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TO IMMEDIATE FCO

TELEGRAM NUMBER 198 OF 11 MARCH 1983

INFO IMMEDIATE BONN AND UKREP BRUSSELS

INFO ROUTINE UKDEL IMF/IBRD WASHINGTON, AND WASHINGTON

INFO SAVING TO ATHENS BRUSSELS COPENHAGEN DUBLIN THE HAGUE

LUXEMBOURG ROME UKDEL OECD AND CONSULATES GENERAL FRANCE

FRENCH ECONOMY: POST-ELECTION DECISIONS

SUMMARY

1. AFTER THE SECOND ROUND OF THE MUNICIPAL ELECTIONS ON SUNDAY THE FRENCH GOVERNMENT MAY WELL SEEK AN EARLY REALIGNMENT OF EMS PARITIES. THE STABILITY OF THE NEW FRANC PARITY WOULD REQUIRE AN ACCOMPANYING PACKAGE OF AUSTERITY MEASURES. A BITTER PILL FOR THE LEFT, WHICH MITTERRAND MAY SWEETEN WITH SOME TEMPORARY PROTECTIONIST MEASURES.

DETAIL

2. THE BANK OF FRANCE HAS SHOWN TACTICAL SKILL IN HANDLING SPECULATION AGAINST THE FRANC THIS WEEK, MAXIMISING COSTS TO SPECULATORS AND MINIMISING ITS OWN EXPENDITURE IN SUPPORT OF THE CURRENCY. IN THE MORROW OF KOHL'S VICTORY IN THE GERMAN ELECTIONS SPECULATORS SAW A POSSIBILITY THAT THE FRANC MIGHT BE DEVALUED BEFORE THE SECOND ROUND OF THE MUNICIPAL ELECTIONS, BUT ON THURSDAY THEY SHIFTED THE FOCUS OF THEIR EXPECTATIONS TO THE WEEK OF 15-22 MARCH.

3. WITH RECENT FIGURES FOR THE TRADE DEFICIT, INFLATION AND THE VALUE OF THE DOLLAR UNFAVOURABLE, MITTERRAND IS UNDER MOUNTING PRESSURE TO ACT SWIFTLY TO STAUNCH THE HAEMORRHAGE OF FOREIGN EXCHANGE RESERVES AND REDUCE THE RATE OF FOREIGN BORROWING, WHICH HAS BEEN RINGING ALARM BELLS. ACCORDING TO BANK OF FRANCE CALCULATIONS LEAKED TO THE PRESS, ON PRESENT TRENDS, BY 1985/86, FRANCE'S MAXIMUM POTENTIAL EXTERNAL BORROWING WOULD BE ENTIRELY ABSORBED IN SERVICING ITS OUTSTANDING DEBT.

4. ALREADY IN JANUARY OF THIS YEAR THE OFFICIAL FORECASTERS IN THE MINISTRY OF FINANCE WERE ASSUMING A DEVALUATION IN THE FIRST HALF OF 1983 AND ANOTHER IN THE FIRST HALF OF 1984, OF 8% AGAINST THE GERMAN MARK. IT SEEMS PROBABLE THEREFORE THAT THE FRENCH WILL WANT A REALIGNMENT OF EMS CURRENCIES VERY SOON.

5. HAVING PUBLICLY REJECTED FOR SO LONG THE IDEA OF A THIRD DEVALUATION OF THE FRANC, THE GOVERNMENT WILL WISH TO PREVAIL

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UPON THE GERMANS TO REVALUE THE MARK AS MUCH AS POSSIBLE. BUT WHATEVER THE SPLIT BETWEEN APPRECIATION OF THE MARK AND DEPRECIATION OF THE FRANC THAT THEY HOPE TO ACHIEVE, THEY WILL SURELY RECOGNISE THAT THE NEW PARITY OF THE FRANC WILL NOT BE CREDIBLE IN THE EYES OF THE MARKET UNLESS THERE IS A PACKAGE OF ACCOMPANYING MEASURES OF SOME WEIGHT. THE CONTENT OF THIS PACKAGE MAY TO SOME EXTENT BE INFLUENCED BY THE VIEWS OF FRANCE'S COMMUNITY PARTNERS, NOT LEAST AS THEY MAY BE EXPRESSED AT ANY REALIGNMENT CONFERENCE.

6. IN HIS NATIONAL TELEVISION BROADCAST ON 16 FEBRUARY, MAUROY DENIED HAVING ANY AUSTERITY PLAN IN HIS DRAWER, BUT THIS DENIAL CANNOT BE TAKEN AT FACE VALUE. AS PREVIOUSLY REPORTED, CAREFUL CONSIDERATION HAS BEEN GIVEN AT THE HIGHEST LEVEL OF GOVERNMENT TO MEASURES TO CUT CONSUMER SPENDING, REDUCE THE DEFICITS ON THE STATE AND SOCIAL SECURITY BUDGETS, AND INCREASE SAVINGS. TRUE, THE COMMUNIST PARTY AND SOME PROMINENT FIGURES ON THE LEFT OF THE SOCIALIST PARTY HAVE MADE KNOWN THEIR OPPOSITION TO ANY PLANNED REDUCTION IN THE PURCHASING POWER OF AVERAGE WAGES, AND THEIR PREFERENCE FOR AN ALTERNATIVE ECONOMIC STRATEGY - DUBBED THE ALBANIAN SOLUTION BY ITS OPPONENTS - WHICH WOULD APPARENTLY BE BASED ON EXTENSIVE PROTECTIONIST MEASURES AND ON REFLATION OF THE ECONOMY. UNDER THIS SCHEME OF THINGS FRANCE WOULD LEAVE THE EMS AND PRESUMABLY RENOUNCE, AT LEAST TEMPORARILY, MANY OF ITS EC OBLIGATIONS. HOWEVER THE EROSION OF SUPPORT FOR THE GOVERNMENT IN THE MUNICIPAL ELECTIONS MAKES IT LESS RATHER THAN MORE LIKELY THAT THE PRESIDENT WILL FEEL IMPELLED TO ADOPT MUCH OF THIS PRESCRIPTION.

7. UNDER THE PREVIOUS ADMINISTRATION, FRANCE WAS ABLE TO TAKE THE FRANC OUT OF THE EMS FOR A SHORT SPELL OF FLOATING WITHOUT AROUSING DEEP-SEATED FEARS ABOUT THE DIRECTION OF FRENCH POLICY. THE SAME WOULD NOT BE TRUE TODAY: AND THIS GIVES THE GOVERNMENT AN INCENTIVE TO TRY TO SET A NEW PARITY RATHER THAN TO FLOAT.

8. HOW FAR MITTERRAND WILL WANT TO GO IN ADOPTING PROTECTIONIST MEASURES IS A MORE OPEN QUESTION. HE WILL PROBABLY SEE MERIT IN SOME MEASURES OF AN AVOWEDLY TEMPORARY NATURE.

MEN ON THE RIGHT OF THE PARTY, SUCH AS ROCARD, SEEM TO REGARD THAT AS HIGHLY LIKELY. AND MITTERRAND WOULD EXACERBATE THE UNHAPPINESS OF THE LEFT IF HIS ACCOMPANYING MEASURES CONSISTED SOLELY OF AUSTERITY. THE IMPOSITION OF A TEMPORARY IMPORT DEPOSIT SCHEME, AND RECOURSE TO PERMISSIBLE EC SAFEGUARDS COULD BE SEEN AS DESIRABLE IN THEMSELVES IN HELPING TO CORRECT THE TRADE DEFICIT AND AS A USEFUL SOP TO THE FAR LEFT. BUT I WOULD NOT EXPECT HIM TO GO FURTHER THAN THIS, NOR, I THINK, WOULD PUBLIC OPINION WANT HIM TO. IN RECENT MONTHS, INFLUENTIAL VOICES SUCH AS THOSE OF DELORS AND OF FORMER PRIME MINISTER RAYMOND BARRE HAVE DONE MUCH TO EDUCATE PUBLIC OPINION ON THE SHORT-SIGHTEDNESS OF PROTECTIONISM AS AN ECONOMIC POLICY.

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9. IN CONSTRUCTING AN AUSTERITY PACKAGE THE GOVERNMENT WILL NO DOUBT WISH TO BE SEEN TO MAKE THE BURDEN FALL LESS HEAVILY ON THE LOWER PAID - SO FAR AS THIS IS FEASIBLE.

10. THE GERMAN EMBASSY HERE BELIEVE THAT FOR THE SAKE OF THE FRANCO-GERMAN RELATIONSHIP THEIR GOVERNMENT WILL GO SOME WAY TOWARDS EASING MITTERRAND'S POLITICAL PROBLEMS OVER REALIGNMENT AND AUSTERITY, EG BY TOLERATING TEMPORARY PROTECTIONIST MEASURES. THEY DO NOT EXCLUDE SOME APPRECIATION OF THE MARK, PROVIDED THE FRENCH ARE PREPARED TO CUT CONSUMER SPENDING AND BUDGET DEFICITS.

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FCO PLEASE PASS SAVING TO ALL EXCEPT UKDEL OECD AND CONSULATES
GENERAL FRANCE

FRETWELL

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