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THE FRENCH ECONOMY: EXCHANGE RATE

1. IN THE PAST FEW DAYS THE FRENCH FRANC HAS COME UNDER SUBSTANTIAL PRESSURE ON THE FOREIGN EXCHANGE MARKETS. THIS HAS LED TO SPECULATION ABOUT A POSSIBLE FURTHER EMS REALIGNMENT INVOLVING A FRANC DEVALUATION. THE PRESSURE ON THE FRANC REFLECTS AN ONSET OF DOUBTS BOTH IN FRANCE AND EXTERNALLY ON THE PROSPECTS FOR THE FRENCH ECONOMY, COMPARED WITH HER MAJOR PARTNERS, AND HAS COME AT A POLITICALLY SENSITIVE MOMENT FOR THE FRENCH GOVERNMENT.

2. SINCE THE LATEST EMS REALIGNMENT ON 21 FEBRUARY THE FRANC HAS WEAKENED STEADILY WITHIN THE EMS. EARLIER THIS YEAR THE FRANC WAS AT, OR CLOSE TO, THE TOP OF THE SYSTEM, BUT THE DEVALUATION OF THE BELGIAN, LUXEMBOURG, AND DANISH CURRENCIES EXPOSED IT TO RENEWED PRESSURE. IT DRIFTED SLOWLY DOWN INTO THE LOWER BAND OF THE SYSTEM TOWARDS THE END OF FEBRUARY THOUGH IT REMAINED WELL WITHIN ITS INTERVENTION LIMITS. IF THE FOREIGN EXCHANGE MARKETS ARE NOW LOOKING ROUND, AS THEY APPEAR TO BE, FOR THE NEXT CURRENCY TO BE DEVALUED WITHIN THE EMS SYSTEM, IT WAS PERHAPS INEVITABLE THAT THE FRENCH FRANC WOULD COME UNDER SCRUTINY.

3. THE COMBINATION OF A NUMBER OF FACTORS RELATED TO THE REAL ECONOMY AND TO EXTERNAL DEVELOPMENTS SEEMS TO HAVE BEEN RESPONSIBLE FOR THE LATEST ACCELERATED FALL. CONFIDENCE IN THE FRANC ALSO APPEARS TO HAVE BEEN JOLTED BY THE GOVERNING MAJORITY'S POOR SHOWING IN THE FIRST ROUND OF THE FRENCH CANTONAL ELECTIONS LAST WEEKEND (MY TEL NO 244) IN SO FAR AS THIS REACTION IS RATIONAL IT PRESUMABLY RELATES TO THE GOVERNMENT'S ESTIMATED READINESS TO ADOPT RIGOROUS FINANCIAL POLICIES. BUT IN ANY CASE RECENT OFFICIAL ECONOMIC INDICATORS HAVE REVEALED THAT THE MODEST CONSUMPTION LED UPTURN IN ACTIVITY IN THE FINAL QUARTER OF LAST YEAR, WHICH IS FUNDAMENTAL TO THE GOVERNMENT'S ECONOMIC STRATEGY, HAS SLACKENED OFF IN THE FIRST TWO MONTHS OF THIS YEAR. THE MOST RECENT INSEE (NATIONAL STATISTICAL INSTITUTE) AND BANQUE DE FRANCE SHORT-TERM FORECASTS SHOW A REDUCED GROWTH PROJECTION FOR THE FIRST HALF OF 1982 AND, ALTHOUGH PRODUCTIVE INVESTMENT SHOWS SOME SIGNS OF PICKING UP, ITS OVERALL LEVEL REMAINS DISAPPOINTING. THE EMPLOYERS ORGANISATION, THE PATRONAT, HAS MEANWHILE SHARPLY CRITICISED THE GOVERNMENT'S ECONOMIC POLICY. THE LATEST RETAIL PRICE INDEX FOR THE FIRST TWO MONTHS OF 1982 SHOWS AN ANNUAL RISE OF 12%. THIS IS BELOW LAST YEAR'S INFLATION RATE (14%) BUT WOULD STILL LEAVE FRANCE WITH ONE OF THE HIGHEST RATES AMONG OECD COUNTRIES.

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4. RECENT MUCH-PUBLISHED INDICATIONS ON THE PROSPECTS FOR THE BUDGET DEFICITS FOR 1982 AND 1983 AND ON THE BALANCE OF PAYMENTS FOR 1982 HAVE BEEN MUCH WORSE THAN THE GOVERNMENT HAD ENVISAGED. IT SEEMS CLEAR THAT THE 1982 BUDGET DEFICIT (PARIS SAVING TEL NO 38) WILL OVER-SHOOT SUBSTANTIALLY THE TARGET OF F 95 BILLION TO REACH AT LEAST F120 BILLION - F130 BILLION; WHILE UNOFFICIAL FORECASTS FOR THE 1983 DEFICIT ON CURRENT PLANS RANGE FROM F170 BILLION - F200 BILLION. PRESIDENT MITTERRAND DECREED AT THE COUNCIL OF MINISTERS MEETING ON 10 MARCH THAT, WHILE PRIORITY IN 1983 SHOULD STILL BE GIVEN TO EMPLOYMENT, THE BUDGET DEFICIT MUST BE KEPT WITHIN 3% OF GDP. TO ACHIEVE THIS AIM, THE GOVERNMENT WILL NEED TO MAKE SOME EXTREMELY PAINFUL CHOICES, GIVEN ITS EXISTING COMMITMENTS. MANY OBSERVERS ARE SCEPTICAL ABOUT THE GOVERNMENT'S WILL AND MARGIN FOR MANOEUVRE TO MAKE THESE CHOICES; ESPECIALLY IN VIEW OF ITS RECENT DECISION, IN RESPONSE TO UNION PRESSURE, TO SANCTION A REDUCTION IN THE WORKING WEEK WITH FULL PAY, AND GIVEN THE POLITICAL IMPORTANCE OF THE 1983 MUNICIPAL ELECTIONS.

5. THE LATEST OFFICIAL FIGURES FOR THE 1981 BALANCE OF PAYMENTS CONFIRM A LARGER CURRENT ACCOUNT DEFICIT (F40.6 BILLION) THAN IN 1980 (F33.1 BILLION), DUE MAINLY TO A REDUCED INVISIBLES SURPLUS, DESPITE A LOWER DEFICIT ON VISIBLE TRADE (F52.3 BILLION IN 1980; F48.3 BILLION IN 1981). MORE WORRYING FOR THE GOVERNMENT IS THE FACT THAT THE VISIBLE TRADE DEFICIT ACCELERATED RAPIDLY IN THE FINAL QUARTER OF 1981, AND THE SAME TREND APPEARS TO BE PERSISTING INTO 1982. THE DANGERS FOR THE BALANCE OF PAYMENTS OF DOMESTIC REFLATION LEADING TO AN IMPORT UPSURGE, COUPLED WITH A FALL IN EXPORT COMPETITIVITY, APPEAR REAL. MEANWHILE, THE WEST GERMAN ECONOMY (BONN TEL NO 227) IS SHOWING SIGNS OF THE LONG-EXPECTED RECOVERY AND THE DM IS BECOMING CORRESPONDINGLY STRONGER WITHIN EMS. THE RECENT WAGE SETTLEMENT BY THE GERMAN METAL-WORKERS UNION AT 2% BELOW THE INFLATION RATE HAS FOCUSED ATTENTION ONCE AGAIN ON THE WIDENING INFLATION RATE DIFFERENTIAL BETWEEN FRANCE AND GERMANY. THE DOLLAR REMAINS AT A HIGH LEVEL WITH US INTEREST RATES FIRING UP AGAIN, ADDING TO THE OVERALL PRESSURE ON THE FRANC.

6. FOR THE TIME BEING THE FRENCH GOVERNMENT IS STEMMING THE TIDE BY THE CLASSIC METHODS. THE BANQUE DE FRANCE IS INTERVENING ACTIVELY IN SUPPORT OF THE FRANC ON THE FOREIGN EXCHANGE MARKETS AT A COST OVER THE PAST TWO WEEKS OF SOME 2BILLION DOLLARS, ACCORDING TO BANKING SOURCES. FRENCH DOMESTIC INTEREST RATES, WHICH HAD BEEN QUIETLY EDGED DOWNWARDS RECENTLY AS PART OF THE GOVERNMENT'S GROWTH STRATEGY, HAVE NOW BEEN RAISED TO THE HIGHEST LEVEL FOR SOME WEEKS. IN A RADIO INTERVIEW YESTERDAY, M DELORS CLAIMED

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TO BE ASTONISHED AT THE AGITATION AND ARGUED THAT THE ECONOMY WAS BEHAVING SATISFACTORILY. NEVERTHELESS, TRESOR AND BANQUE DE FRANCE OFFICIALS WERE UNDERSTANDABLY TIGHT-LIPPED WHEN CONTACTED TODAY. AT THE TIME OF DRAFTING FRENCH INTEREST RATES HAVE BEEN RAISED ONCE AGAIN TODAY WHILE GERMAN RATES HAVE BEEN LOWERED, AND THE BANQUE DE FRANCE IS INTERVENING HEAVILY IN THE MARKET. WITH THE SECOND ROUND OF THE CANTONAL ELECTIONS DUE TO TAKE PLACE THIS WEEKEND, THE FRENCH GOVERNMENT WILL BE PARTICULARLY KEEN, IF AT ALL POSSIBLE, TO RIDE OUT AN EXCHANGE RATE DRAMA AT THE PRESENT MOMENT.

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