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LA CONJONCTURE IN FRANCE

A bi-annual short term economic report by INSEE

THE 1990 PROVISIONAL OUTTURN

In France, as in most OECD countries, economic growth has slowed down in 1990. French GDP has risen by 2.6% in volume, compared with 3.7% in 1989. The services sector is still the main driving-force but it too has been tending to weaken in response to the slowdown in manufacturing : the latter is not only more subject to the cyclical fluctuations in the world economy but has also been hit by the successive depreciations of the dollar and the yen against the currencies in the European Monetary System (EMS). In the case of French manufacturing industry, the loss of competitiveness has meant an export market share loss of the order of 2 points and a decline in the export-import ratio.

Against a background of tougher competition, firms have passed on into their selling prices only part of the sharp increase in unit wage costs in the first half of the year and the rise in oil prices in the second. The special business survey carried out by INSEE concerning the impact of the Gulf crisis reveals the determination of firms to improve their productivity and competitiveness. They have accordingly tightened their margins and maintained

their investment effort, despite heavier financial costs. Jobs are still being created at a high rate although there are clear signs of a slowing down in the final part of the year. Thanks to the reduction in company margins, inflation remains firmly under control and stands at the same level as in 1989 (3.6%), despite the second-half year rise in oil prices. The inflation differential vis-à-vis the main trading partners is widening in France's favour. With household purchasing power flagging in the latter part of the year, private consumption is slowing down, accompanied by a heightened propensity to save, partially in response to the events in the Gulf.

With the help of an improvement in the terms of trade, the deficit on trade in manufactures has levelled out for the first time in six years. The only factor weighing on the external trade deficit is the higher oil price. The balance on interest, dividends and other investment income has deteriorated. Despite the continuing large surplus on services, the result has been a widening of the current-account deficit.

Gross Domestic Product by Type of Expenditure

Constant 1980 prices - Percentage change, except see (1), Annual rates

	Half-year 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.....	4.1	3.3	4.4	2.5	2.5	3.0	3.5	3.4	2.6	3.8	3.7	2.6
Imports.....	6.5	10.1	9.7	3.7	7.9	5.7	7.3	8.4	4.9	8.6	8.3	6.3
Available resources.....	4.5	4.6	5.5	2.8	3.6	3.6	4.3	4.4	3.1	4.8	4.6	3.4
Households' final consumption.....	2.6	4.2	2.7	3.0	3.6	1.2	2.9	2.7	2.4	3.2	3.1	2.8
Gross fixed capital formation.....	8.4	9.1	5.5	4.0	4.3	6.0	8.2	4.9	4.8	8.6	5.9	4.7
Of which NFCU sector (2).....	10.6	10.6	6.8	2.9	6.7	6.2	9.5	4.2	6.2	10.8	6.7	5.6
Households.....	3.5	8.4	-0.3	6.1	-1.0	5.0	5.9	4.5	0.4	4.6	3.4	2.2
Exports.....	5.1	6.7	17.4	3.2	6.1	2.8	4.3	11.9	3.5	8.3	11.0	4.5
Change in stocks.....	0.3	-0.4	-0.1	-0.2	-0.3	0.7	0.4	-0.2	0.0	-0.2	-0.3	0.0
Domestic demand except change in stocks.....	3.9	4.8	3.0	3.0	3.5	2.5	3.9	2.9	3.1	4.2	3.4	3.1
Domestic demand.....	4.4	4.2	2.9	2.7	3.0	3.8	4.3	2.7	3.0	4.0	3.1	3.1

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

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

The services sector is affected by the slowdown in manufacturing growth

As in most OECD countries, economic growth in France in 1990 has continued the slowdown that began around the middle of 1989. On an annual average basis, gross domestic product has grown by only 2.6% in 1990, as against 3.7% in 1989.

Manufacturing production has flagged considerably in 1990 and is now rising at only 2% a year, compared with 5% in 1989. This weakness has particularly affected intermediate goods, which had already started to feel the levelling-off in world demand as early as mid-1989. Cars are another sector feeling the pinch, with activity well down since the start of the year, as in all EEC countries apart from Germany. The car industry, like that of consumer goods, is suffering from the loss of momentum in domestic demand. Capital goods remain the most vigorous sector, but this too has started to weaken.

While still the strongest contributor to growth in 1990, the traded services sector has been hit by the slowdown in industrial activity, especially transport services and professional services to firms. Tourism has grown more slowly after the outstanding performance of 1989, which was due in part to the bicentenary of the French Revolution.

Movements in other sectors of the economy are less marked. The construction sector has maintained a growth rate close to that of 1989 (3% compared with 3.7%), thanks to the continued buoyancy of non-residential construction.

A second year of drought has done less harm to agriculture than its predecessor, but it contributed to yet another slowdown in electricity production. Energy

production in general recovered sharply, however, because of record refinery output.

Slower world growth and tougher international competition

Growth in the OECD region has been slowing down since 1988: from 4.4% in that year to 3.4% in 1989 and now around 2.8% in 1990. Strong domestic demand in Germany and Japan has not been able to make up for almost-zero growth in North America and the United Kingdom. The EEC's GDP growth rate, naturally affected by the world slowdown, has fallen from 3.9% in 1988 to 3.5% in 1989 and 2.9% in 1990.

The Gulf crisis has been of only secondary importance in this year's slowdown. The terms-of-trade gains by the OPEC countries are bound to mean a fall in the real income of the OECD countries, but this is not expected to be felt before the end of 1990.

The slowdown in the OECD countries, mainly explained in 1989 by the movement in private consumption, has now spread to inventory formation and to investment -- both in housing and in productive capacity -- which has been hit by tight monetary policies. Total demand in French export markets is thought to have grown by 7.5% in 1990, compared with 9.4% in 1989.

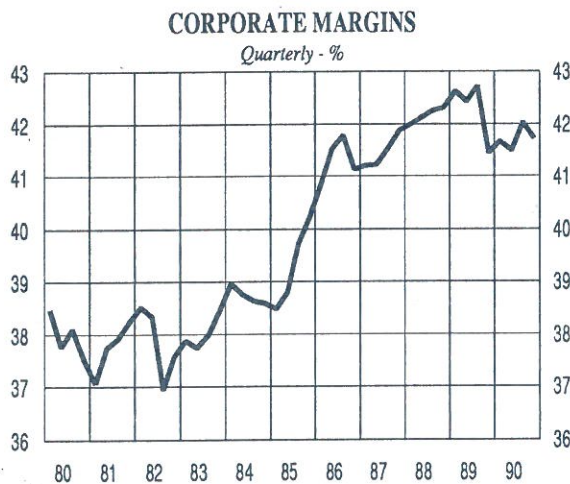
In the period from June 1989 to October 1990, the dollar has fallen by 24% against the franc and its effective rate against the EMS currencies by 16%. The fall in the dollar in the second half of 1989, coupled with that of the yen, meant a loss of competitiveness for the EMS countries against their dollar-zone and Japanese competitors in the second half of 1990. The EMS countries, widely opened to foreign suppliers, lost market share both at home and abroad.

Reduction in French company margins

In order to hold onto market share, French firms have passed on only a part of their higher production costs into their selling prices, while the share of wages in total corporate value added has increased at the expense of profits. The result has been a deterioration in companies' financial situations this year. The rise in operating costs, although moderate over the year as a whole, has been accelerating in the latter part of 1990, as the result of the impact of the higher oil price on the cost of inputs.

This deterioration was particularly noticeable in manufacturing industry. In the first half of the year, productivity stagnation due to the slowdown in activity combined with a marked acceleration in hourly wage rates led to a sharp rise in unit wage costs. In the second half, wage increases moderated and this time it was the turn of input costs to accelerate considerably. Total unit costs grew faster than factory-gate prices, with a corresponding squeeze on operating margins (see graph 1).

Graph 1 :



Investment being maintained

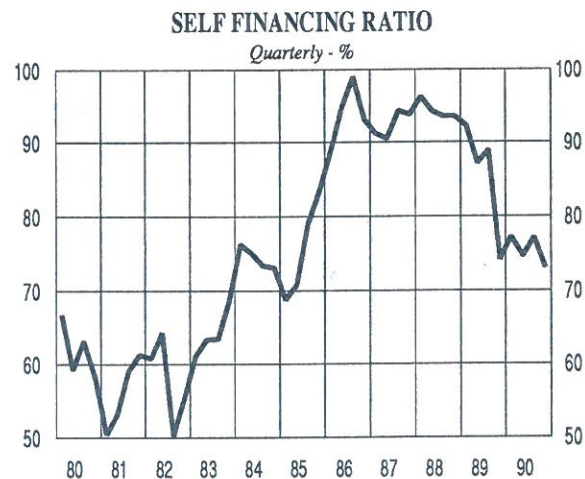
Productive investment, which is one of the most dynamic elements in the French economy, has remained high in 1990, with an annual growth rate of between 5 and 6% in volume, compared with 7% in 1989. As in 1989, it was the sheltered sector of the economy which was responsible for the slowdown, following the exceptional efforts of 1987 and 1988. The accelerator effect is gradually losing its impact.

Firms in the industrial sectors exposed to competition have continued their investment effort, on the other hand, with the annual growth rate as high as the last year (around 9% in volume terms). In response to a decline in their markets, and with the general climate highly uncertain, firms opted in the second half of the

year to shift their effort towards productivity investments at the expense of capacity investments (see box) in order to improve their competitiveness. The investment ratio of corporations and quasi-corporations has risen from 18.9% in 1989 to 19.2% in 1990.

But firms are now having to cope with increased financial constraints. Corporate debt is growing quite strongly. In 1990 the firms' self-financing ratio has fallen to around 75% from 85.6% in 1989 (see graph 2). On top of this, the stock market slump has obliged firms to call more heavily on bank lending to finance their investments, despite the high real interest rates. Heavy expenditures on productive investment in earlier years, coupled with the increase in interest rates, have pushed up the corporate debt burden, the savings ratio falling from 16.2% in 1989 to 14.5% in 1990.

Graph 2 :



A special INSEE business survey concerning the impact of the Gulf crisis was carried out between September 24 and October 10. The results show that the Gulf crisis has made French industry fully aware of the persistent slowdown in world activity and of the harmful effects of the fall in the dollar. With sales prospects on both the domestic and foreign markets now having to be revised downwards, most firms in industry, services or distribution have opted to maintain their capital expenditure and improve the efficiency of their installed plant. The preferred investments are now those that improve productivity and save energy, rather than capacity increases that would have produced more employment but would have been less certain to be profitable in present conditions. In order to cushion the impact of the lower dollar on their competitiveness, firms in manufacturing industry have chosen to cut margins and adjust their wage policies.

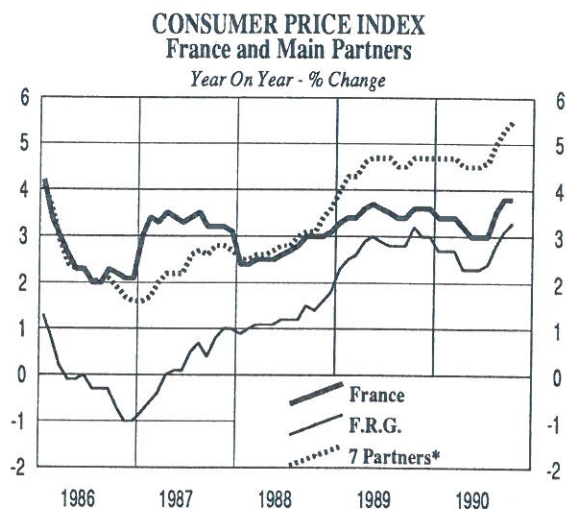
Slowdown in job creation

Taking 1990 as a whole, growth has continued to generate considerable employment, but the job-creation rate slowed down in the second half. The addition to employment during the year is put at 220,000, compared with 290,000 in 1989. The sector most affected by the slowdown in activity was manufacturing industry, which led to a fall in employment in the third quarter of this year. Most of the lay-offs were of workers on temporary contracts, whose increased use has meant that the labour factor can be most readily adjusted to changes in the level of activity, while the main sectors concerned were consumer goods and cars. In the construction and services sectors, by contrast, employment is thought to have continued to increase, but not as strongly as in 1989. The unemployment rate continued to fall until the third quarter of the year, but it is thought to have risen since then.

Inflation well under control

Despite the sharp increase in oil prices in the second half, the year-on-year inflation rate may be slightly under its 1989 level of 3.6%. The ex-energy rate has been steadily slowing down since the end of 1989, from 3.4% to 3.2%. The inflation differential vis-à-vis the principal trading partners continues to widen in France's favour and now stands at between -1.5 and -2 points. The differential vis-à-vis Germany remains less than 1/2 point (see graph 3).

Graph 3 :



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

Retail prices have been only moderately affected by the second-half rise in the oil price. Because of their high tax content, the retail prices of fuels have risen only 7.7% (year on year) in 1990.

The slowdown in prices, ex energy, stems mainly from an easing of food prices, especially the price of meat (beef and pork) which has levelled off in 1990. Price rises for manufactured goods from the private sector have remained moderate (rising by 2%, as in 1989) and have not been affected by the higher fuel costs, while public sector tariffs have risen only slightly (by 1%, following 1.1% in 1989).

Purchasing power growing more slowly but still high

The slowdown in the total private-sector wage bill since mid-1990 and the non-renewal of the special "growth bonus" (1) for civil servants weakened the purchasing power of household disposable income towards the end of 1990, but the purchasing power gains were still higher on an annual average basis than in 1989: 3.8% compared with 3.4%.

In the private sector, hourly wage rates grew faster in 1990 than in 1989. There was an acceleration early in the year as the result of the good company results for 1989 and also because of sectoral agreements in the public works and other sectors. In the second half of the year, the growth in hourly rates was in decline.

In the public sector, the average civil servant's earnings increased more slowly than in 1990, despite special increases for certain categories.

Social transfers made a positive contribution to growth in household incomes: the social benefits grew as fast as in 1989, while social contributions showed a tendency to slow down. Household income from property and dividends picked up again in 1990, as the result of the good company results in 1989 and the improved terms available on financial investments.

Slower growth in household consumption

Household consumption weakened in 1990, slowing down in the latter part of the year after being exceptionally high in the first quarter. The change seems to be the result partly of the decline in household purchasing power but also of the increased difficulty of obtaining credit. These factors were later joined by the impact of the Gulf crisis. There was evidence of an increase in precautionary behaviour, for example in the shape of advance buying of domestic heating oil and a postponement of purchases of durable goods. Purchases of cars and major household items slowed down considerably, whereas consumption of services remained brisk, rising faster than in 1989, as did food consumption.

This slower consumption out of a sustained volume of purchasing power is accompanied by an increase of almost one percentage point in the savings ratio, with the existence of new more attractive financial products

(1)A "growth bonus" warranted by the sharp increase in real GDP was paid out to all public-sector employees at the end of 1989.

contributing to a half-point rise in the financial savings ratio.

The widening in the external trade deficit due to the energy bill

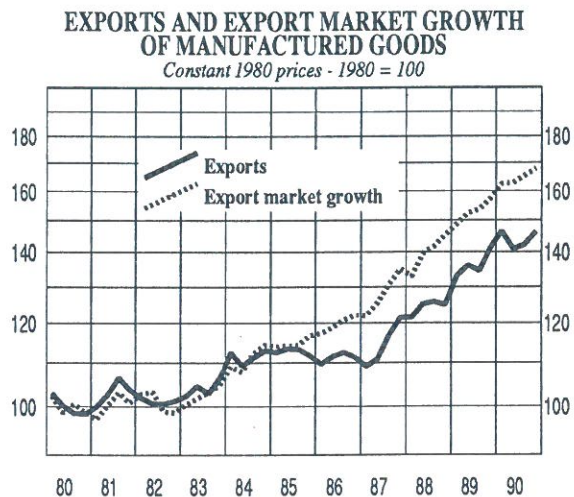
The trade deficit is thought to have widened to 55 billion francs (fob-fob) in 1990, 10 million more than in 1989. The deterioration was due to the increase of more than 10 billion francs in the energy bill (cif/fob) as the result of the higher oil price. The surplus on food and agricultural products remained at its high 1989 level of 50 billion francs.

Thanks to the improvement in the terms of trade, the deficit in manufactures for the year levelled out at around 55 billion francs (cif/fob), after widening by 17 billion in 1989. The export-import ratio, affected by losses in price-competitiveness, worsened slightly in 1990. Exports rose only 5.7% on average, compared with a rise of 7.5% in total demand on French export markets, implying a market share loss of the magnitude of 2 points (see graph 4). The slowdown was felt in all the main sectors apart from cars, which benefited from the strong German demand. Imports also rose less strongly than in 1989, because of the weakening of domestic demand, but nevertheless increased their share of the total French market, as the result of the less satisfactory tendency in domestic competitiveness (see graph 5). This turndown in imports was particularly noticeable for cars, because of lower demand from French households, but also for intermediate goods, in line with the slowdown in activity. Capital goods and consumer goods imports, on the other hand, benefited from the buoyancy of productive investment and to a smaller extent of household consumption.

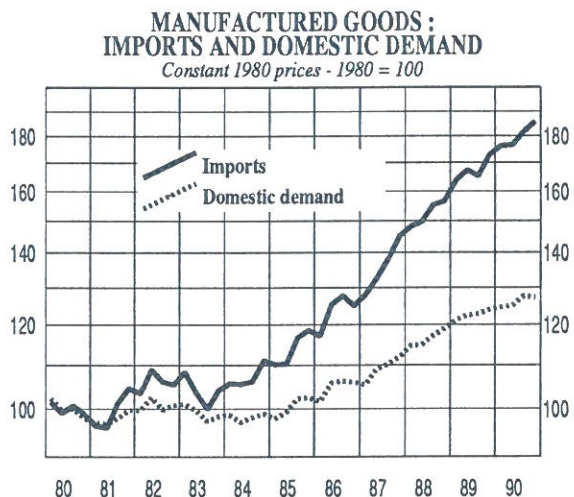
The services balance is thought to have remained high, although slightly down on the record performance of 1989. The balance on interest, dividends and other investment incomes deteriorated as the result of an increase in interest payments to non-residents following the large volume of security purchases from abroad at the end of 1989. For this reason and because of the increase in the trade deficit, the current-account deficit has widened in 1990.

Wage increases have moderated, inflation has been held at a low level and the trade deficit remains small, despite dearer oil. As against this, however, there has been a corresponding slowdown in real increases in the various economic

Graph 4 :



Graph 5 :



aggregates. In an international environment in which competition requires an unrelenting modernization effort, a high level of investment is a prerequisite for the French economy to face the coming years successfully.

Completed on December 18 1990.

