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RFD 447

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

October 21, 1963

Recent Economic Developments in France
July-September, 1963 13 pages

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Recent Economic Developments in France: July-September, 1963

Summary

During the second quarter, domestic production scored a vigorous recovery from the grip of winter and strikes.^{1/} Wage rates continued to rise much faster than productivity; from end-March to end-June hourly wage rates in private employment rose 2.5 per cent. On September 12, the French authorities announced a wide range of measures to arrest the upward trend of prices.

Monetary and fiscal actions to restrain demand are the foundation of the stabilization program. The permissible limit to bank credit expansion has been reduced below the rate set last February, and a cut in the budget deficit is planned for 1964. Some import tariffs have been lowered temporarily and, to absorb liquid funds, another long-term Treasury loan was floated in September. Other steps, supposed to be temporary, were taken to achieve an immediate price stabilization; these included a freeze on factory prices of manufactures and agreements with some sectors to lower prices in return for tax reductions.

Incomplete third quarter data indicate a smaller French external surplus of perhaps \$200 million, compared with \$286 million in the third quarter of 1962. To reinforce the tightening of credit, new regulations to cut back overseas borrowing by French business enterprises were adopted on August 7. The tighter regulations, and repayments of foreign credits, held down August and September reserve gains. However, the trade balance has improved since the spring, and the stabilization action may tend to keep the surplus from falling.

On the exchange market, the franc dipped slightly under its upper limit against the dollar on September 24 and has since continued to trade a bit below the ceiling.

^{1/} For a review of the preceding period, see Recent Economic Developments in France, April-July 1963, dated July 24, 1963.

Comprehensive anti-inflation program launched

A broadly-based program to halt the rise in French prices was announced on September 12. The wide scope of the action, and the inclusion of measures with "teeth," surprised the French financial press, which had expected little more than exhortation and temporary palliatives. The program attempts to dampen down demand by financial restraints; no elements were directly aimed at blunting the rapid uptrend in wage rates. In 1963 the expansion of bank credit and money supply has already slowed appreciably from 1961-62 rates, because of the restrictive monetary and fiscal measures taken last winter and spring.^{1/} But the rate of rise of internal prices has been essentially unaffected. At the consumer level, where inflationary pressures have been strongest, prices in August were 6-1/2 per cent higher than a year earlier.

The French anti-inflation program consists of three basic types of measures:

1. To curtail demand pressures, the authorized rate of bank credit expansion was further reduced, consumer credit terms were tightened, and action was taken to encourage individual saving. On the fiscal side, a cut was made in the proposed 1964 budget deficit and the Treasury floated another long-term bond issue.
2. To introduce competitive pressures on French prices, some import duties were lowered. In addition, to ease the labor market, a decision was made to speed up releases of men from the draft.
3. To provide temporary relief from price rises, several "emergency" price measures were adopted. Factory prices were frozen at August 31 levels, agreements were made with many producers and distributors to sell at reduced prices until the end of the year in return for tax

1/ See Recent Economic Developments in France, January-April 1963, dated April 10, 1963.

favours, and prices of government-produced goods were either reduced or stabilized. Price controls were later applied to many foods and beverages on October 9.

Cutbacks in financial availabilities

The decision to cut down still more on the expansion of bank credit to private borrowers was the most important single component of the program.

Following an 18 per cent rise in 1962, the Bank of France placed, in February 1963, a ceiling on such credit expansion of 12 per cent up to February 1964. The latest action reduces this 12 per cent figure to 10 per cent. The restrictive effect on credit expansion up to next February is more than twice as great as appears at first glance, because the whole reduction of two percentage points is concentrated in the remaining five and one-half months. The banks were allowed to increase their credit by 5 per cent in the six months March-August.^{1/} For the six months September-February, the maximum allowed expansion has now been lowered from 7 to 5 per cent, a reduction of 29 per cent in the expansion rate.

In the installment credit field, minimum downpayments were raised from 25 to 30 per cent on new automobiles and from 20 to 25 per cent on radio and television sets; maximum credit terms on new cars were shortened from 24 to 21 months. The maximum allowable amount of loans outstanding by consumer finance companies was cut from 10 to 9 times their net worth.

To encourage individual saving, the maximum amount that may be held in a single account with savings banks will be raised from the present level of 10,000 francs (\$2,025). However, it is expected that interest rates on savings deposits will be reduced. The French authorities have also decided to allow open-end investment trusts in France. This is the first implementation of recommendations made

^{1/} Because of seasonal factors, the total allowed expansion of 12 per cent was not spread evenly over the 12-month period.

by the Lorain Committee last June on ways to increase the flow of French funds into long-term securities.

Government measures to cut back total spending

The two fiscal measures in the program are designed to reduce liquid funds in private hands and to hold down government spending.

To soak up purchasing power, the Treasury on September 23 floated its second long-term bond issue of 1963 (and the second since 1958). The amount of the issue, 2 billion francs (subscribable in cash only), was double that of the May loan. The bonds were placed almost exclusively with the general public, and absorbed 1-1/2 per cent of the existing money supply. As with earlier Treasury issues, this loan also carries a large tax advantage. Interest on this 20-year loan is exempt from personal income tax for the first 10 years. The bonds were sold at par, and the coupon rate rises from 4-1/4 per cent in the first 10 years to 4-3/4 in the last ten. Redemption will be by lot over the second 10 years, and the redemption price rises from 105 in the eleventh through fifteenth year to 107-1/2 in the final five years.

The proposed budget for 1964 calls for a sharp reduction in the deficit to 4.74 billion francs, down from about 7 billion francs in each of the years 1961 to 1963 (on the basis of authorized expenditures and assessed revenues). The reason for the reduction is to ensure that Treasury operations--despite the appearance of a budget deficit--will have some deflationary impact.

In the years 1960-62, Treasury operations were deflationary in spite of budget deficits because the great volume of French saving which flows automatically to the Treasury on extra-budgetary account exceeded the sum of the cash budget deficit and internal debt amortization. However, this excess has been getting progressively smaller because the cash budget deficit has been rising. The deficit

rose from 4.38 billion francs in 1961 to 6.09 billion in 1962, and is expected to be about 7 billion francs in 1963. The automatic flow of savings to the Treasury consists almost wholly of open-tap sales of Treasury bills to the general public (a highly popular form of saving in France), postal checking accounts, and deposits with French savings banks made available through the intermediary of the Caisse des Dépôts et Consignations.

These flows provided the Treasury with nearly 10 billion francs in 1962. If the budget deficit is cut as planned in 1964, the Treasury should again find its borrowings from nonbank sources in excess of its cash requirements.

Proposed budget expenditures for 1964 are 8.8 per cent higher than those in the initial 1963 budget, and 4.3 per cent more than in 1963 after supplementary authorizations. In a sharp break with tradition, however, the Finance Minister has declared flatly that there will be no supplementary authorizations in 1964. Actual results will hinge largely on whether he holds to this statement. The prospective rise in outlays in 1964 is far smaller than has been customary in recent years. It reflects both a tight limitation on current operation (non-investment) expenditure, and the removal from the budget of more than 1 billion francs of long-term loans to industry, which will now be financed by the Caisse des Dépôts. This shift of loans will cut down the flow of savings to the Treasury; but it still appears that the remaining savings flows will exceed cash requirements.

Budget receipts in 1964 are expected to be 12-1/2 per cent greater than in 1963. Nearly all of the increase reflects a growth in the tax base. Real GNP is forecast as rising more than 4 per cent. In addition, price and wage inflation in the first eight months (at least) of 1963 means that the 1964 tax base will average substantially higher than in 1963. Only about 5 per cent of the rise in receipts will accrue from new taxes, chiefly those on betting gains and on capital

gains from sale of building land and apartments (aimed at curbing recent real estate speculation).

Tariff reductions to introduce competitive pressures

The lowering of import duties, effective on September 13 and described as temporary, apply principally to imports of clothing, durable consumer goods, agricultural machinery, and seafood. For imports of these items from other Common Market countries, the reductions ranged between 15 and 20 per cent of present levels. On imports from non-EEC countries the cuts equalled one-half the difference between the present level and the eventual EEC Common External Tariff. Since importers' profit margins have been frozen, the cuts in duties are expected to be entirely passed on to consumers.

Price rises continue through August

French consumer prices continued to rise in July and August at about the same rate as in the past two years. The monthly rise was 0.6 per cent in July and 0.5 per cent in August. (See Table 1, page 6a.) The general index in August was 6.5 per cent higher than a year earlier and 12.3 per cent above August 1961.

Prices of consumer services have risen much faster than prices of commodities. In the year ending August 1963, increases in the prices of recreational activities were up 8.9 per cent, medical and personal care by 8.8 per cent, and housing by 8.3 per cent. Food prices rose 6.7 per cent. Transportation rose by 4.9 per cent, beverages by 3.2 per cent and clothing by 3 per cent.

Wholesale prices in general were stable in July but rose 1.2 per cent in August when seasonal factors made for a sharp increase in prices of foodstuffs. (See Table 1.) In the twelve months ending in August, the general wholesale price index rose 4.4 per cent. At the wholesale level, by far the greatest upward pressure has been in the foodstuffs category, up 7.1 per cent. The increase was 2.8 per cent for both the fuels and energy group and the industrial products category, which includes only raw materials and semi-manufactures.

**Table 1. France: Price, Wage Rate, and Industrial
Production Indexes, 1959-63**
(1958=100)

	<u>Wholesale Prices</u>	<u>Consumer Prices</u>	<u>Hourly Wages</u>	<u>Industrial Production</u> ^{1/}
<u>Yearly average</u>				
1959	104.8	106.1	106.3	101
1960	107.5	110.0	113.4	110
1961	109.7	113.6	122.1	116
1962	112.7	119.1	132.6	123
<u>Month</u>				
1962-June	111.9	118.6	132.6	122
August	111.8	119.0	--	123
December	115.5	121.6	138.8	125
1963-March	115.2	123.5	141.4	116
April	115.2	124.0	--	128
May	117.9	124.5	--	130
June	115.5	125.3	144.9	132
July	115.4	126.1	--	n. a.
August	116.8	126.7	--	n. a.

^{1/} Seasonally-adjusted.

Source: INSEE (original indexes converted to 1958 base by author).

Wage rates rose sharply in second quarter

The rate of increase in hourly wages in private employment accelerated in the second quarter; the latest data from the Labor Ministry showed a rise of 2.5 per cent between end-March and end-June. (See Table 1) The results dashed official hopes that the slowing of the uptrend in the first quarter was the beginning of a period of more moderate increases. The first-quarter rise was 1.8 per cent, compared with an average of 2.4 per cent per quarter in 1962.

At the end of June, hourly rates in private employment were 9.3 per cent higher than 12 months earlier. Over the same period, hourly wage rates were up between 11 and 13 per cent in the nationalized industries and civil servants' salaries were upped 12.3 per cent. The gains for these latter two groups are partly a reflection of the large "catch-up" increases granted last April.

Payments surplus apparently contracted in third quarter

Partial data for the third quarter suggest that France's balance of payments surplus was appreciably smaller than in the corresponding months of 1962. Available figures for July-September indicate a surplus in the neighborhood of \$200 million, compared with an actual surplus of \$286 million in the third quarter of 1962.

Earlier this year, the French surplus showed a marked year-to-year decline in the first quarter, but in the second quarter was apparently almost as large as it had been a year earlier. For the first nine months of 1963, the surplus would appear to be about \$750 million compared with an actual surplus of \$950 million in January-September 1962. The decline reflects in particular (1) a less favorable trade balance than in 1962, and (2) restrictions on foreign borrowing by French business concerns imposed in early August of this year.

However, since the first quarter of this year France's seasonally-adjusted trade balance has improved. In addition, the stabilization plan introduced last

month may dampen down the trend of import demand. Therefore, it may be questioned whether any renewed weakening of the French trade position will take place.

In July, official reserves rose \$184 million after adjustments, mostly for debt prepayments (\$160 million to the United States and \$61 million to the IBRD). (See Table 2, page 8a.) But this very large gain was made possible by a rise of \$119 million in the net foreign indebtedness of the French commercial banks. (See Table 3, page 8a.) The net gain, deducting these borrowings, was \$65 million.

The official reserve gain in August was \$81 million (adjusted); no information is available on the commercial banks' position since July. The increase in official reserves was held down by new regulations on foreign borrowing by French business enterprises. Previously, companies could obtain abroad without official authorization loans up to 2 million francs per loan, for up to five years, and at an interest rate of no more than 5 per cent. Under new regulations effective August 7, prior authorization is required if the amount exceeds 1 million francs, if the maturity exceeds two years, and if the interest rate exceeds 4 per cent. The main effect of this restriction is to make it impossible to borrow in the Euro-dollar market where rates exceeding 4 per cent now prevail for 90-day deposits.

The reported September reserve gain was \$27 million or \$49 million when adjusted for payments by several franc-area countries of subscriptions to the IMF, IBRD, IFC and IDA. The adjusted gain in the week ending September 26 was only \$3 million, and it was at that time that the franc dipped slightly below its ceiling against the dollar. It appears that French companies were repaying foreign loans they had contracted in the spring, which could not be renewed under the new regulations.

Because of the six-month delay in release of the figures, the latest detailed information on the French balance of payments relates to the first quarter.

Table 2. France: Official Gold and Foreign Exchange Reserves, 1963
(in millions of dollars)

	Amount (end of month)	Change in month	
		Unadjusted	Adjusted ^{1/}
1962 - December	3,610		
1963 - January	3,744	+134	+134
February	3,889	+145	+145
March	3,998	+109	+109
April	4,050	+ 52	+126
May	4,200	+150	+150
June ^{2/}	4,258	+ 57	+ 49
July	4,219	- 38	+184
August	4,295	+ 76	+ 81
September	4,322	+ 27	+ 49

^{1/} Adjusted for changes in IMF position, debt prepayments, subscriptions to international organizations by franc area countries, and transfer of \$8 million of IBRD certificates out of reserves in April.

^{2/} Scheduled debt payments of \$63 million were made in June.

Source: Ministry of Finance.

Table 3. France: Commercial Banks' Net Foreign Position, 1963 ^{1/}
(in millions of dollars)

	Net Position, end of month	Change in month
1962 - December	-118	
1963 - January	-235	-117
February	-226	- 11
March	-275	- 49
April	-260	+ 15
May	-229	+ 31
June	-241	- 12
July	-360	-119

^{1/} Assets and liabilities with foreigners in foreign currencies and French francs. A minus sign indicates a net liability position. The 1963 data have been revised to show smaller net liabilities.

Source: OECD.

The surplus was \$216 million, down \$92 million from the \$308 million surplus in January-March 1962. Almost all of the decline was caused by an \$84 million deterioration in the trade balance. Changes in other current items were small, and private long-term capital inflow of \$115 million was up \$2 million from a year earlier.

Trade balance improves further in June-August

Since the end of May, the French trade balance has undergone a distinct improvement. The seasonally-adjusted deficit (imports c.i.f.) averaged \$16 million per month in June-August, compared with a monthly average deficit of \$42 million in the first quarter and \$27 million in April-May. (See Table 4, page 9a.)

Imports (seasonally-adjusted) have been at a lower level since May; their monthly average in June-August was 4 per cent less than in April-May, when imports were inflated by exceptional demands related to the hard winter and the coal miners' strike. Exports have retained most of the very sharp gain achieved in the spring. Although their monthly average in June-August was 3 per cent under April-May, it was still 11-1/2 per cent higher than in the first quarter.

Industrial output rose vigorously in second quarter

During the second quarter, French industrial production enjoyed a vigorous revival from the winter and the March strikes. April output, seasonally-adjusted, was up 10 per cent from the strike-depressed level in March; additional monthly gains of 1.5 and 2 per cent occurred in May and June, respectively. (See Table 1, page 6a) June output was 5.6 per cent above the December level.

Activity rose most rapidly in construction and public works in order to make up for time lost in the winter. Consumer demand continued to increase, as did public investment and residential building expenditures. The outlook in the equipment goods industries improved; the decline in new orders in this sector, which began soon after mid-1962, leveled out or was slightly reversed in the second quarter.

Table 4. France: Seasonally-Adjusted Foreign Trade, 1962-63
(in millions of dollars; monthly average or month)

	<u>Imports, c. i. f.</u>	<u>Exports</u>	<u>Balance</u>
<u>Quarter</u>			
1962 - I	576	620	+44
II	587	602	+15
III	639	609	-30
IV	663	624	-40
1963 - I	661	619	-42
II	723	702	-21
<u>Month</u>			
1963 - April	706	710	+ 5
May	766	708	-58
June	697	687	-10
July	737	715	-23
August	685	669	-15

Source: OECD.

INSEE experts, writing in July (before the stabilization program), foresaw a continuing increase in industrial production throughout the rest of 1963 at an annual rate of about 6 per cent. Their July survey found entrepreneurs remaining generally optimistic about the outlook for the next few months.