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LA CONJONCTURE IN FRANCE

A bi-annual short Term economic Report by INSEE

THE OUTLOOK FOR 1990

In France, as in most OECD countries, growth has weakened in 1990. On an annual average basis, Gross Domestic Product is rising at almost 3%, compared with 3.6% in 1989 and 3.8% in 1988. The move to more rapid growth began in 1987 under the influence of the recovery in the world economy in general. Growth is still brisk but more modest. Signs of a slowdown began to appear in the spring of 1989, in manufacturing industry first of all, in line with the increasingly evident slowdown at world level. This tendency has been confirmed in 1990 and is more pronounced in industry than in the tertiary sector. But the slowdown is still only moderate. Growth remains substantially faster than in the period 1983-1986 and is still creating many jobs. The French economy has a number of factors operating in its favour: the restoration of a sound corporate financial situation, the moderation shown by wage costs, the concentration of French exports on European mar-

kets, enabling them to benefit from the dynamism of the European economies, especially that of Germany. Since mid-1989, these advantages have been joined by the significant appreciation of the franc against most other currencies, bringing about an improvement in the terms of trade and helping to keep inflation under control.

In the first half of 1990 on a year-on-year basis, GDP has slowed down more than domestic demand. The gap between the two aggregates has meant increasing recourse to imports and a drawing down of stocks, which makes a negative contribution to growth. With internal demand continuing at a firm rate, the gap will be narrower in the second half of the year. The INSEE business surveys show industrialists to be more confident about the outlook for production, as well as about the level of overseas demand.

	Gross Domestic Product by Type of Expenditure											
	Constant 1980 prices - Percentage change, except see (1), Annual rates											
	Semestrial Averages						Year-on-year % Change			Annual Averages		
	88.I	88.II	89.I	89.II	90.I	90.II	1988	1989	1990	1988	1989	1990
GDP	3.9	3.3	4.4	2.4	2.7	3.2	3.4	3.5	3.0	3.8	3.6	2.8
Imports	6.4	10.4	9.4	4.2	10.5	6.2	7.4	8.5	6.3	8.6	8.3	7.8
Current resources	4.4	4.7	5.5	2.8	4.3	3.9	4.3	4.4	3.7	4.8	4.6	3.8
Households' final consumption	2.2	4.6	2.3	3.7	2.9	4.1	2.9	2.9	3.7	3.2	3.2	3.4
Gross fixed capital formation	8.5	8.6	5.2	3.6	6.2	6.1	7.9	4.3	6.4	8.6	5.6	5.5
Of which NFCU sector (2)	10.4	10.4	6.8	3.2	6.8	8.5	9.3	4.0	9.0	10.8	6.7	6.3
Households	4.2	7.3	-1.3	4.2	3.4	0.0	5.5	3.1	0.1	4.6	2.2	2.7
Exports	5.9	5.8	18.1	2.8	9.2	3.8	4.5	12.1	5.5	8.3	11.0	6.2
Change in stocks	0.4	-0.4	-0.1	-0.4	-0.4	-0.3	0.3	-0.2	-0.8	-0.2	-0.3	-0.4
Domestic demand except change in stocks	4.1	5.5	2.9	3.6	3.9	4.7	4.3	3.2	4.5	4.7	3.7	4.0
Domestic demand	4.5	5.0	2.7	3.1	3.4	4.3	4.6	2.9	3.5	4.5	3.4	3.5

(1) Change in stocks as % of previous period's GDP.

(2) Non financial corporate, quasi-corporate, and unincorporated enterprises.

The strong domestic demand already seen in the first half of the year shows no signs of weakening in the second and is due as much to private consumption as to corporate investment. Consumption is being stimulated by the favourable movements in employment and wages, broadly in line with their 1989 tendencies, and by the low inflation rate, which means that nominal increases in household income have been left intact to a greater extent than last year. Corporate investment, 80% of which is financed out of firms' own resources, is a response to expectations of firm domestic and overseas demand and to the strains on production capacity felt since the beginning of 1989. The overall result is that domestic demand excluding stock changes has accelerated slightly from an annual average of 3.7% in 1989 to 4% in 1990.

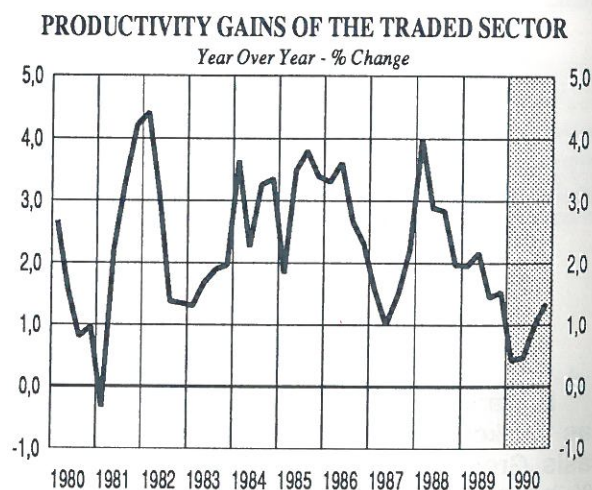
A still substantial job creation

In 1990 as in 1989, growth has been a more prolific creator of jobs than in earlier years. With production slowing down to a more marked extent than job creation, productivity gains, as measured by apparent labour productivity, are at low levels in 1990, among the lowest in the past ten years, in fact.

This continuing high rate of job creation is mainly due to the time-lag in companies' adjustment of their work forces to changes in economic growth. Companies are still tending to match the numbers they employ to the high levels of activity recorded in the two previous years. This time-lag in the adjustment of employment to economic variations (see graph 1) explains why job creation in industry might level off only in the second half of 1990, although it was industry that first felt the effects of the economic slowdown. Industrial productivity should therefore return to its normal growth trend at the end of the year, with the number of jobs created in the whole of 1990 down on the 1989 figure. In the building and tertiary sectors, on

the other hand, the increase in numbers employed is higher than in 1989. The overall unemployment rate can be expected to decrease until the autumn and then level off at 8.7%.

Graph 1 :



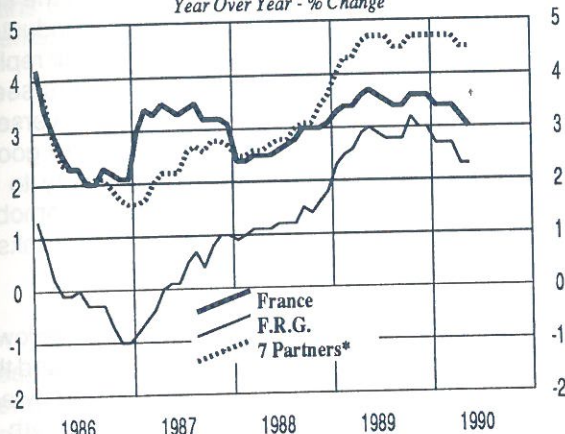
Inflation under control

The international environment is disinflationary for France in two respects: first, because the dollar prices of oil and industrial raw materials are lower than in 1989 and, second, because of the appreciation of the franc against most other currencies. As a result, the prices of imported goods and services have fallen by 1% on an annual average basis, in contrast to the 6.6% rise in 1989. This favourable movement in import costs is more than offsetting the acceleration in unit wage costs, itself due to a combination of the rise in nominal wage rates and the small productivity gains. The annual rate of price increases has steadied at around 3% at the end of the first half of 1990, and the

inflation differential vis-a-vis the main trading partners is continuing to widen in France's favour (see graph 2). A slightly less favourable tendency in German inflation towards the end of the year should produce practically identical inflation rates in the two countries.

Graph 2 :

CONSUMER PRICE INDEX
France and Main Partners
Year Over Year - % Change



* FRG, Italy, United Kingdom, Belgium, United States, Netherlands, Spain, weighted by total bilateral trade.

A slight acceleration in households' purchasing power

Wages are growing faster in nominal terms than in 1989. For the second year running, the share of wages and salaries in gross corporate value added has remained unchanged. The sharing of the fruits of economic growth is no longer tilted in favour of profits, as was the case between 1983 and 1988. In public administration, on the other hand, wages and salaries are growing more slowly than in 1989. One explanation is the payment of a special "growth bonus" to all public administration employees at the end of 1989. The fall in the inflation rate nevertheless means an increase in the purchasing power of the total gross wage bill that is as high as in 1989.

Accompanying this wage tendency is a less favourable evolution in the profits of the self-employed. This category of income grew sharply in 1989, partly because of the subsidies granted to farmers following the drought. In 1990, the non-repetition of these benefits and the slowdown in activity have meant a slower growth in these profits.

Social transfers, on the other hand, have been making a positive contribution to growth in household income. The net result is that household disposable income in real terms has been accelerating slightly (3.7% compared with 3.5%).

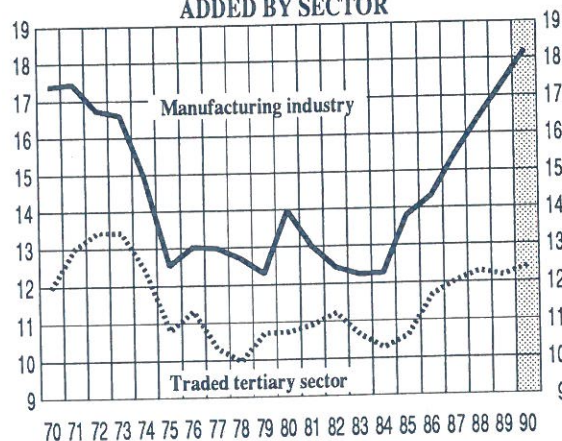
Dynamic consumption and investment

Because of the increase in their purchasing power households are able both to raise their savings rate and to accelerate slightly the growth in their consumption, especially of traded services. Consumption of manufactured goods has slowed down somewhat on an annual average basis (4.1% as against 4.5%), while remaining strong for certain goods especially durables.

Companies are still continuing to invest strongly in 1990 (see graph 3), despite the decline of the accelerator-effect adjustment of capital stock seen since the beginning of the economic recovery in 1987. Capacity utilization rates are still very high in manufacturing industry. Moreover, demand expectations are still positive and the prospect of free circulation of goods and services within the European Community starting in 1993 is inciting firms to improve their competitiveness. Investment in the tertiary sector is expected to grow at the same rate as in 1989, in line with the growth in activity. The investment effort made since 1986 by firms in this sector is particularly striking.

Graph 3 :

INVESTMENT AS % OF GROSS VALUE ADDED BY SECTOR



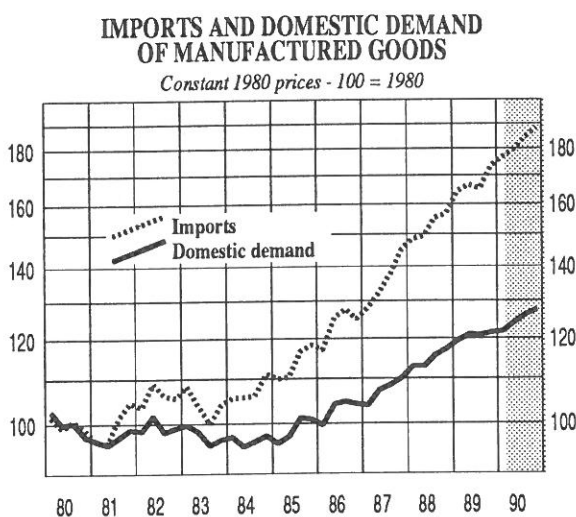
Investment is being financed on slightly less favourable terms than in 1987 and 1988, as long-term real interest rates are at historically high levels. This factor is not sufficiently strong to act as a constraint on the overall level of investment decisions. INSEE's June business survey of investment decisions indicates that investment growth should again be at a high rate this year (around 10%).

Strong growth in export markets

World trade has been slowing down in volume since mid-1989 and this tendency has continued in the first part of 1990. The growth in overseas demand for French exports has been relatively less affected by this turndown. This is because French exports have been substantially redirected to Europe ever since the 1986

collapse in the oil price reduced demand from the oil-producing countries. The European Community, led by West Germany, now accounts for two-thirds of French exports and this is the zone where the slowdown has been smallest. French export growth could nevertheless lag somewhat behind the growth of the markets themselves (see graph 4). One factor in 1990 has been the decline in completed Airbus deliveries due to the strikes at the end of 1989 at the United Kingdom partner and supplier, British Aerospace. In addition, the appreciation of the franc since mid-1989 has led to a loss of competitiveness, despite a narrowing of export margins.

Graph 4 :



Domestic supply catching up with demand by the end of this year

Total supply, meaning domestic production plus imports, will rise somewhat less rapidly in 1990 than demand. The production slowdown is especially marked in two branches: manufacturing industry and services. In the other branches, production has actually been growing faster than in 1989.

Distribution and commerce have benefitted from the slight acceleration in household consumption. Construction is being stimulated by the expansion of road and rail infrastructure, especially through the extension of the high-speed train (TGV) network and the improvement of road access to the Savoy Alps, the region chosen as the site for the 1992 Winter Olympics.

There are two reasons for the slowdown in services. First, more moderate industrial growth is having an unfavourable impact on services through the induced effects on the economy in general. Second, the high level of tourism activity in 1989, due partly to the impact of the Bicentenary of the French Revolution, is likely to level off this year. Exports of services, which include earnings from tourism, will therefore grow more slowly this year, limiting services activity in 1990.

The current weakness of manufacturing production's growth stems partly from that of world activity in general, with its consequent effect on export markets. It is also possible that domestic producers may be finding themselves faced with insufficient supply capacity. This is still a moot point, however. The INSEE surveys indicate both a maintenance of historically high capacity utilization rates and a fall in the percentage of firms reporting production bottlenecks.

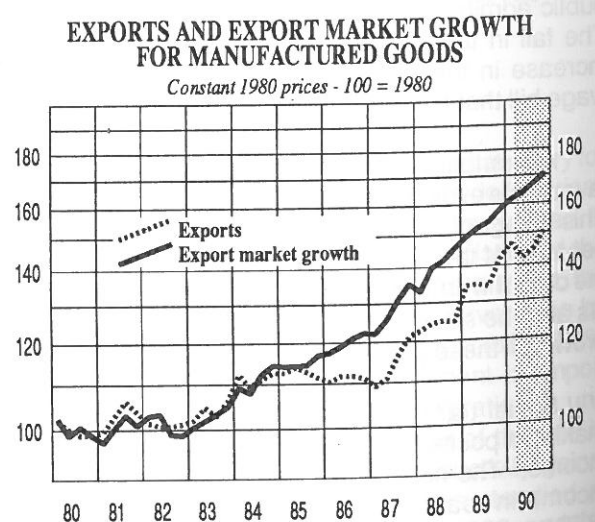
The mismatch between industrial production and total demand should become less marked in the second half, under the influence of increasing industrial production towards the end of the year. In their replies to the INSEE questionnaire, business leaders see a levelling out of the slowdown recorded on overseas markets in the first half of 1990. Intermediate goods producers, in particular, are expecting activity to increase on their markets. Moreover, the automobile industry should continue its rapid expansion, thanks to strong demand both at home and abroad.

Manufacturers' demand expectations were lower in early 1990 than they had been a year earlier and this has led to a downward adjustment in stocks. Between 1987 and the beginning of 1989, the growth in economic activity had tended to incite firms rather to build up their stocks. This tendency was reversed at the turn of the year, with a consequent effect on manufacturing production. The impact of this movement should disappear in the second half of the year.

The trade balance levels out, helped by the terms of trade

After growing at an annual rate of close to 4% between the end of 1987 and the beginning of 1989, domestic supply is now oscillating around a somewhat slower growth rate, while growth in demand remains firm. Stock changes are insufficient to prevent imports

Graph 5 :



from taking a larger share of total supply than would be accounted for by the upward trend in import penetration. As a result, French imports of goods have been growing in 1990 nearly as fast as in 1989, although a slight slowdown in manufacturing imports can be expected on an annual average basis (see graph 5).

Faster growth in imports than in exports is producing a slight deterioration in the export/import volume ratio, following the improvement in 1989. But this tendency is being compensated by the simultaneous gains in the terms of trade brought about by movements in international commodity prices and the

appreciation of the franc. The deficit on trade in manufactured goods, for which the terms of trade improvement amounts to 1.5 points, should therefore widen only slightly. The reduction in the energy bill and the maintenance of a substantial surplus on agricultural and food products should also contribute to a stabilization of the trade deficit for the year as a whole. The balance on service account is also stable, the substantial surplus on this item in 1989 largely compensating for the slower export growth. The current-account deficit was less than 0.4 points of GDP in 1989 and should be around the same percentage this year.

The French trade deficit has not widened, despite the slowdown in world growth. Domestic demand is still growing at a fast rate. Inflation has been kept under control at a lower rate than in many partner countries and the unemployment rate has decreased, despite the moderate growth

in activity. These evolutions in the economy have been made possible by the terms of trade gains themselves partly the result of the appreciation of the franc against most other currencies, and by the slow improvement in productivity.

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