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RFD 591

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

July 19, 1966

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17 pages

Recent Economic Developments in France:  
March-June 1966

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Summary

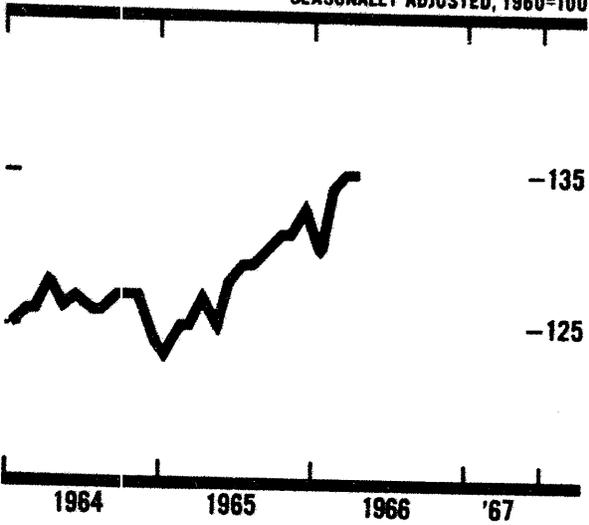
The long-awaited upturn in business spending on new equipment contributed to the maintenance of the upward trend of industrial production during the period under review. In financial markets, the major development was a sharp rise in bond yields in June following a government decision to increase yields on new issues of public sector bonds. Official reserve gains became large again in the months March-June, and they totaled over \$400 million in the first half of this year.

Industrial production continued to increase during the first four months of 1966, at about a 7 per cent annual rate. (See Chart.) Consumer and export demands remained vigorous, and were supplemented by rising orders and rising production in the equipment industries. The upturn in investment spending began late in 1965, after economic prospects had already brightened, but it has been helped by the investment credit that was proposed by the government in mid-February and which has since been approved by Parliament. This provision allows companies to deduct from income tax liabilities 10 per cent of their expenditures on equipment delivered between February 15 and December 31, 1966 (or ordered in that period and delivered in 1967).

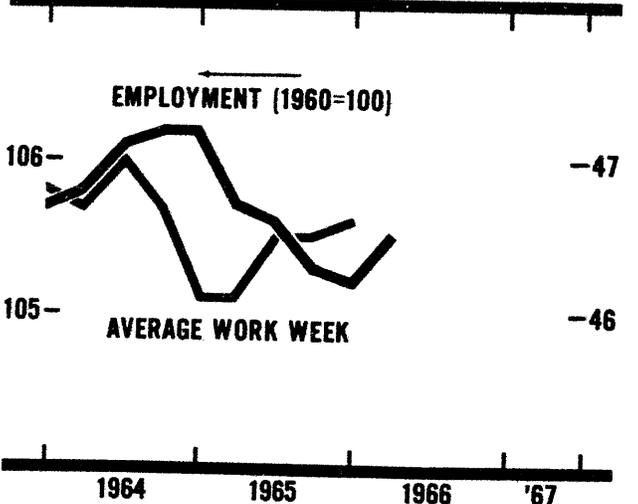
Demands for new automobiles and for housing have moderated this year, but French officials have revised their projection of 1966 GNP to show a 5 per cent rise (in real terms) instead of 4-1/2 per cent as was initially forecast. Business spending for plant and equipment, which had

# FRANCE: MAIN ECONOMIC INDICATORS

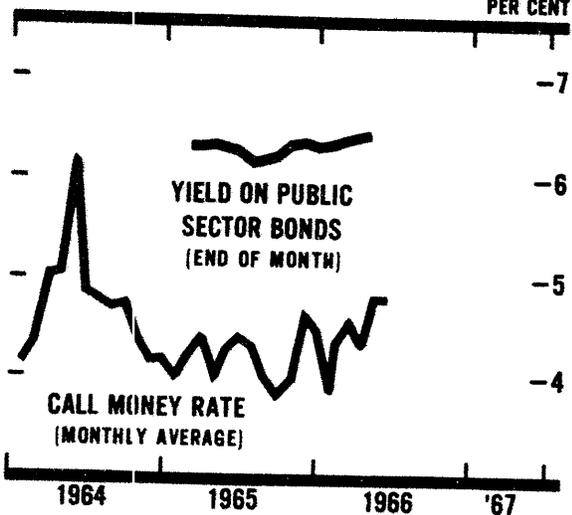
**INDUSTRIAL PRODUCTION (Excl. Const.)**  
SEASONALLY ADJUSTED, 1960=100



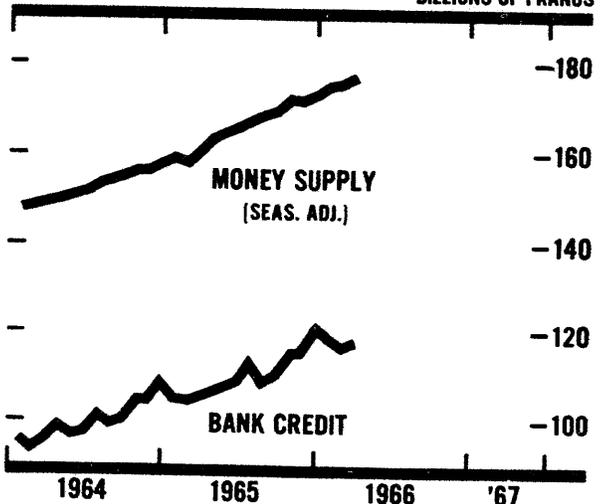
**EMPLOYMENT AND WORK WEEK**  
1960=100 SEASONALLY ADJUSTED HOURS



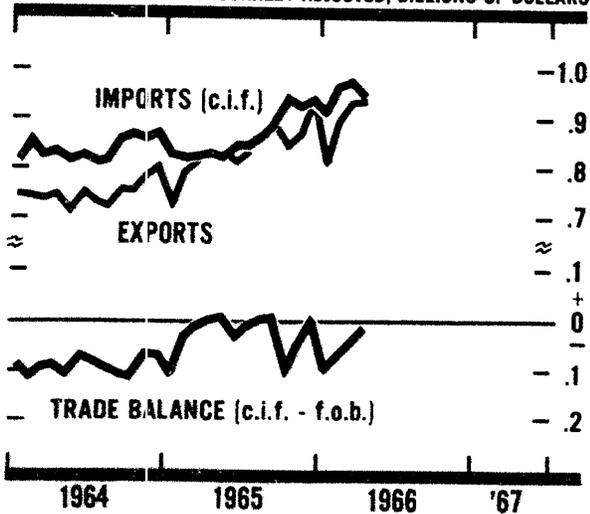
**INTEREST RATES**  
PER CENT



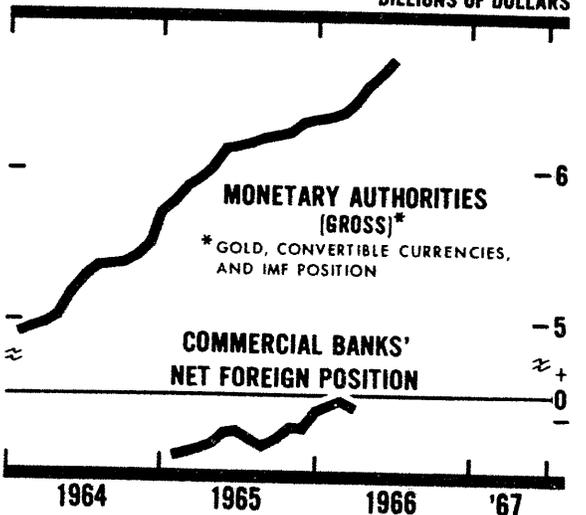
**MONEY SUPPLY AND BANK CREDIT**  
BILLIONS OF FRANCS



**FOREIGN TRADE**  
SEASONALLY ADJUSTED, BILLIONS OF DOLLARS



**INTERNATIONAL RESERVES**  
BILLIONS OF DOLLARS



\* GOLD, CONVERTIBLE CURRENCIES, AND IMF POSITION

been weak in the past three years, is projected to expand more than 6 per cent (at constant prices). The estimate of the increase in real GNP which occurred last year has been revised upwards from 2.5 per cent to 3.5 per cent.

Wage rate increases may have begun to accelerate this year, after slowing down during 1963-64 and the first half of 1965, although the labor market remains less tight than it was in the recent past. After a year of stability, the over-all index of prices of industrial products rose rather sharply from September 1965 to May 1966. French experts minimize the significance of this rise, because it was caused almost entirely by severe run-ups in the prices of copper and leather resulting from changes in world market conditions. But they are somewhat concerned over surveys showing that, since the first of the year, businessmen's expectations of near-term price increases have become more widespread.

French bond yields, which in the past three years had risen very little (less than 50 basis points since May 1963), jumped 30 basis points from the first to the final week of June. Early in that month the Finance Ministry decided that the coupon rate on new bond issues of public sector institutions would be increased from 5-3/4 to 6-1/4 per cent, causing effective yields to rise from the 6.2 -- 6.3 per cent range that prevailed earlier this year. (It would appear that the yields have also risen 1/2 per cent.) The French market for new issues had been weak in 1966, a condition contributed to by rising bond yields in Germany, the Netherlands, the U.K. and the U.S.

Higher money market rates in May-June (see Chart) seem mainly to have been a seasonal development. In the first quarter, the rates at which bank credit and the money supply expanded were not much different from the expansion rates of the immediately preceding quarters. In the nine months following the removal (in June 1965) of the former quantitative ceilings on credit expansion, no upsurge of bank lending took place, even though private investment demand began to increase again. In this period, the Bank of France has made continuous use of changes in the banks' liquid assets reserve requirement, of open market operations, and of adjustments in the rediscount quotas, to affect the volume of recourse to the Bank and thereby control credit expansion.

In the first quarter, the French balance of payments surplus, estimated at \$203 million, fell short of the \$291 million surplus of one year earlier, although the trade balance was about the same. Official reserve gains, which were small in December-February, totaled \$289 million in the second quarter, exceeding the year-earlier rise of \$194 million, but this difference may only reflect differences in the movements of the commercial banks' net foreign position. The continuing rise of French exports has offset the effects on the balance of payments of the increase in imports which has occurred as domestic demand in France has regained its upward momentum. (See Chart.) From the second quarter of 1965 to April 1966, imports and exports (seasonally adjusted) each rose 13 per cent.

#### Investment spending paces production rise

Business conditions in France improved further in the first five months of 1966 as aggregate demand and national output moved to higher levels. Demand for consumer goods remained strong, and the long-awaited upturn in the demand for equipment has now materialized.

The upward trend of industrial production has been maintained at an annual rate of about 7 per cent since the recovery began in the second quarter of 1965. The seasonally-adjusted index for March-April was 2.4 per cent above the average level in November-December, and reports on business conditions suggest a further rise occurred in May. In industry as a whole, the latest INSEE surveys show improvements in several aspects of the situation as viewed from the producers' standpoint. Producers have been stepping up deliveries somewhat faster than their production schedules, with the result that their inventories of finished goods have declined further. New orders have been coming in faster than they can be filled, so that order backlogs have shown some further build-up. As regards the outlook for the immediate future, an increasing proportion of the industrialists covered by the surveys anticipated higher output levels in the forthcoming three or four months.

The most significant industrial development would seem, however, to be the recovery of private fixed investment in equipment which first began to be noticeable in the final two months of 1965 and which has been gathering strength. In April, order backlogs in the equipment industries were still judged to be below normal, but they had risen rapidly from levels that were very low as late as last December. Equally rapid was the rise in the actual output of equipment in the first four months of the year. But producers' deliveries exceeded output by a small margin in January-April, causing a further reduction in their stocks of finished goods, and the brightening of near-term production prospects has been particularly marked in the equipment sector.

With the demand for equipment now outpacing aggregate demand, slowdowns have appeared in two sectors where activity had earlier been increasing at unsustainable rates. Since the beginning of 1966, the demand for new automobiles has been increasing more slowly than it did last year, when registrations of new cars in France rose 21 per cent from the fourth quarter of 1964 to the fourth quarter of 1965. Since February, auto production has tended to level off after 11 months of rapid increase. The other area feeling a slowdown is housing, which until late last year had experienced a boom of several years' duration. INSEE experts believe that the demand for housing leveled off in 1965; last year, housing completions totaled 14 per cent more than in 1964, but permits and starts each increased only 4 per cent. INSEE believes that starts will show a small decline in 1966, mainly concentrated in the second half; consequently, the volume of work in progress in 1966 as a whole would not differ much from the 1965 volume.

Forecasts for 1966 are made more optimistic

French officials expect that 1966 will be a better year than they had originally thought when the first forecasts were made. At its semi-annual meeting in May, the National Accounts Commission forecast that real GNP in 1966 would total 5 per cent more than in 1965, instead of rising 4.5 per cent as indicated by the initial projection made last September. At the same time, the final economic results for last year turned out to be much better than had been thought to be the case until

the May meeting. The Commission concluded that real GNP in 1965 rose 3.5 per cent, compared with an anticipated rise of 2.5 per cent, most of this upward revision being concentrated in personal consumption.

According to the revised 1966 forecast, consumption in real terms will increase 4.3 per cent, compared with 3.3 per cent in 1965, but the most encouraging projection is the one showing a 6.2 per cent increase in fixed investment (at constant prices) by business enterprises (public and private). These outlays had risen only 3.3 per cent in 1965, and that rise was solely the result of a 10 per cent rise in expenditures by public enterprises; the outlays by private companies had dropped 1 per cent. The Commission's projection on plant and equipment presumably draws on the INSEE's survey, conducted in March, concerning the 1966 investment intentions of private manufacturing companies. The survey concluded that these companies, which reduced their fixed investment outlays (in real terms) by 2 or 3 per cent in 1965, would increase them about 4 per cent in 1966. The INSEE has also estimated a 5 per cent rise in 1966 in the expenditures of all private enterprises, i.e., inclusive of nonmanufacturing concerns. But it points out that the rate of rise during 1966 should be much faster than 5 per cent. Because these private fixed investment outlays were tending to decline during nearly all of 1965, they may be increasing in 1966 at close to a 10 per cent annual rate.

Investment by the government is expected to rise 9.2 per cent (in real terms) this year, an increase not much less than the 10.5 per cent rise recorded last year, and an expected 9.5 per cent rise in 1966 exports

(at constant prices) will provide nearly as much stimulus to the economy as did last year's 11.4 per cent gain. The only category of spending to show a significant slowing will be households' investments, i.e., their outlays for new housing and major house repairs. After an 18.5 per cent rise (in volume) in 1966, the increase is expected to drop sharply to 3 per cent this year.

Wage increases tend to accelerate

During the first quarter of 1966, wage rates in private employment increased by an estimated 1.6 per cent, a rise that seems to mark the start of a tendency for wage increases to accelerate. The rise in wage rates during the first quarter exceeded both the 1.4 per cent rise that occurred in the fourth quarter, as well as the 1.3 per cent increase which occurred in the same quarter a year earlier.

Moderate increases in the demand for labor in the early months of 1966 were evident in several indicators. The index of employment in all industries, after seasonal adjustment, increased 0.3 per cent in the first quarter, and unemployment, while fluctuating from month to month, underwent a net decline of 4,000 persons between December and April. INSEE believes that working hours have also continued to increase slowly, although seasonally-adjusted figures for 1966 are not yet available. However, the labor market still remains less tight than it was in 1964 when the indexes of employment and hours worked reached peak levels and unemployment was at a low point.

Despite severe pressure and social agitation, the French government has maintained a "hard line" in its policy on wages in the public sector. For several years, wages of civil servants have been raised no more than 4 per cent per year. Wage increases for workers in the nationalized enterprises have also been prevented from increasing as fast as those received by workers in private employment; in 1965, they increased by 4.6 to 5.6 per cent, compared with nearly 6 per cent in the private sector as a whole. This policy has been adopted partly for budgetary reasons, but probably the main purpose is to set an example of moderation in the hope that it will moderate wage demands in private employment. Widespread strikes in the public sector occurred in January and again in May, but the government has not made significant concessions to the demands for more liberal pay increases. The rise in civil servant's salaries in 1966 is again slated to be 4 per cent, while the increases for workers in the nationalized industries will work out at between 4.5 and 5 per cent.

#### Wholesale price index rises

The wholesale price index in France has been rising since September of last year, but nearly all the increase has been caused by higher prices of copper and leather. The index of prices of industrial products, which had been stable for a year, began to rise last October. This group of products includes raw materials and semi-manufactures, and has a weight of 45 per cent in the over-all wholesale price index.<sup>1/</sup>

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<sup>1/</sup> Food and beverages have a weight of 40 per cent, and fuels and electricity a weight of 15 per cent. The French wholesale price index does not include finished nonfood manufactures.

The industrial products index increased 4.4 per cent in the eight months from September to May. In those eight months, prices of raw hides rose 51 per cent, prices of tanned hides increased 31 per cent, and the index of prices of nonferrous metals advanced 25 per cent because of rising copper prices.

French officials have minimized the importance of these price increases. They note that leather and prices rose because of changing conditions in world markets rather than in France; that these are not really key commodities; and that increases in the prices of other products have been very limited. In the eight months from September to May, the index of prices of industrial products would have gone up only 0.6 per cent if leather and copper prices had been stable.

Other recent price developments have not been particularly noteworthy. Consumer prices have continued to rise at about the same rate as before; the year-to-year rise fell from 2.8 per cent in December to 2.6 per cent in March, but rose again to 2.9 per cent in May. The government does not expect the rate of increase to speed up during the remainder of the year.

One aspect of the question of prices has, however, been causing some concern to French officials, and that is the question of expectations. The INSEE surveys of the situation and prospects in industry and commerce show that, since the start of 1966, an increasing proportion of industrialists has come to believe that the near-term movement of prices in general will be upward. In November 1965, a net balance of 43 per cent of the industrialists

covered by the survey expected that the general level of prices would rise in the near future. This balance rose sharply to 64 per cent in March, and dropped back to 58 per cent in April. In commerce, the net balance of wholesalers expecting prices to rise increased from 36 per cent in November to 58 per cent in March; for retailers, the rise was from 30 per cent to 59 per cent.

#### Bond yields rise sharply

During most of the period under review, bond yields in France showed only a continuation of the gradual rise that had been in effect for several years. The composite yield on public sector bonds, as computed by INSEE for the last day of each month, rose from 6.37 per cent on February 28 to 6.44 per cent on April 30. (See Chart.) According to the calculations made weekly by the Bank of France for its own use (and which are not published), the yield on public sector bonds (net of the 10 per cent withholding tax) rose from 5.88 per cent in the week ending February 25 to 5.97 per cent in the week ending June 3. Through the end of May, new public sector bond issues continued to bear a 5-3/4 per cent coupon, and they gave a yield to maturity of between 6.23 and 6.29 per cent. (The French practice is to issue bonds at par but to provide a substantial redemption premium.)

On June 2, rumors circulated--soon to be confirmed by the facts--that the coupon rate would jump abruptly from 5-3/4 to 6-1/4 per cent, and that the yield to maturity would likewise rise sharply, on new public

sector bond issues beginning with the forthcoming City of Paris issue. On June 13 the City of Paris issue was offered to the public, and it was followed by a Gaz de France issue on June 27. Both bear a 6-1/4 per cent coupon rate, and press reports suggest that the yields to maturity were also raised 1/2 per cent over the previous level. Prices of outstanding bonds plummeted in the first two weeks following market awareness of the new official policy. According to the Bank of France weekly series, the yield on public sector bonds rose almost 50 basis points to 6.43 per cent (net of withholding tax) in the week terminating on June 17. Some recovery of prices ensued which dropped the yield to 6.28 per cent in the week ending July 1, but this still left yields 30 basis points above a month earlier. In the same four weeks, the yields on corporate bonds (in the Bank of France series) rose 35 points to 6.91 per cent.

The Finance Ministry decision to raise the yields on new issues was prompted by the poor reception given to some new issues in the spring, especially the issue of the Caisse Nationale des Autoroutes launched just prior to the switch to higher yields. That borrower sought 400 million francs but reportedly was able to raise only 270 million francs. Bond market weakness is indicated also by the fact that the total volume of bond issues since the start of the year has in fact lagged behind 1965 despite a probable rise in public and private needs for long-term funds. In January-May, new bond issues totaled F 5.00 billion, a sum 9 per cent below the year-earlier figure of F 5.50 billion. As usual, the public sector dominated the new issues market and accounted for 93 per cent of

total new bond issues in that period. One development which has drawn funds away from the French bond market has been the rise in bond yields during 1966 in most other industrial countries, including Germany, the Netherlands, the United Kingdom and the United States. At the new higher yields, the City of Paris and Gaz de France issues were taken up very quickly.

Money market tightens seasonally

In the Paris money market the rate for day-to-day money against private paper rose from a monthly average of 4.34 per cent in February to 4.55 per cent in March, dropped back to 4.34 per cent in April, and then rose to considerably higher levels in May and June. The average of rates on Thursdays was approximately 4.8 per cent in both May and June. This rise appears to be mainly if not wholly a seasonal development related to the demand for currency. The Bank of France used open market operations to keep rates from exceeding a set limit which was generally 4-7/8 per cent, the limit that has been in effect most of the time since April 1965. In late March, the Bank allowed the rate to go as high as 5-1/2 per cent. But this change in policy was followed by a substantial repatriation of funds from abroad by the French banks, to the dislike of the monetary authorities, and policy then reverted to the 4-7/8 per cent ceiling.

The banks' coefficient de trésorerie has been changed frequently this year in accordance with money market conditions; the requirement has tended to be eased since February because of seasonal market pressures.

It was set at 35 per cent of deposits in January and February, 32 per cent in March, 33 per cent in April, 32 per cent in May, and 31 per cent in June. Each change of one percentage point in the coefficient increases or decreases by about 800 million francs the banks' ability to rediscount medium-term paper and thereby their ability to obtain central bank funds without, possibly, paying the penalty rates applicable to excessive rediscounts of short-term paper.<sup>1/</sup> Outstanding rediscounts of all types of paper this year have been running between 14 and 18 billion francs.

Monetary situation shows no basic changes

No marked acceleration of the extension of bank credit was observable in the first quarter of 1966, in spite of the evident strong pick-up in business enterprises' spending on--or at least orders of--equipment. Bank loans outstanding declined during the first quarter, but this was a seasonal development. Credits held in bank portfolios, together with paper acquired by the Bank of France, exceeded the year earlier total by 11.2 per cent at the end of December and 11.6 per cent at the end of March.

As of March, the credit situation still did not betray any visible manifestation of the abolition, at the end of June 1965, of the quantitative ceilings to which bank credit was formerly subject for 28 months. The year-to-year increase of 11.6 per cent was in fact slightly less than the 12.3 per cent rise in the 12 months ending with June of last year, when the ceilings were removed. Market forces, and Bank of France monetary

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<sup>1/</sup> Medium-term paper constitutes most of the total assets held to satisfy the coefficient (liquid assets reserve ratio). A reduction in the ratio permits increased rediscounts of such paper because the banks are required to keep less of it locked up in their own portfolios.

controls affecting the cost of recourse to it by the banking system, have been sufficient to keep the rate of credit expansion from soaring after the ceilings were removed. The public demand for currency, and hence the banks' purchases of currency from the Bank of France, have been increasing more than have the additions to bank liquidity provided by the rising external reserves of the central bank. The banks' recourse to the central bank has therefore expanded, but this expansion has been controlled by the authorities sufficiently to prevent the banks from accelerating credit expansion to any marked degree. The tools employed for this purpose have included variations in the coefficient de trésorerie, open market operations, and the periodic readjustment of the rediscount quotas. French banks can borrow without limit from the Bank of France if they have sufficient eligible paper and are willing to pay the price set by the authorities. The monetary tools referred to above control the volume of recourse to the central bank by determining the relative extent to which the bank can rediscount at the 3-1/2 per cent basic discount rate, or must pay higher rates for rediscounts in excess of the ceilings. In the last analysis, therefore, the control instruments are effective because of their influence on the cost of central bank credit.

During the first quarter, the seasonally-adjusted money supply increased at an annual rate of 9-1/2 per cent. This rise was about the same as the 10 per cent rise that took place in the 12 months up to March.

#### Strength of exports helps to keep reserve gains high

Large additions to the external reserves of the French monetary authorities took place again in March and in the second quarter, following the small accruals that marked the months December through February. Gross

holdings of gold and convertible foreign exchange, together with the French IMF position, had risen only \$55 million in the three months December-February, a small amount by recent French standards, because the French commercial banks reduced their net foreign liabilities by \$208 million during that period, to \$29 million on February 28. It is believed that the banks continued to put funds abroad during most of March, but tighter conditions in the Paris money market in the final days of that month caused a large-scale repatriation of funds by the banks, so that for the month as a whole the banks' net foreign liabilities increased \$18 million. This reversal contributed to a \$73 million official reserve gain in March.

In the second quarter, the gains in official reserves totaled \$289 million and were fairly evenly spread over the three months, amounting to \$118 million in April, \$73 million in May, and \$98 million in June. The total for the quarter was well in excess of the \$194 million gain that was recorded in the second quarter of 1965. But in the April-June quarter of last year the French commercial banks improved their net foreign position by \$106 million, and this held down the reserve gain by that amount. It seems likely that no such improvement occurred this year, and that this difference explains the larger rise in official reserves in the April-June quarter of 1966.

In the first quarter of this year, the over-all French surplus was in fact somewhat smaller than a year earlier. The French Finance Ministry has estimated the surplus at \$203 million, compared with \$291 million in the

first quarter of 1965. The only information available for both these periods shows that the contraction was not the result of any slippage on the trade account. The balance of trade with foreign currency areas (i.e., excluding the outer franc area) was almost identical in these two quarters.

The strength of French exports has been one reason why French reserve accruals have continued to be large even though domestic demand and imports have been rising vigorously since the second quarter of last year. In April, seasonally-adjusted imports were 13 per cent greater than in the second quarter of 1965, but an identical 13 per cent increase has taken place on the export side. In the first quarter, total exports also exceeded the year-earlier total by 13 per cent. Exports to the other Common Market countries (which were 44 per cent of total exports), were up 20 per cent, including increases of 25 per cent to Italy, 23 per cent to Belgium-Luxembourg, 18 per cent to Germany and 15 per cent to the Netherlands. French exports to the U.K. rose 25 per cent, and a 12 per cent gain was shown in sales to the U.S.