156236
MDLIAN 0666

MB

CONFIDENTIAL
FM PARIS
TO PRIORITY FCO
TELNO 1174
OF 191301Z NOVEMBER 87
INFO ROUTINE WASHINGTON, BONN, BRUSSELS, ROME, TOKYO, UKDEL IMF/IBRD
INFO ROUTINE UKREP BRUSSELS

FRENCH ECONOMY: OCTOBER.

SUMMARY

1. A WORRYING MONTH FOR THE GOVERNMENT, WITH ECONOMIC POLICY PUSHED OFF COURSE BY THE TURBULENCE IN THE STOCK AND CURRENCY MARKETS (PRIVATISATIONS SET BACK, 1988 GROWTH PROSPECTS REVISED DOWN, FISCAL POLICY THREATENED). BALLADUR DISPLAYS MONOLITHIC CALM, BUT RECENT POLLS SUGGEST THAT THE MONTH'S EVENTS HAVE DENTED CHIRAC'S PROSPECTS IN NEXT SPRING'S PRESIDENTIAL ELECTIONS, TO BARRE'S BENEFIT.

DETAIL

2. NOT A GOOD MONTH FOR THE CHIRAC GOVERNMENT, FOR WHOM THE STOCK AND CURRENCY MARKET FALLS COME THE WRONG SIDE OF THE PRESIDENTIAL ELECTIONS. INITIAL HOPES THAT THE STOCK MARKET CRISIS COULD BE WISHED AWAY AS AMERICAN-INDUCED, WITH LITTLE RELEVANCE TO FRANCE, FOUNDERED WHEN PRIVATISATIONS HAD TO BE POSTPONED, AND WHEN THE CRISIS SPREAD TO THE CURRENCY MARKETS, RAISING THE SPECTRE OF AN EMS REALIGNMENT, INPLYING A DEVALUATION OF THE FRANC AGAINST THE MARK.

3. THE SET BACK TO THE PRIVATISATION PROGRAMME IS A BLOW FOR THE GOVERNMENT ONLY SIX MONTHS BEFORE THE PRESIDENTIAL ELECTIONS. PRIVATISATION, AND THE RAPID GROWTH OF SHARE OWNERSHIP, HAD BEEN THE ONLY CLEAR POPULAR SUCCESS IN ECONOMIC POLICY AND OPPOSITION ATTEMPTS TO ATTACK THE POLICY OVER THE SUMMER WERE NOT MAKING MUCH HEADWAY. NOW SHARE PRICES IN ALMOST ALL THE PRIVATISED COMPANIES ARE BELOW THE OFFER PRICE AND THE GOVERNMENT HAS HAD TO POSTPONE THE PRIVATISATION OF THE NEXT COMPANIES IN LINE, THE ELECTRONICS/DEFENCE CONGLOMERATE MATRA, AND THE INSURANCE GIANT UAP, UNTIL QUOTE THE NEW YEAR UNQUOTE.

4. FURTHERMORE, THE POTENTIAL LOSS OF F50 BILLION RECEIPTS FROM PRIVATISATION, INCLUDED IN THE 1988 DRAFT BUDGET, WILL MAKE IT MORE DIFFICULT FOR THE GOVERNMENT TO ACHIEVE ITS PLANNED REDUCTION IN THE BUDGET DEFICIT FROM F129 BILLION IN 1987 TO F115 BILLION IN 1988. SO

FAR BALLADUR APPEARS DETERMINED TO ACHIEVE THE REDUCTION BY MAKING ADDITIONAL CUTS IN PLANNED SPENDING IF NECESSARY. BUT THIS WILL NOT BE EASY OR POPULAR.

5. THE OVERRIDING POLITICAL IMPORTANCE OF AVOIDING AN EMS REALIGNMENT LED TO THE 5 NOVEMBER FRANCO-GERMAN AGREEMENT ON INTEREST RATES, OF WHICH MUCH WAS MADE IN THE PRESS AS AN EXAMPLE OF CLOSER FRANCO-GERMAN COOPERATION, AND IN PARTICULAR OF COOPERATION BETWEEN THE BANK OF FRANCE AND THE BUNDESBANK. COOPERATION CERTAINLY HAS BEEN CLOSER, PARTLY AS A RESULT OF THE NYBORG AGREEMENT, BUT TENSIONS REMAIN. IT IS TOO EARLY TO SAY WHETHER THE PROPOSED NEW JOINT ECONOMIC AND FINANCIAL COMMITTEE WILL HELP (OUR TELNO 1169).

6. THE DECISION TO RAISE INTEREST RATES CANNOT HAVE BEEN EASY GIVEN THE COMPARATIVE WEAKNESS OF THE FRENCH ECONOMY AND INTEREST RATE FALLS ELSEWHERE. BUT THE TRESOR HAVE COUNTERED CLAIMS THAT THE INTEREST RATE RISE WILL HARM INVESTMENT AND GROWTH PROSPECTS BY ARGUING THAT THE RISE WILL NOT AFFECT LONG-TERM RATES, WHICH ARE MORE RELEVANT TO INVESTMENT DECISIONS. AS A RESULT OF THE STOCK MARKET FALLS THE TRESOR HAVE, HOWEVER, REVISED DOWNWARD - AT LEAST IN PRIVATE - THEIR ESTIMATES FOR GDP GROWTH IN 1988 FROM THE 2.2 PER CENT INCLUDED IN THE 1988 BUDGET TO BETWEEN 1.5 PER CENT - 2.0 PER CENT. EVEN THIS IS WIDELY SEEN AS TOO OPTIMISTIC, WITH BIPE, A RESPECTED PRIVATE FORECASTING AGENCY, SUGGESTING 1 PER CENT.

7. THERE WAS SOME JOY FOR THE GOVERNMENT IN INSEE'S (KEY ECONOMIC FORECASTING INSTITUTE) UNEXPECTED REVISION OF ITS FORECAST FOR 1987 MARKETED GDP GROWTH UPWARDS FROM 1.3 PER CENT TO CLOSE TO 2.0 PER CENT, AS A RESULT OF THE UNEXPECTED RESILIENCE OF PRIVATE CONSUMPTION AND OF EXPORTS OVER THE SUMMER. OTHER ENCOURAGING FEATURES ARE THAT INFLATION HAS STABILISED AT AN ANNUAL RATE OF AROUND 3.2 PER CENT, UNEMPLOYMENT HAS FALLEN BY 79,000 SINCE MARCH TO 2.596 MILLION IN SEPTEMBER (LARGELY AS A RESULT OF GOVERNMENT MEASURES) AND WAGE INCREASES HAVE REMAINED MODEST. BUT IMPORTS HAVE INCREASED IN RECENT MONTHS, LEADING TO A MARKED DETERIORATION IN THE OCTOBER TRADE BALANCE. THERE IS A BALANCE OF TRADE DEFICIT OF F32.8 BILLION FOR THE FIRST TEN MONTHS OF 1987.

8. EVEN BEFORE RECENT EVENTS THE ECONOMY LOOKED FRAGILE. IT LOOKS MORE SO NOW DESPITE THE SLIGHTLY BETTER FORECASTS FOR THE REST OF THIS YEAR. BALLADUR CONTINUES TO STRESS HIS COMMITMENT TO A FREER ECONOMY, AND TO REFUSE TO ADJUST HIS ECONOMIC POLICY. HE MAY HOPE THAT IT WILL BE POSSIBLE TO TAKE UP THE PRIVATISATION PROGRAMME AGAIN IN THE NEW YEAR, AND TO GIVE THE IMPRESSION OF A POLICY BACK

156236
MDLIAN 0666

ON COURSE. BUT THE POLLS SUGGEST THAT RECENT EVENTS HAVE RUBBED OFF ON THE GOVERNMENT'S POPULARITY AND THAT CHIRAC'S CHANCES NEXT SPRING HAVE, AT LEAST FOR THE MOMENT, BEEN DENTED, WITH BARRE THE BENEFICIARY.

FERGUSSON

YYYY

DISTRIBUTION 185

MAIN 185

FINANCIAL WED

NNNN