

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

January 30, 1967

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9 pages

Recent Economic Developments in France:
Annual Review

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Recent Economic Developments in France: Annual Review

Earlier in 1966, the French economy expanded vigorously but there was a decided slowing of the rise in the autumn because of weakened export demand and more cautious consumer buying.^{1/} In an environment in which price increases did not intensify significantly, fiscal operations and monetary policy were mildly expansionary although interest rates moved up in response to higher rates abroad. After many years of surpluses, the French balance of payments moved into deficit in the closing months of 1966, principally because of flagging sales to Germany, Britain and some other countries. During the past few months, reforms have continued to be made in many financial fields--to stimulate saving, eliminate tax distortions, increase housing financing, strengthen quantitative credit control techniques, and liberalize gold and international capital flows.

Domestic activity

The rise in French economic activity that began in the spring of 1965 was maintained at a brisk pace until last August. Industrial production (excluding construction) rose at an annual rate of about 8 per cent in the first eight months of the year. (See Table 1 and Chart.) There was a revival of private investment in plant and equipment, stimulated in part by a tax credit equal to 10 per cent of

^{1/} For the previous review of French developments, see "Recent Economic Developments in France: March-June 1966," dated July 19, 1966.

Table 1. France: Selected Economic Indicators, 1965-66

Quarterly 1965 -	Industrial Production (Seas. adj.) (1960=100)	Hourly Wage Rates (1960=100)	Consumer Prices (1960=100)	Interest Rates:		Foreign Trade: f/ (Seas. adj.; \$ millions)		Official Reserve Changeh/
				Call Money _{a/}	Bond Yield _{d/}	Imports c.i.f.	Exports Balance	
I	125	139.6	119.1	4.11	6.31	703	654	+234
II	127	141.5	120.4	4.19	6.26	706	690	+194
III	130	143.7	120.6	4.07	6.18	742	728	+275
IV	133	145.5	121.2	4.33	6.32	789	753	+ 95
1966 -								
I	134	147.7	122.2	4.24	6.37	819	757	+118
II	136	150.2	123.1	4.65	6.53	836	794	+288
III	140	152.2	123.8	4.72	6.66	879	790	+199
IV	140 ^{a/}	154.2	124.6	5.46 ^{c/}	6.75 ^{e/}	904	786	-145
Monthly								
1966 -								
July	140	152.2	123.6	4.79	6.60	863	799	+148
Aug.	140	--	123.7	4.77	6.66	844	793	+ 46
Sept.	140	--	124.1	4.60	6.71	929	777	+ 6
Oct.	139	154.2	124.3	5.27	6.76	909	757	- 37
Nov.	141	--	124.6	5.41 ^{c/}	6.74	903	769	- 58
Dec.	n.a.	--	125.0	5.67 ^{c/}	n.a.	899 ^{g/}	823 ^{g/}	- 50

a/ October-November.

b/ Against private paper; monthly average of daily rates.

c/ December is estimated.

d/ End-of-month composite yield on public sector bonds.

e/ October-November.

f/ Monthly average; excluding trade with outer franc area.

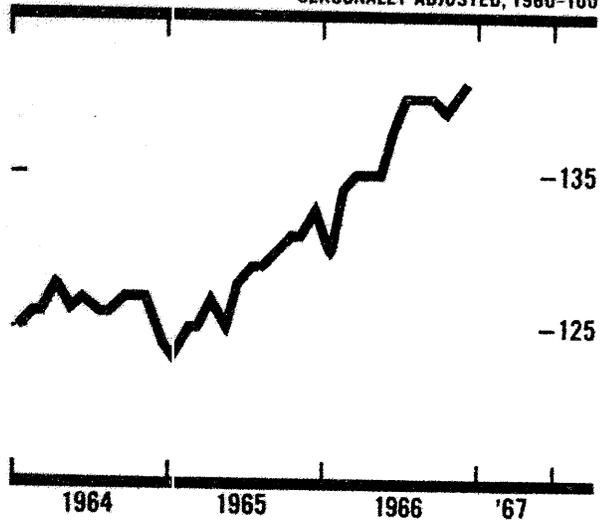
g/ Estimated from provisional data and the 1965 factors for seasonality and working days.

h/ Gold, gross convertible foreign currencies, and IMF position; adjusted for debt prepayments (\$179 million in July 1965 and \$71 million in September 1966).

FRANCE: MAIN ECONOMIC INDICATORS

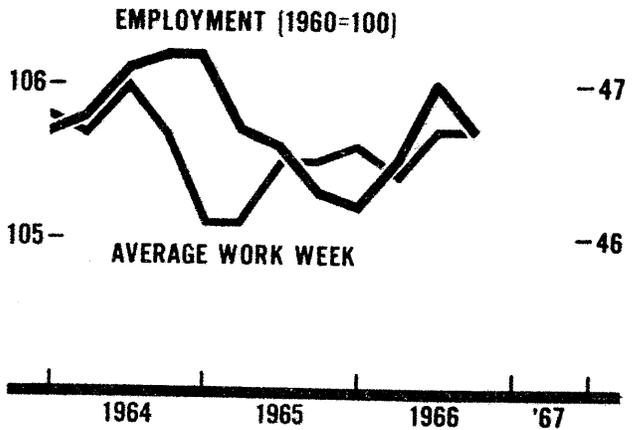
INDUSTRIAL PRODUCTION (Excl. Const.)

SEASONALLY ADJUSTED, 1960=100



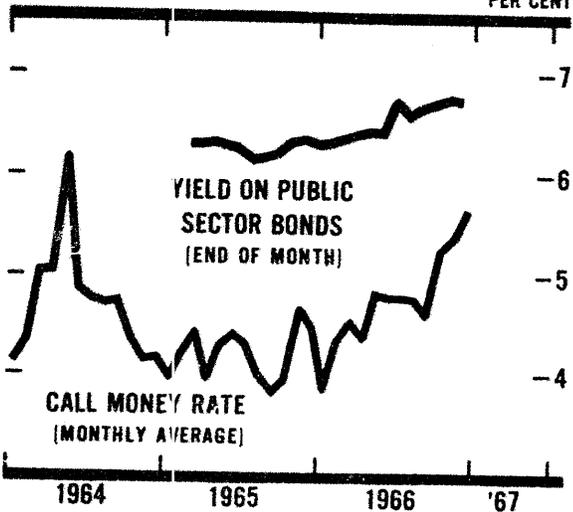
EMPLOYMENT AND WORK WEEK

1960=100 SEASONALLY ADJUSTED HOURS



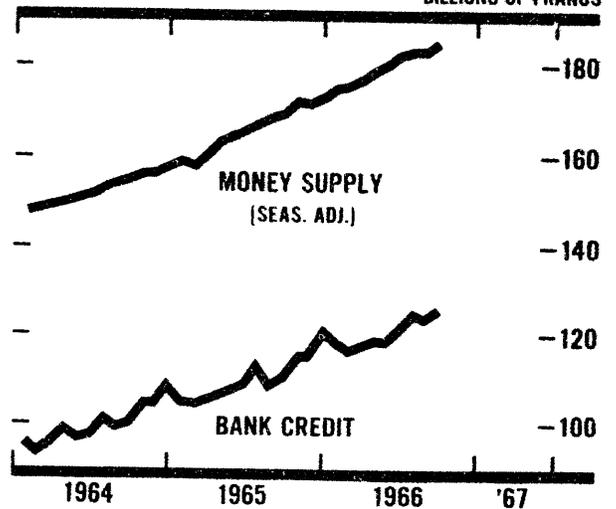
INTEREST RATES

PER CENT



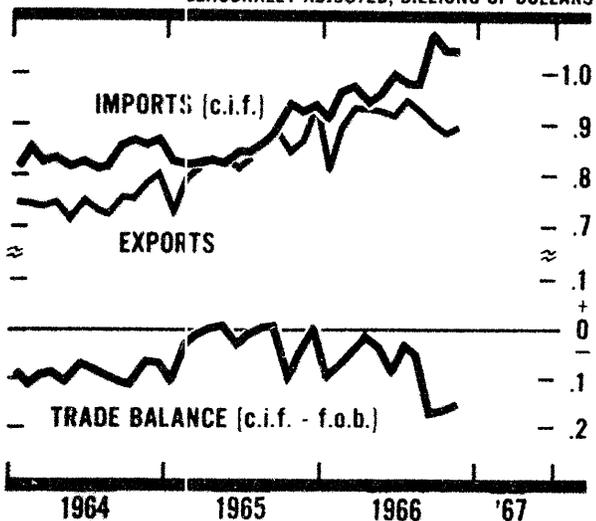
MONEY SUPPLY AND BANK CREDIT

BILLIONS OF FRANCS



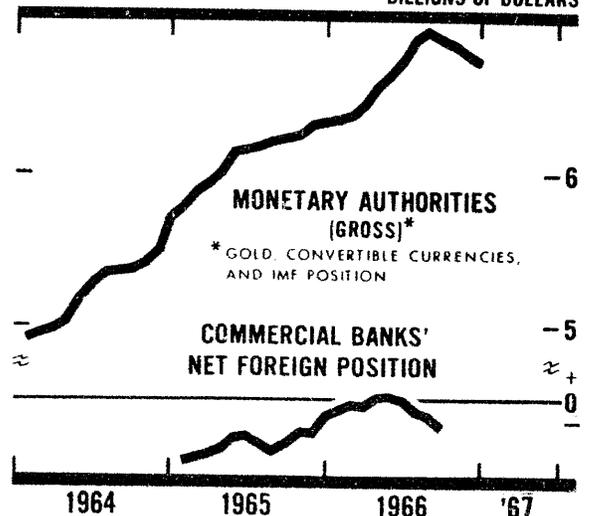
FOREIGN TRADE

SEASONALLY ADJUSTED, BILLIONS OF DOLLARS



INTERNATIONAL RESERVES

BILLIONS OF DOLLARS



* GOLD, CONVERTIBLE CURRENCIES, AND IMF POSITION

outlays for equipment ordered in 1966. This measure, first proposed in February (1966), undoubtedly did much to improve the investment climate, at a time when there was a resumption of over-all growth in the economy. Estimates made about six months ago placed 1966 private plant and equipment spending (in real terms) at 6-1/2 per cent higher than in 1965; by contrast, this spending had declined 1 per cent from 1964 to 1965. But, as 1966 ended, order backlogs in the equipment industries had stopped rising, and production of equipment was beginning to grow more slowly than before.

The slowing of the rise in activity after the summer--the industrial production index rose only fractionally from August to November--evidently had two major causes. French exports flattened out after March. (The domestic impact was delayed, inasmuch as several months intervened between the halt to export growth and the slowing of total production and provided some build-up of stocks of finished goods.) A second cause was the decided deceleration in the rise in over-all private consumption, which affected total spending but was especially notable in the clothing and leather sectors.

Housebuilding was also sluggish in 1966. The three-year boom in house construction began leveling out in 1965; last year, housing starts were down somewhat, and total activity in housebuilding may have dipped slightly.

Because of the sustained expansion in the economy up to August, the national accounts for 1966 will show highly satisfactory annual gains in French output. Last September, the government

projected a 5 per cent rise in real GNP in 1966. The gain actually realized may not have reached this goal, but it will compare very favorably with the small 3.5 per cent rise recorded in 1965. A comparison of 1965 results with the September forecasts for 1966 showed accelerations in two key areas: private consumption up from 3.2 per cent to 4.4 per cent, and plant and equipment expenditures up from 2.5 to 7.1 per cent. These two sectors, together with increased inventory accumulation, more than offset drops in housing (from 16 per cent to no gain at all) and in exports.

Further acceleration of growth during 1967 had been expected a few months ago, but it now seems unlikely. Last September's forecasts for 1967 showed the rise in real GNP accelerating to 5.3 per cent, based primarily on a 4.8 per cent gain in private consumption expenditures; but now private consumption is not expected to rise any faster than 4 per cent a year. It is also strongly doubted that exports in 1967 will achieve the 11 per cent gain shown by last fall's estimates. At best, the outlook for housebuilding this year is for only a small revival. Hence, industrial production for 1967 as a whole may well average only 4 per cent above 1966, compared with the earlier official 1967 forecast of 6.5 per cent, and the gain of about 7 per cent realized this past year.

Last year's expansion of demand did not give rise to wage or price difficulties. The rise in consumer prices accelerated only slightly, reaching 2.8 per cent per year by November. (See Table 1

and Chart.) The labor market has remained free of the tensions that were prevalent before the stabilization program. Productivity has been increasing fast enough to prevent any appreciable increases in employment and working hours; unemployment has remained very low (about 0.7 per cent of the labor force), but it has risen slightly. In these conditions, the rise in wage rates has held steady at a 6 per cent annual rate.

Fiscal operations were a mild stimulus for the economy last year, but probably not as a deliberate stimulant to aggregate demand. The initial budget estimates for 1966 continued the existing policies of keeping the budget balanced and holding the rise in expenditures to a rate close to the expected increase in GNP (at current prices). As it turned out, however, the rise in expenditures last year was larger than planned (12 per cent vs. 7 per cent), and a deficit re-emerged that was partly covered by creation of new money.

On the monetary side, the authorities were concerned to support the economic expansion, since aggregate demand pressures were not excessive. The money stock continued to rise about as fast as before, at a rate somewhat faster than GNP at current prices. Despite the relaxed monetary posture, however, interest rates in France moved up substantially last year in response to pressures from interest rates in other financial centers.

Yields on outstanding public sector bonds rose 40 basis points, mostly in June following a Finance Ministry decision to raise yields 0.5 percentage point on new public sector bond issues. The French

authorities explained that the adverse effects on the French capital market caused by rising long-term yields abroad were the principal motivation for this decision. This move seems also to have increased the supply of funds flowing into the French new issues market. Money market rates also advanced more than one percentage point during the year. Most of the increase took place in the fourth quarter, when the Bank of France largely or entirely abandoned its policy of keeping rates from exceeding an upper limit. That policy, dating from 1964, had been conceived initially to prevent inflows of short-term funds into France, but by 1966 it had become out of date because of the advances in interest rates outside France.

Balance of payments

Even more unexpected than the recent slowdown in domestic activity in France last year was a turnaround in the balance of payments during the second half. For the first six months, the payments surplus was still very large: \$541 million compared to \$639 million a year earlier. However, there were deficits in the months September-December, and a decline in official gross reserves of \$139 million (adjusted for a September debt prepayment). (See Table 1 and Chart.) The main changes occurred in the trade account. French imports rose during 1966 and exports tended to drop after the first quarter. In addition, the net inflow of long-term private capital was reduced in the first half and may well have continued, in the second half, to run below 1965 levels.

The September-December reserve losses were entirely in dollars (or other exchange) rather than in gold. By the end of December, foreign exchange holdings were under \$500 million. French gold purchases ceased after September. After remaining many years at its upper limit vis-à-vis the dollar, the exchange rate of the franc fell continuously from mid-August to mid-December and was below par by early December. Since late December, the spot franc against the dollar has been about 0.2 per cent below the official parity.

Structural reforms

The French authorities have continued their broad-gauged reforms of their tax and financial structure. Last year was the first period when the new tax treatment of investment income designed to augment saving and channel more of it into securities was in effect. Beginning January 1966, interest income is taxed at a maximum rate of only 25 per cent, and dividend income is taxed at much lower rates than formerly. The continuing declines in stock and bond prices in the past year, and the disappointingly low amount of new funds raised by security flotations, suggest that the impact of these reforms has so far been very small. The former income tax exemptions attached to government paper and to bank deposits have been lifted in order to remove uneconomic incentives in the allocation of savings. Minimum interest rates on bank loans to customers, long a feature of French banking, were abolished in April 1966, but freedom in this area has not yet brought down the cost of bank credit.

To raise more capital for housebuilding and bring down the very high cost of mortgages in France, the banks have adopted a savings scheme giving the depositor a right to a mortgage at a very low rate. A market has been instituted in which the banks, nonbank financial intermediaries, and the Crédit Foncier will buy and sell mortgage loans.

A step forward in French credit control techniques was the adoption of cash reserve requirements in January 1967. Some of the existing controls will be dropped this year, or phased out gradually over the next several years; these include minimum holdings of Treasury bills, and the liquid assets reserve ratio.

Important changes have also been made in the regulations affecting financial relations with other countries. The exchange control laws were repealed in December 1966, and in consequence flows of capital to and from France will be freer than before. However, foreign borrowers' access to the French capital market will still be tightly rationed, and foreign direct investments in France will still require official approval.

At the end of January 1967, the import and export of gold were freed from restriction. It seems unlikely that this will significantly affect the French gold market in the short-run inasmuch as imports of gold by French residents have been taking place, some of them illegal, and some legal under a special regulation. However, the French press has speculated that, since foreigners will now be allowed the same

freedom as French residents, the French gold market may attract international business away from other centers. For example, Le Monde of February 2 posed the question whether South Africa might sell part of its production in Paris instead of London.