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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 2, 1963

Recent Economic Developments in France,
October-November 1963 10 pages

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Summary

The Bank of France discount rate was raised from 3-1/2 to 4 per cent on November 14. This was the first use of the discount rate weapon in the anti-inflationary campaign begun last February, and the first change in Bank rate since October 1960. The rate increase dramatizes the government's determination to overcome inflation, and also raises the cost of commercial bank loans. Minimum interest rates on bank loans are traditionally set in relation to the discount rate, and have now been raised by 1/4 of 1 per cent.

Money market rates in Paris rose following the discount rate rise. However, French regulations affecting short-term international capital movements would appear to make it unlikely that this action will cause any significant flow of funds to France.

The French authorities said that an increase in the discount rate had been postponed until now in view of the French external surplus, but was now justified by a "return to relative equilibrium on the exchange market." French reserve gains disappeared in October. However there were renewed accruals totalling \$60 million in the four weeks ending November 21, and the franc has once again been continuously at its upper limit against the dollar since October 25. There is no evidence yet of a basic shift from surplus to equilibrium in the French balance of payments, even though the trade deficit increased sharply in September and October.

The rise in French consumer prices slowed markedly in October, following the imposition of price controls in September-October. But the discount rate rise was accompanied by other anti-inflationary moves. These included (1) a freeze on

the prices of many services; (2) additional tariff reductions; and (3) a reduction in the 1963 budget deficit.

Seasonally adjusted industrial production continued to rise through September, when it was 4.5 per cent above the second quarter average.

France will shortly open up its capital market to new security issues by international organizations, and later will allow borrowings by foreign governments.

Discount rate is raised

In a continuing effort to overcome inflationary pressures, the French authorities raised the Bank of France discount rate from 3-1/2 to 4 per cent on November 14. According to press reports (including The Economist), the rise was opposed by Governor Brunet of the Bank of France. The decision was taken by the 33-man National Credit Council which formulates French monetary policy, and of which the Minister of Finance is President and the Governor of the Bank of France is Vice President. This is the first use of the discount rate weapon in the current anti-inflation drive that opened last February; the rate had been kept at 3-1/2 per cent since October 1960 (when it was reduced from 4 per cent).

The rise in Bank rate is designed to achieve two specific effects. First, in view of the great psychological importance of Bank rate, the move is intended to dramatize the determination of the government to ensure the success of the stabilization plan. (Finance Minister Giscard d'Estaing has implied that he is staking his career on the outcome.) Second, there will be an immediate increase in the cost of commercial bank loans. Under French monetary practice, minimum interest rates charged customers on bank loans have traditionally been set in relation to the Bank of France discount rate. In this particular instance, the National Credit Council has raised the minimum interest rate by 1/4 of 1 per cent, or by one-half of the amount of the discount rate increase. In the past, the entire change in the discount rate

has usually been allowed for in the automatic loan rate increase.

The discount rate rise was accompanied by an increase from 4-1/2 to 5 per cent in the penalty rate paid by banks on rediscounts that exceed by 10 per cent or less the rediscount ceilings the Bank of France establishes for each bank. Left unchanged were (1) the 6 per cent penalty rate on rediscounts exceeding the ceilings by more than 10 per cent, and (2) the preferential 3 per cent rate on rediscounts of export bills and on purchases of Treasury bills.

On the Paris money market, rates on day-to-day money rose immediately from 3-1/2 to 4 per cent following the Bank of France action. This market is sensitive in the extreme to changes in either bank liquidity or Bank of France lending rates. Because French banks have continuous recourse to rediscount accommodation, market rates are only exceptionally below the discount rate applied to rediscounts within the ceilings. However, auction rates on Treasury bills at the November 15 auction were either unchanged from or below those at the November 5 auction.

It seems unlikely that the French discount rate hike will set in motion any significant flow of short-term funds into France from the outside. In the first place, the Paris money market is closed to all but French financial institutions. Second, the French authorities are controlling short-term foreign borrowing by French businesses, and in present circumstances will not wish to see such borrowing increase. Third, foreigners can receive no interest on franc deposits in French banks. Finally, the differences between the discount rate and rates for Euro-dollars leave little or no incentive for French banks to substitute borrowing in the Euro-dollar market for borrowing at the Bank of France.

The French authorities explained that a discount rate increase had been warranted by internal conditions for some time but had been put off because of France's continuing balance of payments surplus. But they said that the move was

then justified by the "return to a relative equilibrium on the exchange market." French reserve increases did halt for a time in September-October; however, they have resumed since and there is no evidence that the French external position has yet undergone a basic shift from surplus to equilibrium.

Reserve gains reappear and franc returns to ceiling

After a brief hiatus, recent weeks have witnessed renewed reserve gains by the Bank of France. Reserves rose \$60 million in the four weeks ended November 21. (See Table I.). Earlier, in the four weeks from September 26 to October 24, there was no increase (after adjustment for special official transactions). The pause in that period was at least partly caused by two temporary factors. These were (1) changes in leads and lags in trade payments, which earlier had been very favorable to France, and (2) repayments of foreign loans by French companies which could not be renewed under the tighter regulations imposed on such borrowing last August. The franc has been continuously at its upper limit against the dollar on the foreign exchanges since October 25, after being slightly off the ceiling in the preceding four weeks.

The French trade balance in September and October was notably less favorable than in the summer months, and for all of 1963 has been much less favorable than in 1962. But there is yet no indication of any large changes in other balance of payments components which have been a large and continuing source of foreign exchange for more than four years. Last year, France had surpluses of \$290 million on services, \$400 million on private long-term capital movements, and \$145 million on the transactions of the overseas franc area with third countries. This year, there was a first-quarter over-all surplus of \$216 million. On the basis of adjusted changes in official reserves and changes in the foreign position of commercial banks, there were

Table 1. France: Adjusted Changes in Official Reserves, 1963 ^{1/}
(In millions of dollars)

<u>In month ending:</u>			<u>In week ending: 2/</u>	
January	31	+134	September 19	+15
February	28	+145	26	+ 3
March	31	+109	October 3	+ 1
April	30	+126	10	+ 2
May	31	+150	17	+ 7
June	30	+ 49	24	-10
July	31	+183	31	+22
August	31	+ 81	November 7	+30
September	30	+ 54	14	- 4
October	31	+ 17	21	+12

1/ Adjusted for special official transactions.

2/ Bank of France holdings only.

Sources: Ministry of Finance and Bank of France.

estimated over-all surpluses of \$312 million in the second quarter and \$278 million in the third quarter.

Trade deficit rises again

France's seasonally adjusted trade deficit (imports c.i.f.) rose from a \$20 million monthly average in July-August to \$83 million in September, and in October appears to have risen to around \$120 million. (See Table 2.). These changes followed a reduction in the average monthly deficit from \$51 million in the first quarter to \$16 million in the second.

Imports in September were up 4.9 per cent from July-August. In October, the rise over the previous month was apparently 10.8 per cent. (An estimated seasonal factor has been used.) This came in the wake of tariff cuts on many items effective September 13. Exports in September were down 0.4 per cent from July-August, but they rose an estimated 6.8 per cent in October.

For all of 1963 to date, the adjusted trade deficit was \$324 million for the first nine months, and an estimated \$444 million for the first ten months. Last year there was a surplus of \$55 million in the first nine months and of \$72 million in the first ten months. The changes reflect a greater increase in imports than in exports. The nine-month percentage increases (for unadjusted trade) were 13.6 per cent for imports and 9.4 per cent for exports.

France will open up capital market

Finance Minister Giscard d'Estaing said on November 14 that France was giving up its long-standing opposition to the flotation of foreign securities in Paris. He announced that issues by international organizations will be allowed in the next few months and that later foreign governments will be able to borrow long-term funds in France. In December the European Investment Bank will borrow

Table 2. 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	580	617	+36
II	589	599	+11
III	639	611	-29
IV	655	628	-27
1963 - I	668	616	-51
II	714	697	-16
III	728	687	-41
<u>Month - 1963</u>			
June	691	696	+ 5
July	739	708	-30
August	690	681	- 9
September	755	672	-83
October	<u>1/</u> 837	<u>1/</u> 718	<u>1/</u> -119

1/ Estimated.

Sources: OECD and Bank of France.

60 million francs (\$12 million) for 20 years, at a 5.7 per cent yield to the lender. The European Coal and Steel Community has opened negotiations for a loan.

Price rise moderated, but new measures are taken

The October increase in French consumer prices was 0.15 per cent, a rise only one-third as large as the average monthly increase in the last year. (See Table 3.) These results were partially a consequence of direct price action--the freezing of factory prices in September, and the application of controls to a few retail prices in October.

New steps to combat inflation were taken on November 14. Ceiling prices were set on a great number of services, hitherto exempted from direct controls. The ceiling prices are generally the prices in effect on October 31. In addition, further tariff reductions were ordered. The cuts, ranging from 25 to 50 per cent, applied principally to lead, zinc, woolen and linen cloth, fish, fats and canned vegetables. The government also enlarged import quotas on goods not manufactured in France. Finally, to hold down the 1963 budget deficit, the final supplementary expenditure authorization for this year will be kept well below the level of the "supplementary receipts," i.e., the expected excess of actual receipts over the amount initially projected in the budget law passed last winter. The effect is to cut the expected deficit from 7 to 6.22 billion francs.

September production hits new high

Seasonally adjusted industrial production continued to rise rapidly through September. Industrial production in September was up 2.7 per cent from June and 4.5 per cent from the second quarter average. Because of the vigor of the economy evidenced by the latest available data, the Finance Minister said in November that the estimated rise in real GNP from 1962 to 1963 should probably be

Table 3. France: Price and Production Indexes.
(1953=100)

	<u>Consumer Prices</u>	<u>Wholesale Prices</u>	<u>Industrial Production</u> 1/
<u>Quarterly average</u>			
1961 - III	137.1	131.7	183
1962 - III	144.9	134.5	193
IV	146.8	137.2	196
1963 - I	149.9	139.8	191
II	151.4	140.2	202
III	154.2	140.5	205
<u>Month - 1963</u>			
June	152.3	139.4	206
July	153.2	139.3) 2/ 201
August	154.0	140.9	
September	155.2	141.2	212
October	155.4	n. a.	n. a.

1/ Seasonally adjusted.

2/ Adjustment factor fails to reflect extension of vacation period in 1963. The index is for July-August combined.

Sources: OECD and Bank of France.

revised upward from 4-1/2 to 5 per cent. The INSEE survey of business sentiment made in early September (just before the mid-September stabilization decisions) showed industrialists generally to be even more optimistic than in July over the near-term outlook, even though the outlook in the capital goods industries was still mediocre.