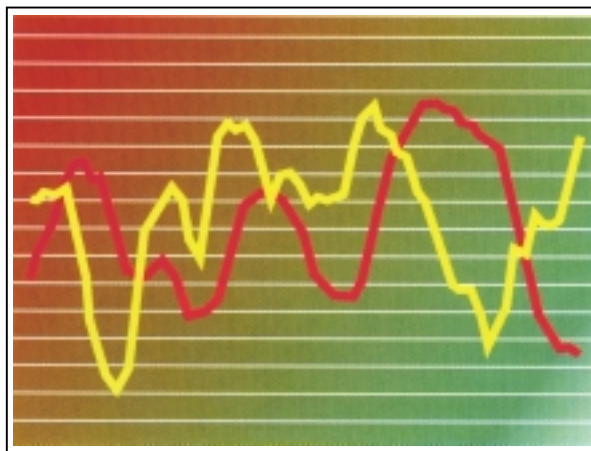


CONJONCTURE IN FRANCE

DECEMBER 1998



INDUSTRY MARKING TIME

Industry marking time

With 3.1% growth, 390,000 jobs created (290,000 of them in the traded sector) and a fall of almost one point in the unemployment rate, 1998 has seen a continuation of the upturn that began in France in mid-1996. Growth in activity was founded entirely on domestic demand. Consumption turned out to be particularly dynamic, thanks to a rise of more than 3% in household purchasing power. 1998 bears the traces of the crisis that originated in Asia, in the form of a negative foreign trade contribution to growth, a gradual slowdown in GDP and an exceptionally low price rise due to the sharp fall in commodity prices. Via this imported disinflation and the fall in interest rates, the Asian crisis has also indirectly helped to sustain domestic demand in France.

The end of 1998 finds France's international environment in a poor state. Japan and most of the Asian emerging countries are in recession; the producers of oil and raw materials are curbing demand in response to the fall in their export earnings; the United States economy is starting to slow down, despite the remarkable and unexpectedly robust performance of domestic demand. In these circumstances, the Euro zone stands out as a privileged island of growth. However, the financial crisis, the weakening of world demand and the downward tendency in the price outlook have since the summer produced a marked deterioration in business leaders' ex-

pectations in our principal partners, and this is now being reflected in a slowdown in activity. This tendency could be interrupted in the spring of 1999, especially if household consumption in Germany and Italy picks up as expected.

In France, the deterioration in industrial leaders' expectations occurred a few months later than in our partners and is now starting to produce its effects: after accelerating sharply in H1 1998, corporate investment is slowing down and seems set to stabilise in H1 1999. Tighter stock-building has been introduced and this is liable to hold back activity throughout the winter. However, the momentum shown by consumption remains unimpaired, thanks to the real income gains generated by the disinflation and the maintenance of highly favourable expectations on the part of households. Along with demand for housing, consumption is providing a platform for growth that will enable the upturn to be resumed once the adjustment in corporate demand has been completed -- especially if the European environment takes a turn for the better. All in all, after easing distinctly early in the year, growth should pick up again in Q2, with the resulting growth in employment sufficiently substantial to bring the unemployment rate down still further. The year-on-year price rise is likely to remain very small (0.5% in June 1999).

Industry marking time

A degraded international environment

France's external environment has continued to deteriorate. The crisis affecting the emerging economies has spread to other parts of the world and has begun to make itself felt in the OECD economies.

Most of the emerging economies in Asia were forced into severe adjustments following the monetary and financial crises of the summer of 1997, with GDP in the region falling by more than 5 points in 1998. However, in a certain number of countries the drop in production seems to have been halted, exchange rates have risen again against the dollar and exchange reserves are being re-built thanks to balance-of-payments surpluses -- for the moment due more to declines in imports than to growth in exports. Economic stabilisation in the region, if confirmed, would admittedly lead to fiercer

competition on all markets, but it would also be accompanied by increased demand for Western goods.

By the summer, the financial crisis had spread to all the emerging economies. Russia, where the budget situation was already very difficult, suffered in addition from the fall in prices of oil and other commodities. The financial markets' mistrust also affected the countries of South America, notably Brazil -- economies likely to post very low growth at best in H1 1999.

Of the developed economies, Japan is the one most severely hit by the Asian crisis, having formally moved into recession in Q4 1997. The impact of the crisis on Japan's external trade is aggravating the structural problems of an economy that has been depressed since the bursting of the speculative bubble at the beginning of the 1990s. Domestic demand is incapable of making up for the weakening of foreign trade, being affected by

Gross domestic product (volume) by type of expenditure

(at 1980⁽¹⁾ prices, % change from previous period)

		1997				1998				1999		1997	1998	1999 Carry over ⁽²⁾
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	(100%)	0.2	1.1	0.9	0.8	0.7	0.8	0.5	0.6	0.3	0.6	2.3	3.1	1.7
Imports	(29%)	-0.1	4.5	3.6	1.0	2.6	0.9	1.9	0.7	0.1	0.3	8.1	8.3	2.0
(of which merchandise)	(26%)	-0.3	4.7	3.5	1.3	2.8	1.0	2.3	0.6	0.0	0.3	8.2	8.9	2.0
Households' consumption	(60%)	0.2	0.1	1.2	1.1	0.7	1.1	0.8	0.6	0.6	0.7	0.9	3.6	2.2
General government consumption	(19%)	0.1	0.2	0.3	0.4	0.4	0.4	0.2	0.4	0.5	0.3	1.2	1.4	1.2
Total investment (GFCF)	(20%)	-1.4	1.2	0.9	0.4	1.5	1.0	0.8	0.6	0.1	0.3	0.1	3.9	1.4
Corporate sector ⁽³⁾	(11%)	-2.7	1.5	1.2	0.9	2.5	1.6	0.9	0.7	-0.2	0.1	-0.2	6.1	1.2
Households	(5%)	-0.7	0.0	0.9	-0.6	-0.1	1.2	-0.3	1.3	0.7	0.6	-0.6	1.0	2.3
Others	(4%)	1.3	1.7	0.1	0.3	0.5	-1.2	2.1	-0.7	0.1	0.3	2.1	1.2	0.6
Exports	(30%)	2.0	6.4	3.2	1.0	1.1	0.4	2.9	0.1	0.7	0.8	12.6	6.8	2.9
(of which merchandise)	(25%)	2.3	7.2	2.3	1.9	1.2	-0.1	3.3	-0.1	0.5	0.6	13.0	7.2	2.5
Domestic demand		-0.5	0.5	1.0	0.8	1.2	1.0	0.2	0.8	0.1	0.5	0.9	3.5	1.4
Contributions to the growth of GDP														
Inventory changes		-0.3	0.1	0.1	0.0	0.4	0.1	-0.5	0.2	-0.4	0.0	0.1	0.3	-0.5
Trade in goods and services		0.7	0.7	-0.1	0.0	-0.5	-0.2	0.4	-0.2	0.2	0.2	1.4	-0.3	0.3
Domestic demand excluding inventories		-0.2	0.3	0.9	0.8	0.8	0.9	0.7	0.6	0.4	0.5	0.8	3.1	1.8

(1) National Quarterly Accounts evaluate growth at 1980 prices. Growth rates are usually slightly lower once calculated at the prices of the preceding year.

(2) The statistical carry-over is the annual average growth rate that would result if growth were to be zero in Q3 and Q4 1999.

(3) Corporate and quasi-corporate enterprises (including unincorporated enterprises).

Forecasts

the credit crunch resulting from the crisis in the country's banking system and by a jittery attitude to consumption on the part of households, brought about in large part by the rise in unemployment. After falling by almost 3% in 1998, GDP is not expected to pick up before the second half of 1999.

World growth is now dependent on the pole consisting of the North American and continental European countries, where activity is still strong but where the slowdown has begun. This pole is far from homogeneous, however.

In the United States, the strong non-inflationary upswing that began in 1991-1992 seems to be coming to an end. Despite the continuing buoyancy of domestic demand, there are now numerous signs of slowdown: investment weakened distinctly in Q3, in conformity with the fall in capacity utilisation rates, the decline in exports and the worsening of business expectations. In response to the difficulties experienced by the financial systems in the United States and indeed the rest of the world, the Federal Reserve has cut interest rates and this could help to underpin domestic demand.

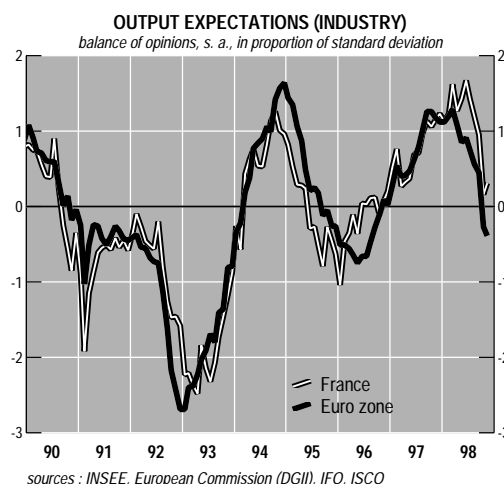
Industrial growth slowing down in the Euro zone

From the beginning of 1998, the weakening of external demand led to a gradual slowdown in inter-industry trade in the Euro zone, with the intermediate goods branch particularly affected. Activity in other branches remained firm, however, benefiting from the strength of domestic demand.

The extension of the Asian crisis in the summer to Russia and Latin America, together with the ensuing turmoil on the western financial markets, has produced a marked deterioration in industrial leaders' expectations, clearly visible from business surveys, which are also reporting a very depressed outlook for prices. This change in expectations has held back stock-building and investment in Q4. Pressures on productive capacity have already eased, as shown by the decline in capacity utilisation rates in Q4. The reduction in inter-industry trade following the adjustment in firms' demand is another factor still holding back manufacturing output. After weakening distinctly in the winter, manufacturing output is then expected to stabilise in the early months of 1999. However, consumption and building are expected to remain lively and to keep GDP growth in the Euro zone close to an annual rate of 2%.

A somewhat delayed impact in France

In the first half of 1998, France was relatively less affected than its partners in the Euro zone, being less specialised in the export of products affected by the increased competition from Asian goods, such as textiles and footwear. Moreover, the proportion of French exports going to countries outside Europe is smaller than for Germany or Italy. This meant that external demand, although in decline, continued to act as a driving force for French output. The car sector, for example, benefited from generally strong consumer



demand in Europe, while the capital goods sector was boosted by exports of aircraft and satellites.

At the same time, French manufacturing activity benefited from an upturn in domestic demand that occurred earlier and was, in addition, more vigorous. Private consumption, which has been rising strongly since mid-1997, underpinned activity in the consumer goods sector. French households' purchases of cars, as well as corporate investment in heavy goods vehicles, also picked up. Finally, the sharp growth in industrial investment, as well as household purchases of computer products, benefited production of capital goods.

The end of 1998 finds the French economic situation approaching that of its neighbours. The sharp deterioration in the business outlook in H2 means that more restrictive stock behaviour is likely to be seen, culminating during Q1 1999. Having been strong until the summer, investment has slowed down in H2 and is expected to weaken further in the early part of 1999. In these circumstances, industrial output is likely to slow down still further, with annualised growth of 2.5% in the second half of the year. Despite a pickup in Q2, it should be stable overall in H1 1999.

Production remaining firm in the domestic sectors

Investment in industrial and commercial buildings showed a marked recovery in 1998, benefiting, like productive investment, from the strength of activity and the low level of interest rates. The slowdown now being seen in the industrial sector could lead firms to postpone certain projects, but in the other sectors the strong tendency in investment in buildings is unlikely to be called into question. Moreover, the upturn in construction activity is fairly recent, so that, given the time-lags and the irreversible nature of ongoing projects, growth in the sector should remain relatively firm.

Private investment in housing also showed firm progress in 1998. In addition to the highly supportive situation on the labour market, households were able to take advantage of low prices and extremely favourable housing loans. In a more limited sector of the market, the accelerated tax-deductibility of depreciation on new housing bought for rental purposes permitted under the "Périssol" Act undoubtedly encouraged this form of investment while its extension to the purchase of existing housing could provide support for maintenance and renovation activity. The revival of output in this sector should mark the end of the massive de-stocking seen for more than a year now.

These various elements should permit activity in the construction sector to remain persistently strong in coming quarters.

In the business services branch, activity has been at a high rate in 1998. Despite a slight weakening in line with the slowdown in industry, it is now expected to remain strong in coming months, as demonstrated by business surveys for the sector. Computer services activity is set to remain positively headed, in view of the highly favourable context consisting of the introduction of the Euro and the adaptations made necessary by the approach of the year 2000.

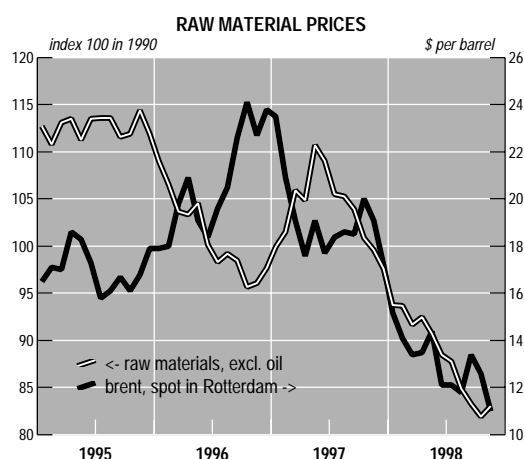
Employment set to rise more modestly

Following net job creations totalling 190,000 in 1997, dependent employment in the traded sector is expected to show a rise of 290,000 in 1998, thanks to the strength of the economy. For the year as a whole, industry is expected to show a rise in employment despite the slowdown in activity in H2. Numbers employed in construction have stabilised, while job creation in the tertiary sector has remained very strong, by reason of the firmness of activity. The rise was particularly marked for the temporary employment agencies.

The non-traded sector showed the impact of government employment policies, especially those in favour of "emplois-jeunes" (jobs for young people). Overall, employment is expected to show a rise of 390,000 for the year 1998.

In H1 1999, against a background of slower growth having only a modest impact on firms' financial situations because of the restraint shown by production costs, dependent employment can be expected to continue to rise but at a slower rate. Roughly 90,000 jobs will probably be created in the non-farm traded sector in H1. This figure, which is relatively high given the tendency in activity, owes much to the sectoral composition of growth. Moreover, looking this far ahead, the arrangements in support of the move to the 35-hour week are likely to have a greater impact than in H2 1998.

In industry, the slowdown in activity seen in H2 1998 is likely to lead to job losses, but these will remain relatively small in H1 1999 because of adjustment time-lags. Job creation in the business services sector -- and especially in temporary employment -- could feel the impact of the reduced activity in industry, although this



would be cushioned by the strength of activity in computer services and the continuing vigour shown by the construction sector, which has traditionally made substantial use of temporary agency employees. Job creation in household services and distribution is liable to continue, given the buoyant state of household consumption. In particular, private services should continue to create jobs, especially as the rise in wage costs in the sector has remained very modest. Finally, the building sector is showing a distinct upturn, so that the job losses that are structural in the sector are likely to be mitigated in coming quarters.

Job creation in the non-traded sector is likely to benefit from the continuation of the "emplois-jeunes" programme and the revival in the public-sector job creation now consolidated under the law combating social exclusion. On the assumption of a continuing tendency in employment policy, total employment can be expected to rise by roughly 135,000 in H1 1999.

The continuous growth in employment in 1998 has led to a distinct fall in unemployment. In October 1998, the rate was down to 11.6%, having been 12.5% a year earlier. Despite the slowdown in job creation in the early part of next year and the strong growth in the labour force, the unemployment rate can be expected to continue to decline, but at a slower rate, reaching 11.4% in June 1999.

Persistently weak inflation

Inflation continued to decline in 1998, with the year-on-year price rise easing from 1.0% at the beginning of the year to below 0.5% from October 1998 on. This tendency is largely linked to the fall in world commodity prices and especially that of crude oil, which fell by almost 40% between January and November 1998. The

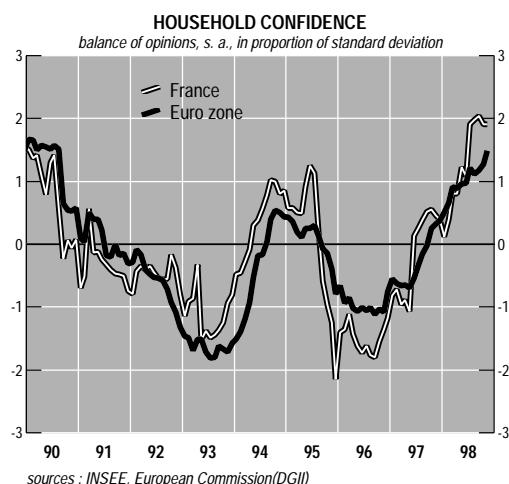
moderation in wage costs seen throughout 1998 was in line with the easing of inflation. In agriculture, live-stock farmers and producers of fruit and vegetables were faced with problems of surplus production caused by the collapse in exports to emerging economies and to Russia. Disinflation in the manufacturing sector was also fuelled by aggressive pricing policy on the part of the large-scale retailers, especially for audio-visual and computer equipment. Finally, despite the strength of household consumption, the services sector experienced no upward pressure on prices.

The first half of next year should see continuing moderation in the evolution of wage costs, while the gradual stabilisation of commodity prices should bring the phenomenon of imported disinflation to a halt. The world market for crude oil should finally bottom out at very low price levels, with prices of final products stabilising in consequence. On the other hand, food prices are likely to continue to fall, albeit more moderately. In the case of manufactured goods, business surveys in the retail sector are pointing to a slight upward tendency, probably in response to the very strong household demand. Finally, increases in rents, which were substantial in 1998, are likely to continue, in a lagged reflection of the rise in the construction cost index on which most rents are indexed. In the services sector, inflation is not likely to rise in the first half, following the slowdown in nominal wages and salaries seen in 1998. All things considered, the year-on-year price rise is expected to increase slightly to reach 0.5% in June 1999, with underlying inflation remaining around 1.0%.

Modest slowdown in earned income

The purchasing power of household incomes rose by more than 3% in 1998, a figure not seen since the end of the 1980s. This increase was made possible by the slowdown in the price rise and the substantial number of job creations. The reduction in unemployment was not accompanied by growth in real wages on any greater scale than in 1997. The quarters preceding the definitive application of the law on the reduction in the working week were perhaps marked by a certain tendency to "wait and see", as suggested by the sharp fall in the number of wage negotiations reported. Nominal wages accordingly slowed down throughout 1998, in line with the disinflation.

The slowdown in job creation in H1 1999 is liable to mean slower growth in total wage income. Growth in nominal wages can be expected to stabilise gradually as the factors producing the earlier slowdown lose their influence. Wage negotiations can be expected to build up somewhat and inflation to stabilise towards the end of the second half. Income from capital is likely to continue to move positively. All in all, compulsory contributions by households are unlikely to be affected by the latest legislation and, as a result, their growth should be in line with earned income. Social security benefits are expected to show a moderate rise.



Finally, household purchasing power should again be safeguarded by the low rate of inflation. Even so, it is likely to slow down in H1 to a growth rate of the order of 2.5%.

Consumption still buoyant

Household consumption rose sharply in 1998, by an annual average of 3.5%, compared with 0.9% in 1997. Growth on this scale has not been seen since 1986. Consumption benefited from the strength of earned income, combined with falling inflation, while the more favourable situation on the labour market has led to a marked improvement in household confidence and permitted a decline in precautionary saving. Car registrations therefore strengthened and purchases of new electronic goods picked up substantially. The leisure industries -- hotels, catering, transport and tourism -- attracted numerous customers.

Over the first half of 1999, the slight slowdown in earned income is likely to be reflected in household consumption, against a background of a stabilisation in the saving ratio. The growth in household consumption is liable to be accompanied by an acceleration in the diffusion of innovative products (personal computers, audio-visual equipment, telephones), as shown by the example of countries where the penetration ratios for these products are much higher than in France. Moreover, the dynamism seen in recent quarters also corresponds to a compensation for the weakness of consumption seen in the first half of the 1990s. Stocks of durable goods (furniture, electrical household equipment and, to a lesser extent, cars) have aged considerably. The upturn in housing investment could well incite households to continue the renewal of their stock of equipment.

All in all, household consumption is expected to fall from an annualised rate of almost 4% -- that seen between mid-1997 and Q3 1998 -- to a rate closer to income growth, of the order of 2.5%. In other words, it would remain fairly firm and would continue next year to be the principal motor for French growth.

Gradual decline in imports

Given the upturn in domestic demand, import growth remained firm throughout 1998. Imports of manufactures were particularly dynamic, showing 15% year-on-year growth in Q2 of this year. In H1 1999, however, they are likely to slow down, reflecting the levelling off in corporate demand, and record virtual stability.

Further slowdown in exports in Q4

The fall in external demand due to the Asian crisis, to the slowdown in the United Kingdom and to competitiveness losses linked to movements in exchange rates, has acted as a considerable brake on exports. The second half of 1998 has seen exports of manufactures

affected by a further industrial slowdown in the Euro zone and are likely to decline still further during the winter of 1998-1999. In Q2 1999, exports of manufactures are likely to return to moderate growth, thanks to the stabilisation of activity in the Asian countries and to the firmness of consumption in the Euro zone. After stagnating during the winter, they would then achieve growth of close to 3% at annual rate.

More moderate growth

GDP has been slowing down in H2 1998, with the annualised growth rate falling to slightly below 2.5% from close to 3% in the first half of the year. The main origins of the slowdown are to be found in exports and corporate demand. In the first half of 1999, consumption is expected to continue to provide the main prop for growth, while the de-stocking begun in H2 1998 is liable to hold back activity until the end of Q1. The levelling off in imports can be expected to bring the external contribution back to neutrality. As a consequence, after weakening distinctly early in the year, GDP growth should pick up again in Q2. ■