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Recent Economic Developments in France:
December 1965 - March 1966

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Summary

Economic conditions in France showed further improvement in the period under review, partly because private business investment seems to have finally turned upward.[1/] Investment this year will be encouraged by a 10 per cent investment tax credit, as well as by the impulses from the cyclical upturn. Monetary policy is designed to encourage expansion, and the authorities have been forced to take steps to prevent an unwanted tightening of credit in response to external monetary influences as well as domestic fiscal developments.

On February 16, the government proposed that French enterprises be permitted to deduct from their income tax liabilities 10 per cent of their expenditures for equipment goods. In general, the credit would apply to equipment amortizable over eight or more years, but would be restricted to equipment delivered in 1966 or 1967. Even though over-all economic activity is expected to expand at a satisfactory rate this year, French official and industrial circles have been concerned over the effects on French productivity growth of a possible prolongation of the recent weakness of private outlays on plant and equipment. Total expenditures of this type, deflated for price rises, increased at only 4 per cent yearly in 1963-64 and probably even declined in 1965; in manufacturing alone, they are believed to have decreased in

1/ For a review of earlier developments, see Economic Developments in France: September-December 1965, January 4, 1966.

all three years. A profit squeeze in 1963-64, together with adverse effects on producer expectations from the stabilization plan, are commonly cited as important causes of this weakness.

Industrial production in December was 7 per cent higher than in the first quarter of 1965; a setback in January was attributed mainly to the weather. (See Chart.) Gains in employment and working hours in the fourth quarter, together with another 1.4 per cent quarterly rise in wage rates, boosted incomes and helped keep consumption expenditures on the rise. (See Chart.) Exports and government expenditures rose further, but outlays on housing may have levelled out after a boom of several years' duration. French government economists believe that private fixed invesment stopped falling and began to rise late in the second half of 1965. The near-term economic outlook in France is favorable. All major categories of spending, except outlays on housing, are expected to show satisfactory increases in 1966, and the rise in industrial production is projected at a 7-8 per cent annual rate in the first half year.

Tightness in the Paris money market since last November can be traced to two sources. Treasury credit from the Bank of France has been cut back, while tighter monetary conditions abroad--notably the U.S., Canada and Britain--have induced French banks to add to their net foreign assets. The Bank of France has intervened massively to prevent undesirably high money rates, and in March the authorities reduced the banks' liquid assets reserve requirements by 3 percentage points. The French authorities continue to make important structural

reforms in the financial field, the latest reform being the abolition of minimum bank lending rates in March. After more than 20 years, the banks are again free to set their own rates, but no widespread reductions are expected for the near future.

Provisional data show France's external surplus rising from about $800 million in 1964 to $1.1 billion last year, because of a favorable shift in the trade balance to which the stabilization plan contributed strongly. (See Chart for trade and reserve changes.) But the net inflow of foreign long-term private capital fell quite sharply, by nearly $150 million. All of the yearly decline was concentrated in the fourth quarter, but further details are needed before the reasons for the decline become clear.

Expansion rates of bank credit and money supply were little changed in the fourth quarter. In December, the increases in outstandings from one year earlier were 11.1 per cent for bank credit and 9.4 per cent for money supply; in both instances, the annual increases were only minimally larger than those which took place in 1964.

The French economy in 1965 continued to be characterized by a much more rapid rise in the money supply than in the value at current prices of France's gross national expenditure, which last year probably rose 4.50 to 4.75 per cent. In the six years 1960-65, the money supply has increased, on the average, at a rate some 40 per cent faster than the money value of gross national expenditure.

Investment credit is proposed

On February 16, the government announced a number of proposals in the economic field, one of which--an investment tax credit--is of major significance for the national economy. The administration is anxious to promote an upturn in private investment spending, not for business cycle reasons but rather to improve the prospects for longer-run French productivity growth.

The investment tax credit proposal, which must be passed by Parliament, would permit companies and individuals to deduct from business and personal income tax liability a sum equal to 10 per cent of expenditures for equipment goods to be amortized over eight or more years; machine tools and certain trucks, however, will qualify regardless of the length of their economic life. A major omission from the list of eligible expenditures is building and other construction outlays, which currently are about 30 per cent of total business fixed investment. These exceptions to the general rule probably reflect the fact that the machine tool and commercial vehicle industries have languished during recent years, while the housing boom and expanding public works have kept the construction industry at a high level of activity. Because the government wants the investment credit to have an early impact on investment spending, the time period for application of the credit is scheduled to be quite short. To be eligible for the credit, the equipment must be either 1) delivered between February 15 and December 31, 1966, or 2) ordered in that period, and delivered prior to the end of 1967 unless delivery requires more than a year.

The investment credit proposal underscores the concern existing in both official and industrial quarters over the weakness that has persisted for several years in certain forms of investment spending in France, specifically, private enterprises' outlays on plant and equipment. In the last year (1964) for which precise data are available, expenditures in this category accounted for 40 per cent of total gross fixed investment expenditures and 55 per cent of total gross fixed investment exclusive of the construction of dwellings. Private companies' plant and equipment outlays (deflated for price rises) increased at an average rate of 12 per cent a year in 1960-62; the annual increases then dropped off sharply to around 4 per cent in 1963 and 1964, and in 1965 these outlays (in real terms) are believed to have been about 2 per cent less than the year before. According to INSEE estimates based partly on direct surveys and partly on national accounts data, this slowing and retrogression was more marked in manufacturing than in the other sectors as a group (construction, agriculture, and services).

Two major explanations have been given for this development. First, private corporations' after-tax profits, which increased 33 per cent from 1959 to 1962, rose only 4.3 per cent in 1963 and 6.7 per cent in 1964, expressed in money terms. But the prices of materials used for plant and equipment rose 4.5 per cent in 1963 and nearly 3 per cent in 1964; the increase in "real" profits was therefore nil in 1963 and only about 3-1/2 per cent in 1964. This erosion of profits adversely

affected private companies' ability to finance expansion from retained earnings; the percentage of total (fixed and inventory) investment expenditures financed from retained earnings in fact declined from 66 per cent in 1962 to 57 per cent in 1964 for all types of private companies and sole proprietorships outside of agriculture.

A second widely-cited cause of weak private investment is the 1963 stabilization program. In 1963-64, the stabilization plan affected investment mainly through expectations of a slowdown of economic activity. In 1965, although French production was rising throughout the year, the degree of unused capacity was sufficient to discourage any speed-up of plant expansion.

Social measures are announced

The investment credit proposal was accompanied by the announcement of a number of other measures of a "social" nature designed specifically to aid the lower income groups. These steps included:

a. a 2.1 per cent increase in the general minimum wage and a 3 per cent increase in the agricultural minimum wage;

b. a decision to build 27,000 low-cost public dwellings over the next three years, to replace shantytowns and to house the aged, young workers, and unmarried persons. (This number of dwellings, at an annual rate, is 1-1/2 per cent of the 590,000 dwellings for which construction permits were issued in the 12 months ending September 30, 1965.);

c. the increase in family allowances on August 1 will be 4.5 per cent instead of 3.5 per cent as originally planned;

d. a 5 per cent rise in old age pensions under social security will occur on July 1 instead of October 1.

Business conditions improve further; investment revival is expected

Economic activity continued to expand through the end of 1965 and into the early weeks of the current year. French government experts believe that, sometime during the last half of 1965, the decline in private industries' outlays on plant and equipment came to an end. An expected revival of these expenditures is one element in the upward course which the French economy is expected to take in 1966.

Seasonally-adjusted industrial production (excluding construction) advanced strongly through December, when it was 7 per cent above its average level in the first quarter of 1965, the cyclical low point. The index dropped a sharp 2.1 per cent in January. (See Chart.) However, this is thought to have resulted mainly from extremely cold weather conditions; moreover, because the monthly rise in December was particularly large, random factors may have shifted some production back from January to December.

The production gain from the first quarter to the fourth of last year was spearheaded by two important consumer goods industries, viz., automobiles (up 26.7 per cent) and textiles (up 11.7 per cent). The 1965 production recovery was in fact general for the consumer goods industries with the sole exception of electrical appliances, according to INSEE surveys reported in the INSEE's Situation and Outlook for the French Economy in January 1966 released in early March. Consumer expenditures continued to increase through the end of the year, but INSEE surveys and retail sales data do suggest that the increase was somewhat less vigorous in the autumn than it had been in the spring and summer.

Private industrial expenditures on plant and equipment probably reached a bottom and then turned upward sometime in the second half of 1965. INSEE experts reached this conclusion partly on the basis of the semiannual questionnaries in which businessmen indicate relative changes in their orders for capital goods (equipment goods and construction). In addition, in the equipment goods industries themselves, the replies to the recent monthly surveys show a definite upturn in production in the months November through January. Rising exports and increasing government expenditures were other elements producing a growing aggregate demand. In housing, however, a levelling off of activity in the late months of the year may have occurred.

Labor market developments in the fourth quarter were uniformly favorable to expanding demand. From October 1 to January 1, total man-hours worked (seasonally adjusted) increased 0.4 per cent: both employment and the length of the average work week were up 0.2 per cent. For employment, this was the first increase since the third quarter of 1964. (See Chart.) Wage rate increases have been very stable over the past year. The 1.4 per cent rise in average hourly wages (in private employment) in the fourth quarter was equal to the rise occurring in the same quarter a year earlier, and compared with increases of 1.4, 1.5, and 1.3 per cent in the first three quarters of 1965. In January, these wage rates were 5.8 per cent higher than a year earlier. (See Chart.)

The near-term outlook for the French economy is quite favorable, in the view of INSEE economists. They estimate that overall industrial output in the first half of 1966 will rise at an annual rate of 7 to 8

per cent. Some acceleration of consumer demand is probable, and retailers' orders to industry will rise at least as rapidly as in the second half of 1965. Concurrently, private expenditures on plant and equipment will revive. For the full year 1966, the value (at constant prices) of these outlays could well be 4 per cent more than the annual total for last year. Because these expenditures were declining during 1965 but are expected to be rising during 1966, the rate of rise during 1966 could be appreciably faster than 4 per cent. (The projected 4 per cent rise in annual totals is a bit greater than the 3-1/2 per cent increase shown in the 1966 national accounts projections made last autumn.) This INSEE forecast, based largely on surveys made in late 1965, does not take account of the effect on producers' intentions of the 10 per cent investment credit. Total investment will be strengthened by projected increases (in real terms) of 9 per cent in government investment expenditures and of about 6-1/2 per cent in plant and equipment expenditures of public enterprises. The only category of spending likely to weaken appreciably in 1966 is expenditures on housing, which may show little if any rise.

Bank of France moves to combat tight money

The French money market has been subject to strain almost continuously since early November, because of developments in the French public finances and the tightening of credit conditions in the United States and some other foreign countries. This tightness does not show up very strongly in market rates; the Bank of France has kept call money rates from exceeding 4-5/8 per cent, the informal "ceiling" which

the Bank has maintained since the discount rate reduction of April 1965. To this end, the Bank has made purchases of money-market paper in amounts and at rates of interest determined on a day-to-day basis by the authorities, such accommodation being extended en pension (with repurchase) for several days straddling the month-end when market pressures are strongest. At the end of February, the Bank had to extend what it termed a "massive" amount of such accommodation to hold the market rate, even though the banks were also rediscounting at penalty rediscount rates.

The monetary authorities do not want credit conditions in France to tighten, but in early March they estimated that the next two months (at least) would see no essing of basic conditions and might see a tightening. Consequently, in mid-March the Bank of France announced that the banks' liquid assets reserve requirement would be reduced from the current 35 per cent to 32 per cent for March 31 and 33 per cent for April 30.

Banking system accommodation from the Bank of France has continued to run high in 1966, averaging 16.3 billion francs in the first 10 weeks of this year compared with 13.2 billion francs a year earlier. A major cause of this tightness has been the relatively low level of Treasury indebtedness to the Bank of France since last autumn. In the first 10 weeks of this year, it averaged 10.1 billion francs, down from 12.4 billion francs in the year-earlier period.

A small part of this difference results from the fact that to date the Treasury has reportedly disbursed to industry less than one-half of the proceeds of last October's 1 billion franc National Equipment Loan.

The larger part stems from a sudden change in the balance of the public finances last autumn. In October-November, the surplus of Treasury cash receipts over disbursements for those two months was 1.4 billion francs more than in the same months of last year, because of a swelling of tax receipts and some lags in expenditures, and since November there has evidently been no year-to-year deterioration in the Treasury's position.

At the end of November, Treasury operations showed an 11-month surplus of F 1,540 million, compared with F 590 million in November 1964. There was a cash deficit for the full year 1965; but this deficit may have been F 1 billion smaller than the 1964 deficit of F 3.46 billion which had been made up of F 1.90 billion of long-term debt redemption and a F 1.57 billion deficit on budgetary transactions. Finally, a third reason for the decline in Treasury recourse to the Bank of France was a larger inflow of funds to the Treasury from lenders other than the Bank of France. In the first eleven months of 1965, net borrowings from all other lenders amounted to F 1.1 billion, compared with a virtual zero for such borrowings in the year-earlier period.

The French money market has also been tightened by the pull of tighter money abroad which has induced French banks to add to their net foreign assets. Ordinarily, the foreign exchange accruing to France (because of the French surplus) is sold to the Bank of France by the French commercial banks, which must meet the public's rising demand for currency. However, in December, January, and most of February, the banks either added to their placements in foreign centers, or used exchange to pay

off foreign borrowings, in amounts that were very substantial (probably close to $150 million, or 740 million francs, in December and January). This channelling of funds abroad served to reduce French official reserve gains (including changes in the IMF position) to only $10 million in December and $17 million in January. February reserve gains totalled $35; nearly all of it accrued in the closing days of the month when the banks repatriated funds because of the tightness of conditions in Paris.

French monetary conditions have remained quite stable in recent months. Bank credit rose 9.9 per cent in the fourth quarter, an increase that was almost entirely seasonal and which was scarcely larger than the 9.1 per cent rise of a year earlier. At the end of December, outstanding credit was up 11.1 per cent on the year, compared with an annual increase of 10.8 per cent during the course of 1964. The money supply increase of 2.0 per cent (seasonally-adjusted) in the fourth quarter compares with quarterly increases in the seven previous quarters of 1964-65 which ranged between 1.6 and 3.1 per cent and averaged 2.1 per cent.

The money supply in France has continued to exhibit one of its outstanding secular characteristics, viz., the tendency to increase much faster than national expenditure valued not only at constant prices but at current prices as well. In the six years 1960-65, for example, the annual increases in the money supply averaged 40 per cent greater than the increases in gross national expenditure valued at current prices. In 1965, the differential was larger than this 1960-65 average.

The money supply rose 9.4 per cent during the course of the year (December to December) and averaged 8.8 per cent more than in 1964; the value of gross national expenditure at current prices in 1965 can be estimated at 4.50 to 4.75 per cent above 1964, corresponding to an estimated increase of 2.3 per cent in real terms and a rise in prices of similar magnitude.

Stabilization plan increased 1965 external surplus

The effects of the stabilization plan launched in 1963 could be seen in the increase in the French balance of payments surplus from $796 million in 1964 to $1,091 million (provisional) in 1965. (See Chart for 1965 reserve gains.) The cause of the rise was a shift in the trade balance (f.o.b.) from an $89 million deficit in 1964 to a $480 million surplus last year, as measured on a payments basis.

Last year was an excellent one for French exports; for the year as a whole, exports to countries outside the franc area were 14 per cent more than in 1964. Strongly rising import demand in Germany, Italy, and the United States were important to the rise in French exports, but an additional factor was the smaller price increase in France than in most European countries. The effects of the stabilization program were more apparent in the behavior of French imports, which moved sideways for the first half of the year and then started to increase again in response to the expanding domestic economic activity. (See Chart.) Imports from countries outside the franc area last year totalled only 4-1/2 per cent more than in 1964.

Investment inflow declined last year

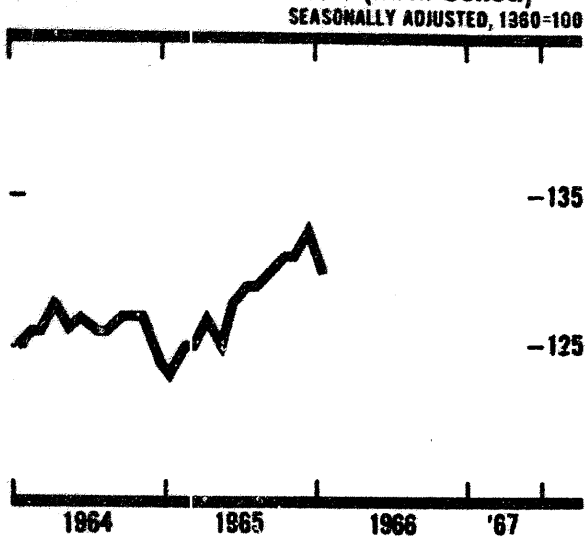
In contrast to the shift in the trade balance, the net inflow of long-term private capital into France decreased significantly last year. French long-term investment abroad increased from $76 million in 1964 to $140 million in 1965, while foreign long-term investment in France dropped from $603 million to $460 million. Rather severe declines occurred in foreign purchases of French securities and in loans from foreigners of one-year or more maturity, whereas other forms of direct investment were nearly as large as in 1964.

All of the decline in this foreign capital inflow occurred in the last quarter of the year. For the first three quarters, the inflow was exactly the same in both years, but the fourth-quarter figures show a very sharp drop from $237 million in 1964 to $94 million in 1965. This decline is partly a reflection of a heavy surge of foreign investment in France in the fourth quarter of 1964: 43 per cent of the total investment by the U.S. and Canada in 1964 was concentrated in the fourth quarter of that year, and 38 per cent of the annual investment by residents of other countries occurred in October-December.

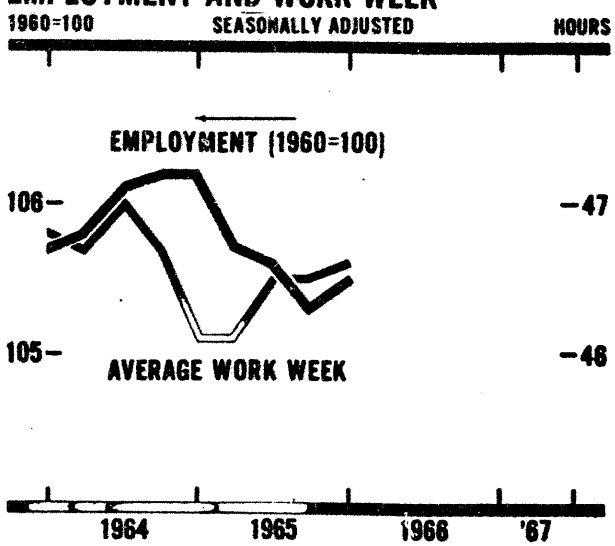
In addition, there may have been an abrupt decrease in U.S. investment in France in the last quarter of 1965: this seems implied by an article in Le Monde of March 8 which states that the lower total foreign investment (from all sources) in 1965 was more a consequence of the voluntary U.S. balance of payments program than of the "filtering" of U.S. investment in France by the French government. But in thenfirst three quarters of 1965, U.S. (and Canadian) investment amounted to $92 million, about 10 per cent more than in the same period of 1964.

FRANCE: MAIN ECONOMIC INDICATORS

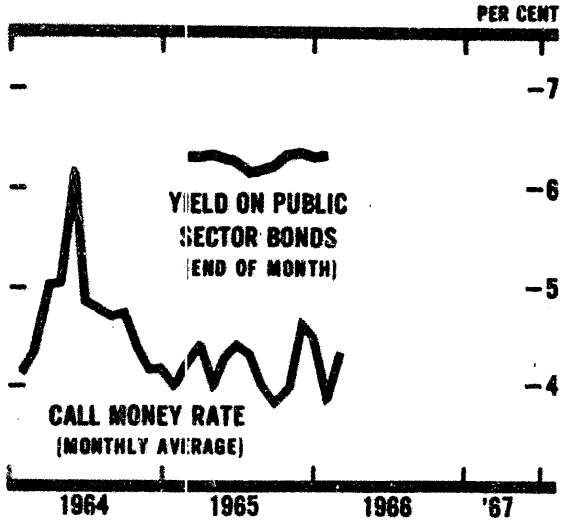
INDUSTRIAL PRODUCTION (Excl. Const.)



EMPLOYMENT AND WORK WEEK



INTEREST RATES



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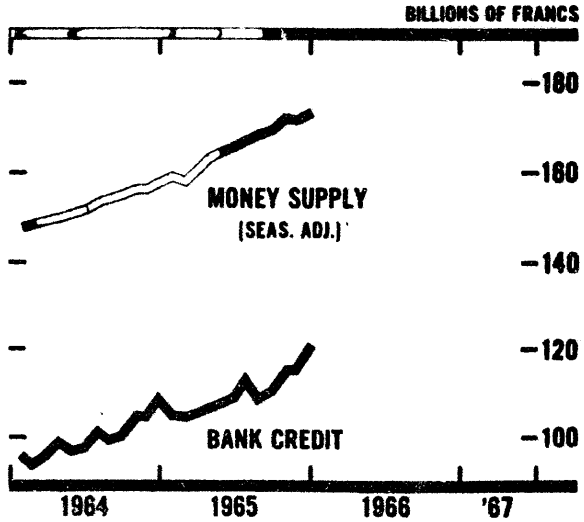

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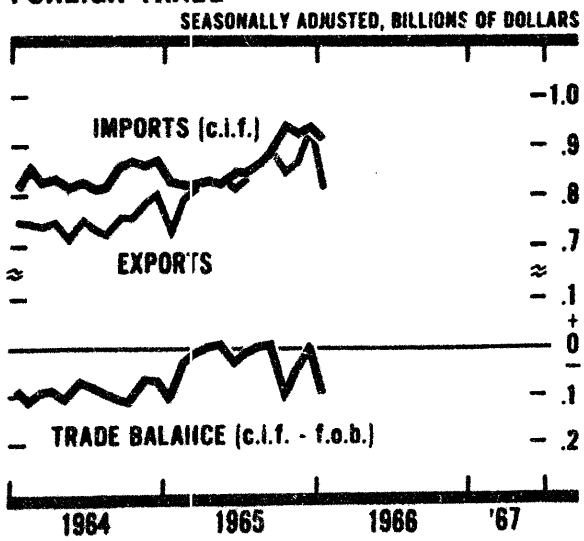
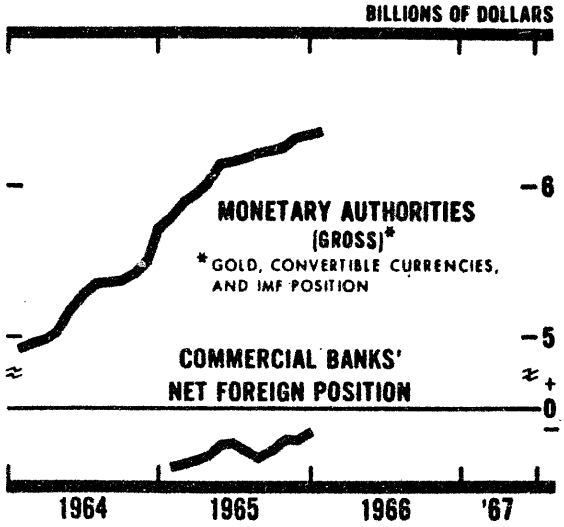
INTERNATIONAL RESERVES