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RFD 417

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

April 10, 1963

Recent Economic Developments in France:

January-April, 1963

12 pages

Rodney H. Mills, Jr.

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Summary

Price trends continue to be a key problem in France. Both the severe winter weather in January and February and the terms of settlement of recent labor disputes have fostered cost and price advances; on the other hand, measures of credit restraint by the Bank of France may have a moderating influence. Despite price increases and a reduction in the trade surplus, official reserve accruals during January and February were much larger than a year earlier, probably in part because of exchange market pressures on the pound sterling.

The terms on which recent serious labor troubles have been settled will not only aggravate the price problem; they may also produce difficulties for the budget and the realization of the Four-Year Plan. Wage increases granted to the coal miners, ending a five-week strike, and to the railroad workers will widen the deficits of these two nationalized industries; coal prices and railroad rates will have to be raised unless subsidies from the budget are to be augmented. The coal strike settlement also provides for a longer paid vacation and a promise to discuss this autumn the question of reducing the length of the work week. The government has so far opposed reductions in hours worked by labor as a threat to planned output goals. Gas and electricity workers have also been granted substantial wage increases.

At the end of February, the Bank of France took steps to slow the expansion of bank credit in 1963 by about one-third the rate of increase in 1962. The steps taken comprised (1) an increase in the banks' required minimum liquidity ratio, and (2) a request to the banks to limit the increase in credits (with some exceptions) to 12 per cent in the next twelve months. For the past three years,

the money supply, fed largely by bank credit, had increased by 16 to 18 per cent annually.

French official reserves increased during the January-March quarter by the exceptionally large amount of \$387 million. These gains reflect in part the development of favorable leads and lags. Nevertheless, a high Bank of France official has forecast a substantial reduction in the French surplus in 1963, possibly from the 1962 figure of about \$1,150 million to \$500 million, mainly because of a deterioration in the merchandise trade balance. The latest survey of the French foreign trade outlook, together with the adverse changes which have occurred in the trade balance since mid-1962, suggests that the French surplus will indeed be smaller in 1963 than in 1962.

Industrial production rose further in January. A comprehensive survey of the state of the French economy in February concluded that prospects were good for continued expansion of economic activity because of increasing consumer demand and rising government outlays. Little or no stimulus was expected from exports or private investment.

#### Coal strike settlement terms add to government's problems

France's most serious labor trouble since the advent of the de Gaulle regime ended with a compromise settlement on April 3 of the five-week strike in the nationalized coal mines. The miners won something less than they had demanded, but the terms are also far less favorable to the government than its original proposals. The government will now find it harder to hold down the budget deficit, to slow the rising trend of prices, and to attain planned output goals.

The strike revealed how far wages in the private and public sectors had diverged. Coal miners and other public sector workers have been disaffected not because the government has been niggardly but because private industry workers have

been receiving rapid advances, out of proportion to productivity increases. For two years the French Government has made no attempt to slow down wage increases in private industry; these wage rates rose 8 per cent in 1961 and 9-1/2 per cent in 1962.

The miners' wages will be increased 12-1/2 per cent between now and April 1964, of which 6-1/2 per cent will be granted immediately. This 12-1/2 per cent rise is about twice as large as the government's initial offer; the miners struck for an immediate 11 per cent raise, plus further increases in the course of the year.

The findings of a group of "wise men" appointed by the government (after the strike began) to investigate wage grievances in the four largest nationalized industries are of great significance for France's public sector finances. In contrast to previous official denials, this group determined that since 1957 wage rates in the nationalized industries had lagged substantially behind those in private industry, as much as 8 per cent or more in the case of the miners. Their findings of substantial wage lags for the railroad, gas and electricity workers have now obliged the government to make settlements favorable to them. On April 4, the railroad employees were granted an immediate 5 per cent raise and an additional 3.2 per cent raise next January. Press reports state that the gas and electricity workers received increases of 7.3 per cent between April and December of this year.

As a result of the wage increases now granted, annual operating costs are expected to rise 375 million francs in the coal mines and 467 million francs in the railroads. Both industries are already incurring deficits covered by budget subsidies. If the cost increases were to be made up by higher subsidies, this would increase the over-all budget deficit by about 15 per cent over the estimated 1962 results. However, it seems more likely that the higher costs would be met by raising coal prices and railroad rates.

The coal strike settlement went beyond wage rates. Since the Renault action last December, an extension of paid vacations from three to four weeks per year has become a goal of French labor; the miners won a partial victory by getting three and one-half weeks. The government also agreed to discuss with the miners in September the question of reducing the work week to 40 hours from the present 46 to 48 hours. In the past, the government has maintained that any shortening of the work week in French industry before 1965, and any widespread extension of the vacation period, would jeopardize the attainment of the goals of the Four Year Plan.

Measures taken to restrain monetary expansion

At the end of February, the Bank of France instituted two measures to slow down the expansion of money supply by moderating the growth of bank credit. The rates of expansion in both have been very rapid in recent years. The new moves are designed to cut down credit expansion by roughly one-third from the 1962 rate.

In the first place, the banks' required minimum liquidity ratio was raised from 32 to 35 per cent effective March 31.<sup>1/</sup> The liquidity ratio was first introduced in January 1961 at 30 per cent and was raised to 32 per cent in February 1962. The present increase should not have much immediate impact on bank lending because bank liquidity is seasonally high, but it will cut down on the ability of the banks to lend from accruing resources.

The second measure, a new device in France, greatly resembles the gentlemen's agreements on credit restraint reached in Switzerland in the past year. The Bank of France has requested each bank to limit to 12 per cent the increase in bank

<sup>1/</sup> The percentage of total deposit liabilities held in cash, deposits with the Bank of France and the Treasury, Treasury bills, medium-term paper, export paper, and paper for financing the grain trade.

credit over the twelve months from February 28. This restriction does not apply to the financing of exports (which of late have not been increasing) or of equipment goods (demand for which has been falling).

Although no important changes occurred in the French monetary situation in the weeks and months preceding these steps, the new measures reflect the concern that a continuation of the growth of money supply at the rapid rates experienced in the past three years would be undesirable. The supply of money and quasi-money increased 16 per cent in 1960, 17 per cent in 1961, and 18 per cent in 1962.<sup>2/</sup> Such increases were between two and three times larger than the corresponding increases in GNP, in current as well as constant prices. Until late 1961, these increases, while large, served to rebuild the ratio between money supply and GNP to the 1956 level, which had been reduced by the sharp 1957-58 price inflation. But in 1962, the ratio rose substantially above the 1956 level.

Bank credit to the economy has been the main source of the increases in money supply, accounting for 64 to 71 per cent of the increase in each of the past three years. (See Table 1.) Yearly expansion rates for this credit ranged between 18 and 20 per cent. The expansion of credit financed from the banks' own resources has been even more rapid. Because the balance of payments surpluses provided banks with sufficient funds, there was very little increase in Bank of France rediscounts in 1961-62.

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<sup>2/</sup> For money supply alone, the increases in these three years were 14, 15, and 18 per cent.

Table 1. France: Money Supply and Counterparts, 1959-62  
(In billions of francs; end of year)

	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
<u>Supply of Money and Quasi-Money</u>	<u>90.2</u>	<u>104.8</u>	<u>122.3</u>	<u>144.5</u>
1. Currency and demand deposits	83.9	95.8	110.6	130.6
2. Commercial bank time deposits and deposit certificates	6.3	9.0	11.7	13.9
<u>Counterparts</u>	<u>90.2</u>	<u>104.8</u>	<u>122.3</u>	<u>144.5</u>
1. <u>Gold and net foreign exchange of Bank of France</u>	<u>8.2</u>	<u>11.5</u>	<u>16.3</u>	<u>20.1</u>
2. <u>Credit to Treasury</u>	<u>30.3</u>	<u>32.3</u>	<u>33.6</u>	<u>37.6</u>
Of which: Bank of France	10.6	8.6	9.2	9.6
Commercial banks	9.2	11.0	9.5	10.2
Non-banks <u>a/</u>	10.4	12.7	14.9	17.8
3. <u>Credit to the Economy</u>	<u>51.7</u>	<u>62.0</u>	<u>73.3</u>	<u>87.5</u>
Of which: Commercial banks	36.1	41.0	52.3	64.6
Bank of France (rediscounts)	17.7	21.0	21.0	22.9

a/ Mainly postal checking accounts.  
Source: Conseil National du Crédit.

The balance of payments surpluses as conventionally measured have actually accounted for more of the growth of money supply than is indicated by Table 1, and credit to the Treasury has been less of a factor than would appear to be the case. The rise in gold and net foreign exchange assets of the Bank of France of 8.6 billion francs in 1961-62 is the increase after prepayments of official foreign debts totalling 4.5 billion francs. An equal amount should be deducted from the actual rise in credit to the Treasury (amounting to 5.3 billion francs in 1961-62) in order to measure the effect before debt prepayments.

Exceptional increases in official reserves in 1963

In January-February of this year, France's official reserves rose even faster than in the comparable weeks of 1962. Gains amounted to \$134 million in January and \$145 million in February, compared with adjusted increases of \$60 million and \$45 million in the corresponding months last year. But the French

balance of payments surplus did not increase correspondingly. Favorable changes in leads and lags in trade payments probably accounted for a substantial share--perhaps as much as one-half--of the rise in official reserves in January-February, reflecting the desire of French residents, after the breakdown of the U.K.-Common Market negotiations in January, to reduce their sterling holdings, notably in early February.

In March, official reserves rose \$108 million, a rate not much below that of a year before.

Reduced but still large surplus foreseen for 1963

France's balance of payments surplus in 1962 appears to have been about \$1,150 million, or nearly \$100 million less than in 1961. The balance for January-September is shown in Table 2. French officials expect the surplus will show a more substantial decrease this year, mainly because of a deterioration in the trade balance.

Mr. J.-P. Koszul, General Manager of the Foreign Department of the Bank of France, writing in the February issue of Banque, holds that "it appears reasonable to expect that the 1963 balance of payments will continue to show a surplus, which may amount to as much as \$500 million, perhaps more, but which will certainly be less than in 1962." The principal cause of the expected shrinkage of the over-all surplus is a lower trade surplus for 1963, in the amount of \$250 to \$300 million (imports f.o.b., payments basis). This compares with a trade surplus in 1962 which Mr. Koszul estimated at \$480 million in his published article but which later data suggest was probably around \$425 million. The reasons given for this expected decline were the rising trend of prices in France relative to prices in other countries, government forecasts of a more rapid increase in imports than in exports, and the deterioration in the French trade balance in the latter part of 1962.



Table 2. France: Balance of Payments, January-September, 1961-62  
(In millions of dollars)

	<u>1961</u>	<u>1962</u>
<u>A. CURRENT ACCOUNT</u>		
Imports f.o.b.(payments basis)	-3,245	-3,883
Exports (payments basis)	<u>3,560</u>	<u>4,265</u>
Trade balance	314	382
Foreign travel	152	138
Other items	<u>252</u>	<u>141</u>
Total current account	718	661
<u>B. PRIVATE CAPITAL</u>		
Long-term:		
Residents	17	- 26
Non-residents	308	320
Short-term (excluding banks):		
Residents	- 73	-120
Non-residents	12	18
Operations pending settlement	<u>- 20</u>	<u>- 11</u>
Total private capital	244	181
<u>C. OFFICIAL CAPITAL (excluding advance debt redemption)</u>	- 89	-106
<u>D. NET BALANCE OF OVERSEAS</u>		
<u>FRANC AREA WITH THIRD COUNTRIES</u>	70	120
<u>E. ERRORS AND OMISSIONS</u>	113	128
<u>F. SURPLUS (A+B+C+D+E)</u>	1,056	984
<u>G. FINANCED BY:</u>		
Advance debt redemption	- 320	- 476
Official reserves	- 699	- 591
IMF position	- 243	- 12
Official liabilities	137	- 23
Commercial banks' net foreign position	68	118

Sources: INSEE and IMF.

But for 1962, the French surplus turned out to be substantially larger than was projected by French officials a year ago, and current forecasts may have a pessimistic bias.

There was a marked deterioration in France's trade balance with the OECD countries in the second half of 1962 because of a more rapid increase in imports than in exports. Of total French trade with foreign countries (i.e., the trade entering into the balance of payments), the OECD countries currently take about 80 per cent of exports and supply 70 per cent of imports. For the entire year 1962, France had a surplus on this trade of \$392 million (customs figures, imports c.i.f.). But after mid-1962, this surplus was greatly reduced on a seasonally-adjusted basis. At an annual rate, the adjusted surplus in the months October 1962 to January 1963 was \$132 million, or \$260 million less than the surplus for all of 1962. (See Table 3.) Thus, if the trade balance in 1963 should show no improvement over recent months, the 1963 surplus would be well below the 1962 level. Trade with the non-OECD countries, with which France runs a deficit, also became much more unfavorable in the second half of last year. (See Table 4.)

The most recent assessment of French trade prospects concludes that the trade balance with foreign countries will probably worsen. The monthly review of the INSEE (National Institute of Statistics and Economic Studies), in a lengthy survey of the state of the French economy in February, stated:

"Foreign orders in recent months have been considered by French exporters/ to be rather weak, and their forecasts of exports to foreign countries have been for a slight decline. Against this relatively cautious outlook for exports--even admitting that they may be a bit pessimistic--one can make a surer prediction of an increase in French imports, especially in the sector of manufactured consumer goods."

In January, seasonally-adjusted total French imports showed virtually no change from either December or the fourth quarter average. Exports rose sharply from December but were still considerably under the fourth quarter average.

Table 3. France: Seasonally-Adjusted Trade with OECD Countries, 1961-63  
(In millions of dollars; monthly average or month)

		<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
<u>1961</u>				
Qtr.	I	291	332	41
	II	318	353	35
	III	332	354	42
	IV	335	356	21
<u>1962</u>				
Qtr.	I	326	387	61
	II	337	381	44
	III	374	382	8
	IV	387	396	9
<u>1962-63 by months</u>				
1962-	October	376	427	51
	November	403	402	- 1
	December	383	360	-23
1963-	January	370	387	17

Source: OECD.

Table 4. France: Trade with Non-OECD Foreign Countries (Unadjusted), 1961-63  
(In millions of dollars; monthly average or month)

	<u>By quarter</u>				<u>Month</u>
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Jan.</u>
<u>Imports c.i.f.</u>					
1961	124	120	114	126	114
1962	126	130	126	145	123
1963	--	--	--	--	153
<u>Exports</u>					
1961	94	92	92	105	91
1962	102	111	87	109	93
1963	--	--	--	--	104
<u>Balance</u>					
1961	-30	-28	-22	-21	-23
1962	-24	-19	-39	-36	-30
1963	--	--	--	--	-49

Sources: INSEE and OECD.

Note to Tables 3 and 4: Imports for January 1962 have been adjusted downward for a change in statistical procedure.

For February, the preliminary statistics show improvement but should be treated with caution. Total adjusted exports rose 3 per cent from January to regain the fourth-quarter level, while imports fell 7 per cent below both January and the fourth quarter. February imports may well have been affected by the U. S. longshoremen's strike which ended January 23.

Economic activity expected to rise further

The labor unrest in March impeded production, and some effects on output may continue to be felt in the near future. However, the mid-February INSEE survey of the French economy was confident that over-all economic activity would increase further in the next few months. On the basis of periodic soundings of business opinion in November-January, INSEE experts concluded that industrial production would rise about as fast as in the months June-October 1962, or by about 9 per cent at an annual rate.

Consumer demand, which has been rising very fast since mid-1962, is expected to be the major element in the increase. It should be supplemented by increasing demand for housing, by rising government expenditures (notably public works and military capital outlays), and by a further revival of exports to Algeria. On the other hand, little or no stimulus is anticipated in the first half of 1963 from exports to foreign countries or from investment outlays by business firms. The annual survey of business investment intentions for 1963, made in November, actually indicated a decline in these investment expenditures from the 1962 level. In partial explanation of this pessimism, the INSEE suggested that the intentions revealed by the survey should be corrected somewhat for a downward bias observed in the past, and should be interpreted as indicating no change. It also felt that, if consumption should keep on increasing strongly, the propensity to invest might pick up in the latter part of 1963.

The new index of industrial production, on a 1959 base, showed a 1.2 per cent rise between December and January (seasonally-adjusted). The old index (with 1952 as the base year) had risen 1-1/2 per cent in November and remained unchanged in December, when it was 6.2 per cent higher than a year previous. According to press reports, the new index shows a rise for the past year only two-thirds as large as that given by the old index.

Continued pressure on prices

Severe winter weather accentuated underlying upward price pressures in both January and February. Wholesale prices rose another 0.6 per cent in January, compared with a 1 per cent decline in January 1962. Consumer prices rose a further 1.3 per cent in January, as against 0.7 per cent a year before. A seasonal 0.2 per cent drop in wholesale prices in February was said to be smaller than normal, although it compares with no change in February 1962. While consumer prices rose only 0.1 per cent in February, a year earlier there had been a dip of the same magnitude.

New monetary measures

On April 10, the French announced a series of new financial measures designed: (a) to reduce the inflow of foreign funds; (b) to shift French funds from the Treasury bill to the long-term capital market; and (c) to enhance the Bank of France's powers to check credit expansion.

To discourage the inflow of foreign funds, the payment of interest on foreign-owned bank accounts in French francs has been prohibited. This regulation is similar to measures taken in 1960 by Germany and by Switzerland. Thus far, little short-term capital inflow has apparently come into France; but it is thought that this step was a precautionary measure because the credit restraints imposed in February might encourage greater inflows at a time when France is still running a large payments surplus.

To encourage a shift in French capital into the long-term capital market, the authorities reduced by one-fourth percentage point the prevailing rates on all Treasury bills sold to both financial institutions and the general public. The rate was slashed from  $3\frac{1}{8}$  to  $2\frac{7}{8}$  per cent on the most common maturity of bills sold to financial institutions. The authorities also took steps to restrict the availability of Treasury bills to financial institutions by introducing a new arrangement for marketing bills similar to the one introduced in Italy last November. Under the new arrangement, the private banks will continue to be able to obtain on a "tap" basis at fixed rates a special issue to meet the fixed proportion of their assets (presently 15 per cent of deposits) which must be held in this form. Otherwise, Treasury bills will be available to financial institutions only by regular auction. The closing of the "open window" of these Treasury bills is designed both to reduce short-term rates and to encourage a flow of funds from bills into capital market assets. The strong preference in France for short-term assets, an outgrowth of

domestic inflations and exchange-rate devaluations over the past 45 years, has undoubtedly prevented the external payments surplus and the improved availability of funds in financial markets from having its full impact on credit availabilities and on market rates in the French capital market.

Finally, to arm the Bank of France with further powers to restrain credit, the Bank was empowered to raise the minimum liquidity ratio of the private banks from its present 35 per cent ceiling--to which the ratio was increased on March 31--to 38 per cent whenever it deems such a raise necessary.