods branch. Even so, inflationary pressure is likely to remain subdued. Productive capacity utilisation rates have been rising in the past two quarters, but still remain close to their long-period averages. The absence of manpower bottlenecks in these sectors means that upward pressure on wages is weak. Finally, the intensification of competition, notably in transport and communications, is likely to limit the increase in prices of services. By mid-2000, inflation could stand at 1.2%, with underlying inflation remaining below 1%.

### Purchasing power and household demand both firm

Against a background of wage restraint, the strength of job creation has been the main factor behind this year's rise in purchasing power, which is expected to amount to slightly more than 2.5% on an annual average basis, the result being to stimulate households' consumer spending. In a highly favourable confidence climate, households' consumer spending is rising at a firm rate.

The maintenance of highly favourable financing conditions has permitted an appreciable rise in household investment. This was particularly strong between the end of last year and the first half of this, as the result of substantial purchases of housing for rent in order to benefit from the tax advantages available under the "Perissol Act". As a corollary, the levelling off in household investment seen in Q3 is unlikely to last. In fact, following last winter's peak, housing starts seem to have found a new lease of life since the middle of

this year. The reduction of the VAT rate for spending on house repair and maintenance that came into effect in mid-September is also likely to bolster household investment. Activity in the building sector is rising strongly, to such an extent that since the beginning of the year the sector has reported a substantial increase in production bottlenecks.

### **Slight weakening of activity in H1 2000**

The first half of 2000 is likely to see a slight slowdown in activity, with domestic demand excluding inventories liable to decelerate under the impact of higher inflation and interest rates, while world growth is likely to turn out to be less exceptional.

Purchasing power is expected to grow at much the same rate as in 1999, with the accelerated job creation offset by the rise in inflation. The saving ratio is expected to stabilise, the result being a rise

in household consumption at an annualised rate of roughly 2.5%, in line with the growth in purchasing power. Corporate capital spending, boosted in H2 1999 by the sharp acceleration in activity, should continue to post firm growth. A small de-stocking movement due to the transition to the year 2000 is likely to be followed by the return of a positive contribution from stocks in line with the growth in the demand for industrial goods and the recovery in price expectations. Following the uneven movement in the second half of 1999, the contribution of foreign trade to GDP growth can be expected to become neutral in H1 2000, given that growth in France will remain slightly above that of the euro zone as a whole. The rate of activity in the zone is liable to weaken slightly next spring, as the result of the slowdown in world activity and the rise in interest rates. In France, once the scissors effect due to the change of year is out of the way, GDP growth will probably return to a rate slightly above 3%. ■