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Recent Economic Developments in France: March-June 1964

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Summary

A very large increase in French official reserve gains in May can be directly attributed to a tightening of conditions in the French money market last spring and not to any marked improvement in the French trade balance or long-term capital position. However, the latest indicators of economic activity suggest a distinct relaxation of demand pressures within the French economy since the start of this year.

Increasing tightness in the money market during March-May was related to reductions in Bank of France credit to the Treasury, whose position has improved dramatically since last autumn. In May, French banks were almost continuously paying penalty rates on excess borrowing from the Bank of France. These conditions were one factor in the rise in adjusted French official reserve gains from a relatively small $24 million a month in the first quarter to $56 million in April and $147 million in May. The money market eased in June, in part because of the May inflow of exchange.

To ease the money market, in June the French authorities reduced the banks' required liquidity ratio. In May the requirement on banks' holdings of Treasury paper was also eased, as part of a structural reform. These measures do not imply any relaxation of the control of bank credit expansion, which remains subject to the current ceiling of 10 per cent a year. Partly to emphasize this point, the Bank of France's highest ("super-hell") penalty lending rate was raised from 6 to 7-1/2 per cent on June 5.

Demand pressures in the markets for goods and services appear to have slackened this year. Retail prices rose only 0.1 per cent a month in February-April, and department store sales resumed in March-April the downward trend initiated

in the fourth quarter. Industrial production was up only 1/2 of 1 per cent from January to April. The March survey of industry reported a considerable decline since November in the expansion of demand, and less optimism over production increases in the next few months. In the labor market, wage rates continued to rise rapidly in the first quarter, but the market evidently eased appreciably in March-April. Imports and the trade deficit have tended to stabilize since January.

Recently released data on French Treasury operations show that since last September, when the stabilization program was launched, the Treasury's deficit has been far below that of a year earlier, because of restraint in the expansion of expenditures. The Treasury expects to make further reductions in the deficit this year. Treasury operations for last year (as a whole) and for the first quarter of this year were not inflationary, and could have a deflationary impact this year.

Money market tightens

Internal financial developments in the period under review were highlighted by increasing tightness in the money market. The market eased in early June, but is expected to be tight again over the June month-end.

In March and April, day-to-day money rates exceeded 6 per cent over the month-end (when the currency drain is heaviest). In May, the banks were forced almost continuously to rediscount with the Bank of France in excess of 110 per cent of their rediscount ceilings and thus to pay the "super-hell" penalty which at the time was still 6 per cent. Thus, market rates were 6 per cent or more during most of the month. One factor contributing to the market tightness was the improved position of the Treasury. Aided by its March long-term bond issue and a reduced cash budget deficit, the Treasury repaid nearly 1.2 billion francs of Bank of France advances during April and May.

The market eased in June, and the day-to-day money rate dropped to around 4 per cent in the period June 10-18. Contributing to the easing were stepped up Treasury outlays and heavy official reserve gains in May which themselves reflected substantial inflows of short-term capital in response to tight credit conditions.

Monetary measures taken

In May and June, the National Credit Council approved the adoption of several new monetary regulations, some of which were to relieve money market tensions but others to strengthen the effectiveness of the Bank of France to curtail credit.

First, the required minimum ("floor") for bank holdings of Treasury certificates was cut from 13 to 10 per cent of deposits, effective May 31. The reduction--the fifth since 1961--is in line with the long-run goal of abolishing entirely a mechanism that provides funds automatically for the Treasury; its timing reflects the Treasury's current favorable position. This step will tend to increase Treasury borrowing costs, since the certificates are sold at artificially low rates, but it will tend to ease the money market by releasing funds to the banks with which to hold down penalty-rate borrowing at the Bank of France.[1/]

Second, the banks' required liquidity ratio was temporarily reduced from 36 to 33 per cent of deposits, effective June 30.[2/] This gives the banks more flexibility in their choice of assets, and will help to ease the money market. Banks can hold down penalty-rate discounts at the Bank of France with funds formerly employed in meeting the (higher) liquidity ratio (cash, Treasury paper, medium-term paper,

1/ The full effect of the reduction will not be felt for about 5 or 6 months, since practically all the certificates have a two-year maturity.

2/ A decision on June 4 to reduce it to 34 per cent was followed by an announcement on June 26 of a reduction to 33 per cent.

export paper, and grain paper). This could be accomplished rapidly by rediscounts of paper no longer required to be held, viz., export paper rediscountable without limit at the Bank of France, and medium-term paper rediscountable with the Credit National.

Third, the Bank of France "super-hell" penalty borrowing rate was raised on June 5 from 6 to 7-1/2 per cent. Last November this rate was left unchanged when the basic discount rate was raised 1/2 of 1 per cent to 4 per cent. The increase means that, in times of money market tightness, it will cost the banks more to obtain Bank of France accommodation over and above 110 per cent of their rediscount ceilings, and the normal upper limit to money market rates will therefore be 7-1/2 instead of 6 per cent.

Fourth, the Governor of the Bank of France will apply more severe sanctions against banks that increase credit faster than the rate prescribed by the agreed ceiling (currently 10 per cent a year). The sanctions have taken the form of reductions in rediscount ceilings.

One reason given for both the rise in the "super-hell" penalty rate and the more severe sanctions is to dispel any doubts that the lowering of the Treasury certificate "floor" and of the liquidity ratio might constitute a relaxation of credit. The expansion of bank credit remains subject to the 10 per cent annual ceiling.

Finally, the maximum amount of credit that instalment finance companies can extend was slashed from 9 to 8 times their net worth. This follows the cut (from 10 to 9 times net worth) effected last September.

Demand pressures subside

The most recent French statistical indicators confirm earlier estimates that the stabilization program begun last year has produced a distinct deceleration of demand pressures in the economy.

On the price front, the consumer price index rose only 0.3 per cent between January and April, compared with 1.1 per cent in the same period last year. (See Table 1.) In 1963, prior to the stabilization program, the index was rising at a rate of nearly 6 per cent a year; the recent rise thus seems to indicate an annual rate of increase of something like 1-1/2 or 2 per cent. Influenced by downward seasonal pressures on prices of foodstuffs and of fuel and power, the wholesale price index fell in each of the first four months of 1963, the total decline coming to 2-1/2 per cent. In contrast, last year, despite seasonal influences, the decline in this period was only 0.3 per cent. In April the general wholesale price index was up only 1.6 per cent over a year earlier, compared with a year-to-year 3.9 per cent rise in December.

Table 1. France: Selected Economic Indicators, 1962-64
(indexes: base 1953=100)

	Consumer Prices	Wholesale Prices	Dept. Store Sales 1/	Industrial Production 1/
Month				
1962-December	n.a. 2/	139.4	333	194
1963-January	148.3	140.2	307	195
February	149.1	140.0	312	193
March	149.6	139.1	320	179 3/
April	149.9	139.0	322	199
December	154.6	144.8	353	213
1964-January	155.2	144.5	332	216
February	155.4	143.2	358	215
March	155.5	141.9	341	214
April	155.6	141.2	338	217
Quarterly Average				
1962-IV	n.a. 2/	137.1	324	195
1963-I	149.0	139.8	313	190
II	150.6	140.2	331	204
III	152.7	140.5	365	204
IV	154.3	143.4	348	212
1964-I	155.4	143.2	344	215

1/ Seasonally adjusted.
2/ Because of the introduction of a new index for the period beginning January 1963, the indexes for earlier periods are not comparable.
3/ Production affected by strikes.

Source: OECD

Since factory prices (and some other prices as well) have been frozen since last September, the price indexes cannot be taken as the sole guide to changes in demand pressures. But most other indexes, and qualitative reports, show that the economy has lost much buoyancy in recent months. In the first place, seasonally adjusted department store sales have continued the downward trend initiated in the fourth quarter. In April, sales were down 2.9 per cent from the fourth quarter average and down 7.4 per cent from their peak in the third quarter of last year. (See Table 1.)

Second, seasonally adjusted industrial production has shown little increase since January. Declines in both February and March were followed by a rise in April, but April production was only 1/2 of 1 per cent above January. In contrast, last year production increased 7.7 per cent (fourth quarter to fourth quarter). The latest complete INSEE four-monthly survey of the situation and outlook in industry, made during March, reported that in the months December-March demand increased much less rapidly than in the months July-November 1963. In March, order books were less well-filled than in November, and delays in deliveries were slightly smaller. The percentage of industrial leaders who thought production would increase in the next three or four months was lower in March than in November, although the majority still looked for increases.

Third, on the labor market, some easing apparently took place in March-April. In the first quarter, wage rates in private employment were still rising rapidly; the quarterly increase was 1.9 per cent, a rate nearly identical with the average quarterly rise last year. (See Table 2.) But between February and April, seasonally adjusted unemployment rose by 7,000 (8 per cent) while seasonally adjusted job vacancies declined by 6,000 (11 per cent). In the INSEE March industrial survey, business leaders reported that employment had risen more slowly in the previous four months, and that they expected a slowing down of the rate of rise in wage rates.

Table 2. France: Labor Market Statistics, 1962-64

Month	Hourly Wages: January 1956 =100 1/	Hourly Wages: 1953=100 2/	Unemployment (000's) 3/	Job Vacancies (000's) 3/
1962-December	173.7	207	97	85.6
1963-March	176.9	211	99	56.4
June	181.3	215	96	51.4
September	184.6	219	97	52.7
December	187.4	222	92	51.9
1964-January	--	-	90	53.6
February	--	-	87	53.6
March	190.9 4/	n.a.	88	51.2
April	--	-	94	47.8

1/ All private employment.
2/ Manufacturing.
3/ Seasonally adjusted.
4/ Estimated from press reports.

Sources: INSEE and OECD.

Finally, seasonally adjusted imports have tended to stabilize at a level below their January peak. (See below.)

Treasury position shows dramatic improvement

The improved position of the French Treasury since the launching of the stabilization program last September has been one of the key elements in the policy of reducing demand pressures. The Finance Minister is also determined to continue to restrain expenditures and bring down the Treasury deficit in 1964 well below both last year and the level for this year initially budgeted last fall.

During the first nine months of 1963, the Treasury deficit ran much higher than the year before; at the end of last September, the cumulative deficit on cash budget operations and debt amortization totaled 9.66 billion francs for the three quarters, up from 6.62 billion francs in January-September 1962. (See Table 3.) Figures released in May show that, in the fourth quarter, restraint in expenditures cut the budget deficit very sharply below the comparable 1962 level, so that the total Treasury deficit in the fourth quarter was only 1.27 billion francs compared to 4.23 billion francs in October-December 1963. For the year, the 1963 total deficit of 10.93 billion francs was scarcely higher than in 1962, although the budget deficit was up substantially.

Table 3. France: Treasury Deficits by Quarter, 1962-64
(in billions of francs)

	I	II	III	IV	Year
Total Deficit[1/]					
1962	0.70	1.58	4.34	4.23	10.85
1963	1.72	1.94	6.00	1.27	10.93
1964	0.44	n.a.	-	-	-
of which:					
Deficit on Budget Operations					
1962	0.35	0.61	2.21	2.92	6.09
1963	1.53	1.46	4.70	0.53	8.21
1964	0.20	n.a.	-	-	-

1/ Budget operations and debt amortization.
Source: Ministry of Finance.

Table 4. France: Treasury Operations, 1962-64
(in billions of francs; - = expenditure or deficit)

	Year 1962	Year 1963	1st Quarter 1963	1st Quarter 1964
I. Budget Operations	-6.09	-8.21	-1.53	-0.20
Current receipts	74.49	84.94	20.95	24.36
Current expenditures	-75.00	-86.42	-20.96	-23.46
Loan expenditures (net)	-5.58	-6.73	-1.52	-1.10
II. Debt Amortization	-4.76	-2.72	-0.19	-0.24
III. Total Treasury Position	-10.85	-10.93	-1.72	-0.44
IV. Financing	10.85	10.93	1.72	0.44
Bank of France advances	0.85	0.10	0.58	1.11
Treasury bills held by com'l banks and Bank of France	0.05	0.85	1.70	-0.99
Treas. bills sold to public	3.44	2.27	1.03	0.35
Long-term bond issues	-	3.00	-	1.50
Postal checking accounts	3.72	2.78)	-1.59	-1.53
Other	2.79	1.93)		

Source: Ministry of Finance

The improvement has continued this year. In the first quarter, the total deficit was 0.44 billion francs, down sharply from 1.72 billion francs in 1963, entirely because of a cut in the budget deficit. Current receipts in the first quarter were up 16.4 per cent over last year, while the rise in current expenditures and net loan expenditure was held to 9.3 per cent.

For 1964, the initial budget presented to Parliament last fall called for an administrative deficit of 4.75 billion francs, well below 1963 when there was an administrative deficit of 6.2 billion francs (and a cash deficit of 8.21 billion francs). But in recent statements, M. Giscard d'Estaing has said he expects to reduce it to 3 billion francs.

Treasury operations had no inflationary impact in 1963 (taken as a whole) or in the first quarter of 1964, thanks to the strong measures taken to halt the trend toward increasing deficits. Advances from the Bank of France and increased holdings of Treasury bills by the banking system totaled only 0.95 billion francs in 1963 and 0.12 billion francs in January-March 1964; in 1963, the Treasury's resort to bank credit was more than equalled by deflationary repayments of external debt. The French Treasury's noninflationary sources of finance (shown in Table 4) included long-term bond loans (two loans totaling 3 billion francs in 1963, and a 1.5 billion franc loan in March 1964); sales of Treasury bills to the public; new deposits to postal checking accounts; and funds received from public institutions which keep accounts with the Treasury and which subscribe to Treasury bills. It seems likely that, if the 1964 budget deficit is in fact reduced to 3 billion francs, Treasury operations could exercise a substantial deflationary impact this year.

<u>Reserve gains rise sharply in April-May</u>

Accruals to France's official reserves of gold and foreign exchange were comparatively small in the first quarter but then rose sharply, especially in May. First quarter gains totaled \$21 million unadjusted, and \$72 million (\$24 million in each month) after adjustment for a \$51 million improvement in France's IMF position (resulting mainly from Italy's drawing of \$50 million equivalent of French francs in late March). These relatively small increases reflected the worsening of France's trade position over the previous 18 months.

The reserve gains rose to \$56 million in April and \$147 million in May. Several reasons have been advanced for this stepped-up rate of accruals:

1. Seasonally higher receipts from tourism and a seasonal decline in some imports, including coal;

2. A decline in French Government expenditures abroad (chiefly for military equipment);

3. An increase in foreign-owned franc accounts with French banks (despite the prohibition of interest payments on such accounts);

4. An improvement in leads and lags in trade payments.

In addition, an inflow in May, estimated at about $50 million, resulted from changes in the net forward exchange position of residents and nonresidents and related to the tight liquidity position of the French banks. It is reported that in May the net forward exchange position of French residents declined by perhaps as much as $20 million. This released an equivalent amount of foreign exchange which banks held as cover for forward purchases of exchange by residents; the banks apparently sold the released exchange to the monetary authorities to obtain francs to ease their liquidity position. Concurrently, the net forward position of nonresidents reportedly increased, perhaps by as much as $30 million; nonresidents increased their purchases of forward francs to take advantage of an increasing discount on forward francs that reached 2 per cent per annum by end-May. French banks borrowed foreign exchange abroad for immediate conversion into francs to cover their forward franc sales. They might not have done this if their franc liquidity had not been so strained.

In early June the inflow of exchange continued; official reserves were apparently up some $50 million between June 4 and June 11 after adjustment for a special $50 million swap transaction with the U. S. Treasury. It is reported that in early June the Chrysler Corporation made a transfer of $18 million to increase the capital of Simca. French officials are concerned that the customary tightening of the money market at the end of June might bring on further inflows of funds.

Trade deficit stabilizes at lower level

Since February, France's deficit on total foreign trade (imports c.i.f.) has tended to stabilize; seasonally adjusted deficits in the months February-May ranged between $64 million and $101 million per month. (See Table 5.) These deficits were below the $110 million average of the fourth quarter and well under the peak deficit of $136 million reached in January. Imports, which had risen rapidly during most of 1963, have run since February at levels below January, while exports have fluctuated on either side of their January level.

Table 5. France: Foreign Trade, 1963-64
(in millions of dollars)

Total Trade, Seasonally Adjusted

		Imports c.i.f.	Exports	Balance
1963 - Quarter:	I	668	619	-49
	II	714	695	-19
	III	727	686	-41
	IV	805	695	-110
1964 - Month:	January	881	741	-139
	February	854	768	-86
	March	811	709	-102
	April	833	769	-64
	May	814 (p)	713 (p)	-101

Trade with Foreign Countries, Unadjusted

		Imports f.o.b. 1/	Exports	Balance
1963	January	492	475	-17
	February	455	481	+26
	March	572	537	-35
	April	575	559	-16
	May	615	584	-31
1964	January	670	589	-81
	February	652	610	-42
	March	673	631	-42
	April	703	635	-68
	May	632 (p)	595 (p)	-37

1/ Estimated values (92 per cent of c.i.f. values).
Sources: OECD, INSEE and Bank of France.

The French trade position has been considerably less favorable in the first five months of this year than in the same period last year; this worsening has held down the French surplus and official reserve gains in 1964. To assess the significance of the trade results for the French external position, it is necessary to consider the trade with foreign countries alone (to the exclusion of trade with the overseas franc area) and to place imports on an f.o.b. basis (estimated officially at 92 per cent of the c.i.f. value). The data are not seasonally adjusted. The figures in Table 5 give a deficit of $270 million in the first five months of 1964 compared with a $73 million deficit in January-May 1963.

These figures are for physical shipments and not foreign exchange payments; they therefore do not show the effects of leads and lags in payments. For the full year 1963, for example, there was a deficit on shipments of $73 million but a surplus on trade payments of $177 million. No payments data are yet available for 1964.

Money market conditions affect forward dollar in Paris

The tightening of the French money market during the spring caused the forward dollar in Paris to rise. French residents increasingly stepped up their net purchases of forward dollars, presumably because tight money conditions induced importers to hold back on spot purchases of foreign exchange and exporters to accelerate sales of spot exchange. The premium on the one-month forward dollar rose steadily from 0.63 per cent per annum on March 11 to 2.30 per cent on June 3 while the premium on the three-month forward dollar rose in the same period from 0.58 to 2.00 per cent per annum. With the easing of the money market, the premium dropped by June 17 to 1.83 per cent on the one-month and 1.66 per cent on the three-month forward dollar.

The spot franc has been at its upper limit of 20.41 cents almost continuously, the main exceptions being the period June 9-15 and on June 26, when it declined to around 20.40 cents.