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The French Economy Under President Giscard

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THE FRENCH ECONOMY UNDER PRESIDENT GISCARD

1. The elevation of Finance Minister Giscard d'Estaing to the presidency probably will not have a pronounced effect on the French economy or government economic policy. The short-term outlook is for continued moderate growth, rapid inflation, stable employment, and a manageable trade deficit. Production will continue to be constrained more by inadequate capacity than by deficient demand. These prospects could be upset before yearend by serious labor troubles, since the unions oppose Giscard's conservative economic policies.

2. As the chief architect of recent French economic policy, Giscard is unlikely to institute any more changes than he feels he has to. Because his victory was so narrow, he is apt to lean a little more toward expansionary policies at the expense of the anti-inflation campaign. An advocate of the free market, he will continue to resist adding a wage-price freeze to the present policy mix of tight credit restraints and flexible price controls. At the same time, his slim victory margin will reduce his ability to withstand demands for inflationary wage increases. To forestall labor unrest, Giscard is likely to move quickly in making good on campaign promises of reforms benefiting pensioners, the unemployed, and low-paid workers.

3. In international negotiations, Giscard's pragmatic approach should be more to Washington's liking than the dogmatic posture sometimes assumed by his Gaullist predecessors. Giscard reportedly opposed the Pompidou government's obstinate stand at the Washington Energy Conference as well as the bilateral deals with Arab oil producers. His friendship with new German Chancellor Helmut Schmidt may also augur well for improved relations within the Community. In view of widespread popular support for Gaullist foreign policies, however, Giscard is unlikely to stray far from the independent, nationalist stance of the past. In particular, he can be expected to overrule foreign objections to steps deemed essential to eliminating the French trade deficit by 1976.

The Pre-Election Economic Climate

4. As expected, the French economy has suffered less than most industrialized nations from the oil crisis. The growth rate through April dipped from last year's exceptional 6% but still proceeded at an enviable clip - perhaps 3% or so. The major components of total demand have remained strong: investment and government spending are high, consumer purchases are up except in the hard-hit automobile market, and exports are booming. Businessmen and consumers complain about tight credit but manage to go on spending. Many consumers appear to be buying now because they fear higher prices in the future.

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5. According to the official index, industrial production continued to stagnate in the first quarter. Many firms reported order backlogs because of lack of production equipment, while some were plagued by labor and raw material shortages. Capital goods output, which is not adequately reflected in the official index, has grown considerably since December. Consumer goods production has dipped slightly, mainly because of sharply reduced demand for automobiles. Construction activity, which had dropped substantially in January, rebounded in February to a level 8% above the 1974 average.

6. A 35% gain in exports held the first-quarter trade deficit to \$700 million, compared with a \$300 million surplus in the same period last year. Imports jumped by nearly 50% even though the 1 January oil price hike was not fully felt until late in the quarter. Higher prices for raw materials and a larger volume of finished goods imports contributed to the rise in import value. April brought a sobering trade deficit of \$400 million as imports exceeded the year-earlier level by a remarkable 72%. Export earnings grew by 38%, buoyed by heavy demand for French agricultural products and semi-finished goods. Depreciation of the franc bolstered the competitive positions of French goods in foreign markets.

7. The news along the inflationary front has been mostly bad. Consumer prices in the first quarter shot up at an annual rate of 18% from their end-of-1973 level. Retail prices for finished industrial goods rose at an annual rate of about 27%; the industrial wholesale price index, which covers mainly semi-finished goods, soared at a 72% rate. Prices of imported raw materials took another jump, rising at an annual rate of close to 100%. The only bright spot in the picture was agricultural wholesale prices, which declined slightly. With hourly wages up during the first quarter at an estimated 20% annual rate, further large price increases are assured.

Prospects During Giscard's First Few Months

8. Like most leaders in the industrialized world, Giscard at times will find it politically difficult to make rational economic choices in the months ahead. His latest growth forecast for 1974 as a whole is 3.8% -- France's poorest performance since 1959. Even with slow growth, the control of inflation may prove to be especially difficult, particularly if wage demands escalate. Giscard's strategy calls for reversing recent inflationary trends by mid-summer, then easing policy to stimulate growth. He apparently intends to loosen credit limits and fiscal constraints at that point. Should the growth rate show signs of dropping much below 4%, Giscard probably also would -- reluctantly -- cut value-added taxes.

Reasonably Strong Growth Factors

9. Most industries have enough orders to ensure a reasonably high level of activity until fall. Chemicals and basic metals look particularly strong, capacity

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being the chief obstacle to expanding output. Production of electrical equipment should continue to grow rapidly, as should the output of most other capital goods except transport equipment. Consumer-goods manufacturers foresee generally moderate gains, including some comeback by the automobile industry.

10. Consumer demand will be the big question mark in the months ahead. Its first-quarter behavior was erratic; an unexpected surge during the first two months was followed by a decline in March and a recovery in April. Buyers have the means to increase their spending: real wages are up 5% from year-earlier levels and liquid savings are at a record high. The government is seeking to hold down consumer buying by restricting credit and limiting wage gains, partly in an effort to free goods for export. But the decisive factor will be the attitudes of consumers themselves. If inflation remains their prime concern, heavy buying to beat price rises is likely. If recession and unemployment become more threatening, consumers may increase savings as a precautionary measure. On balance, it appears that the volume of consumer purchases in the next few months will be some 3% to 4% above year-earlier levels.

11. The other components of demand also point to moderate growth. Government spending -- making up about one-fifth of GNP -- is budgeted to increase by 13% in nominal terms. The current outlook for private investment is for a 5% increase over last year's volume, rather than the 8% forecast a few months ago. New measures to boost export-related investments, expected in July, could raise this forecast. Aided by the depreciation of the franc since it was floated in January, exports should continue well above 1973 levels, assuming that recession and import restrictions do not seriously weaken foreign demand for French goods.

Continuing Tug of War Between Prices and Wages

12. Even if the worst surge of inflation is now past, continuing substantial increases in prices are likely. Higher costs for labor and raw materials will exert upward pressure throughout the year. The government's goal of holding real wages constant during the remainder of the year is almost certainly unrealistic, given the mood of French labor. The most likely prospect is that money wages will continue to rise through the summer at an annual rate of about 20%, further boosting unit labor costs. Even if consumer prices thereafter return to their late 1973 pattern, rising about 1% monthly, the inflation rate for 1974 would average about 14%.

13. Unemployment and increasing labor militancy -- not pressing problems yet -- could become serious in a few months. The number of unemployed has held steady at about 425,000 -- 2.0% of the labor force -- mainly because most firms faced with production cutbacks have reduced working hours rather than employment rolls. Unemployment should move upward this summer as school graduates enter the labor force, possibly reaching 500,000 later in the year.

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14. Because Giscard is anathema to the unions, which are generally far to the left in the political spectrum, his election could provoke a serious clash with labor. With real growth reduced and 2% of GNP being absorbed by the rise in the oil import bill, labor's demands cannot easily be satisfied. A clash, however, is not likely to come before fall. As a tactical maneuver, the unions probably will first give Giscard a chance to show his hand.

A Large But Manageable Current Account Deficit

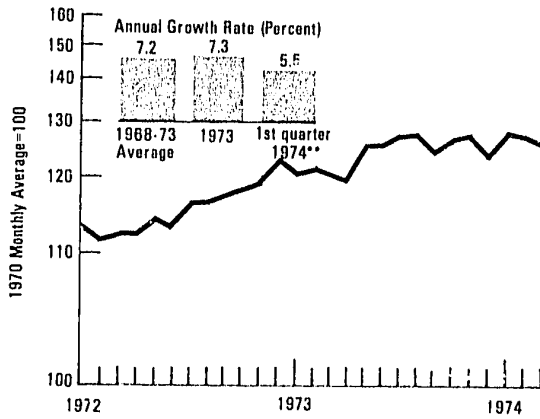
15. The trade deficit is expected to worsen in coming months. Conservation measures notwithstanding, higher oil prices will add about \$400 million monthly to the import bill. The stimulative effect of depreciation on French exports will be largely offset by slow economic growth in other industrialized countries. A deficit of \$4 billion is now in prospect for 1974, compared with the 1973 surplus of \$1.4 billion. The current account deficit probably will reach \$6 billion, since France's surplus in the services account will, as usual, be more than offset by government transfers and workers' remittances.

16. Despite the sharp deterioration in its current account, Paris is intent on preserving its foreign reserves at about their current level. It apparently will have little trouble doing so. Unlike Italy and some other heavy borrowers, France retains a sound credit rating in private capital markets. Paris already has lined up some \$3 billion in the Eurocurrency market and almost certainly can obtain more if it wishes. To limit debt service payments, however, Paris will continue to enlarge its export promotion program. To this end, it already has provided financing for investment in export industries, expanded its export insurance guarantees, and increased its effort to induce oil-rich countries to buy French goods.

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FRANCE: DOMESTIC ECONOMIC INDICATORS

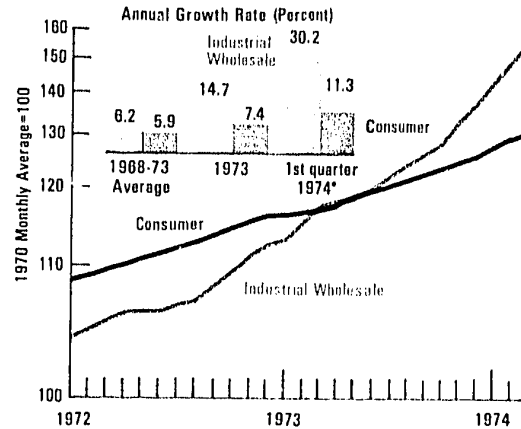
INDUSTRIAL PRODUCTION*



*Seasonally Adjusted

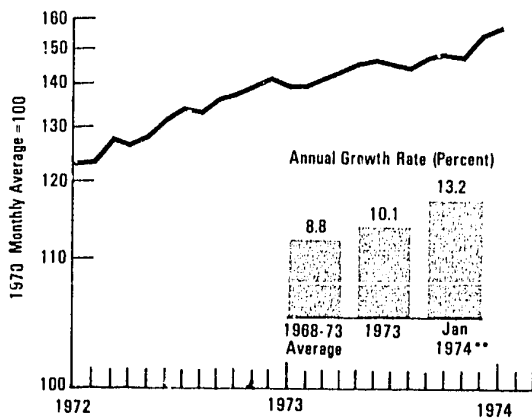
**Increase over comparable period of 1973.

PRICES



*Increase over comparable period of 1973.

MONEY SUPPLY*

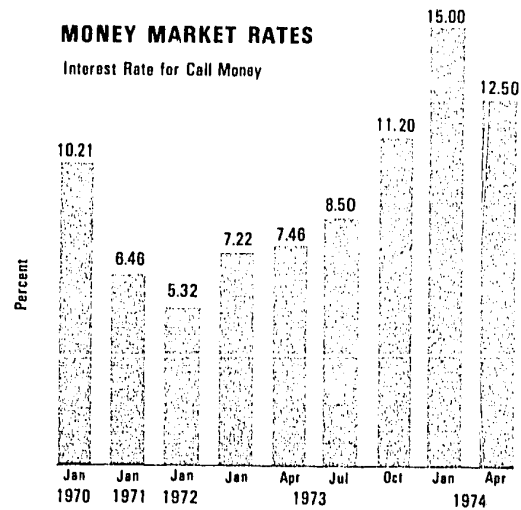


*Seasonally Adjusted

**Increase over comparable period of 1973.

MONEY MARKET RATES

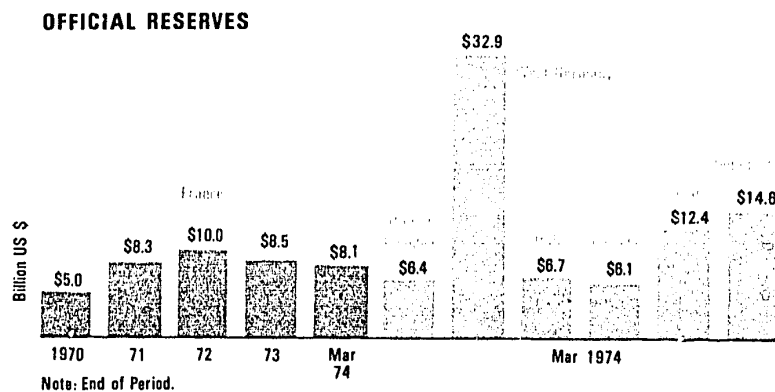
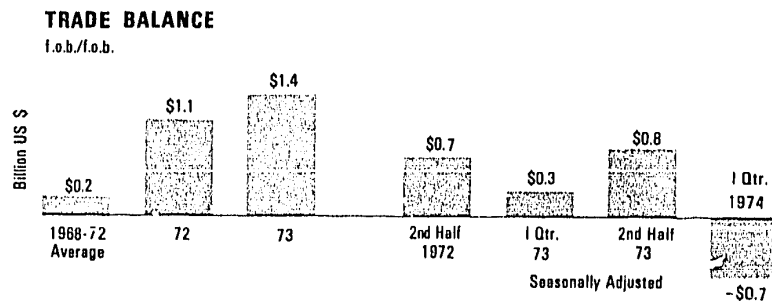
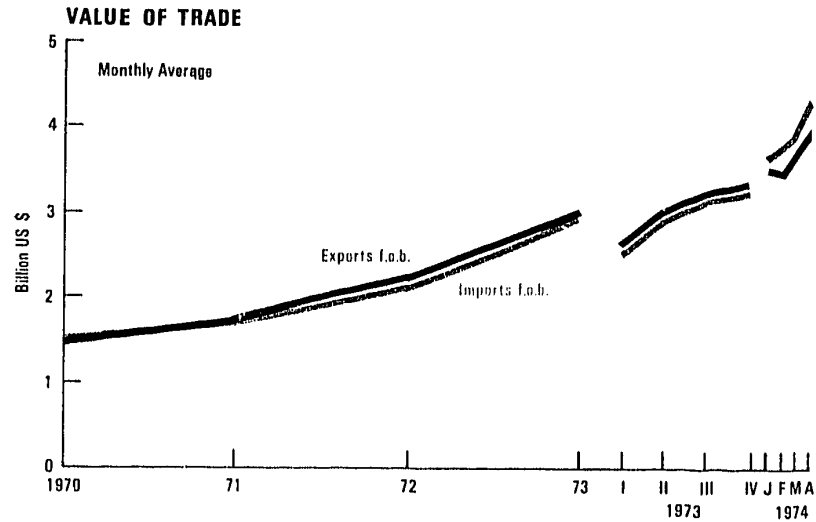
Interest Rate for Call Money



Note: End of Period

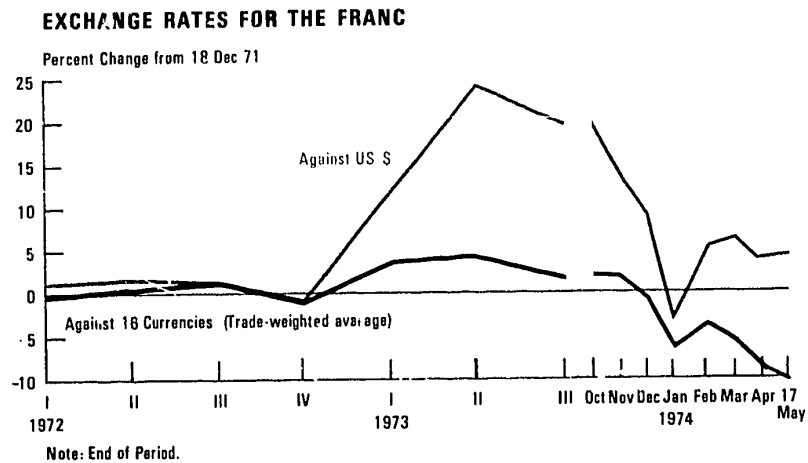
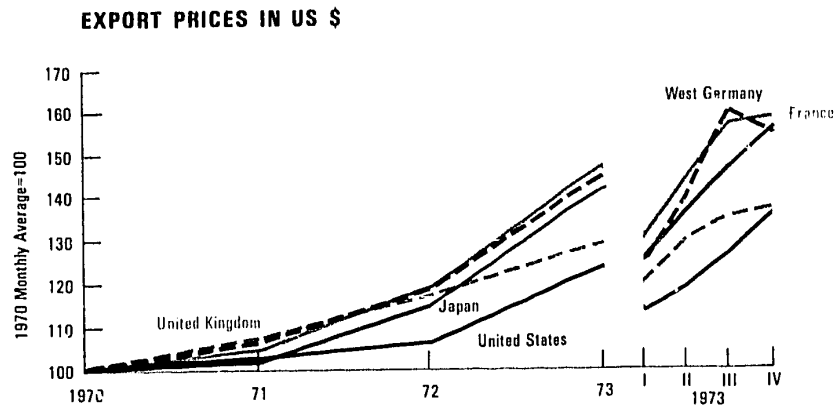
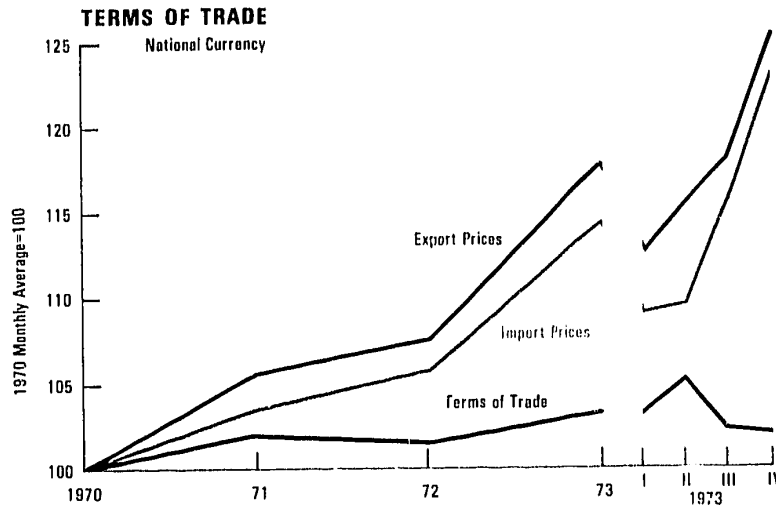
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FRANCE: EXTERNAL ECONOMIC INDICATORS



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