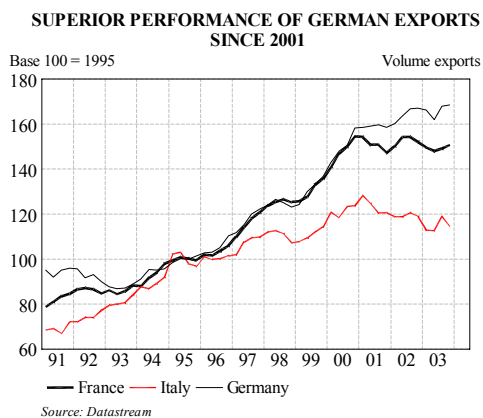


FOREIGN TRADE: FRENCH WEAKNESSES

Strong recovery in France depends largely on demand from high growth regions, which would permit raising exports after their decline in 2003. However, French exports are growing at a much slower pace than their German counterparts. As such, France's poor export performances cannot be attributed to the appreciation of the euro alone. A comparison of the French, Italian and German export sectors reveals that cost and price competitiveness are similar in France and Germany but handicapping for Italy. Above all, it shows that Germany currently leads the way in terms of geographic and sector specialisation, a position it is constantly reinforcing thanks to favourable non-price competitiveness.

Germany's superior export performance

At a time when economic forecasters are predicting that an upturn in world trade will reinvigorate economic growth in the eurozone, export performances are crucial. Indeed, the ability of eurozone countries to re-establish solid growth will depend largely on how much these countries are able to capitalise on the upswing in demand from Asia (imports into China and Hong Kong grew 23% in volume in 2003 and Japanese imports grew 5%), Eastern Europe (+13.25%) and the United States (+4%). An examination of export performances in Germany, France and Italy highlights the strengths and weaknesses of these countries on this issue. In fact, although they have suffered from a common disadvantage in recent years, namely the euro's appreciation in nominal terms (+5.5% on average in 2002 versus 2001, and +19.7% in 2003), these three countries vary between themselves in terms of exports.

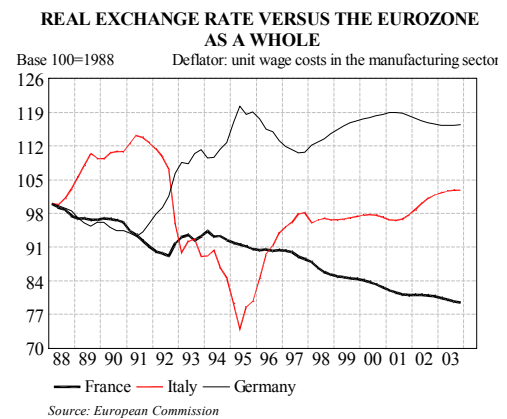


Italy has proven much less dynamic in this area than France or Germany, while Germany has made significant headway on France since late 2000. Germany's exports are now growing much more rapidly than those of France. In 2003, Italian and French goods and services exports fell 3.9% and 2.1% respectively in volume terms, while German exports rose 1.1%. The mediocre results posted by Italy and, to a lesser degree, France raise the question of how Germany is able to win market share over its European competitors.

Differences that cannot be explained by cost competitiveness and price competitiveness alone

An analysis of cost-competitiveness and price-competitiveness indicators does not point to any strong advantage for Germany over France. It does however show that Italy is suffering a distinct handicap. First, real effective exchange rates (REER, the nominal effective exchange rate deflated by unit wage costs in the manufacturing sector) seem to favour France. Indeed, French competitiveness relative to the rest of the world measured in these terms has tended to improve since mid-1994. By contrast, Germany's REER rose sharply after unification as wages in East Germany converged with those of West Germany without an adjustment in productivity levels to justify the process. Certainly, this

trend has slowed down since 1995, but Germany's REER thus measured has stabilised at a much higher level relative to the early 1990s. Lastly, Italy suffered a marked deterioration in competitiveness measured this way in 1996-97, having benefited from a sharp reduction in REER in the first half of the 1990s due to lira devaluations in 1992 and 1995 and disinflationary policies aimed at meeting Maastricht criteria. Certainly, Italy's REER is much less of a handicap now than it was during the early 1990s, but it deteriorated again in 2002, when France and Germany were registering an improvement¹.



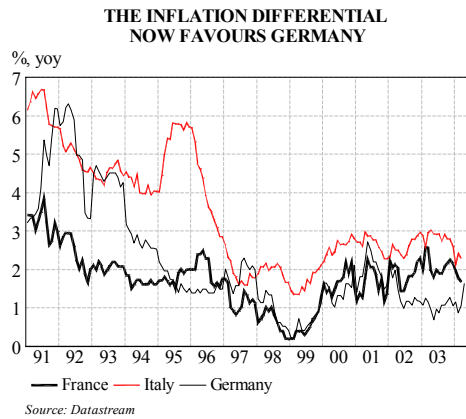
In terms of price competitiveness, however, the situation is somewhat different. On the one hand, inflation has been higher in Italy than in Germany and France on an almost constant basis since 1990. On the other hand, German prices have slowed significantly, after outpacing French prices in the early 1990s. For the past two years, Germany's inflation rate has been much lower than France's.

These differences in price trends have direct repercussions on the price competitiveness of the three countries. Thus, the REER obtained by deflating the nominal effective exchange rate by export prices puts Germany slightly ahead of France, while Italy is still trailing behind according to this principle. Various factors explain the slight advantage Germany now enjoys on price competitiveness²: the slightly slower increase in unit wage costs in the service sector in Germany relative to France, resulting in lower intermediate consumer prices for German producers, and rising imports of intermediate goods from Eastern Europe where costs are lower are the classic explanations.

While relative cost competitiveness and price competitiveness trends in France, Germany and Italy may explain Italy's underperformance in terms of exports, it does not really account for the different growth rates of German and French exports.

¹ In this case, REER is based on 1988, a year which seems to constitute an "equilibrium point" for this indicator.

² Direction de la Prévision, "Inflation et compétitivité extérieure de l'économie allemande", *Analyses Économiques*, n°26, January 2004



The importance of geographic and sector orientation

Another explanation lies in the geographic and sector specialisation of German exports. German exports are not only much more intensely focused on economies with high import growth such as the United States, CEEC and China than their French and Italian competitors, but they also specialise in products that are in the greatest demand across the world (see Table 1). Mechanical equipment, vehicles and motor vehicle equipment, and electrical and electronic hardware constitute the three biggest types of export products throughout the world, and the general increase in capital expenditure is currently boosting trade in these products.

Germany enjoys a very clear advantage over France in terms of geographic specialisation (particularly when it comes to CEEC countries), but much less so over Italy, whose share of exports to the United States, CEEC and China is only slightly below that of Germany (see Table 2).

On the other hand, Germany's sector specialisation gives it a distinct advantage over both France and Italy. The three types of products with the highest global demand accounted for 48.3% of German exports in value terms in 2003, versus 34.9% and 35.4% for France and Italy respectively. It is also important to stress that the weight of France's aircraft exports (9.8% of exports in value terms in 2003) represents a significant handicap at present given that world trade in the sector fell by 14.5% in 2002 and stagnated in 2003.

Therefore, Germany's specialisation in regions where demand is strongest and in the biggest import products is an additional explanation for Germany's ability to outperform France and Italy on exports.

A primary factor: non-price competitiveness

Apart from its favourable geographic and sector orientation, Germany is winning market share segments where world demand is

Table 1
Top 5 global imports in value terms

	Market share, %		
	2000	2001	2002
Mechanical equipment	14.7	14.4	13.9
Vehicles and motor vehicle equipment	10.0	10.3	10.9
Electrical and electronic hardware	12.2	11.5	10.6
Mineral commodities and oil	8.5	8.3	8.1
Pharmaceutical products	1.9	2.4	3.6

Table 2
Share of exports in value terms (%)

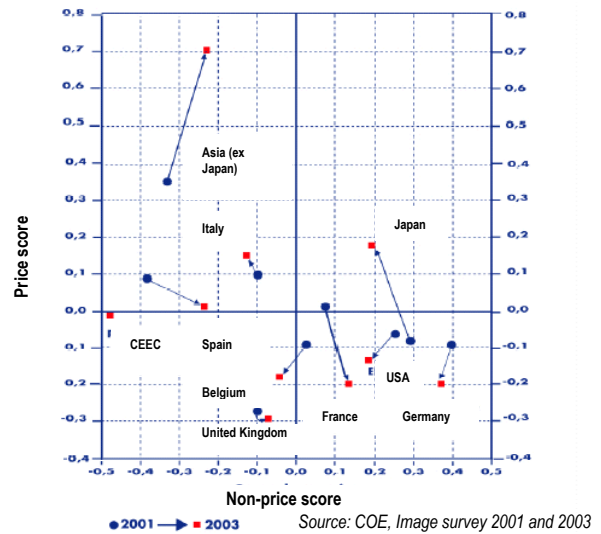
To...	CEEC			United States			China + Hong Kong		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
From... Germany	8.1	8.5	8.9	10.5	10.4	9.2	2.5	2.9	3.3
France	2.9	3.2	3.4	8.6	7.8	6.8	2.1	1.8	2.0
Italy	5.8	6.1	6.8	9.6	9.7	8.5	2.4	2.7	2.5

Source: Eurostat

most buoyant. In 2002, when world imports of the three types of products most in demand fell by 4.1% in value, France and Italy's exports of these products fell by 2.7% and 5.3% respectively (-6.2% and -0.9% in 2003), whereas Germany registered an increase of 2.3% (-0.5% in 2003).

Likewise, Germany is consolidating its leading position in high growth regions. In 2003, it saw its exports to China (including Hong Kong) grow 17.6% in value against 6.6% for France and -7.8% for Italy. Its exports to CEEC rebounded 6.1% compared with 7.9% in France. Although Germany managed to maintain its level of exports to the United States in 2002, they slipped by 9.5% in 2003, whereas France and Italy suffered an even greater fall in exports to the United States in 2003 (-15.7% and -14.8%) on top of a sizeable drop in 2002.

CHANGES IN PRICE AND NON-PRICE FACTORS BETWEEN 2001 AND 2003



This trend is clearly not due to Germany's superior cost or price competitiveness relative to France or Italy. Instead, Germany's capacity to win market share is certainly due in part to an advantage related to non-price competitiveness. The image survey covering intermediary goods and mechanical and electrical imports on the European market carried out by the French Economic Observation Centre (COE) supports this idea: German products lead the way on non-price factors, while France, which trails behind Japan and the United States, is penalised by a low score on quality, innovation and design.

Italy, for its part, is below the average of countries covered by the survey, mainly because of a very poor score on product-related services and delivery timeframes.

To avoid losing any more ground on growth markets (and a great deal is at stake here), France will have to work to improve the image of French products and focus on the quality of products and associated services.

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