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I
Economic Developments in France:
June-September 1965

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Rodney H. Mills

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Economic Developments in France: June-September, 1965

Summary

Rising consumption and industrial output in the second quarter was evidence that the French economy was expanding again after nearly a year of recession, and further increases in output are expected this year and in 1966.^{1/} Credit markets eased over the summer, and foreign exchange inflows continued to be large. Changes in banking practices were announced, and revolutionary tax concessions will be offered to induce Frenchmen to save more.

Industrial production (excluding construction) in June was up 1.3 per cent over March and 2.5 per cent from its January low. The gain was concentrated in the consumer goods area. Consumer demand picked up in the second quarter, when personal incomes rose further and consumers became less reluctant to spend. Rising exports, increasing internal spending for public investment and consumption, and the boom in residential building should continue in the second half of this year, but stagnation of private business investment is expected to restrain the further advance in production. For 1966, officials project a 4-1/2 per cent rise in real GNP, compared with 2-1/2 per cent this year; this pick-up in the rate of growth depends in part on a reversal of this year's drastic decline in additions to inventories. The 1966 budget, announced in September, is calculated to help economic expansion.

^{1/} Earlier developments, including credit measures adopted in June, are reviewed in Economic Developments in France: March-June 1965, June 24, 1965.

Bond yields have receded moderately since mid-June, and, in response to seasonal influences, the money market eased noticeably in August. The authorities apparently wish to avoid any money market tension in the September-December period, and have reduced the banks' liquid assets reserve requirement applicable to those months.

On the external side, imports were a bit less depressed in June-July, and exports rose further. Official reserves (and France's IMF position) would have improved by \$310 million in the four months, May-August, had not France made a \$179 million debt prepayment to the United States on July 1. This prepayment, together with British and U.S. drawings of francs from the IMF and continuing gold purchases, reduced the foreign exchange holdings of the French monetary authorities to \$846 million on August 31.

Important banking reforms were announced on September 23. French banks will be able to make rediscountable term loans of up to seven years maturity, instead of five years. However, other rediscounting regulations have been tightened to guard against excessive demands for rediscounts of term loans. In another reform, the authorities have lifted long standing restrictions which, in the past, have separated the activities of the commercial banks from those of the banques d'affaires (mixed banks).

A fundamental overhaul of the taxation of investment income is being made to induce the French saver to save more, particularly by buying securities. Beginning next January, interest on bonds and savings deposits will not be taxed at a rate higher than 25 per cent. Moreover, if securities are purchased under a new 10-year savings plan, the income will be entirely tax free. Other steps are also being taken to encourage additions to savings deposits. These new measures follow other important tax concessions granted to stockholders earlier this year.

The government, however, has decided that future Treasury obligations, including savings bonds, will not carry the income tax exemptions traditional in the past, thereby removing a major element of discrimination in the competition for savings. Another innovation will be a large Treasury loan in October for relending to French industry as a means of encouraging an expansion in private investment.

Second-quarter production gain reflects increased consumer demand

Seasonally-adjusted industrial production (excluding construction) increased 1.3 per cent during the second quarter. Output turned up in February, advanced slightly further in March, stabilized in April-May, and then rose fairly sharply in June. The total gain from January to June came to 2.5 per cent, and it recouped all of the decline during the preceding eight months. (See Table 1.)

Table 1. France: Seasonally-adjusted Industrial Production, 1963-65^{1/}
(excluding construction; 1959 = 100)

	<u>1963</u>	<u>1964</u>	<u>1965</u>
January	123.4	137.0	135.4
February	121.2	137.3	136.8
March	115.0	137.1	137.0
April	125.2	138.4	137.2
May	129.3	138.5	136.8
June	130.5	137.8	138.8
July	132.0	137.6	n. a.
August			
September	132.1	137.8	n. a.
October	133.2	138.7	
November	131.2	137.4	
December	135.1	136.8	

^{1/} This is a new series. The seasonal adjustment takes account of the fourth week of paid vacation granted since 1963. The seasonally-adjusted series published in INSEE, Bulletin Mensuel, and used by the OECD, is inaccurate because of failure to make allowance for this change.

Source: INSEE, Situation et perspectives de l'economie française en juillet 1965, supplement No. 8 to Etudes et Conjoncture, 1965.

The second-quarter rise in over-all production was concentrated in lines producing consumer goods, according to surveys conducted by INSEE; output increased in textiles, clothing, automobiles, and other consumer durables. Stronger consumer buying was revealed by retail sales surveys, business turnover figures, and sales tax receipts. Retailers reduced their inventories, and producers' orders of consumer goods increased. Output of equipment goods was essentially unchanged, and changes in the production of basic and intermediate products were mixed.

A further rise in personal income was one factor behind the rise in consumption. Seasonally-adjusted total incomes from wages, salaries, and family allowances received by employees in industry, commerce, and government rose an estimated 1.3 per cent from the first to the second quarter. (See Table 2.) After correction for the rise in the consumer price index, the gain was 0.3 per cent, but the increase would have been larger had not a temporary factor raised the consumer price index sharply in June. These increases in income were slightly greater than those in the first quarter (although still less than in 1964). Employment and working hours are thought to have declined less, seasonally-adjusted, in the second quarter than in the first, and the rise in hourly wage rates (outside agriculture and government) accelerated from 1.3 per cent during the first quarter to 1.7 per cent during the second. (See Table 3.)

Table 2. France: Estimated Quarterly Increases in Incomes, 1963-65^{1/}
(seasonally-adjusted; percentage increase during the quarter)

	1963	1964				1965	
	<u>IV</u>	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>I</u>	<u>II</u>
Actual change	2.2	2.0	2.1	1.3	1.5	0.8	1.3
"Real" change ^{2/}	1.2	1.3	1.9	0.5	0.7	0.2	<u>3/</u> 0.3

^{1/} Incomes from wages, salaries, and family allowances (excluding those earned in agriculture).

^{2/} After adjustment for change in the consumer price index.

^{3/} Reflects a temporary factor which raised consumer prices sharply in June.

Source: INSEE, Situation et perspectives de l'economie française en juillet 1965, supplement No. 8 to Etudes et Conjoncture, 1965.

Table 3. Quarterly Increases in Hourly Wage Rates, 1963-65^{1/}
(percentage increase since end of previous quarter)

	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>
1963	1.8	2.5	1.8	1.5
1964	1.9	1.9	1.2	1.5
1965	1.3	1.7	n.a.	

^{1/} In private employment, excluding agriculture. Based on Ministry of Labor surveys of wage levels at beginning of each quarter.

Source: INSEE.

The second-quarter wage rate gain was to some extent seasonal, but INSEE concluded that the declining trend of wage rate increases at least came to a halt. The government and the nationalized enterprises continued to raise wage rates by 1 per cent per quarter, and family allowances and pensions were raised. Incomes other than from wages, salaries, family allowances and pensions, while not ascertainable, are believed to have increased.

A second factor affecting consumption was a favorable change in consumers' spending behavior. Since early in 1964, the French consumer had been earning more but spending less. In the 12 months, April 1964 to March 1965, the trend of consumption spending was slightly downward, although real incomes from wages, salaries, and family allowances rose by an estimated 3.3 per cent. By contrast, consumption increased in the second quarter of this year even though the rise in incomes was substantially smaller than in any quarter of 1964.

In other areas of final demand, higher exports helped to increase production and incomes. Seasonally-adjusted exports in the second quarter were up 7-1/2 per cent over the first. Residential building activity remained at a high level. However, it is not possible to estimate quarterly changes in this area nor in public and private investment.

Modest output increases are foreseen for second half

The INSEE survey of the French economic situation in July reported expectations of modest gains in economic activity for the second half of 1965.

Public investment will continue to be a source of strength for over-all demand. In 1964, investments made directly by government contributed 17.2 per cent of total fixed capital formation (excluding residential construction) or 2.5 per cent of GNP. For 1965, these outlays should rise a further 11 per cent valued at constant prices. Because these expenditures lagged greatly in the first half, a speed-up is anticipated for the rest of the year. Investment outlays by the national enterprises in 1965 are expected to rise in volume terms by 7.8 per cent. But exports, which rose rapidly in the first half, should not be expected to rise as fast in the second half. Housebuilding (5.7 per cent of GNP last year) should at least hold at its advanced level, especially since a large fraction is public housing financed by the government.

Investment expenditures by private business enterprises and competitive public enterprises (e.g., Renault) will, it is believed, continue to be a drag on growth. In volume terms, they are not expected to be greater in 1965 than in 1964. INSEE surveys suggest the volume will be down 6 per cent in manufacturing and up 6 per cent in agriculture, services, construction, etc.

Faster growth is forecast for 1966

French government experts have projected a gain in real GNP of 4.5 per cent for 1966. This rise will be almost double the 2.5 per cent rise expected for 1965. With a 9 per cent rise in imports in 1966 expected, total resource availability (production and imports) should be 5 per cent higher in 1966. (See Table 4.)

Those forms of spending not directly related to current income--exports, public expenditures, and private fixed investment--will rise 5.7 per cent at constant prices. This is less than the 7.3 per cent increase expected for 1965, because of a very sharp drop in the rate of rise of personal outlays for residential construction and somewhat smaller increases in government consumption and direct government investment. Exports will again rise 7 per cent. Investment by private and public enterprises, and public housing expenditures, will increase more in 1966 than in 1965. This forecast shows private investment expenditures on plant and equipment rising 3.5 per cent, after apparently stagnating this year.

A key to the stepping up of growth is inventories. This year's poor results can be largely related to the fact that inventory accumulation in 1965 shrank to less than one-tenth as much as in 1964, a decline equal to 1.9 per cent of the entire 1964 GNP. Stock-building is expected to increase nearly three-fold in 1966.

Table 4. France: National Accounts, 1964-66
(values in billions of francs)

	1964 (values at current prices)	Yearly percentage change at constant prices		
		1964	1/1965	1/1966
Available Resources	435.2	+6.5	+2.3	+5.0
A. GNP	384.8	+5.7	+2.5	+4.5
B. Imports (merchandise)	50.5	+13.4	+0.8	+9.0
Uses of Resources				
A. Exports	51.0	+7.3	+7.0	+6.9
1. Merchandise	45.7	+7.5	+7.4	+7.2
2. Net services	5.3	+5.2	+3.1	+4.0
B. Public Consumption ^{2/}	18.7	+6.4	+6.6	+4.5
C. Gross Fixed Investment	88.8	+8.5	+7.2	+5.4
1. Government ^{2/}	11.4	+9.4	+11.2	+9.1
2. Households (housing)	17.3	+17.9	+18.2	+5.0
3. Enterprises (nonfinancial)	60.0	+5.4	+3.3	+4.7
a) Public: plant & equipment	(17.2)	+8.4	+8.5	+6.6
b) Private: plant & equipment	(35.4)	+4.0	n.a.	+3.5
c) Housing	(7.5)	+10.2	n.a.	n.a.
D. Increase in Inventories ^{3/}	8.9	+104	-91	+167
E. Private Consumption	267.8	+4.2	+2.4	+4.1

^{1/} Forecast.

^{2/} Including financial enterprises, for which amounts are extremely small.

^{3/} The increase in inventories declined from 8.9 billion francs in 1964 to 0.8 billion francs in 1965, and is expected to rise to 2.2 billion francs in 1966.

Sources: For 1964, Ministry of Finance and Economic Affairs, Rapport sur les comptes de la nation de l'année 1964; for 1965 and 1966, Le Monde, September 22, 1965.

Total spending other than private consumption will rise 6.5 per cent in 1966, compared with 2.1 per cent in 1965. The rise in private consumption will be 4.1 per cent, up from 2.7 per cent this year.

In September, Finance Minister Giscard d'Estaing presented France's first 100 billion franc budget to the National Assembly. Total outlays of 106 billion francs are 6.6 per cent more than the amount budgeted for this year (6.8 per cent rise in 1965). The budget again shows a balance between receipts and expenditures. However, the budget should be regarded as at least a potential stimulant to the economy, because the rise in receipts necessary to the balanced position is predicated on a rise in GNP of close to 6-1/2 per cent at current prices and of 4-1/2 per cent at constant prices. A failure of GNP to rise as expected would produce a deficit which would have the effect of propping up the economy.

Financial markets turn easier

Bond yields in France declined after mid-June, and most of the rise which occurred in the spring was reversed. Yields on public sector bonds calculated by the Bank of France eased from 5.80 per cent (net of withholding tax) in mid-June to around 5.70 per cent in July-August and returned to 5.73 per cent by September 17. Yields on corporate bonds fell 13 basis points from their mid-June level, to 6.33 per cent in September. Yields before withholding tax on July 31 were 6.10 per cent on public sector bonds and 7.12 per cent on corporate bonds, according to a new series published by INSEE. (See Table 5.)

Table 5. France: Bond Yields, 1965 ^{1/}
(in per cent per annum)

A. Bank of France series (net of withholding tax)

<u>Week ended</u>	<u>Public Sector</u> ^{2/}	<u>Corporate</u>
January 8	5.72	6.23
March 12	5.73	6.26
June 18	5.81	6.46
July 30	5.70	6.31
August 27	5.70	6.29
Sept. 17	5.73	6.33

B. INSEE series (gross yields) ^{3/}

<u>Date</u>	<u>Public Sector</u> ^{2/}	<u>Corporate</u>
February 28	6.31	7.16
March 31	6.31	7.23
April 30	6.32	7.32
May 31	6.28	7.28
June 30	6.27	7.24
July 31	6.10	7.12

^{1/} Excluding indexed and participating bonds.

^{2/} Excluding Treasury bonds, because tax exemption features result in artificially low yields.

^{3/} These yields are computed only for the last day of each month, beginning February 1965.

Sources: Bank of France and INSEE.

The money market eased in August with the seasonal decline in the currency circulation. Until that time, the market had remained tight. Bank of France intervention (together with maintenance of the banks' liquid assets reserve requirement at a reduced level of 34 per cent) was necessary to keep end-of-month rates for day-to-day money from exceeding 4-7/8 per cent. Since early August, rates have been at or close to 3-1/2 per cent, even though the "normal" 36 per cent liquid assets reserve requirement was restored in August. The 3-1/2 per cent rate, equal to the basic discount rate, is an effective floor to the price of day-to-day money, and its persistence is a sign of easy conditions.

In September, the Bank of France took steps to forestall a tightening of the money market at the year-end. On September 20 the banks' liquid assets reserve requirements was reduced to 34 per cent through the end of December. For 1965, the 36 per cent level, heretofore considered to be "normal," will have been in effect for only four months.

Imports and exports increase

French imports in June-July were 2.1 per cent above the April-May average (seasonally-adjusted), probably in response to increased internal production. This rise was the first sign of a revival of imports, which have been depressed this year; the recent pick-up still left them 2.3 per cent lower than in the last quarter of 1964.

Exports have risen further, although not so fast as earlier this year. July exports, seasonally-adjusted, were up 3.3 per cent from April, and were 9.8 per cent more than in the last quarter of 1964. Since April, monthly changes in the trade balance have been erratic.

The surging demand for imports in Germany has been important to the sharp export gains registered this year by France and other countries (Italy in particular). French exports to Germany (France's largest foreign market) in the second quarter were 23 per cent more than a year ago, compared with an 8 per cent rise in exports to other countries. In absolute figures, exports to Germany in the second quarter were nearly \$90 million more than a year earlier, or \$360 million at an annual rate.

Reserve gains continue to be large

France's official reserves and IMF position increased \$136 million in May-June, and would have risen \$174 million in July-August in the absence of a debt prepayment to the United States amounting to \$179 million.^{2/} The IMF position (including lendings under the GAB) rose \$216 million, mainly because of the British drawing in May and a U.S. drawing of \$40 million equivalent of francs at the end of July. Gold reserves rose another \$245 million in May-August. Holdings of foreign exchange were greatly reduced by the U.K. and U.S. Fund drawings and by the debt prepayment, and they fell \$266 million; at the end of August, these holdings were \$846 million.

^{2/} These "pairings" of months are made because the separate monthly figures are greatly distorted by lags in the conversions of francs drawn from the IMF.

In the first six months of this year, official reserves and the IMF position rose \$429 million, but the French balance of payments surplus was larger than this figure. The French commercial banks reduced their net foreign liabilities by \$109 million in these six months. The sharp decline of \$63 million in these liabilities in May helps to explain why the official reserves and IMF position (adjusted for the delay in Britain's conversion of francs) rose only \$22 million in May.

Financial reforms are announced

On September 23, Finance Minister Giscard d'Estaing announced a long series of far-reaching financial reforms affecting bank credit, bank deposits, rates of taxation, and outlets for savings. The reforms have three major goals: (1) to make banking practices more flexible and better able to serve the needs of both borrowers and depositors; (2) to increase saving, particularly long-term saving and purchases of securities; and (3) to narrow the area of tax discrimination on investment income.

a. Bank credit. The maximum maturity of commercial bank loans rediscountable at the Bank of France is raised from five to seven years in the cases of new equipment and construction credits, effective next January 1. (Exports credits and outstanding credits are not affected.)^{3/} The banks have been legally allowed to extend

^{3/} In the past year the Bank of France has been sending to the Federal Reserve System material clarifying and detailing important changes in French financial regulations.

credits of more than five year's maturity, but the inability to rediscount them has helped to keep the amount of such credits at a low level.

To reduce the possibility of excessive bank demand for rediscounts of longer-term paper, the Bank of France will not discount equipment and construction credits which, at the time of rediscounting, have more than three years remaining to final maturity. Until now, the Bank has been willing to take up paper with as much as five years to run. In addition, the Bank will apply a penalty rate on paper with more than two years to run (probably 1/2 of 1 per cent above the normal rate).

These reforms are important because medium-term lending by the banks, and rediscounts of such loans, have attained large proportions since World War II, when steps were taken to overcome French banks' former reluctance to enter this field.

b. Bank deposits. A major distinction between the commercial banks and the mixed banks (banques d'affaires) is removed.^{4/} Commercial banks will be allowed to accept time deposits, and issue deposit certificates, with more than two years maturity, which was not formerly allowed. The banques d'affaires will be freely allowed to accept deposits at sight or of less than two years maturity, a facility which was formerly greatly restricted. This reform should stimulate inter-bank competition and widen the scope of operations in which an individual bank will wish to engage.

^{4/} The banques d'affaires engage in both investment and commercial banking.

c. Tax and other incentives for savings. Beginning next January 1, French savers will be able to purchase securities over a 10-year period and be exempted from paying any income tax whatsoever on the interest and dividends, if they enroll in a new savings plan. The saver must make a "savings commitment contract" with his bank or broker, obligating him to deposit a fixed amount each year, quarter, or month, for ten years; the saver may choose the securities to be bought with these funds. All income from the securities is to be reinvested. If any funds are withdrawn before ten years, all the income earned since the contract was signed becomes taxable. This plan is designed for the "small-saver": the annual deposits cannot exceed one-fourth of the saver's average annual income in the three previous years. The prescription of fixed and continuing deposits is to prevent massive transfers of funds out of other savings instruments.

Interest on other forms of savings will also benefit from reduced income taxation effective next January. Interest on bonds purchased in the ordinary way (i.e., not under the long-term savings plan) and interest on savings accounts with commercial banks will be taxed at a special rate of only 25 per cent, at the taxpayer's option, instead of at ordinary income tax rates which might effectively be much higher.

Savers will be allowed to put more funds into deposits with the savings banks. Heretofore, the maximum deposit has been 15,000 francs per person. (The interest is tax-free.) Savers may

now also own "complementary" deposits of up to 15,000 beginnings in January. The interest on the complementary deposits will be subject to a maximum 25 per cent income tax.

A special saving incentive is offered to prospective homeowners. A new type of savings deposit in a commercial or savings bank entitles the depositor to a mortgage, the amount and maturity of which increase proportionately with the duration and amount of the deposit. Interest on the deposit (2 per cent) is tax-free, and the borrower receives a tax-free interest subsidy.

d. Some tax exemptions are removed. The government is moving to abolish the tax preferences which it has traditionally granted on its own instruments. No income tax has been paid on Treasury savings bonds, a popular savings instrument similar to U.S. savings bonds but with shorter maturities (one to five years). Starting next year, interest on new issues of these bonds will be taxable up to a maximum rate of 25 per cent. The same change of tax status also applies to the deposit certificates of the Caisse Nationale du Crédit Agricole.

Long-term bonds issued by the French Treasury since World War II have enjoyed total or partial tax exemptions. The next issue, probably in October, will not carry fiscal privileges (other than the 25 per cent maximum rate). It seems likely that this will represent a permanent change in the tax status of Treasury bonds.

The October issue, which will be for 1 billion francs for 15 years, will be an innovation in another sense, because the Treasury will reloan the proceeds to industry (private and public). French industry cannot borrow directly on the capital market as readily or as advantageously as the Treasury. Industry will pay, on the average, the same 5-1/2 per cent rate which the bond coupons will carry. In reflection of the absence of a tax exemption, this rate is much higher than the 4-1/4 per cent coupon on tax-free Treasury issues last year. But bond issues of industrial borrowers this year have carried yields between 6.5 and 6.6 per cent.