

L.5.2

RFD 434

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

July 24, 1963

**Recent Economic Developments in France,
April - July, 1963**

14 pages

Rodney H. Mills, Jr.

This article was prepared primarily for internal circulation, and should not be cited or quoted. The views expressed do not necessarily represent the views of the Board of Governors of the Federal Reserve System.

July 24, 1963

Rodney H. Mills.

Recent Economic Developments in France: April - July, 1963

Summary

Further substantial additions to official reserves and a marked pickup in business activity were the dominant developments in France in the period under review. Credit conditions tightened and French banks have been borrowing more heavily abroad. Prices continued to advance and rising imports continued into April and May.

Official reserves rose \$300 million in the second quarter after adjustment for special official transactions. Even so, official reserve gains for the March-June period were about \$100 million lower in 1963 than in 1962. The trade balance was much less favorable but the capital inflow greater this year than a year ago. The franc has held at its ceiling against the dollar of 20.41 US cents during the period under review. The French have announced they would prepay \$160 million on July 26 to the United States and would also soon make a \$59 million prepayment to the IBRD (following a \$61 million prepayment in April).

The restrictive credit measures put in effect have contributed to some slowing down in the growth of the money supply and bank credit.^{1/} A further increase in the banks' compulsory liquidity ratio led to a sharp tightening of the money market in late June and heavy borrowing at the Bank of France at penalty rates. To absorb liquidity a long-term Treasury loan was floated in May.

The estimated budget deficit for 1963 has been held at the now-customary 7 billion francs despite supplementary increases in budgeted expenditures equalling

^{1/} See "Recent Economic Developments in France: January-April, 1963," dated April 9 and "Recent French Monetary Measures," dated April 11.

4 per cent of initial estimates. The higher outlays include the recent wage increases for workers in the nationalized enterprises and salary increases for civil servants and the military. Coverage of the additional outlays includes new taxes and upward revisions of estimated receipts. Part of the higher operating costs of the nationalized enterprises will be offset by increases made in May in electricity and railroad rates. Recently-released figures on 1962 Treasury operations show that once again the cash budget deficit was smaller than expected, and financing of the over-all Treasury deficit was not inflationary.

Industrial production recovered sharply in April and May from the effects of the severe winter and the strikes in the public sector. Rising demand also led to renewed increases in prices and imports. Exports continued to rise. Official projections show a continuation of economic expansion. Real GNP in 1963 is expected to be 4.3 per cent above 1962. While this is less than the 5-1/2 per cent gain in 1962, the slower rate of growth reflects an absence of any further significant rise in agricultural production after last year's excellent harvests.

Reserve gains continue to be heavy

France's official reserves of gold and foreign exchange increased a further \$259 million in the second quarter. The gain would have been \$300 million in the absence of special official transactions including a \$61 million advance debt repayment by France to the IBRD in late April and receipt in early April of a \$33 million indemnity payment from Germany, the last of three such annual payments.

Seasonal increases in tourist receipts contributed to the rise in accruals from \$93 million in April (adjusted) to \$150 million in May. The smaller increase in June of \$57 million reflected scheduled debt payments

(interest and principal) of \$63 million (of which \$62 million to the U. S. and \$1 million to Canada). These reserve gains have been heavy but since March they have been smaller than in the comparable months of last year. (See Table 1.)

The reduced reserve gains recently reflect the much larger trade deficit with foreign (i.e., nonfranc area) countries in 1963 than in 1962: from March to June, there was a \$237 million deficit on this trade in 1963 compared with a \$74 million surplus last year. (See Table 2.)

Despite the larger trade deficit, reserve accruals have continued to be large because of greater capital inflow and increased net borrowings abroad by French banks. The net foreign liabilities of the French commercial banks increased \$48 million in March and a further \$16 million in April (See Table 3) and the French financial press believes this process has continued since then. Tighter credit conditions have prevailed in France since last winter's moves to restrict bank credit expansion. This net borrowing by French banks was even larger earlier this year--\$150 million in January-February--and was a major explanation of the extremely heavy accretions (\$279 million) to official reserves in those two months (when tourist receipts are negligible). The French press has also speculated that the political situation in Italy and the new tax laws in Belgium have caused funds to flow to France.

The French authorities are continuing the policy of prepaying external debts. It was announced that \$160 million of debts to the United States would be paid ahead of schedule on July 26, and that another prepayment of \$59 million would shortly be made on debts to the IBRD.

Monetary expansion slows and money market tightens

The changes in monetary policy last February contributed to a slowdown in monetary expansion in the first quarter of 1963 (latest data available). A further rise of

Table 1. France: Official Reserve Changes, 1962-63

(In millions of dollars)

<u>Month:</u>	<u>1 9 6 2</u>		<u>1 9 6 3</u>	
	<u>Actual</u>	<u>Adjusted</u> ^{a/}	<u>Actual</u>	<u>Adjusted</u> ^{a/}
January	+ 53	+ 60	+134	+134
February	65	+ 45	+145	+145
March	+164	+156	+109	+109
April	+ 97	+123	+ 52	+ 93
May	+174	+174	+150	+150
June ^{b/}	- 8	+ 82	+ 57	+ 57
July-December	+126	+599	--	--
<u>Totals:</u>				
January-February	+118	+105	+279	+279
March-June	+427	+535	+368	+409
January-June	+545	+640	+647	+688
January-December	+671	+1,239	--	--

^{a/} Adjusted for debt prepayments, changes in IMF position, indemnity payments from Germany, and changes in reciprocal balances with the Federal Reserve System.

^{b/} Figures for June reflect scheduled debt payments (\$71 million in 1962 and \$63 million in 1963), including interest and principal.

Sources: IMF Statistics and press releases of Ministry of Finance.

Table 2. France: Trade with Foreign Countries, January-June, 1962-63
(In millions of dollars)

	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
<u>1962</u>			
January	426	455	+29
February	472	469	- 3
March	516	538	+22
April	462	475	+13
May	506	501	- 5
June	469	513	+44
Totals:			
January-February	898	924	+26
March-June	1,953	2,027	+74
January-June	2,851	2,951	+100
<u>1963</u>			
January	535	475	-60
February	495	481	-14
March	622	537	-85
April	625	559	-66
May	668	584	-84
June (preliminary)	567	565	- 2
Totals:			
January-February	1,030	956	-74
March-June	2,482	2,245	-237
January-June	3,512	3,201	-311

Source: INSEE

Table 3. France: Net Foreign Position of Commercial Banks, 1961-63^{a/}
(In millions of dollars; end of month)

<u>1961</u>		<u>1963</u>	
December:	-25	January:	-258
<u>1962</u>		February:	-268
March:	-26	March:	-316
June:	-115	April:	-332
September:	-158		
December:	-118		

a/ Assets and liabilities with foreigners in foreign currencies and French francs. A minus sign indicates a net liability position.

Source: OECD

Table 4. France: Treasury Operations, 1961-62
(In billions of francs)

	<u>1961</u>	<u>1962</u>
<u>I. Budgetary Operations</u>		
A. Ordinary receipts	67.61	74.49
B. Ordinary expenditures	-65.93	-75.00
C. Loans and advances (net)	- 6.06	- 5.58
D. Balance on budget operations (A-B+C)	- 4.38	- 6.09
<u>II. Debt Amortization ^{a/}</u>		
A. Internal	- 1.66	- 1.40
B. External	- 1.43	- 3.36
C. Total	- 3.09	- 4.76
<u>III. Over-all Treasury Deficit (ID+IIC) ^{a/}</u>	- 7.47	-10.85
<u>IV. Coverage of Deficit</u>		
A. Recourse to banking system	- 1.99	1.02
1. Bank of France <u>b/ c/</u>	- 0.53	0.37
2. Commercial banks	- 1.46	0.65
B. Other financing	+ 9.46	+ 9.83
1. Public Treasury bills	+ 3.72	+ 3.44
2. Deposits with Treasury	+ 5.18	+ 7.11
3. Other (net)	+ 0.56	- 0.72

a/ The figures for 1961 exclude redemption of 1.11 billion francs of Treasury bills held by the IMF resulting from net drawings of francs from the IMF.

b/ The figure for 1961 has been adjusted downward by 1.11 billion francs to exclude advances made necessary by the operations referred to in note a.

c/ For 1962 an upward adjustment of 1.04 billion francs has been made to exclude the reduction in advances permitted by transfer in May 1962, from the Treasury to the Exchange Stabilization Fund, of the franc resources extended to the IMF.

Sources: The basic data are taken from Finance Ministry and Bank of France, publications. The data on the financing of the deficits have been supplemented by reports of the National Credit Council.

one percentage point in the banks' compulsory liquidity ratio in May was one factor in a sharp tightening of the money market in late June that forced the banks into heavy borrowing at penalty rates from the Bank of France for the first time in over a year, and caused money market rates to soar.

Money supply increased only 0.8 per cent between end-December and end-March compared with 2 per cent in the same period a year earlier. Bank credit to the "economy" (all borrowers but the Treasury) contracted 2-1/2 per cent in contrast to no change the year before. (This is a seasonally slow quarter.) The exceptionally cold weather and the March strikes probably contributed to this. The credit tightening steps taken at the end of February (a ceiling on credit expansion and a rise of three percentage points in the banks' compulsory liquidity ratio) had a similar effect. The contraction in bank credit took the form of a reduction in Bank of France rediscounts of medium-term paper. The raising of the liquidity ratio effective March 31 forced the banks to hold more of this paper in their own portfolios. But the banks' total outstanding credits in their portfolios increased by a smaller amount than the reduction in Bank of France rediscounts, as they began to comply with the directive limiting the expansion of their credits to 12 per cent a year, a rate only two-thirds as large as in the previous year.

In a further move to restrict monetary expansion, the liquidity ratio was raised again--from 35 to 36 per cent--effective May 31. This step caused a temporary rise in the day-to-day money rate against private paper (all money market paper other than Treasury bills) from the usual level of around 3-1/2 per cent (the basic rediscount rate) to 6 per cent at the end of May. Shortly thereafter, it also added to the normal mid-year pressure on bank liquidity at the end of June. For the first time in fourteen months, the French banks

beginning in late June were forced to rediscount heavily in excess of their rediscount ceilings. Over the period from June 21 to July 11, banks were paying both the 4-1/2 per cent ("hell") and 6 per cent ("super-hell") rates on rediscounts in excess of 100 and 110 per cent, respectively, of their ceilings. In the money market, the day-to-day rate on private paper consequently averaged around 6 per cent in this period, but on some occasions it went as high as 8-1/2 per cent.^{1/}

In the second and third weeks of July the market eased, penalty rediscounting (done en pension) was terminated, and the cost of day-to-day money on private paper fell to 3-1/2 to 3-5/8 per cent on July 18. But the market remained highly vulnerable to any influences that would serve to tighten it again.

Debt management was also employed to soak up liquid assets. On May 20 the French Treasury floated its first long-term bond issue since 1958. The issue was for 1 billion francs for 15 years subscribable for cash only. It was not large in comparison with some other postwar loans; but, unlike several pre-1959 issues, it is neither indexed nor exempt from death and gift taxes. However, the interest (as on other long-term Treasury obligations) is exempt from personal income tax. The yield is higher than the 4-1/4 per cent coupon rate, since the bonds will be amortized by lot at 102-1/2 from the fifth to the tenth year and at 105 from the tenth to the fifteenth.

Firm line is taken on the budget

The Finance Minister is holding the line on the budget deficit in the face of new additions to expenditures. Despite wage increases for public sector

^{1/} Such rates reflect very short-term market imperfections, since banks can rediscount without limit at 6 per cent.

workers and supplementary outlays for other purposes, the estimated budget deficit for this year remains at 7 billion francs. This has been the customary deficit estimate since 1959.

Wage increases for workers in the nationalized industries in early April were soon followed by substantial increases in the salaries and pensions of active and retired government employees, both civil servants and members of the armed forces. These increases will apparently add some 2.3 billion francs to public sector costs in 1963.^{1/} To cover about 500 million francs of these added costs, increases were effected in May in electricity rates (7 per cent), railroad freight rates (3-3/4 per cent), and railroad passenger fares (11-3/4 per cent), and the nationalized enterprises were directed to make operational economies of 100 million francs. To obtain further funds, the Finance Ministry sent to Parliament in May the first 1963 supplementary budget bill asking for 1,823 million francs for increased subsidies to the nationalized enterprises and for increased salaries of government workers.

To cover these new budget outlays, some new taxes were voted--550 million francs of miscellaneous business taxes and 225 million francs from continuation of a personal income surtax that had been due to go off the books this year. Budgeted expenditures in other budget sectors were cut back 513 million francs. Finally, the estimate of 1963 budget receipts (other than from the new taxes) was raised. (Such revisions have become standard since 1959, because receipts have been very conservatively estimated at the start of each year.) This upward revision, amounting to 2,243 million francs, will also cover virtually all of the 1,989 million francs of other supplementary

^{1/} The added costs will be still higher in 1964, when all the wage increases will have taken effect and will also be effective for a full year.

expenditures in the two separate supplementary budget bills submitted in May and June. The net total of supplementary expenditures in the two bills, amounting to 3,299 million francs, increased budgeted expenditures for 1963 from the 84,905 billion francs in the initial budget to 88,204 million francs, or by 3.9 per cent.

The actual budget deficits over the last four years 1959-62, as measured by cash receipts and disbursements, have in fact been smaller than the 7 billion franc figure given each year by the estimates, and their financing has not been inflationary. Information released just recently on the 1962 results shows a cash budget deficit of 6.09 billion francs, which was somewhat higher than the 4.38 billion franc deficit in 1961. (See Table 4.) These deficits, along with amortization of the long- and medium-term public debt, resulted in a total Treasury deficit of 7.47 billion francs in 1961 (after adjustment for IMF franc operations) and 10.85 billion francs in 1962.

In covering these total deficits, the primary sources of funds have been (1) net sales of Treasury bills to the public (i.e., individuals and non-financial institutions) and (2) increases in cash deposits with the Treasury of public and semi-public institutions, notably the Post Office (which receives funds from the public in the form of deposits to postal checking accounts), and the Caisse des Dépôts et Consignations (to which flow the deposits with French savings banks). The Treasury's indebtedness to the banking system (after adjustment for IMF franc operations) actually declined 1.99 billion francs in 1961. Although it increased 1.03 billion francs in 1962, in both years Treasury operations were in fact slightly deflationary in their effect on the French economy because of the large-scale repayments of foreign public debt. Such

repayments, contractual and advance, totalled 1.43 billion francs in 1961 and rose to 3.36 billion francs (\$681 million) last year because of the much greater volume of prepayments.

Renewed expansion expected to continue

The French economy has been expanding again after the rigors of the winter and the labor troubles in the public sector. Business men are generally optimistic, and official projections point to another substantial output rise for 1963.

Seasonally-adjusted industrial production was cut back sharply in March because of the coal miners' strike and the other work stoppages. Because these difficulties did not end until April 5, the April output figure was also affected. The adjusted index for April was up 10 per cent from March and 2 per cent from December. (See Table 5.) According to press reports, output in May rose about 3 per cent above the April level. Although output as a whole was expanding, reports in April indicated that demand for equipment goods was still falling.

The vigor of increasing demand is indicated by the recent movements of both imports and prices. After remaining unchanged between the fourth and first quarters (on a quarterly average basis), seasonally-adjusted imports in April were up 7 per cent from the first quarter level and rose another 8-1/2 per cent in May (See Table 6.) Upward price pressures have continued. Wholesale prices jumped 2.2 per cent in May, after downward seasonal influences affecting foods, fuels, and electricity had held them nearly unchanged between January and April. The May rise was largely centered on foodstuffs, but prices of industrial products continued to advance slowly. (For this latter group, the index in May was 2.7 per cent above a year earlier.) Consumer prices resumed their inexorable

Table 5. France: Production, Price, and Wage Indexes, 1960-63
(1953=100)

<u>Year</u>	<u>Industrial production</u> (seasonally-adjusted)	<u>Wholesale</u> <u>prices</u>	<u>Consumer</u> <u>prices</u>	<u>Hourly</u> <u>wages a/</u>
1960	167	130	134	169
1961	175	132	138	183
1962		136	145	198
<u>Month</u>				
March	190	136	143	194
June	190	135	144	198
September	194	135	145	202
December	194	139	148	207
1963-				
January	196	140	150	--
February	195	140	150	--
March	181	139	150	211
April	200	139	151	--
May	b/ 206	142	151	--

a/ Figures refer to the beginning of the month following the month indicated in the table. The index is computed only once every three months.

b/ Estimate based on press reports.

Source: OECD

Table 6. France: Seasonally-Adjusted Foreign Trade, 1962-63
(In millions of dollars; monthly average or month)

<u>Quarter</u>	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
1962 - I	576	620	+44
II	587	602	+15
III	639	609	-30
IV	663	624	-39
1963 - I	661	619	-42
<u>Month</u>			
1963 - January	659	607	-52
February	613	625	+12
March	711	625	-86
April	706	710	+ 4
May	766	713	-53

Source: OECD

rise with increases of 1/2 per cent in each of the months April and May, after remaining essentially unchanged in February and March.

Serving to increase over-all demand of late has been an unexpected upsurge in exports. First-quarter increases in seasonally-adjusted exports totalled 11 per cent between December and March. In April, exports surged 14 per cent above the March level, and another 1/2 per cent rise occurred in May. Over the five months from December to May, the rise in exports came to 26 per cent. In contrast to these facts, INSEE surveys of the French economy in February and April declared that by and large export demand was stagnant and no upturn was to be expected.

On the internal sources of demand, it appears that consumption has been advancing while private investment spending has increased little this year or may even have declined from end-1962 levels. INSEE surveys have concluded that private fixed business investment in 1963, in real terms, might be little if any higher than in 1962. At the end of May, the National Accounts Commission forecast that these outlays might be only 2.2 per cent greater this year than last, as against a year-to-year rise of 8.3 per cent last year.

In spite of the weakening of private investment demand, the Commission has projected real GNP this year at 4.3 per cent above 1962. This is smaller than the 5-1/2 per cent rise registered in 1962. But the less rapid advance foreseen for this year is predicated on the expectation that agricultural production can scarcely increase further over the high levels attained last year, especially after the severity of last winter's weather. The expected rise in industrial production of 5-1/2 per cent is only fractionally below the 5.7 per cent increase achieved in 1962, the slightly smaller gain reflecting the loss of output caused by the strikes in March.

Consumer demand is expected to remain very strong. Consumption outlays in 1963, at constant prices, are placed at 6.2 per cent above last year, an increase equivalent to that actually recorded in 1962. The expected year-to-year rise in exports at constant prices of 7.4 per cent is not greatly below the 9-1/2 per cent increase experienced last year. On the other hand, the expansion rate of total capital formation, in real terms, is foreseen as dropping from 11 per cent last year to 3.7 per cent this year. In addition to a much smaller increase in private fixed investment, this predicted slowdown has its roots in a sharp slackening of inventory accumulation, following the heavy build-up last year when accumulation was nearly twice as large as in 1961. Fixed investment in the public sector is expected to show a rise about equal to the 10 per cent increase last year.