

L.5.2

RFD 477

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

March 31, 1964

Recent Economic Developments in France:  
December 1963 to March 1964

14 pages

Rodney H. Mills, Jr.  
Leonard A. Lupo

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.

March 31, 1964

Recent Economic Developments in France:  
December 1963 to March 1964

Rodney H. Mills, Jr. and  
Leonard A. Lupo

Summary

A marked improvement in the trade balance in February has been pointed to by French officials as further confirmation that the stabilization program is reducing inflationary pressures within the country. Earlier, the money supply expansion--the central feature of the stabilization effort--had been gradually cut down by limitations in the rate of growth of bank credit (which were extended in January at the current rate) and by a decline in the external surplus. (See Table 1.) Fiscal cutbacks (including debt-management operations) have reinforced the effectiveness of these two restrictive factors.

As a result, even though the price rise has not been halted, it has been slowed. Production has continued to rise, but not quite so fast, and business circles have become somewhat less optimistic about future production increases. Stock prices have been falling since September. The rise in hourly wage rates slackened further in the fourth quarter, even though the labor market continued to tighten. Conditions seem favorable for the continuation in 1964 of the monetary and budget restraints the French authorities have imposed, and the task of restraining demand should be made easier by a reduced balance of payments surplus this year.

Because of a big upsurge in imports, France's trade deficit has widened greatly since early last fall. As a result, the balance of payments surplus in the fourth quarter of \$100 million was less than half of the year-ago figure, and official reserves rose only \$38 million in January-February. At the current rate, the trade deficit is about equal to the invisibles surplus so that the current account this year may show no surplus. However, it is also probable that the deterioration in the trade balance has largely run its course for the time being.

If this is true, then the over-all payments position in 1964 will be determined by the sum of capital and other transactions. Over the past three years, these items have run at a yearly surplus of between \$300 and \$500 million, as may be seen in the following annual totals (in millions of U.S. dollars):

	<u>1961</u>	<u>1962</u>	<u>1963</u>
Long-term capital			
Private	359	403	466
Official	-120	-127	-145
Net	<u>239</u>	<u>276</u>	<u>321</u>
Overseas franc area	72	145	100
Short-term private capital	-118	- 81	
Errors and omissions	<u>111</u>	<u>31</u> }	<u>106</u>
Totals	304	371	527

It is on the assumption of a continued net surplus on these combined accounts that recent estimates for 1964 published in the press have been for a surplus of \$400 to \$500 million.<sup>1/</sup>

Monetary expansion is reduced

Bringing down the expansion of the money supply is the core of the French stabilization program. Efforts to achieve this goal, first begun in early 1963 and then intensified last September, have borne fruit. On a year-to-year basis, the rise in the money supply last year became progressively smaller in relation to the corresponding period of the preceding two years. (See Table 1.) For the year, the money supply is reported to have increased 13-1/2 per cent in 1963 compared with 18 per cent in 1962 but, for the final quarter, the increase was about 5.3 per cent in 1963, or one-third less fast than the increase a year earlier.

The principal tool employed by the monetary authorities to accomplish this end has been the ceiling on the expansion of bank credit to the "economy" (all borrowers but the Treasury). In January, Finance Minister Giscard d'Estaing renewed the existing limitation on bank credit expansion which was scheduled to

<sup>1/</sup> The Economist, February 22, 1964.

expire at the end of February. Over the seven months March-September, the banks will not be allowed to increase credit more than 4-1/2 per cent. This limitation, which is equivalent to a seasonally-adjusted annual rate of 10 per cent, is the same as the expansion rate set in the ceilings last September. The 10 per cent limit contrasts with an actual increase of 20 per cent in 1962.

Table 1. France: Changes in Money Supply and Counterparts, 1962-63  
(In billions of francs)

		<u>Qtr. I</u>	<u>Qtr. II</u>	<u>Qtr. III</u>	<u>Oct.-Nov.</u>
<u>MONEY SUPPLY</u>					
Absolute increase:	1962	1.26	6.77	4.84	1.58
	1963	0.92	6.13	5.08	-0.11
Percentage increase:	1962	1.1%	6.1%	4.1%	1.3%
	1963	0.9%	4.2%	3.7%	-0.1%
<u>COUNTERPARTS</u>					
1. Increase in bank credit to private economy	1962	0.48	2.35	3.64	2.65
	1963	-2.48	4.37	0.64	1.63
2. Balance of payments surplus <u>1/</u>	1962	1.52	1.93	1.41	1.03
	1963	1.07	1.97	1.03	0.49
3. Increase in bank credit to Treasury <u>1/</u>	1962	-0.76	1.34	0.76	-1.77
	1963	3.39	-0.21	2.49	-2.16
4. Other (net)	1962	0.02	1.13	-0.97	-0.33
	1963	-1.06	--	0.92	-0.07

1/ Before official external debt prepayments.

Source: Conseil National du Cr dit for most data; Finance Ministry for balance of payments and debt prepayments.

In addition, the decline in France's external surplus has been helping the French authorities to reduce monetary pressures. The balance of payments surplus was one-fourth lower in the third and one-half lower in the fourth quarter of 1963 than a year earlier. Reserve increases in 1964 have been comparatively small.

The Finance Minister has said he thinks the money supply will rise no faster than 10 per cent in 1964, a rate about one-half below the 1962 rates. At this point there is every reason to believe the authorities will succeed in this endeavor. The authorities have resisted whatever pressures there may have been to ease the credit restrictions, and have a firm hand on the budgetary situation. On an administrative basis, the budget deficit was reduced from 7 billion francs in 1962 to 6.2 billion francs in 1963 2/ and the 1964 budget calls for a deficit of 4.7 billion francs which the Treasury should be able to cover without resort to bank credit. Mr. Giscard d'Estaing has also announced his intention to keep the deficit from rising in 1965. On a cash basis, the budget deficit in 1963 rose to 8.1 billion francs in the first eight months alone, and bank credit to the Treasury expanded sharply. (See Table 1.) But this cash deficit was brought down to 5.4 billion francs for the first eleven months of 1963, and credit to the Treasury was cut back after August. Continuing the policy reintroduced last year of raising Treasury funds by long-term loans, another 20-year bond issue was floated in mid-March for 1.5 billion francs.

Price rise slows down

With the pressure of demand abating, price increases since last September have generally been much smaller than they were a year earlier. Consumer prices in January 1964 were up 1.04 per cent over last September; the increase in the same period 12 months before was 3.23 per cent.3/ For each one of the three large components of this index--food and drink, non-food manufactures, and services--the increases in the recent period were substantially below the

---

2/ Actual receipts were much higher than expected. Contrary to previous practice, the excess receipts were used to reduce the deficit rather than to increase expenditures.

3/ There is a marked seasonal rise in food prices at this time of year which of course affects the over-all index.

increase in the earlier period. (See Table 2.)

At the wholesale level, the over-all index in January was 2.10 per cent higher than in October, a rise also well under that of a year before. The greatest change was the far smaller rise in prices of foodstuffs. Industrial prices, however, rose very slightly more (1.26 per cent) than a year ago. But this appears to have resulted partly from the changed situation regarding import prices. The rise in prices of imported goods, amounting to 3.70 per cent in these four months, was nearly double the increase in the same period last year.

Table 2. France: Price Changes, 1963-64  
(In per cent)

	Rise in 4 months ending:		Rise in 12 months ending:	
	<u>Jan. '63</u>	<u>Jan. '64</u>	<u>Sept. '63</u>	<u>Jan. '64</u>
Consumer prices	3.23	1.04	6.97	4.68
of which:				
Food and drink	4.14	1.03	6.81	4.27
Non-food manufactures	1.01	0.56	5.24	3.76
Services	3.84	1.70	11.08	8.48
Wholesale prices	3.80	2.10	4.55	2.89
of which:				
Foodstuffs	7.34	2.68	5.55	2.79
Industrial products	1.19	1.26	2.96	3.02
Imported goods	2.09	3.70	5.10	6.76

Source: INSEE.

One feature of the price picture is of course the existence of the price controls applied last autumn, notably on factory prices of manufactures.<sup>4/</sup> But the relative movements have been favorable for those indexes largely unaffected by the controls, e.g., consumer prices and wholesale food prices. Furthermore, with a few exceptions, it has been possible to maintain the price ceilings for six months. This fact indicates some success in tempering the underlying market forces. Recently some firms have been allowed to raise prices because of rising costs of imported materials.

<sup>4/</sup> French statistics do not permit a measurement of the role played by the controls, as opposed to market forces, in the recent price behavior.

Wage rates rise more slowly

Upward pressure on wage rates has also slackened. In private employment, hourly wages rose 1.51 per cent in the fourth quarter, down very sharply from 2.42 per cent in the fourth quarter of 1962. (See Table 3.) The comparison is given added weight because it represents an intensification of a slowdown in the rate of increase. By contrast, second quarter results showed a 2.49 per cent rise in wage rates in private employment in 1963 and 2.59 per cent a year earlier; the third quarter rise in 1963 slowed down to 1.82 per cent from 2.11 per cent a year before. Thus, the fourth quarter results constituted a further flattening in the upward wage trend. However, a note of caution should be inserted here: even though increases in wages have slowed down, total labor costs may have risen somewhat faster in 1963 than did wages alone.

Table 3. France: Changes in Hourly Wages, 1962-63 <sup>1/</sup>  
(In per cent)

	End of Quarter			
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>
Quarterly rise				
1962	2.47	2.59	2.11	2.42
1963	1.84	2.49	1.82	1.51
Year-to-year rise, 1963	9.26	9.15	8.84	7.89

<sup>1/</sup> In private employment.

Source: INSEE.

The slowing of the rise in wages in late 1963 occurred despite an apparent further tightening of the labor market. Seasonally-adjusted unemployment fell from an average of 98,000 in the third quarter to 94,000 in the fourth, and dropped to 87,000 in February 1964. (See Table 4.) The number of jobs vacant rose from an average of 52,000 in the third quarter to 54,000 in the fourth and held at this level in January-February. As a result the ratio of vacancies to unemployed increased steadily in these months.

Table 4. France: Selected Economic Indicators, 1963-64

	1963				1964	
	I	II	III	IV	Jan.	Feb.
<u>Production</u>						
Seasonally-adjusted industrial production, excluding construction (1953=100)	191	202	205	212	216	n. a.
Construction (unadjusted) Index (1953=100)	109	166	153	157	1/145	n. a.
Year-to-year rise (in %)	-13	15	12	10		
Passenger cars (unadjusted) Number (monthly average in 000's of units)	149	153	110	155	168	152
Year-to-year rise (in %)	21	16	10	5	3	8
<u>Department Store Sales (Paris)</u>						
Seasonally-adjusted deflated index (1953=100) <sup>2/</sup>	241	252	271	257	245	n. a.
<u>Labor Market (seasonally-adjusted)</u>						
Unemployment (000's)	99	96	98	94	90	87
Jobs vacant (000's)	66	48	52	54	54	1/54
Ratio vacancies/unemployed		.50	.53	.57	.60	.62

<sup>1/</sup> Estimated.

<sup>2/</sup> Deflated by consumer prices of manufactures.

Sources: INSEE and press reports.

Growth in consumption may have slackened

Consumption increases apparently slackened during fourth quarter and again in January, exerting downwards pressure on the growth of real demand. 'Real' sales of Paris department stores, seasonally adjusted, fell sharply in the fourth quarter after exceptional activity in the second and third quarters. (See Table 4.) Sales in January were down 5 per cent from the third quarter levels, and down 3 per cent compared to a year ago. The fall in consumption appears to have extended to autos--the annual rate of growth of French passenger car production, compared to a year ago, has fallen steadily and markedly from 21 per cent in the first quarter 1963 to 5 per cent in January-February 1964. Renault's stocks of

unsold cars designed for the domestic market were increasing recently at more than 10,000 per month. As a result, Renault reduced prices in mid-February; the slash in the price of one model exceeded 3 per cent.

Business climate less exuberant

The expectations French businessmen expressed in the January INSEE survey are only moderately optimistic, compared with the September survey (which preceded the introduction of the stabilization program). Production is expected to continue expanding, but less rapidly than in the autumn; in addition, enterprises reported that their order books remain favorable for the season, but less so than in the autumn. The price outlook also is for only moderate advances-- individual firms now expect to raise their prices very little, if at all. These firms indeed expect only moderate general price rises. Stocks of fabricated goods are still judged very low, however. The stock market has continued to reflect bearish opinion, and stock prices have now fallen nearly 15 per cent since early last September.

Seasonally adjusted industrial production grew more slowly through the fourth quarter 1963 and January, reflecting lessening real demand pressures, and growing bottlenecks in labor supply in the construction and the consumers' goods industries. (See Table 4.) The INSEE enquiry for January reveals "a small decrease in the rhythm of growth, which however remains high." The balance of industrialists reporting an increase in output to INSEE over those reporting a decrease fell to 27 per cent in January, compared to 33 per cent in November, the recent peak month. Further, this decrease is reported by firms in a range of industries, rather than just by those in the depressed capital goods industries.

The adjusted index of industrial output (excluding construction) now is growing at an annual rate of 4-6 per cent (4 per cent per year during the fourth quarter, 5.6 per cent per year from September-October through December-January). These solid current growth rates imply less strain on French resources than the 8 per cent growth in industrial output registered between fourth quarter 1962 and fourth quarter 1963. The rate of growth of construction also has slackened off considerably recently: in building and public works, the annual growth rate has fallen from 15 per cent in the second quarter to 10 per cent in the fourth, compared to the corresponding year-ago period.

#### Interest rates rise

With bank credit harder to get, and also more expensive since the November discount rate rise, long-term bond yields in France have risen. Market yields on governments in March were around 5.66 per cent, or about 30 basis points higher than just prior to the September measures. A rise of about 40 basis points on corporates has occurred in this same period, bringing these yields to 6.35 per cent by mid-March.

Rates have risen also on "free investment" Treasury bills. In part this reflects the higher interest rates banks charged customers. In addition, in late January the Finance Ministry removed the 2.88 per cent ceiling on the rates it was prepared to pay at the auctions of one-year bills. These yields rose to 3.69 per cent at the January 29 auction. By mid-March they had slipped back to 3.47 per cent but were still well above the former 2.88 per cent limit.

#### Trade deficit rises but may now stabilize

Over the past several months, France's trade balance has generally tended to move very unfavorably because of an upsurge in imports. But a marked improvement in February may herald the end of the recent phase of deterioration

that began last September. A continuation through 1964 of the deficits of the past six months would nevertheless mean something close to equilibrium in the current account as a whole: the trade deficit would about equal the surplus on invisibles transactions.

Seasonally-adjusted total imports (c.i.f.) rose 11 per cent from the third quarter to the fourth, and in January-February advanced a further 7 per cent. (See Table 5.) Exports rose hardly at all in the third quarter, but then scored sharp monthly gains of almost 4 per cent in January and nearly 5 per cent in February. The deficit rose from a monthly average of \$41 million in the third quarter to \$110 million in the fourth, and for January-February averaged \$106 million. Within these last two months, the deficit dropped from \$137 million in January to \$74 million in February as imports fell and exports rose.

Table 5. France: Foreign Trade, 1963-64  
(In millions of dollars; monthly average or month)

<u>Seasonally-adjusted Total Trade, Imports c.i.f.</u>						
	<u>Imports c.i.f.</u>			<u>Exports</u>	<u>Balance</u>	
1963 - I		668		619		- 49
II		714		695		- 19
III		727		686		- 41
IV		805		695		-110
1964 - January		880		743		-137
February		852		778		- 74

  

<u>Trade with Foreign Countries, Imports f.o.b. 1/</u>						
	<u>Imports f.o.b.</u>		<u>Exports</u>		<u>Balance</u>	
	<u>Un- adjusted</u>	<u>Seasonally adjusted<sup>2/</sup></u>	<u>Un- adjusted</u>	<u>Seasonally adjusted<sup>2/</sup></u>	<u>Un- adjusted</u>	<u>Seasonally adjusted<sup>2/</sup></u>
1963-Sept.	499	572	507	548	+ 8	-24
Oct.	619	635	631	584	+12	-51
Nov.	585	579	569	544	-16	-35
Dec.	634	609	612	582	-22	-27
1964-Jan.	655	670	589	597	-66	-73
Feb.	638	644	620	633	-18	-11
6-mo. totals	3,630	3,709	3,528	3,488	-102	-221

1/ Imports f.o.b. estimated at 90 per cent of the c.i.f. value.

2/ Estimates obtained by applying the seasonal adjustment factors used for total trade.

Source: Trade figures from INSEE, adjustment factors from OECD.

The burst in imports since the summer of 1963 was in part a reflection of the unilateral French tariff cuts last autumn. The other factors accounting for the exceptional size of this increase are not readily apparent. But in large measure the recent trade balance deterioration has also been a continuation of the basic trend in French trade since mid-1962, when import growth began to outstrip the rise in exports. For the full year 1963, exports were up a healthy 10 per cent over 1962, almost wholly in sales to other Western European countries; these exports benefited from booming demand in those countries as well as the intra-Common Market tariff cuts. But French imports in 1963 were as much as 18-1/2 per cent more than in 1962 (compared with a rise in GNP in 1963 of 4-1/2 to 5 per cent in real terms and probably about 11 per cent in money terms). The far greater rise in total imports was spread over all commodity groups, but was spearheaded by a 37 per cent increase in imports of non-food consumer goods.

The French Finance Minister has said that the improved balance in February represented a return to more normal conditions. Certainly imports cannot be expected to rise indefinitely at the rate of recent months. The rise in average monthly imports from the third quarter of 1963 to January-February of this year (a period of less than 6 months) was 20 per cent. Both the ending of the expansionary effect of the late-1963 French tariff reductions and the easing of inflationary pressures underlie expectations for an improvement in the trade balance even though both exports and imports should grow further in 1964.

However, it is useful to assess the balance of payments implications of the recent levels of the French trade deficit. If the deficit were to continue in 1964 at the average level of the last six months, France should be close to equilibrium on current transactions this year. For the months September 1963 through February 1964, it may be estimated that, at an annual rate, the

seasonally-adjusted foreign exchange deficit on f.o.b. trade was \$440 million.<sup>5</sup> (See Table 5.) This estimated deficit in fact exceeds the \$300 million surplus on current account registered in 1963.

Payments surplus runs at reduced levels

Because of the shift in the trade position, the over-all French surplus since mid-1963 has been running well below the comparable year-ago levels. Only comparatively small French reserve gains have materialized during the early weeks of 1964.

The over-all surplus (before debt prepayments) in the third quarter was \$209 million (\$286 million in 1962). For the fourth quarter of 1963, French estimates place the surplus at \$100 million (\$209 million in 1962). (See Table 6.) In the entire second half of 1963 the over-all surplus was down \$186 million with the trade account (payments basis, f.o.b.) deteriorating by \$195 million.

In distinct contrast to the merchandise account, the surplus on other items (combined) was well maintained. On all non-trade items taken as a whole, the period July-December 1963 recorded a surplus of \$253 million, up \$9 million from a year earlier. Somewhat reduced surpluses were recorded on long-term private capital and on the net balance of the overseas franc area; the net income from services declined sharply. But the combined deficit on short-term capital and errors and omissions was reduced, and the donations account shifted from deficit to surplus, probably because of a decline in foreign grants by the French Government.

---

<sup>5/</sup> This deficit is obtained by considering only the trade with foreign countries (i.e., excluding the trade with the overseas franc area). The f.o.b. value of these imports is officially estimated at 90 per cent of the c.i.f. value. The seasonal adjustment factors valid for total trade have been applied to this trade. This procedure may overstate or understate the adjusted deficit on trade with foreign countries. However, the trade with foreign countries exceeds 80 per cent of the total on both the import and export sides. Even on an unadjusted basis, the deficit on trade with foreign countries ran at an annual rate of over \$200 million in this period.

Table 6. France: Balance of Payments, 1962-63 <sup>1/</sup>  
(In millions of dollars)

	<u>First Half</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Year</u>
Trade balance				
1962	233	158	94	476
1963	43	98	-41	100
Services				
1962	181	- 6	109	289
1963	135	- 5	54	184
Donations				
1962	77	27	-49	55
1963	61	26	28	115
Long-term private capital				
1962	172	119	110	403
1963	268	108	90	466
Long-term public capital <sup>2/</sup>				
1962	-51	-55	-22	-127
1963	-59	-57	-29	-145
Short-term private capital				
1962	-33	-77	33	-81
1963	-42	-12	<u>3/-46</u>	<u>3/-55</u>
Overseas franc area				
1962	57	63	26	145
1963	73	9	18	100
Errors and omissions				
1962	65	58	-97	31
1963	137	42	<u>3/-18</u>	<u>3/161</u>
Over-all balance <sup>2/</sup>				
1962	698	286	209	1,193
1963	617	209	100	926

<sup>1/</sup> Figures for the fourth quarter of 1963 and for the full year 1963 are estimates of the French Finance Ministry.

<sup>2/</sup> Before debt prepayments.

<sup>3/</sup> It is not known whether, for the final quarter of 1963, items pending settlement are included in short-term private capital or in errors and omissions. For the other periods they are included in short-term private capital.

Source: French Finance Ministry as reported by the U.S. Embassy, Paris.

The outlook for the French payments balance in 1964 is for a continued but reduced surplus, in the range of perhaps \$200 to \$500 million. As discussed above, the current account will perhaps be close to equilibrium because of the recent adverse change in the trade balance. But for the three years 1961-63 France has had a comparatively stable surplus of \$350 million to \$470 million a year on long-term private capital, which has apparently not been affected by the somewhat cool official French attitude toward foreign investment in France. Unless the profits outlook in France worsens, further inflow in 1964 can be expected. In addition, the overseas franc area has been contributing about \$100 million yearly to French reserve gains. Against these surpluses may be set the long-term net foreign loans and investments of the French Government which in recent years have been running at somewhat under \$150 million yearly.

Recent official reserve accruals by France have been modest in comparison with the past several years and confirm the expectation of a lower surplus. Reserves rose \$24 million in January and \$14 million in February. From February 27 to March 12 the gain was apparently about \$2 million. But the French press reports that in the next few days they rose \$12-17 million in reflection of the run on the lira in that week.

The comparatively reduced strength of the franc also shows up in the exchange rate. On the exchange markets, since the beginning of the year the franc has been quoted at just below its upper limit against the dollar 60 per cent of the time in January, 50 per cent of the time in February, and 50 per cent in the first 23 days of March.