

SECOND HALF OF 1997

Acceleration in activity

The information published this summer on the economic situation have confirmed the existence of recovery in France and of the mechanisms underpinning it. French exporters are benefiting from a positive international environment and favourable exchange rates, to the point that the external sector remained the principal source of growth in the first half of the year.

Now, however, all the main components of domestic demand are gradually participating. Inventory changes were already making a positive contribution to activity in Q2 and this tendency is likely to be maintained in the second half. Private consumption, following a hesitant first half, is being helped by a

number of positive factors and was already picking in Q3. The upturn in investment is proving to be more gradual, with its evolution dependent mainly on the continuation of positive expectations on the part of industry.

GDP growth, after reaching an annualized rate of almost 2.5% in the first half, is expected to continue to accelerate to an annualized rate of more than 3% in the second, giving 2.3% annual average growth for the year as a whole. The acceleration in employment growth that was already perceptible at the end of 1996 and early in 1997 is set to continue between now and the end of the year. Given the above-trend growth in manpower resources, the result would be a stabilization of unemployment.

A buoyant international environment

The outlook for the world economy remains good for the second half of 1997. Growth remains solidly based in the United States and the United Kingdom, but the most notable feature is the entrenchment of the upturn in continental Europe. The stabilization of the Russian economy, following several years of recession, should make up for the slowdown now expected in the Central and Eastern European countries. The locomotive role played by the rapidly-developing countries is likely to weaken somewhat because of the South-East Asian crisis, which is also likely to delay recovery in Japan.

Figures published during the summer have confirmed the solidity of United States growth, which was in the region of 3.5% (annualized) in Q2. The momentum behind this growth is coming from domestic demand, with private consumption expected to rise by close to 3% in 1997 and growth in productive investment possibly exceeding 9%. The substantial increase in United States productive capacity should enable growth to be maintained in coming months without provoking any particular strains in the economy. Much the same tendency seems to be taking shape in the United Kingdom, even though investment there seems less dynamic than in the United States. Growth has been running at an annual rate of more than 3% for several quarters, propped up by lively household demand, and inflationary pressures should remain under control. Despite a predict-

able gradual slowdown, due essentially to the appreciation of the dollar and sterling and, in the United Kingdom case, to the recent tightening of monetary policy, growth in the two economies is likely to be not far off 3.5% in 1997.

The drop in Japanese activity in Q2 1997 had been expected. What was surprising was its extent, with GDP declining at an annualized rate of more than 12%, dragged down by domestic demand in reaction to the 1 April rise in the rate of sales tax. In coming months the Japanese economy will also probably be hit by the crisis affecting Thailand, Malaysia, the Philippines and Indonesia, countries which take 12% of Japan's merchandise exports and where the Japanese banking and financial systems have a significant exposure. Once these two influences are out of the way, there is still the probability of a return to moderate growth.

Continental Europe is experiencing an acceleration in activity. Year-on-year growth was close to 2% in mid-1997, as against 1% a year earlier. The end of the year could see it close to 3%, giving around 2.5% on an annual average basis. The export improvement that began in H2 1996 gathered pace in H1 1997 under the influence of the exchange-rate movements. At the same time, the higher import prices associated with the depreciations of the European currencies led firms to adopt inventory behaviour that in turn helped to accelerate activity. This was the first manifestation of the enlargement of the recovery to domestic demand. With interest rates still favourable, the acceleration in demand was able to give a boost to investment -- a tendency that is already visible in certain countries, including Germany. And house-

Gross domestic product (at 1980 prices) by type of expenditure

(% change from previous period)

		1996				1997				1995	1996	1997
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	(100%)	1.3	-0.2	0.8	0.2	0.3	1.0	0.9	0.9	2.1	1.5	2.3
Imports	(29%)	3.0	-1.4	3.0	1.3	-0.2	3.1	3.0	2.1	5.1	2.8	6.4
(of which merchandise)	(26%)	2.3	-1.7	4.0	0.9	0.0	3.5	3.0	2.1	5.8	2.4	7.0
Households' consumption	(60%)	2.4	-0.9	0.9	-0.5	0.2	0.0	1.4	0.7	1.7	2.1	0.9
General government consumption	(19%)	0.6	0.3	0.5	0.5	0.4	0.3	0.6	0.1	0.0	1.4	1.7
Total investment (GFCF)	(20%)	-1.1	-1.2	1.8	-0.1	-1.2	0.0	0.7	0.8	2.5	-0.5	-0.1
Corporate sector ⁽¹⁾	(11%)	-1.2	-1.4	2.9	-0.3	-1.3	0.4	0.8	1.1	3.3	-0.7	0.4
Households	(5%)	-2.5	1.4	0.1	0.8	-2.5	0.0	1.1	0.7	2.3	-0.2	-0.9
Exports	(29%)	4.8	-2.0	3.6	1.9	2.0	4.8	1.7	2.1	6.3	4.7	10.0
(of which merchandise)	(24%)	4.1	-2.2	4.4	1.5	2.2	5.9	2.0	2.1	7.9	5.0	11.3
Domestic demand		0.8	0.0	0.7	0.1	-0.4	0.4	1.3	0.9	1.8	1.0	1.2
Contributions to the growth of GDP												
Inventory changes		-0.5	0.7	-0.3	0.3	-0.3	0.4	0.2	0.3	0.3	-0.5	0.3
Trade in goods and services		0.5	-0.2	0.2	0.2	0.7	0.6	-0.3	0.0	0.3	0.6	1.1
Domestic demand excluding inventories		1.3	-0.7	1.0	-0.2	0.0	0.1	1.1	0.6	1.5	1.4	0.9

(1) Corporate and quasi-corporate enterprises (including unincorporated enterprises)

Forecasts

hold incomes in all countries but to differing degrees are likely to benefit from the upturn and so permit a gradual acceleration in consumption, against a background of controlled inflation.

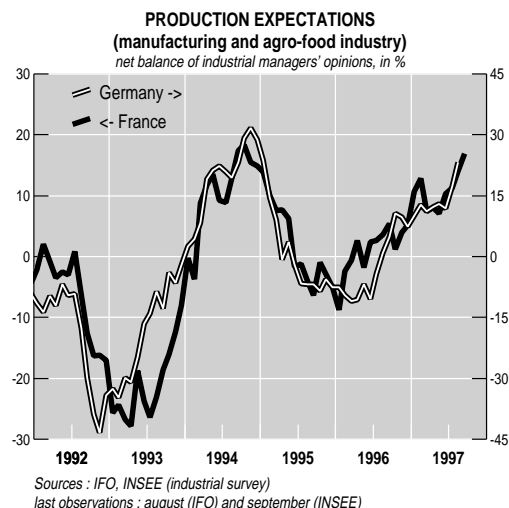
Industry and exporters the initial beneficiaries of the upturn

France is participating in this general tendency in continental Europe. The national accounts for Q2 have confirmed the acceleration in activity, which has now lasted since mid-1996. Ignoring the vagaries of the working calendar, which has produced some wide intra-period fluctuations, growth in H1 1997 was at an annual rate of close to 2.5%. The first sector to benefit has been industry, with the year-on-year rise in manufacturing output reaching 4.2% in mid-1997, up from 1.7% at the end of 1996. Business surveys for July and September indicate that this acceleration is set to continue, with year-on-year growth in manufacturing output probably around 6% by the end of the year. Other parts of the economy are likely gradually to participate in the improvement, with activity picking up in the building and public works and accelerating in the energy, agro-food and tertiary sectors.

The upturn originated in the external sector, with net exports accounting for more than half the growth recorded in Q2. French exporters have been able to take advantage of the strength of the world economy but they have also benefited from the improved competitiveness brought about by the depreciation of the franc's effective exchange rate (almost 7%, year on year, at the end of September), which helped them to make significant market share gains. In addition, as far as the manufacturing sector was concerned, certain exceptional exports (Airbus, merchant ships) were particularly strong this year. For 1997 as a whole, the trade surplus (customs basis) seems likely to set a new record, of the order of FRF 170 billion (fob-fob).

Recovery in corporate demand

In coming months, the cyclical gap between France and its main trading partners is likely to narrow progressively. This tendency would stem partly from the slowdown in the United States and United Kingdom economies, but most of the catching-up would come from an acceleration in French domestic demand. This has already been seen to some extent in Q2, operating through the



demand from the corporate sector. The acceleration in re-stocking seen in Q2 shows signs of being intensified -- replies to the latest business surveys show firms still regarding their inventories as being on the low side. This is especially true of the intermediate goods sector, where de-stocking had been particularly substantial in 1996. This same sector is also reporting order books to be well above average, signalling that price rises are to be expected. These various elements taken together suggest that inventory changes will turn out to have made a substantial contribution to growth in manufacturing output in H2 1997.

Corporate investment, after falling slightly in 1996 and at the beginning of 1997, managed a timid recovery in Q2. There are three main explanations for this timidity, at a time of improving demand and with companies still enjoying a favourable financial situation. First, business leaders seem to be relatively prudent as to the durability of growth, an attitude reflected in the answers by some of them in recent surveys; second, borrowing costs have remained relatively high by comparison with the evolution in producer prices; third, there is still appreciable spare capacity. The importance of all three of these factors is now fading. Moreover, the corporate self-financing ratio is likely to remain at around 110% for the year (difficult to evaluate with any precision because of the counterbalancing effects of the decline in interest rates and the end-year rise in the rate of corporation tax). This would indicate that the conditions are now in place for an acceleration in investment growth in coming months, especially if expectations remain favourable. Several indicators (capital goods imports, sales at wholesale level) are showing that this acceleration was already taking place to some extent in Q3.

The determinants of household consumption positively headed

The purchasing power of household incomes, after stagnating in 1996, is expected to show an annual average rise of around 2% in 1997. For the time being, incomes are still benefiting from the cuts in income tax, from the exceptional increase in the new-school-year allowance and, on a more durable basis, from rises in wage rates and employment.

Over the year as a whole, household purchasing power is also being helped by the slowdown in the consumer-price rise (1.3% on an annual average basis, compared with 2.0% in 1996). The rest of the year should see the price rise pick up slightly, because of the depreciation of the franc. The effect is likely to be felt mainly in the manufacturing sector, where prices have been showing year-on-year falls since last May. Many of these falls have involved the car sector and prices in the sector seem now to have stabilized. Prices of manufactures can therefore be expected to start picking up again slightly, whereas those of telecommunications are set to fall. Price increases in the other sectors are likely to remain generally unchanged. All things considered, the year-on-year consumer-price rise is expected to be 1.2% in December 1997.

Taking just the first half of the year, the evolution in consumption (0.2% up on the previous half-year) was less than the corresponding figure of 1% for gross disposable income. Part of this slackness is explained by the car sector. Following the ending last October of the government's "car-scraping" bonus, monthly registrations fell almost without a break until June, when they reached a low of 110,000 (SA), lower than at any time in many years. Registrations recorded in Q3 (a monthly average of more than 150,000, SA) suggest a return to normal. More generally, the consumption of manufactures in July-August indicates an upturn in household purchases, pro-

ducing a statistical carry-over for the rest of Q3 of almost 3%. Despite the marked slowdown on an annual average basis (a rise of 0.9%, compared with the 2.1% recorded in 1996), consumption will in fact probably turn out to have accelerated in H2, and is likely to show year-on-year growth of more than 2% by the year-end -- thus tracking, with a small time-lag, the evolution in purchasing power. Excluding cars, consumption growth this year on an annual average basis would then be 1.5% (compared with 1.8% in 1996). The saving ratio, after falling by 1.5 points in 1996, would then have increased by 1 point on average in 1997, bringing it to around 13.9% of disposable income.

Employment gathering pace, stability in the unemployment rate

The most recent figures available for the year 1996 and H1 1997 have confirmed that dependent employment in the traded sector is responding rapidly to the current upturn. Certain sectors are admittedly lagging behind in this respect (building and public works, particularly), because of continuing weak activity. Even so, the upturn in employment, which had seemed initially to be confined to the services sector (including temporary employment), is gradually spreading to the rest of the economy. The fall in the manufacturing work-force has slowed down considerably, to the point that there may even turn out to have been net job creation in H2. Job losses in the building sector have also slowed down. In these circumstances, dependent employment in the traded sector could well rise by some 150,000 in 1997. Overall employment can be expected to move in parallel, with job creations in the non-traded sector making up for the fall in independent employment. When the evolution in the labour force is taken into account, the unemployment rate, after rising until Q3 1997, is likely to have levelled off in H2, at around 12.5%. ■

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