INTERNATIONAL MONETARY FUND

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FRANCE

September 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR FRANCE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with France, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 20, 2017 consideration of the staff report that concluded the Article IV consultation with France.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 20, 2017, following discussions that ended on July 17, 2017, with the officials of France on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 5, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for France.

The documents listed below have been or will be separately released.

Selected Issues

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September 21, 2017

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IMF Executive Board Concludes the 2017 Article IV Consultation with France

On September 20, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

The recovery is picking up, with real GDP growth projected to reach 1.6 percent this year and 1.8 percent in 2018. Growth is primarily driven by buoyant corporate investment, a rebound in residential construction, and solid consumer demand. Net exports, by contrast, have been a drag on growth, and France's external position is assessed to be weaker than implied by economic fundamentals. Private sector job creation has begun to accelerate moderately and the unemployment rate has begun to recede moderately from its 10 percent post-crisis mark. Despite the cyclical upturn, the inflation outlook remains subdued as in many other euro area economies. Fiscal consolidation, on a structural basis, has stalled since 2015, and the public debt ratio is still rising.

The new government is advancing an ambitious economic reform strategy aimed at making France's economy more dynamic and its public finances sustainable. On the fiscal front, the strategy focuses on reining in public spending with a view to gradually reducing the fiscal deficit while lowering the tax burden. Labor market reforms seek to enhance firm-level flexibility in labor negotiations, revamp unemployment insurance, and improve professional training and apprenticeship programs. Tax reforms are designed to boost growth, employment, and competitiveness.

Medium-term prospects will critically depend on the implementation of the reform agenda. While the output gap is projected to close over the medium term assuming that the recovery sustains its momentum, potential growth remains constrained by modest total factor productivity growth (as in other advanced economies), a stagnant working age population, high structural unemployment (especially among the young and low-skilled), and weak external competitiveness. Comprehensive labor, tax, and spending reforms would help raise potential growth and boost employment while rebuilding room for fiscal maneuver.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors welcomed the new government's broad reform agenda, which seeks to address France's longstanding economic challenges. With the recovery gaining strength and job creation picking up, they noted that there is now an important window of opportunity for a bold and comprehensive strategy to boost growth, reduce unemployment, ensure the sustainability of public finances, and improve competitiveness, while also promoting inclusiveness and social mobility. The key challenge will be implementation, especially with regards to the envisaged fiscal strategy and labor market reforms.

Directors supported the government's gradual expenditure-based fiscal consolidation plan, which aims for a near-balanced budget over the medium term. This would create room for fiscal maneuver and place debt on a downward trajectory. They noted, however, that given past fiscal slippages and the envisaged tax relief for 2018/19, success will critically depend on the timely specification and implementation of efficiency-oriented expenditure reforms. Comprehensive spending reviews could help identify savings at all levels of government while ensuring adequate social protections, which would help make consolidation sustainable.

Directors welcomed the proposed reform of France's labor laws, which should help enhance flexibility at the enterprise level, improve the social dialogue, and reduce judicial uncertainty related to dismissals. They stressed that complementary measures will be needed to bring down the high level of structural unemployment. In this respect, they welcomed the authorities' plans to reform the unemployment insurance and professional education and apprenticeship systems, and recommended continued wage moderation.

Directors considered that the planned cut in the corporate income tax rate, together with a further reduction in the labor tax wedge, will help make France more competitive. To maximize the growth benefits, they recommended that these reforms be complemented by measures to improve the efficiency of capital taxation, including by limiting exemptions, reducing the debt bias, and eliminating disincentives to company growth. They saw merit in the envisaged unification of tax rates on interest, dividends, and capital gains, and recommended streamlining the taxation of long-term savings.

Directors noted that the financial sector has become more resilient since the crisis, with the large banks having buttressed their balance sheets and provided adequate financing to the economy. However, they stressed that banks and insurers need to continue adapting their business models to the low interest environment, new technologies, and evolving regulatory standards. Directors stressed the need for supervisors to remain vigilant with respect to market risks—including a potential increase in interest rates—and the rise in corporate indebtedness.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

France: Selected Economic Indicators, 2015–18

	2015	2016	2017	2018
			Projections	
Real economy (change in percent)				
Real GDP	1.1	1.2	1.6	1.8
Domestic demand	1.6	1.9	1.9	1.7
Private consumption	1.4	2.2	1.2	1.6
Public consumption	1.1	1.3	1.2	0.5
Gross fixed investment	1.0	2.9	2.9	3.1
Foreign balance (contr. to GDP growth)	-0.5	-0.8	-0.3	0.0
Exports of goods and services	4.3	1.8	3.0	3.9
Imports of goods and services	5.7	4.2	3.5	3.5
Nominal GDP (billions of euros)	2194	2229	2283	2351
CPI (year average)	0.1	0.3	1.2	1.3
GDP deflator	1.1	0.4	0.8	1.2
Gross national savings (percent of GDP)	22.3	22.0	22.1	22.3
Gross domestic investment (percent of GDP)	22.8	23.0	23.3	23.0
Public finance (percent of GDP)				
General government balance	-3.6	-3.4	-3.0	-3.0
Revenue	53.1	53.0	53.1	52.5
Expenditure	56.7	56.4	56.2	55.6
Structural balance (percent of pot. GDP)	-2.0	-1.9	-1.8	-2.2
Primary balance	-1.7	-1.7	-1.4	-1.4
General government gross debt	95.6	96.3	96.8	97.0
Labor market (percent change)				
Employment	0.2	0.6	0.7	0.5
Labor force	0.3	0.3	0.0	0.0
Unemployment rate (percent)	10.4	10.0	9.5	9.0
Total compensation per employee	1.0	1.1	...	...
Credit and interest rates (percent)				
Growth of credit to the private non-financial sector	3.2	4.1	5.2	5.8
Money market rate (Euro area)	-0.2	...	...	...
Government bond yield, 10-year	0.8	0.5	...	...
Balance of payments (percent of GDP)				
Exports of goods	21.0	20.7	21.0	20.6
Imports of goods	-22.1	-21.9	-22.4	-21.7
Trade balance	-1.9	-2.0	-2.3	-2.0
Current account	-0.4	-1.0	-1.1	-0.8
FDI (net)	-0.1	0.1	0.2	0.4
Official reserves (US$ billion)	55.2	56.1	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.90	0.90	...	...
NEER, ULC-styled (2000=100)	97.9	98.7	...	...
REER, ULC-based (2000=100)	92.7	92.0	...	...
Potential output and output gap				
Potential output (change in percent)	1.0	1.0	1.1	1.3
Memo: per working age person	0.6	0.6	0.6	0.8
Output gap	-2.4	-2.2	-1.8	-1.3

Sources: Haver Analytics, INSEE, Banque de France, and IMF staff calculations.

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

September 5, 2017

KEY ISSUES

The government's ambitious reform strategy could go a long way toward addressing France's central economic problems: persistent fiscal imbalances, high structural unemployment, and weak competitiveness. With a strong mandate, the government has now a unique window of opportunity for a bold and comprehensive economic reform package, as the recovery is gaining pace and job creation is picking up. Such reforms would help boost growth and rebuild fiscal room for maneuver, including to address potential shocks or transition costs of structural reforms. The key challenge will be implementation, especially with regards to the fiscal strategy and labor reforms.

The government has rightly emphasized the need to rein in public spending to support gradual consolidation and create room for tax relief. For the strategy to work, deep spending reforms are needed at all levels of government, including by reducing the wage bill, consolidating local governments, improving the targeting of social benefits, making health spending more efficient, and further raising the effective retirement age. Major efforts are needed from the start to meet 2017/2018 deficit targets, with many measures yet to be specified.

The labor market strategy should stimulate job creation and reduce structural unemployment. The authorities are moving swiftly to enact a package of reforms that would enhance enterprise-level flexibility and reduce judicial uncertainty. Plans to reform unemployment insurance and strengthen professional training and apprenticeship systems are welcome and should focus on integrating vulnerable groups, notably the youth and the low-skilled. Continued wage moderation would support faster job growth.

The planned corporate, capital, and labor tax reforms should help boost jobs and competitiveness. To maximize their benefits, the package should also include measures to reduce the corporate debt bias, remove inefficient exemptions, address disincentives to company growth, and streamline taxation of long-term savings. This should be complemented by further efforts to simplify business regulations and enhance competition in services.

The financial sector has become more resilient since the crisis, but banks will need to continue adapting to a changing economic and regulatory environment. The rise in corporate debt bears watching closely.

Approved By
Jörg Decressin and Vikram Haksar

Discussions took place in Paris from July 4–17, 2017. The staff team comprised C. Mumssen (mission head), Ms. Batini, Messrs. Gbohoui, Hallaert, Jewell, Tressel (all EUR), Mmes. Burova, Santos, Mohd Nor, and Mr. Mason (from HQ). Messrs. Thomsen, Decressin (EUR), de Villeroché, and Badirou-Gafari (OED) participated in the discussions. Staff met with Minister of Economy and Finance Le Maire; *Banque de France* Governor Villeroy de Galhau; senior officials in the president and prime minister's offices, ministries, the *Banque de France*, and the *Cour des Comptes*; private sector interlocutors, think tanks, and academics; and trade union and employer association representatives. A press conference was held at the end of the mission.

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CONTEXT

1. **President Macron's electoral victory creates a unique window of opportunity to transform France's economy.** Running on a pro-reform and pro-EU platform, Emmanuel Macron defeated his far-right challenger by a large margin to become France's first independent candidate to win the presidency since the beginning of the Fifth Republic in 1958. His newly created party, *La République En Marche*, subsequently won a large majority in parliament, giving the new government headed by Prime Minister Philippe a clear mandate for change in a country that has long struggled to overcome entrenched economic problems. The authorities are now moving swiftly to implement an ambitious set of structural reforms, while curtailing government spending and reducing taxes, in order to make France's economy more dynamic and its public finances more sustainable.

2. **Growth is accelerating thanks to robust domestic demand, catching up to euro area peers.** Annualized quarter-on-quarter real GDP growth picked up to over 2 percent in the first two quarters of 2017. The main driver was buoyant corporate investment, supported by the low interest environment, temporary tax incentives, and an improved growth outlook. In addition, residential construction has rebounded strongly after a decade of stagnation. Consumer demand has remained solid for three years, with household purchasing power supported by refinancing opportunities afforded by the ECB's accommodative monetary policy, although the recent increase in energy prices has dampened consumption early this year. Net exports, by contrast, have been a drag on growth, partly reflecting exceptional factors in 2016 (a weak harvest and the impact of terror attacks on tourism), but also a trend that reflects France's comparatively weak external competitiveness. Real GDP growth is projected to reach 1.6 percent this year, and 1.8 percent in 2018, which would reduce staff's estimate of the output gap to 1¼ percent of GDP next year.

3. **With still ample slack in the economy, the recovery is not yet translating into higher core inflation, despite solid employment growth.** After hovering around 10 percent since the crisis, the unemployment rate fell to 9.5 percent in the second quarter of 2017, as employment growth increased to about ¾ percent year-on-year. Despite the cyclical upturn, the inflation outlook remains subdued as in many other euro area economies. Headline inflation is expected to average 1.2 percent in 2017, driven by accelerating prices of energy, services, and food. Core inflation remains low, at ½ percent year-on-year in the second quarter, contained in part by wage moderation (including policy-induced) and falling prices of communication services. Convergence toward the euro area medium-term inflation goal is projected to be gradual, as even the more cyclically-advanced economies are not yet seeing sustained inflation above 2 percent.

4. **Financial conditions have supported the recovery, with solid credit growth since the crisis.** Staff's macro-financial analysis indicates that the ongoing looseness of financial conditions is likely to have contributed to the cyclical upturn (Annex II). The banking sector has provided companies with ample access to financing, supported by accommodative euro area monetary policy. With credit growth above comparators, corporate debt has increased rapidly and is among the highest in the euro area, at 128 percent of GDP. Much of this debt appears to have been used to finance growth and private investment, including outward FDI. Household debt has also increased

but, at 57 percent of GDP, remains manageable, and debt service is low. Household savings are well above the euro average as a share of disposable income, encouraged by tax subsidies and regulated interest rates.

Figure 1. France: Key Economic Developments

The recovery is gathering pace…

Annual Real GDP Growth
(Percent)

France
Euro area excl. France
projected

…but net exports continue to be a drag on growth.

Average Contribution to Real GDP Growth by Period
(Percent; first period 1995 to 2008, second 2009 to 2012, third 2013 to 2016)

Private consumption
Public consumption and investment
Construction and business investment
Net exports
Gross domestic product

France Germany* Italy

* Germany public investment is instead included in grey block, as opposed to green.

Unemployment has eased later and more slowly than in other countries.

Unemployment Rate
(Percent)

France
Germany
United Kingdom
United States
Italy

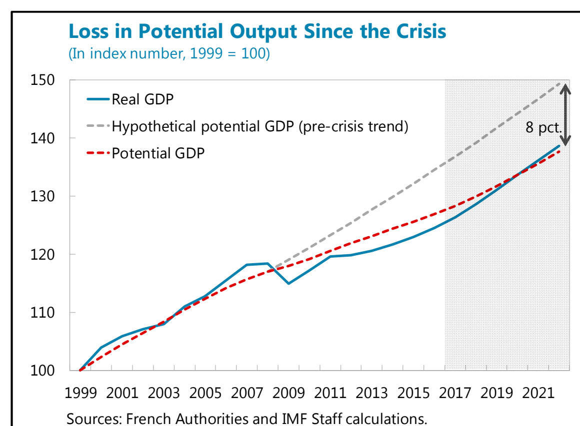
Energy prices have picked up while core inflation remains low.

Consumer Price Index
(Y-o-y percent change, until 2017Q2)

France
France, core
Euro area
Euro area, core

Sources: World Economic Outlook and Haver Analytics.

5. Medium-term growth prospects depend critically on the implementation of the government's reform agenda. Potential output growth is projected to rise gradually, from an estimated 1 percent in 2016 to 1½ percent by 2022, supported by the recovery of investment as well as structural reforms in the government's economic program. However, further increases are constrained by modest total factor productivity (TFP) growth (as in other advanced economies) and a stagnant working age population. The output gap is expected to close by 2021 assuming the recovery sustains its momentum. Low interest rates



and the implementation of the reform agenda should support continued solid credit growth and support the cyclical recovery in private consumption and investment. Faster growth in the euro area should result in stronger external demand. By contrast, fiscal consolidation will be a modest headwind to aggregate demand—suggesting the need for a gradual pace of adjustment while there is still ample slack in the economy. Efforts to boost external competitiveness through structural reform, tax relief, and wage moderation, combined with gradual fiscal consolidation, should help reduce the moderate real effective exchange rate overvaluation and improve net export growth.

6. The main downside risk relates to the implementation of reforms, which could falter if it encoutered public opposition. While the President's economic platform was implicitly validated by majorities in the presidential and parliamentary elections, the high rates of abstention suggest that public sentiment could shift. Eventual political or social resistance to the government's policies could complicate the social dialogue and undermine business sentiment, slowing investment and hiring. It could also derail fiscal consolidation, leading to an entrenchment of the budget deficit and public debt at current high levels. Failure to deliver on fiscal consolidation and structural reform commitments could create outward spillovers by weakening the credibility of euro area governance.

7. External downside risks include geopolitical disruption or financial stress from market corrections. Global policy uncertainty, including around trade policies and post-Brexit negotiations, could affect France's external position and investment. Higher interest rates could negatively impact corporate balance sheets. Debt dynamics could deteriorate in the event of a growth shock and failure to consolidate (Annex III and Annex IV). Additional risks to staff's baseline projections include lower-than-assumed pay-off from structural reforms, and a greater drag on growth from fiscal consolidation and ECB monetary normalization. Conversely, if the government succeeds in swiftly implementing a broad and ambitious package of reforms that effectively addresses France's structural problems, the medium-term growth and employment picture could brighten further.

POLICY DISCUSSIONS

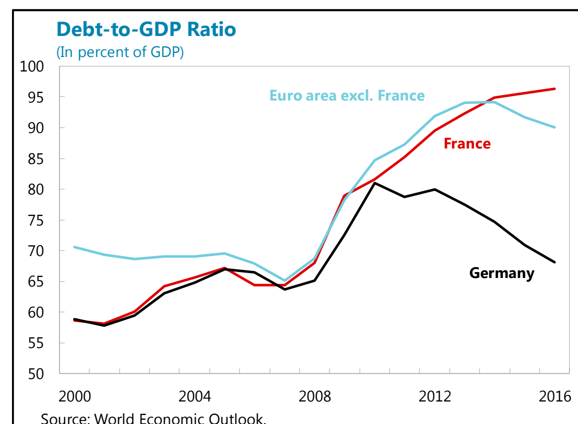
A. The Reform Strategy

8. The government is pushing ahead with a broad and ambitious economic program aimed at making France's economy more dynamic and its public finances sustainable. The program calls for unprecedented efforts to reduce public spending, together with structural reforms to improve the functioning of the labor market, lower the tax burden, and boost competitiveness. Recognizing that the current window of opportunity could close quickly, the government is moving swiftly to enact the bulk of reforms before the end of next year.

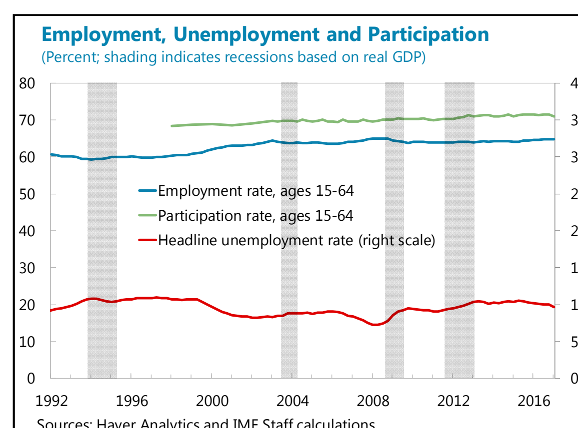
9. This is an important opportunity to address France's longstanding economic problems:

- **Persistent fiscal imbalances.** Government spending—the highest in the EU at 56½ percent of GDP—remains at the heart of France's fiscal problems. Rapid growth in social, wage bill, and local government spending—together with fiscal stimulus during the global financial crisis—contributed to high budget deficits and forced successive tax increases. The fiscal deficit was

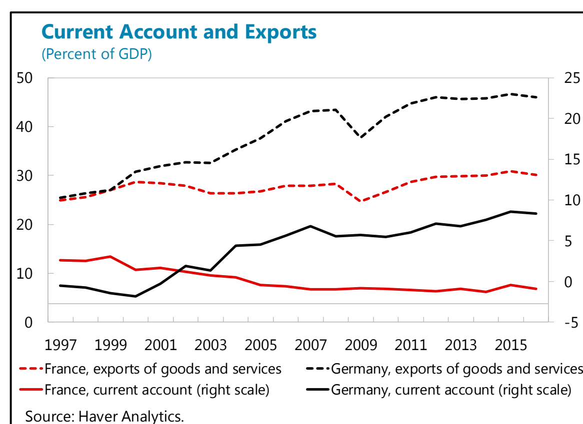
reduced after the crisis, initially by large tax increases, and later by spending containment and falling interest rates. Efforts at expenditure-based fiscal consolidation since 2014 have fallen short, given difficulties in forging consensus around specific cuts and because broad nominal containment efforts did not deliver the hoped-for fiscal savings in the context of low growth and inflation. The public debt ratio has reached nearly triple digits and continues to increase in contrast to most euro area countries.

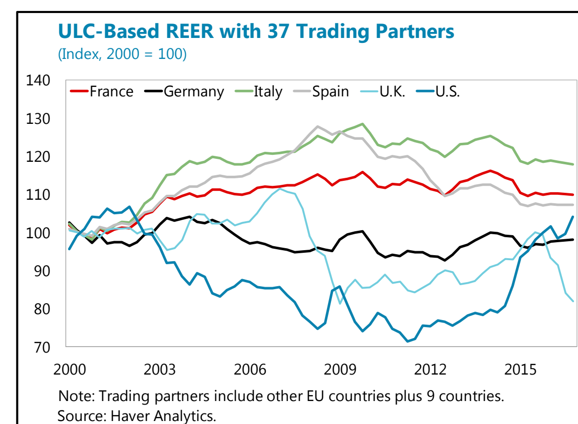


- **Stubbornly high unemployment.** France's unemployment is high and largely structural, reflecting entrenched rigidities. Since the crisis, it has come down more slowly and later than in many peer countries, and the employment rate has remained comparatively low. With a sharp rise in long-term unemployment and falling employment rates among vulnerable groups (the young, low-skilled, and immigrants from outside the EU). In the absence of fundamental reforms to the labor market, the unemployment rate would decline only gradually.



- **Weak external competitiveness.** While domestic demand has been robust, supported by rising government spending and wages, net exports have become a significant drag on growth in recent years. Export growth has underperformed relative to Germany, partly reflecting less wage moderation in the 2000s. The external position is weaker than suggested by economic fundamentals, with the current account registering a deficit of just over 1 percent of GDP in 2016, which is 2¾ percent of GDP below the EBA-estimated norm when correcting for the cycle. Staff considers the real exchange rate to be overvalued by between 8 and 14 percent (Annex I).





10. Many of the planned reforms are in line with past Fund advice, although most measures are yet to be specified in more detail (Table 1). The fiscal strategy emphasizes the need to rein in public spending with a view to gradually reducing the fiscal deficit while creating room for tax relief. Labor market reforms seek to enhance firm-level flexibility in labor negotiations, revamp unemployment insurance, and improve professional training and apprenticeship programs. Tax reforms are designed to boost growth, employment, and competitiveness. The authorities are moving quickly to implement their reform agenda: fiscal consolidation efforts are underway, an initial package of labor reforms is expected to be enacted by end-September, and several tax cuts are due to be implemented in 2018.

11. The government's program is built on reasonable macroeconomic assumptions and sets ambitious but achievable fiscal targets. In its initial projections (*Rapport préparatoire au débat d'orientation des Finances Publiques*), the treasury sees real GDP growth increasing from 1.6 percent in 2017 to 1.8 percent by 2022. Inflation is expected to average 1.4 percent. The program calls for gradual fiscal consolidation, in line with fiscal rules. Over five years, the aim is to cut public spending as a share of GDP by over 3 percentage points, lower the tax burden by 1 percentage point, and reduce the deficit from 3 percent in 2017 to ½ percent of GDP in 2022.[1] Structural reforms are assumed to raise potential growth very modestly while bringing the unemployment rate down to about 7 percent by 2022.

12. The strategy could have sizeable medium-term benefits, but this will depend critically on the design of the specific reform measures and their full implementation. The authorities' fiscal strategy strikes a reasonable balance between reducing the deficit and nurturing the accelerating economic recovery (see below). The central challenge will be to identify the spending measures needed to underpin gradual consolidation while providing the planned tax relief, much of which is frontloaded to 2018/19. This will require going beyond nominal expenditure containment by moving expeditiously to specify and implement deep, efficiency-oriented, spending reforms (Section B). The first-wave of labor reforms announced on August 31 are expected to improve the flexibility of the labor market. To achieve a sizeable reduction in structural unemployment, this would need to be followed by a detailed implementation plan for the envisaged reforms of unemployment insurance and professional training and apprenticeship systems, and complemented by efforts to keep wage growth in line with productivity (Section C). The planned tax reforms are expected to boost investment and competitiveness. Their growth impact could be enhanced if the tax reforms were broadened to address inefficiencies and distortions in the system. Further efforts to simplify business regulations and enhance competition in services would magnify the benefits of the strategy, in particular by raising productivity growth (Section D). The financial sector has become more resilient since the crisis, but some risks continue to merit attention (Section E).

[1] In contrast to accounting conventions used by the Fund, the authorities exclude tax credits from spending, in particular the *Crédit d'impôt pour la compétitivité et l'emploi* (*CICE*). The planned conversion of the *CICE* into a permanent cut in employer social contributions would reduce the spending ratio, as measured in this report, by an additional 0.9 percent of GDP.

Table 1. France: Key Elements of the Government's Economic Program

	Rationalize public expenditure
Key issue	***The high level of government spending is at the heart of France's fiscal problems.***
Government program	• Pursue gradual, expenditure-based fiscal consolidation, bringing the budget deficit to about ½ percent of GDP by 2022. • Reduce spending by more than 3 percentage points of GDP over the next 5 years. • Cut public sector employment by about 120,000, including 70,000 at the local level, and reintroduce the freeze of the public sector wage scale. • Rationalize local government spending in a new pact with subnational governments. • Reform housing benefits. • Raise welfare and pension minima. • Invest €50 billion over the next five years in training, environmental initiatives, health, agriculture, government modernization, and transportation. • Reform the pension system by unifying different regimes and introducing a points-based or notional accounts system.
Related and additional staff advice	• Limit primary spending growth to around the rate of inflation, targeting budget balance by 2022, with flexibility regarding the precise fiscal consolidation path under the rules. • Implement deep reforms at all levels of government to reduce spending and enhance efficiency. Key areas include: reducing the wage bill, consolidating local government, improving the targeting of social benefits, making health spending more efficient, and further raising the effective retirement age. See staff's published analysis (footnote 4).
Macro impact	*Efficiency-oriented reforms could reduce public spending by 3–4 percentage points of GDP by 2022 and create fiscal space without detracting significantly from the recovery.*
	Reduce unemployment
Key issue	***Unemployment is high and largely structural. The youth, the low-skilled, and non-EU immigrants are the most vulnerable.***
Government program	• Enhance the scope for labor negotiations at the enterprise level, including opt out from sector-level agreements, enhanced scope for referenda, and fewer obstacles to agreements within SMEs; merge required firm-level committees. • Cap compensation for unfair dismissals and limit the time for recourse to labor arbitration. • Introduce a more flexible type of work contract for projects. • Replace the CICE with a permanent 6 percent reduction in employer payroll contributions. • Cut employee payroll contributions, to be financed by an increase in the general income tax. • Give a greater role to the state in managing the unemployment insurance system; expand coverage to the self-employed and voluntary job leavers, require employers that hire primarily through short-term contracts to internalize part of the cost on the unemployment system. • Strengthen professional training by enhancing transparency and direct access based on individual needs. • Improve apprenticeships by tightening the link between the education system and employers, subjecting programs to regular review, and reorienting resources toward the low-skilled.
Related and additional staff advice	• Ensure that reforms of professional training and apprenticeship systems are well designed to adapt better to labor market and individual needs. • Tighten eligibility for unemployment benefits, including by strengthening job search requirements and incentives through the institutional support and control framework. • Contain wage growth by enhancing flexibility for enterprise-level negotiations, limit automatic minimum wage increases to inflation, and allow the future National Productivity Board to play an advisory role on wage setting, including by providing guidance on the link between wage dynamics and economic conditions.
Macro impact	*Comprehensive labor market reforms could help significantly reduce structural unemployment, raise labor force participation, reduce inequality, and increase potential growth by around 0.2 percentage points over the medium term.*

Table 1. France: Key Elements of the Government's Economic Program (Concluded)	
Boost external competitiveness	
Key issues	***The tradable sector has steadily lost competitiveness, as evidenced by declining shares in global markets. Causes include labor, tax, and product market rigidities.***
Government program	• Gradually reduce the corporate tax rate from 33 percent to 25 percent. • Replace the wealth tax with a narrower tax on real estate. • Introduce a unified tax of around 30 percent on interest income, dividends, and capital gains. • Reduce employer and employee payroll contributions (see above). • Reduce, and later eliminate, the local housing tax. • Reduce charges for micro-enterprises, in particular during their first year of operation.
Related and additional staff advice	• Broaden the scope of corporate tax reforms to address other distortions and inefficiencies in the system, including the debt bias, disincentives to company growth, inefficient exemptions, and production taxes. • Support wage moderation (see above). • Transform tax breaks for certain savings instruments into a general tax-advantaged long-term savings scheme. • Continue simplifying regulations, especially for start-ups, and further liberalize services.
Macro impact	*Well-designed comprehensive reforms could spur innovation and investment, increasing the TFP contribution to potential growth by up to 0.2 percentage points in the medium term.*

13. The synergies and trade-offs of reform and consolidation can be illustrated in stylized macro-structural scenarios. Table 2 shows three illustrative scenarios that assume different degrees of reform implementation, using standard assumptions for fiscal multipliers and estimates of the impact of reform based on benchmarks in the literature.[2]

- **Baseline with identified reforms and gradual fiscal consolidation.** Based on current information regarding specific policies and reforms that are likely to be implemented, staff's preliminary projection is that real GDP growth will increase to close to 2 percent in the medium term, and potential growth will gradually rise to 1.5 percent over the next five years, partly reflecting the recovery of investment and partly tax and labor market reforms. The unemployment rate is projected to fall to just below 8 percent by 2022, and to around 7 percent within ten years, as the recovery reduces labor market slack and labor reforms help reduce structural unemployment. A slowdown in real primary spending growth, to about 0.2 percent per year (excluding the impact of the *CICE* conversion) from 2019–22, supports a gradual pace of consolidation that reduces the structural deficit to around 1 percent of GDP by 2022, all the while allowing tax relief throughout the five-year horizon. Public debt dynamics turn around in 2019, with debt declining gradually to around 91 percent of GDP in 2022.

[2] Fiscal multipliers are assumed to be one when the output gap is closed, and move with the business cycle. In line with staff's analysis in the forthcoming *World Economic Outlook*, multipliers and spillovers are higher when there is economic slack. The calibration of the impact of structural reforms on GDP level and growth rates is based on prior (dynamic, general equilibrium) model simulations evaluating the GDP implications of France's 2012–15 reform agenda taking specific account of France's historical response to reforms as well as the characteristics of individual reform measures. The simulations suggest that these labor, product market and tax reforms would generate GDP level increases of around 1.2–1.6 and 3–3.7 percent over the next 5 and 10 years respectively, with a corresponding impact on GDP growth equal to 0.2–0.3 and 0.3–0.4 percentage points at the 5 and 10 year horizons, respectively (see OECD, 2014; and EC, 2016). While the new reform agenda that is now under consideration is more comprehensive, we assume here a cumulative impact broadly in line with the estimates from the previous reform agenda. Given the nature of the planned reforms, it is reasonable to assume that the economic benefits will come in gradually, and still be present in the outer years, for instance via labor force participation increases and higher TFP.

- **Comprehensive structural and spending reforms.** This stylized scenario assumes full implementation of the economic reform strategy, enhanced by additional tax, labor, and product market reforms broadly in line with staff advice. This would add to the level of potential output via 0.2 percentage points higher potential growth over the medium term, reflecting in particular higher potential employment and TFP growth. Broad, efficiency-enhancing spending reforms underpin a slightly faster pace of fiscal consolidation, keeping real spending growth flat until 2022 while limiting the drag on growth. As shown in Table 2, much of the payoff from this more ambitious strategy becomes apparent in the outer years, as an improved fiscal position and higher longer-term growth improve debt dynamics and reduce unemployment more significantly than in the baseline. In the near term, the growth and employment benefits from reform are partly offset by less fiscal support, illustrating the intertemporal tradeoff of a faster pace of fiscal adjustment.

- **Unchanged policy scenario.** The benefits of the baseline and comprehensive reform scenarios can be illustrated by a hypothetical counterfactual scenario without any reform or fiscal adjustment. The lack of tax and labor reforms would keep potential GDP growth lower, and structural unemployment higher throughout the forecast horizon. The fiscal deficit would be significantly higher over the medium term, given more rapid real primary spending growth (at the average of the past few years) and higher debt service resulting from an increased sovereign risk premium. Thus, while the scenario does not build in the planned tax cuts, debt dynamics become problematic, especially in the outer years, as a result of low growth and a high deficit.

14. The analysis suggests that timely implementation of sufficiently ambitious reforms can create some degree of flexibility regarding the precise path of fiscal consolidation under the rules. Growth-oriented structural reforms would not only help reduce unemployment but also create fiscal space and improve debt dynamics, which can help when addressing potential transition costs of reform. Efficiency-oriented spending reforms would help create room for fiscal maneuver and tax relief while detracting less from growth than other consolidation measures. The simulations also highlight a key risk of the government's strategy: A successful reform effort will require strong political support over extended period, as the growth payoff from reforms may take some time. If the reform momentum were to slow, the medium-term growth and fiscal objectives would be difficult to achieve, and debt dynamics could deteriorate significantly.

Authorities' Views

15. The authorities stressed their determination to seize the current window of opportunity to push for wide-ranging reforms aimed at transforming the French economy by making it more dynamic and bolstering fiscal sustainability. They reiterated their commitment to follow through on President Macron's campaign platform and to respect their European obligations. They indicated that all reforms were on the table—even the most politically difficult ones. Immediate priorities are to enact the recently unveiled labor reform package and reduce the budget deficit to 3 percent of GDP.

Table 2. France: Stylized Macro-Structural Scenarios 1/
(Percent of GDP / Potential GDP / Percent)

		Projections							
	2016	2017	2018	2019	2020	2021	2022	...	2027
Baseline Scenario (Preliminary Staff Projection Based on Identified Policies and Reforms) 1/									
Real GDP growth	1.2	1.6	1.8	1.9	1.9	1.9	1.8	...	1.5
Potential GDP growth	1.0	1.1	1.3	1.4	1.4	1.5	1.5	...	1.6
Output gap	-2.2	-1.8	-1.3	-0.8	-0.3	0.0	0.3	...	0.0
Employment rate	61.4	61.9	62.2	62.4	62.8	63.1	63.3	...	64.3
Unemployment rate	10.0	9.5	9.0	8.7	8.3	8.0	7.8	...	7.3
Revenue	53.0	53.1	52.5	51.6	51.3	51.2	50.9	...	50.9
Expenditure	56.4	56.2	55.6	54.8	53.1	52.4	51.7	...	51.8
Fiscal balance	-3.4	-3.0	-3.0	-3.2	-1.8	-1.2	-0.8	...	-0.9
Structural fiscal balance	-1.9	-1.8	-2.2	-2.6	-1.6	-1.2	-1.0	...	-1.0
Gross debt	96.3	96.8	97.0	97.0	95.6	93.6	91.2	...	80.8
Comprehensive Structural and Spending Reforms 2/4/									
Real GDP growth	1.2	1.6	1.6	1.9	1.9	1.9	1.9	...	1.7
Potential GDP growth	1.0	1.1	1.3	1.4	1.5	1.6	1.6	...	1.8
Output gap	-2.2	-1.8	-1.5	-1.0	-0.7	-0.4	-0.2	...	0.0
Employment rate	61.4	61.9	62.2	62.5	62.8	63.2	63.5	...	65.2
Unemployment rate	10.0	9.5	9.1	8.6	8.2	7.9	7.6	...	6.4
Revenue	53.0	53.1	52.5	51.6	51.3	51.2	50.9	...	50.1
Expenditure	56.4	56.2	55.5	54.7	52.9	52.1	51.3	...	50.2
Fiscal balance	-3.4	-3.0	-3.0	-3.0	-1.6	-0.9	-0.4	...	-0.1
Structural fiscal balance	-1.9	-1.8	-1.9	-2.3	-1.1	-0.6	-0.3	...	-0.1
Gross debt	96.3	96.8	97.1	97.0	95.4	93.0	90.2	...	75.9
Unchanged Policy Scenario (Historical Spending Dynamics And No Reform) 3/4/									
Real GDP growth	1.2	1.6	1.6	1.5	1.9	1.9	1.7	...	1.3
Potential GDP growth	1.0	1.1	1.3	1.3	1.3	1.3	1.3	...	1.4
Output gap	-2.2	-1.8	-1.5	-1.2	-0.6	0.0	0.3	...	0.0
Employment rate	61.4	61.9	62.2	62.1	62.3	62.5	62.6	...	62.8
Unemployment rate	10.0	9.5	9.1	9.0	8.7	8.6	8.5	...	8.7
Revenue	53.0	53.1	53.0	53.0	53.0	53.0	53.0	...	53.0
Expenditure	56.4	56.2	56.3	56.8	57.1	57.0	56.9	...	57.1
Fiscal balance	-3.4	-3.0	-3.3	-3.9	-4.1	-4.0	-3.9	...	-4.1
Structural fiscal balance	-1.9	-1.8	-2.4	-3.2	-3.8	-4.0	-4.2	...	-4.1
Gross debt	96.3	96.8	97.4	98.4	99.2	99.9	100.5	...	103.9

Sources: French Authorities and IMF Staff calculations.

1/ Staff's preliminary projections reflecting information on policies and reforms specified as of July 2017. Real primary spending growth in 2019-22 (excluding CICE) at around 0.2 percent per year, planned tax cuts in 2018-22, constant structural deficit thereafter. Labor and tax reforms are projected to yield around 0.3 percentage points potential growth over the medium term, in roughly equal parts from higher potential employment and TFP growth.

2/ Full implementation of tax, labor, and product market reforms, broadly in line with staff advice. Relative to baseline, potential growth is higher by about 0.2 percent over the medium term. Growth benefits in the the first five years are broadly offset by a somehwat faster pace of fiscal consolidation, with flat real primary spending growth from 2019. This is underpinned by efficiency-oriented spending reforms that create room for additional tax relief (and thus higher growth) in the outer years.

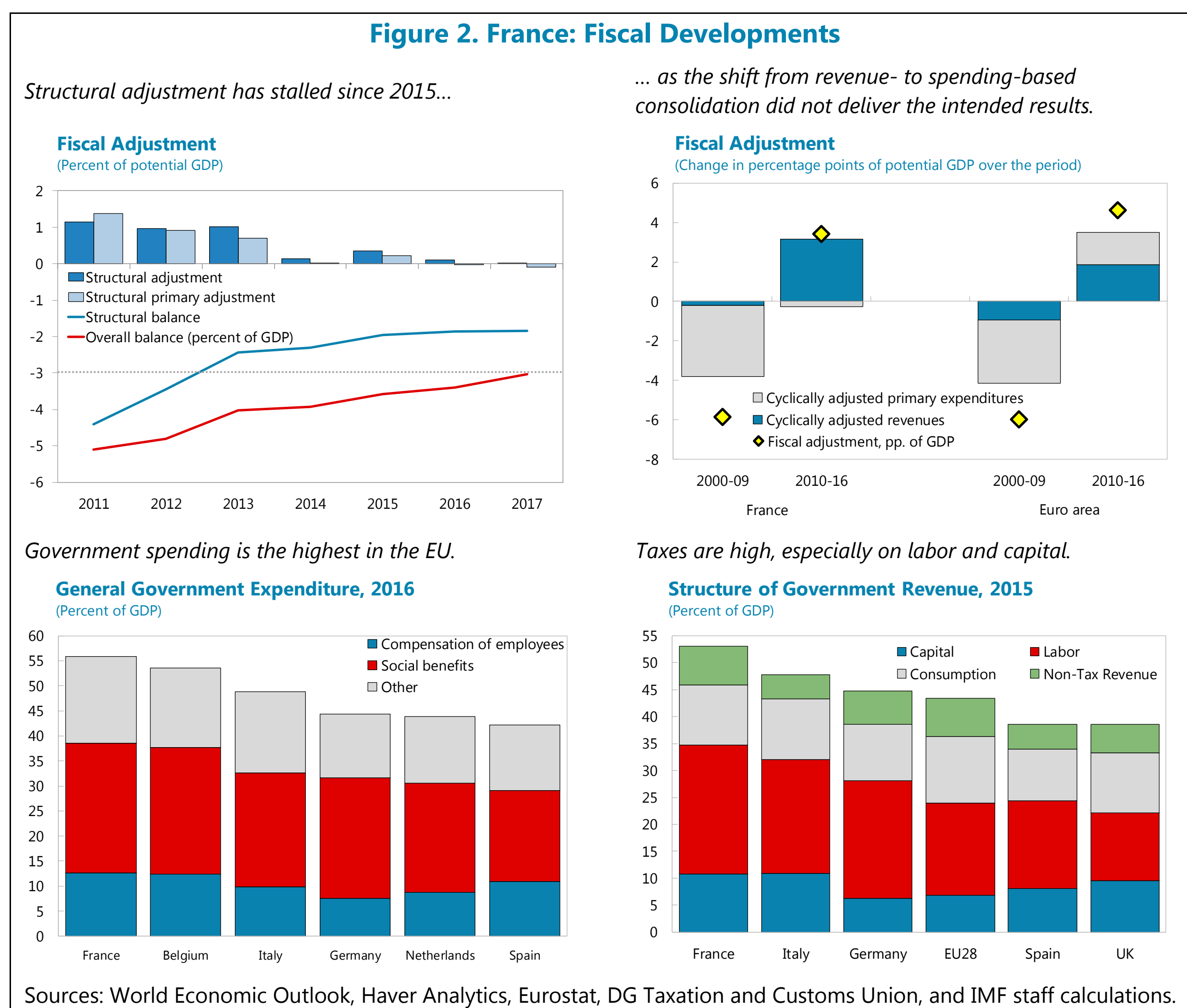
3/ No major policy changes or structural reforms. Real spending growth at 1.2 percent per year, no tax changes, primary balance unchanged at around zero after 2020, and 150 bp higher risk premia.

4/ Growth projections reflect changes in the fiscal stance relative to the baseline. The revenue and spending multipliers are assumed to be 1.0 when the output gap is zero, and move with the cycle.

B. Spending Reform—The Key to Fiscal Sustainability

16. France has limited fiscal space under European rules, and recent consolidation efforts have not delivered the envisaged results. Despite the ongoing recovery, the ratio of public debt to GDP has continued to rise.[3] Structural fiscal adjustment has stalled since 2015, and France is one of just a few countries in the euro area still subject to the Excessive Deficit Procedure. Debt dynamics could become problematic in the event of a growth shock, with debt climbing to well above 100 percent of GDP (Annex III). While France still has some fiscal space to respond to shocks there is little near-term room for maneuver while the deficit remains above 3 percent of GDP.

Figure 2. France: Fiscal Developments



Sources: World Economic Outlook, Haver Analytics, Eurostat, DG Taxation and Customs Union, and IMF staff calculations.

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[3] The rise in the debt ratio would be even stronger had the government not issued bonds with a sizeable interest premium above market rates in 2015/16.

17. In this context, the gradual, expenditure-based fiscal consolidation planned by the government is generally appropriate. Reducing the budget deficit to ½ percent of GDP by 2022 would help place public debt on a downward trajectory and create room for fiscal policy maneuver without unduly detracting from the recovery. It is also broadly consistent with European and national constitutional rules, which both foresee gradual consolidation to near structural balance. The central pillar of the strategy—bringing down government spending by over 3 percentage points of GDP by 2022—is appropriate, as the high level of government spending has long been at the heart of France's fiscal problems. Indeed, rapid growth in spending between 2001 and 2009 was the driving force behind widening deficits, rising debt, and a high tax burden.

18. Strong actions are needed from the start to slow the growth in government spending and meet the deficit targets. Fiscal consolidation in 2017 and 2018 is complicated by inherited spending slippages identified in the recent *Cour des Comptes* audit, and the frontloading of tax relief of over ½ percent of GDP. For 2017, meeting the commitment to bring the budget deficit down to 3 percent of GDP requires major efforts, including across-the-board spending freezes, which have already taken effect. For 2018, the spending effort will have to continue and become more structural, as measures of almost 1 percent of GDP will be needed to meet the 2018 deficit objective—an exceptional effort by historical standards, with significant implementation risks.

19. To make the fiscal strategy credible and compatible with growth and social objectives, it will be critical to design and lock in deep spending reforms at all levels of government. Comprehensive spending reviews should identify areas for efficiency gains and savings while maintaining adequate social protections. Local governments are integral partners in these efforts, and the new pact with the state should include an agreed system of monitoring and incentives. Staff's recent analysis[4] suggests that the envisaged reduction in the spending ratio is ambitious but achievable provided that key reform areas are addressed and measures are well-designed to mitigate the impact on growth and inequality:

- The relatively high wage bill could be reduced by shrinking the number of public employees in non-priority areas and reforming the salary system across the different levels and functions of the public sector.
- Restructuring and computerization of administrations could be supported by the €50 billion temporary investment plan announced by the president.
- Stepping up efforts to consolidate local government, especially the large number of small communes, could yield important economies of scale.
- Social transfers—notably housing aid—should be better targeted to the people most in need of support, including through enhanced means testing.
- Health spending could be made more efficient to curtail rising costs, including by reforming hospitals, enhancing the use of generics, and reviewing co-pays and deductibles.

[4] Hallaert and Queyranne (2016) "From Containment to Rationalization: Increasing Public Expenditure Efficiency in France," IMF Working Paper 16/7.

- The envisaged reform of the pension system, which intends to unify different regimes and introduce a points-based or notional accounts system, should include incentives for later retirement.

Authorities' Views

20. The new government has made a strong public case for reducing France's dependence on public spending. The authorities expressed their determination to reduce the budget deficit to 3 percent of GDP this year and further thereafter, arguing that consolidation was overdue and was essential for rebuilding fiscal space and meeting France's European commitments. They defended their decision to frontload several tax cuts, which they believe will support domestic demand, while sending a clear message that fiscal consolidation will be expenditure based and not achieved at the cost of increasing France's already high tax burden. They acknowledged that across-the-board freezes, while unavoidable this year, would be insufficient in 2018 and beyond, and that structural spending reforms would be necessary at all levels of government. They welcomed staff's suggestions on spending reforms and outlined areas where they are looking for savings— including the wage bill, housing aid, health care, public investment, unemployment insurance, and local government spending—while reinforcing the social safety net. Regarding European fiscal governance, they saw merit in further integration, including a common budget and finance minister for the euro area, and reiterated their preference for the simplification of fiscal rules.

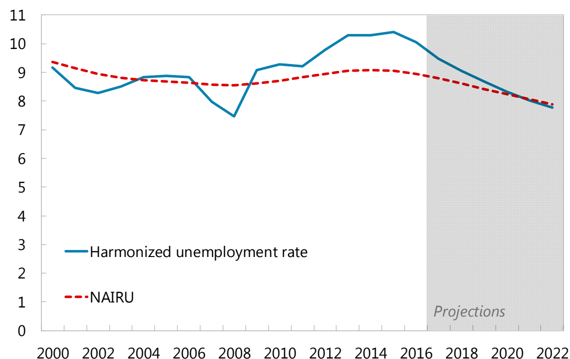
C. Unlocking France's Untapped Labor Market Potential

21. Unemployment remains high and is mostly structural. After hovering around 10 percent for years, the unemployment rate has started to edge down this year as employment is growing about around ¾ percent year-on-year. Without fundamental labor market reforms, however, unemployment is expected to decline only slowly and remain high over the medium term, converging to staff's estimated NAIRU of just under 8 percent by 2022. Long-term unemployment is well above pre-crisis levels, and employment rates have stagnated for decades, falling behind many European peers. Key structural rigidities, which make unemployment relatively unresponsive to the business cycle, include: labor agreements at the branch level for over 700 branches; long and uncertain judicial procedures around dismissals; generous eligibility for unemployment and welfare benefits; a minimum wage that is closer to the median wage than in peer countries, with a formula that provides automatic annual adjustment, usually above inflation; and a still sizeable labor tax wedge.

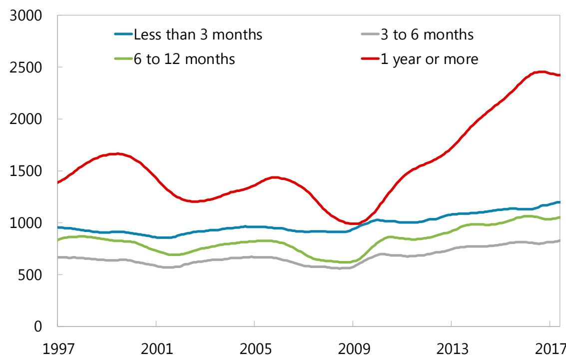
22. Three vulnerable socio-economic groups account for a large share of France's structural unemployment. Staff's econometric analysis of labor force survey data suggests that the probability of being unemployed is significantly higher for the youth, the low-skilled, and immigrants from outside the EU, controlling for other personal characteristics (Annex V). Moreover, the relative labor market disadvantage for these groups is higher than in relatively crisis-resilient peer countries. In contrast to other countries, these group-specific vulnerabilities have not worsened significantly since the crisis, suggesting that reasons are structural rather than cyclical.

Figure 3. France: Labor Market Developments

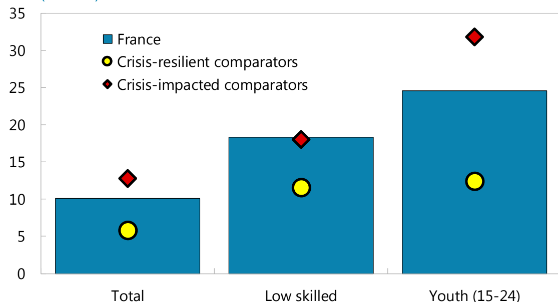
Unemployment is expected to come down only slowly.



Long term unemployment is declining but remains high.

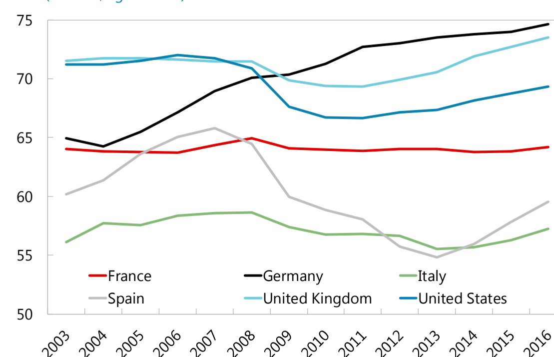


Unemployment affects in particular the youth and low-skilled.

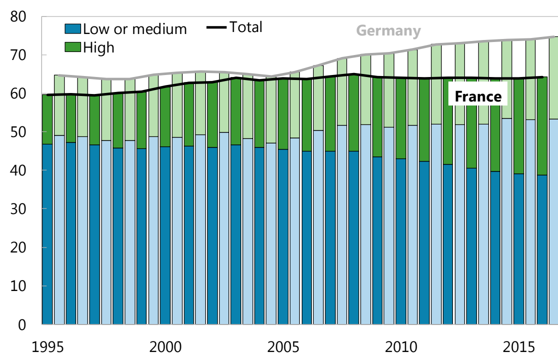


Notes: Low skilled refers to lower secondary education.
Crisis-resilient comparators include Austria, Belgium, Germany, The Netherlands, and the UK.
Crisis-impacted comparators include Ireland, Italy, Portugal, and Spain.

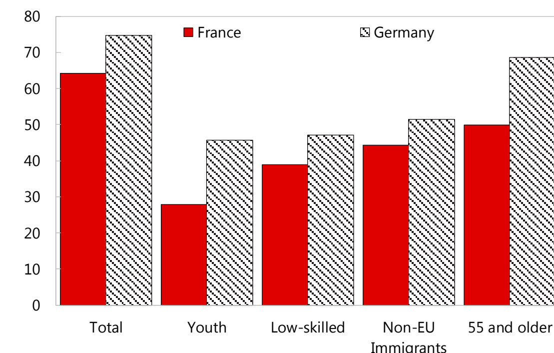
The employment rate has been stagnant and lags many EU peers.



Employment rates among the low-skilled are low and declining.



The labor market has considerable untapped potential.



Sources: Eurostat, DARES, OECD and IMF staff calculations.

23. The government's first-stage reforms aim to improve the dynamism of the labor market. The government unveiled on August 31 details of a major reform package, to be implemented by ordinances. It includes measures to give greater flexibility for negotiations at the enterprise level, including by allowing opt outs from branch level agreements, broadening the scope for workplace referenda, and removing barriers to firm-level agreements within SMEs. The reforms also streamline the social dialogue, reduce judicial uncertainty around dismissals, and introduce a more flexible type of contract for projects. These steps should improve the functioning and flexibility of the labor market over the medium term. The near-term impact is uncertain and may involve frictions, which are however mitigated by the strengthening recovery where hiring is already exceeding dismissals.

24. The government also plans to reform unemployment insurance to make it a broader social protection system. This would give a greater role to the state in managing the system while expanding coverage to the self-employed and to those who leave their jobs voluntarily. There are also plans to make employers who hire primarily through short-term contracts internalize part of the cost on the unemployment insurance system. Employment agencies are expected to receive more resources and enforce more strictly sanctions for those who refuse job offers. Given the comparatively low employment rate and existing inactivity traps, staff stressed the particular need to strengthen job search requirements and incentives through tighter eligibility and a more effective institutional support and control framework.

25. The envisaged overhaul of the professional training and apprenticeship systems will be especially important for helping France's most vulnerable socio-economic groups. The government envisages a broad reform of the current training system that would make it more transparent and more directly accessible based on individual needs. It has earmarked €15 billion from President Macron's €50 billion investment plan to train 1 million existing low-skilled unemployed workers and 1 million youth who are neither in school nor working. With respect to apprenticeships, the government is seeking to strengthen the link between the education system and employers by developing periods of pre-apprenticeships in all vocational schools, subjecting programs to regular review, and reorienting resources from the apprenticeship tax—which currently finances higher education—toward the low-skilled. Staff emphasized that these reforms should be designed to better link training and apprenticeship systems to labor market and individual needs.

26. The government's plan to further reduce the still sizeable labor tax wedge should support job creation. Employer payroll contributions have been cut significantly under the *Pacte de Responsabilité et Solidarité* (PRS) and the *Crédit d'Impôt Compétitivité Emploi* (CICE). The new government intends to covert the CICE (a temporary, wage-based tax credit for employers) into a permanent payroll tax cut, which should lower unit labor costs and encourage hiring. The transition cost of CICE conversion, amounting to around 1 percent of GDP, could be defrayed by phasing in the payroll tax cut over two years. In addition, the government plans to cut employee payroll contributions, to be financed by an increase in the general income tax (CSG).

27. Labor tax cuts should be complemented by continued wage moderation. Staff recommends enhancing firm-level flexibility in wage negotiations as part of the first-wave labor reforms, limiting increases in the minimum wage to inflation, and giving a strong advisory role to the future National Productivity Board, including guidance on the link between wage dynamics and economic conditions (including unemployment, productivity, and competitiveness), see Box 1.

Box 1. Wage Setting and National Productivity Boards

The EU Council has recommended to its members to establish National Productivity Boards (NPB) in charge of the analysis of productivity and competitiveness developments and policy challenges. NPBs should be able to carry out objective and fully independent high-quality economic and statistical analyses. To this end, NPBs should be granted functional autonomy vis-à-vis any public authority, with procedures for experience and competency-based nomination of their members, appropriate access to information, and capacity to communicate publicly in a timely manner.

Currently, substantial differences exist between national practices and institutions for wage formation. In France, the government annually sets the minimum wage (SMIC) based on a formula that is linked to a measure of inflation and purchasing power of workers' wages. An expert group provides an annual analysis and recommends to the government whether discretionary increases should be added to the formula. In Belgium, wages in the private sector grow through automatic wage indexation, which is linked to inflation (excluding certain price categories), as well as through real conventional wage increases. The latter are negotiated biannually by social partners, after a maximum allowed growth is set by the Central Economic Council. This maximum is based on expected wage developments in neighboring France, Germany and the Netherlands, as well as a correction mechanism and safety margin to take account of estimation errors. If the social partners are not able to reach an agreement, the government can impose a maximum real conventional wage increase. There is no wage indexation in Germany. Minimum wage adjustments are decided by the government upon recommendations by a commission of employer representatives, trade unions, as well as two non-voting academic advisors. The UK government sets the minimum wage annually upon recommendation by a commission of employers, employees, and academics acting in an individual capacity.

Authorities' Views

28. The authorities explained that the overarching philosophy behind labor reforms is to increase freedom for firms and employees while at the same time safeguarding social protections. Reforms to the labor code are the immediate priority because of their potential to increase growth. In this context, the authorities noted that the dialogue with social partners has been constructive. The next priority is to reform unemployment insurance, broadening the scope and strengthening its governance. The authorities agreed that professional training and apprenticeships systems needed to be better adapted to market and individual needs. They also agreed that wage moderation was important in light of previous wage increases that hurt France's competitiveness, and they said that giving an advisory role to the future National Productivity Board could be helpful.

D. Boosting External Competitiveness and Productivity

29. France has lost external competitiveness over the past two decades, reflecting both price and non-price factors. The world market shares of French exports of goods and services have declined more steeply than in many other advanced economies, particularly in manufacturing where France has been losing its comparative advantage in more high-tech and knowledge-intensive sectors. Consequently, the contribution of tradable sectors to growth and jobs has been modest compared to some peer countries. The loss of external competitiveness reflects several factors:

- *Trading partner growth*. Relatively slow demand growth of France's trading partners, especially in the high-tech sector, partly explains the erosion of export market shares relative to peers.
- *Exchange rate*. The appreciation of the euro after its introduction affected competitiveness across the currency zone.[5]

[5] The euro appreciated against the U.S. dollar in nominal terms by 63 percent between end-2000 and end-2009.

- *Unit labor costs and prices.* The pre-crisis period opened a competitiveness gap against Germany, largely reflecting differential wage growth, especially in services. However, given solid labor productivity growth, France's unit labor costs did not grow faster than in other euro area countries, while firms compressed their margins to protect their price competitiveness.
- *Cost of non-tradables.* The rapid rise in the relative price of non-tradables, largely driven by public and social services, may have contributed to declining competitiveness by increasing the cost of inputs to the export sector.
- *Total factor productivity.* TFP growth has declined, as in many other advanced countries, with the slowdown more substantial in services than in manufacturing.

30. Tax policies also appear to have hurt France's competitiveness. The overall tax burden on capital and labor is high, and rules are changing frequently. The statutory corporate income tax (CIT) rate is considerably higher than the EU average, but CIT revenue productivity is low (Box 2). Uncertainty in CIT policy and administration is a concern in the business community. The broader tax system has many distortions and inefficiencies, including a bias toward debt (over equity) financing, ineffective size-dependent regimes, and inefficient tax incentives.

31. The government's envisaged reforms of labor, corporate income, and capital taxation should help boost competitiveness and investment. In addition to the conversion of the CICE tax credit to a more efficient labor tax cut, planned for 2019, the government's pro-business tax agenda includes a phased reduction of the CIT rate from 33.3 to 25 percent. Staff welcomes these measures but recommends a broader reform of the tax system to reduce the debt bias (for instance, by further limiting interest deductions), remove inefficient tax exemptions, and eliminate the special regime for small business, which creates disincentives for company growth. Production taxes, which are relatively high, should also be reviewed. The planned narrowing of the wealth tax and introduction of a unified tax (of around 30 percent) on interest income, dividends, and capital gains should be complemented by measures to transform instrument-based tax breaks—including for life insurance, real estate investments, and regulated savings—into a general tax-advantaged long-term savings scheme.

32. To support productivity growth and competitiveness, it will also be important to continue simplifying business regulations, strengthening efforts to promote integrity, and enhancing competition in services. In addition to the government's plans to ease regulations and charges for start-ups, SMEs, and the self-employed, there is scope to further enhance competition in services (especially retail and professional services),[6] simplify administrative processes, and continue reforming the insolvency process. Effective implementation of the recently adopted *Sapin II* law and "moralization law" will help strengthen France's anti-corruption framework.

Authorities' Views

33. The authorities said the reform of the corporate income tax, combined with a reduction in labor taxes, will make French companies more competitive. They pointed out that previous tax reforms had already started to address competitiveness issues at the firm level (e.g., the elimination of

[6] See past Staff reports and Selected Issues notably Country Report 12/342 and 13/3; 14/182; 15/178 and 15/179.

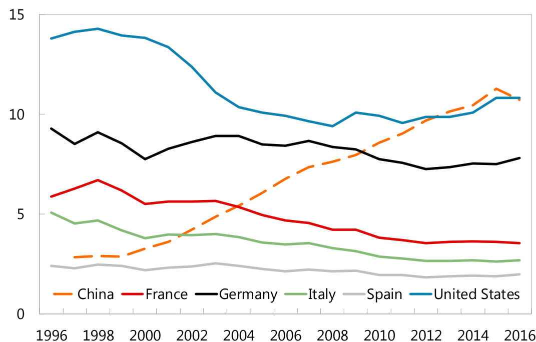
the professional tax, introduction of the CICE) and reduce the bias in the tax code for debt financing. They broadly concurred with staff's diagnosis, and are actively considering policy options for reforming capital taxation, noting that the tax burden as a ratio of GDP tends to be higher in France than the EU average.

Figure 4. France: Competitiveness Indicators

The decline in France's world export market share has been steeper than in most peer countries.

World Market Share: Exports of Goods and Services

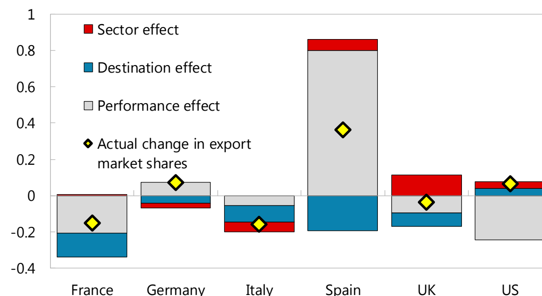
(Percent)



Weak domestic performance has been the main driver of the decline in market shares.

Shift Share Analysis of Market Shares Among AEs

(Percent over the period 1995-2011)

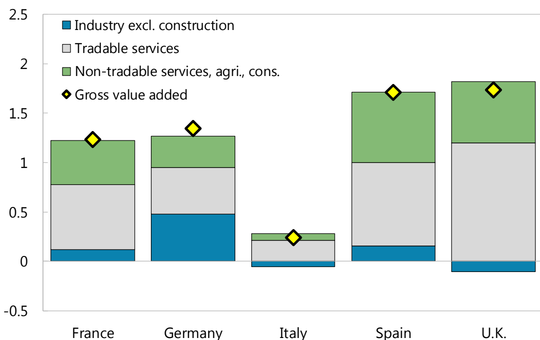


Note: based on estimated fixed effects in regressions of export market shares among 21 advanced economies, with 63 destination countries and 22 sectors.

France's tradable sectors have generated only modest gross value added growth.

Average Contribution to Real GVA Growth

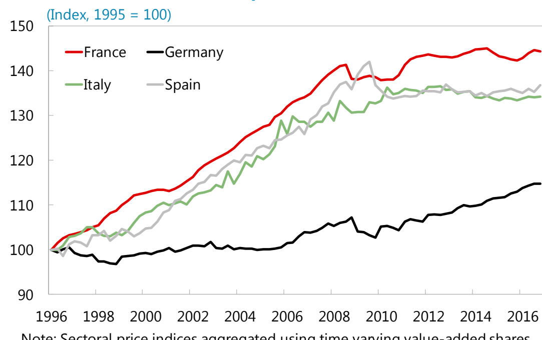
(Percent over the period 2000-2016)



A key factor constraining competitiveness has been the sharp increase in the relative price of non-tradables.

Relative Output Prices: Non-Tradable Sectors / Tradable Sectors

(Index, 1995 = 100)

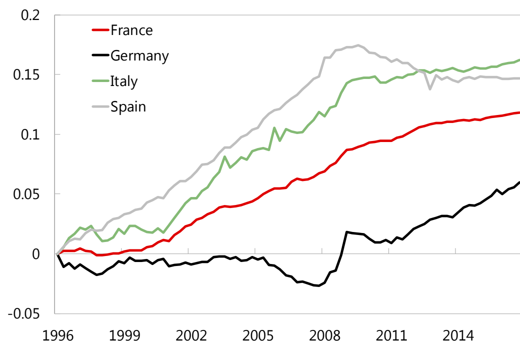


Note: Sectoral price indices aggregated using time varying value-added shares.

Unit labor costs have increased, albeit less than in some other euro area countries.

Evolution of Unit Labor Cost

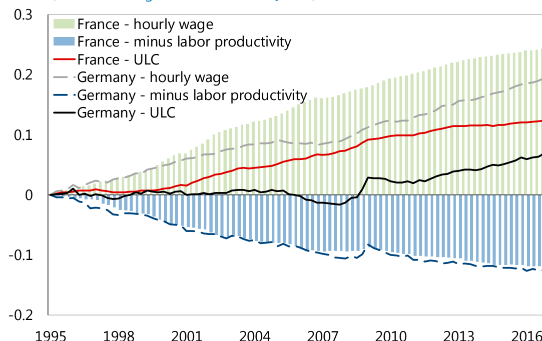
(Cumulative log differences, 1996:Q1 = 0)



Unit labor costs grew more than in Germany before the crisis, reflecting differential wage dynamics.

Evolution of Unit Labor Cost and Components

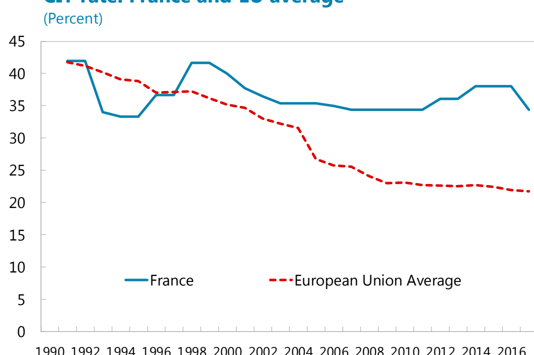
(Cumulative log differences, 1996Q1 = 0)



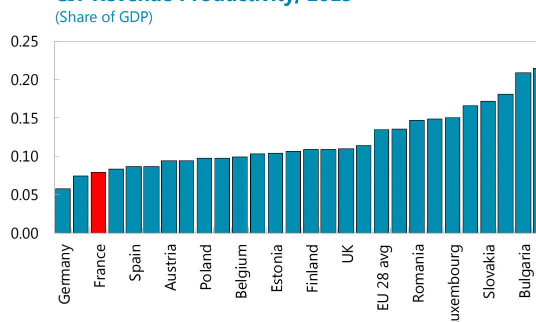
Sources: Eurostat, Haver Analytics, OECD TiVA, World Economic Outlook and IMF staff calculations.

Box 2. Growth-Friendly Corporate Income Tax Reform in France

There are opportunities for efficiency-enhancing pro-growth reforms of the French corporate income tax (CIT) system. The statutory rate, currently 34.43 percent, is considerably higher than in most other EU countries where rates have been on a downward trend for over two decades. France's CIT is imposed on a relatively narrow base, reflecting tax incentives and a comparably low corporate profitability. Revenue productivity is among the lowest in the EU.



Sources: OECD and Eurostat.



CIT productivity is an indicator of CIT revenue performance defined as: CIT revenue / (GDP*CIT standard rate).
Source: IMF staff calculation using OECD revenue statistics.

The government's plan to reduce the statutory standard rate to 28 percent by 2020, and 25 percent by 2022, would help reduce the risks of outbound profit shifting, and could make France a more attractive location for investment. However, if not accompanied by changes in the taxation of non-corporate firms it could worsen incentives for tax arbitrage between business forms, which could lead to further revenue losses. More broadly, there is scope to make the CIT regime more attractive by addressing distortions, including reducing or neutralizing the discrepancy between taxing debt and equity finance.[1] Important efficiency gains could also be realized through base broadening, for instance by abolishing ineffective size-dependent regimes and inefficient tax incentives.[2] Additional efficiency-enhancing reform options include abolishing the patent box regime and revisiting the design of the R&D tax credit.

Complementing CIT reform with additional measures to improve business and capital taxation would provide further growth benefits. For example, the plan to lower the relatively high labor tax wedge by replacing the CICE tax credit with a permanent reduction in the employer's social contribution rate is likely to enhance efficiency. The decision to replace employee social contributions by an increase in the CSG is also helpful in this respect. Production taxes, which are comparatively high and insensitive to profits, are another area where reform may be warranted. Moreover, the envisaged reforms of wealth and capital income taxation could be extended to streamline tax incentives for long-term savings.

Finally, the frequency of CIT policy changes and their administrative implications, as well as unnecessary complexity in the system, can hinder the investment climate. Addressing some of these issues would substantially contribute to improving France's investment climate vis-à-vis its European peers.

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[1] IMF (2016) Fiscal Policies for Innovation and Growth, *Fiscal Monitor*.

[2] Offering reduced taxes for small businesses harms productivity by deterring company growth, and jeopardizes revenues by incentivizing firms to split into smaller entities to avoid higher tax rates. Similarly, other size-dependent taxes, such as surcharges and employers' social security contributions, warrant a critical review. See IMF (2016b) Tax Policy, Leverage and Macroeconomic Stability, IMF Policy Paper.

E. Financial Sector—More Resilient but Keeping an Eye on Risks

34. Financial sector risks are mitigated by improved capitalization, but banks and insurers still face economic and regulatory challenges. France's large banks have improved their financial buffers, profitability, and capitalization since the crisis, partly by adapting business models and cutting costs. They have also reduced their reliance on wholesale funding. Nevertheless, a prolonged period of low growth or low interest rates could weaken profitability—particularly in the context of above-market returns on regulated savings accounts—and create incentives for banks to take more risks. The rise of Fintech could constrain profits, and banks could lose customers in the retail market as a result of service sector liberalization. Potential regulatory changes under Basel III, including the introduction of output floors for banks using internal models, would help enhance the system's resilience and provide a safety net against model risk, while potentially requiring some French banks to raise additional capital over the medium to longer term as new regulatory measures are phased in. The recently adopted *Sapin II* law introduced a new class of senior non-preferred ("bail-inable") debt, allowing banks to comply with new EU regulatory standards. French insurers still face challenges related to the transition to the Solvency II regulatory regime.

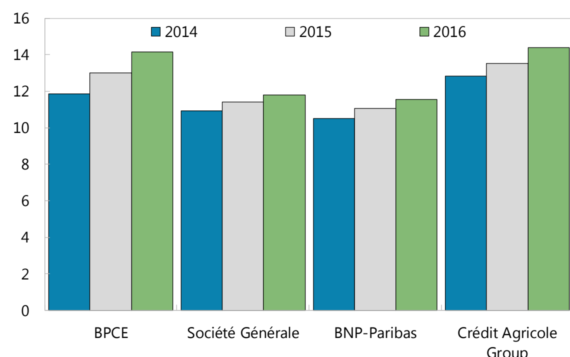
35. A sudden increase in interest rates could have negative balance sheet effects. In particular, it could adversely impact banks' profitability through higher wholesale funding costs, given the large share of mortgage that have been refinanced at low fixed rates. The rise in corporate debt may expose some French companies, which have about two thirds of their debt contracted at variable rates, to interest rate risk. On the other hand, corporate leverage ratios have been relatively stable at the aggregate level. Households are largely shielded from interest rate rises due to the prevalence of fixed-rate mortgages.

Authorities' Views

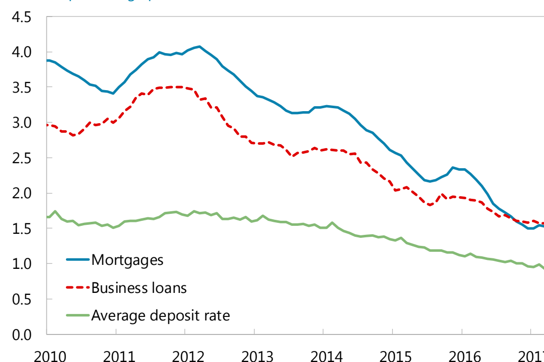
36. The authorities noted that the French banking system has increased its resilience through improved profitability, capitalization, and funding structures. The new class of senior non-preferred debt has been a success, providing a transparent approach to meeting the EU MREL and TLAC requirements. The authorities agreed that balance sheet risks—particularly in the corporate sector—and risks associated with high valuations in financial markets should be monitored. They argued that Basel III should create a level playing field and should not impose unnecessarily high output floors for banks using internal models. They favor completion of the banking union and the removal of remaining regulatory impediments to cross-border banking flows in the euro area.

Figure 5. France: Financial Sector Developments

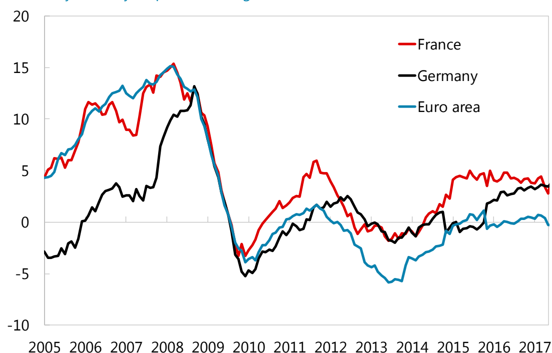
Banks have rebuilt buffers…



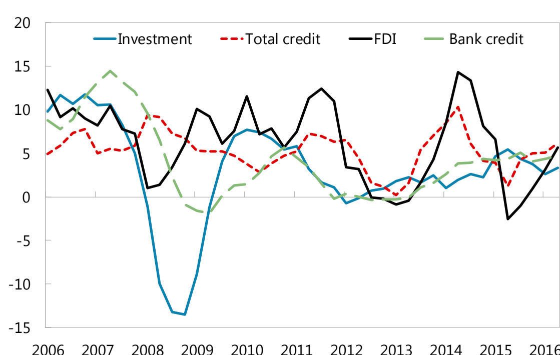
…while net interest margins have been squeezed.



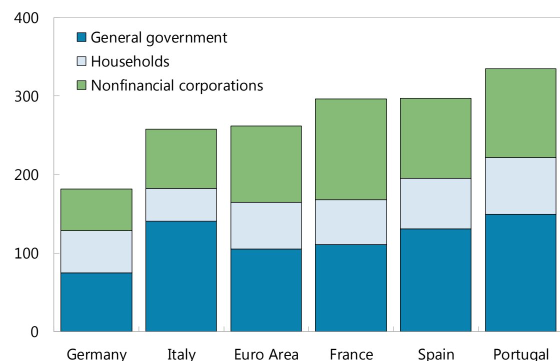
Corporate lending remains strong…



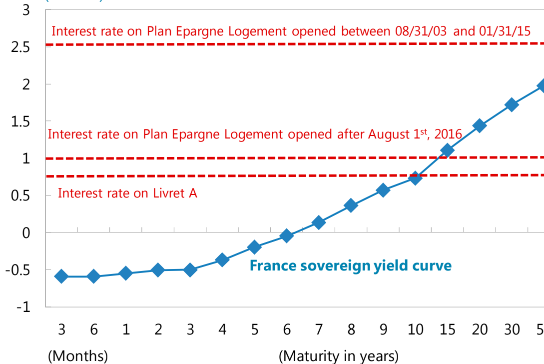
…and has helped to finance domestic and foreign investment.



Overall indebtedness is slightly above the euro area average, mainly reflecting corporate debt.



Rates on regulated savings accounts remain above market values.



Sources: SNL, Haver Analytics, Agence France Trésor and IMF staff calculations.

STAFF APPRAISAL

37. France has a unique, and possibly short, window of opportunity to address its longstanding economic problems. Previous governments have struggled to resolve persistent fiscal imbalances, stubbornly high unemployment, and weak external competitiveness. President Macron's victory in the presidential election, together with his party's securing of a large majority in parliament, gives the new government a clear mandate for change.

38. With the economy improving, the time is right to resume gradual fiscal consolidation and push ahead with structural reforms. As the recovery is accelerating and job growth picking up, economic conditions are now more conducive to reforms. Although gradual consolidation will dampen domestic demand somewhat, efficiency-oriented spending reforms can mitigate adverse effects and create room for growth-friendly tax relief. Tax, labor, and product market reforms can improve competitiveness, encourage investment and hiring, and ultimately lead to higher growth. Higher growth, in turn, would improve fiscal dynamics.

39. The government's economic program is ambitious and sensible—success will depend critically on the ability to deliver the necessary reforms. Many of the envisaged structural reforms are in line with past Fund advice. Medium-term fiscal targets are ambitious but achievable, based on reasonable macroeconomic assumptions. Targeting gradual consolidation that achieves a balanced budget over the medium term would help place public debt on a firm downward trajectory and create room for fiscal maneuver without unduly detracting from the ongoing recovery. Provided that fiscal reforms and medium-term targets are firmly established, the government can retain flexibility to buffer potential short-run transition costs of key structural reforms. If implemented swiftly and comprehensively, the program should pay off in terms of noticeably higher growth, lower unemployment, and more sustainable public finances over the five-year term and beyond. However, implementation risks are significant, especially with respect to the fiscal strategy and labor market reforms.

40. For the strategy to work, the government needs to move decisively to specify and implement deep spending reforms at all levels of government. The government has rightly emphasized the need to rein in public spending, which has long been at the heart of France's fiscal problems. However, many of the necessary structural spending measures are yet to be identified. This leaves the overall strategy vulnerable to the risk that the envisaged savings will not be realized. Strong actions will be needed from the start, given past spending slippages, frontloading of several tax cuts, and the commitment by the authorities to respect the European fiscal rules. Comprehensive efficiency-oriented reforms should be identified and locked in up front, including in the context of the 2018 budget and multiyear budget law (about to be considered by parliament), to underpin gradual consolidation and create room for fiscal maneuver and tax relief. Broad spending reviews should identify areas for efficiency gains and savings at all levels of government while ensuring adequate social protections. This should include a gradual reduction in the wage bill, consolidation of local governments, better targeting of social benefits, more efficient health spending, and measures to further raise the effective retirement age.

41. **The envisaged labor market reforms, if well designed and implemented, should help address the high rate of structural unemployment.** The government's reform strategy covers the most important areas—steps to further reduce the labor tax wedge, make labor negotiations more flexible at the enterprise level, reduce judicial uncertainty around dismissals, reform the unemployment insurance system, and overhaul the professional training and apprenticeship systems. If the specific measures are well designed and implemented fully, these reforms would help bring down structural unemployment and raise participation by lowering labor costs, reducing market rigidities, addressing skills mismatches, and better integrating vulnerable socio-economic groups. The reforms should be complemented by efforts to ensure continued wage moderation that reflects productivity developments, including by adjusting the minimum wage formula and giving a strong advisory role to the future National Productivity Board.

42. **The planned tax reforms will help improve competitiveness, but should be broadened to address inefficiencies and distortions.** The planned reduction in the corporate tax rate to near the European average is reasonable, but should be combined with measures to reduce the bias in the tax code for debt financing, remove inefficient exemptions, and eliminate disincentives to company growth. The envisaged reform of capital taxation is an opportunity to streamline the taxation of long-term savings. Production taxes should also be reviewed.

43. **The financial sector has become more resilient, but will need to continue adapting.** Banks have improved their financial buffers, profitability, and capitalization since the crisis and continue to provide adequate financing to the economy. But banks will need to adapt their business models to the low interest rate environment, new technologies, and changing regulatory standards. The rise in corporate debt bears watching closely, particularly in the event of a sharp increase in interest rates.

44. **It is proposed that the next Article IV consultation take place on the standard 12-month cycle.**

Table 3. France: Selected Economic Indicators, 2013–2022

	2013	2014	2015	2016	Projections 2017	2018	2019	2020	2021	2022
Real economy (change in percent)										
Real GDP	0.6	0.9	1.1	1.2	1.6	1.8	1.9	1.9	1.9	1.8
Domestic demand	0.7	1.4	1.6	1.9	1.9	1.7	1.8	1.8	1.8	1.8
Private consumption	0.5	0.8	1.4	2.2	1.2	1.6	1.8	1.9	1.9	2.0
Public consumption	1.5	1.3	1.1	1.3	1.2	0.5	0.4	0.5	0.5	0.5
Gross fixed investment	-0.8	0.1	1.0	2.9	2.9	3.1	3.5	3.3	3.0	2.8
Foreign balance (contr. to GDP growth)	-0.1	-0.5	-0.5	-0.8	-0.3	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	1.9	3.3	4.3	1.8	3.0	3.9	4.0	4.3	4.3	4.3
Imports of goods and services	2.1	4.8	5.7	4.2	3.5	3.5	3.7	3.8	3.9	3.9
Nominal GDP (billions of euros)	2115	2148	2194	2229	2283	2351	2429	2513	2601	2692
CPI (year average)	1.0	0.6	0.1	0.3	1.2	1.3	1.6	1.7	1.7	1.8
GDP deflator	0.8	0.6	1.1	0.4	0.8	1.2	1.4	1.5	1.6	1.6
Gross national savings (percent of GDP)	21.4	21.5	22.3	22.0	22.1	22.3	22.5	22.8	23.0	23.1
Gross domestic investment (percent of GDP)	22.3	22.7	22.8	23.0	23.3	23.0	23.0	22.9	23.1	23.2
Public finance (percent of GDP)										
General government balance	-4.0	-3.9	-3.6	-3.4	-3.0	-3.0	-3.2	-1.8	-1.2	-0.8
Revenue	52.9	53.2	53.1	53.0	53.1	52.5	51.6	51.3	51.2	50.9
Expenditure	57.0	57.1	56.7	56.4	56.2	55.6	54.8	53.1	52.4	51.7
Structural balance (percent of pot. GDP)	-2.4	-2.3	-2.0	-1.9	-1.8	-2.2	-2.6	-1.6	-1.2	-1.0
Primary balance	-1.9	-1.9	-1.7	-1.7	-1.4	-1.4	-1.5	-0.1	0.5	0.9
General government gross debt	92.3	94.9	95.6	96.3	96.8	97.0	97.0	95.6	93.6	91.2
Labor market (percent change)										
Employment	0.1	0.8	0.2	0.6	0.7	0.5	0.5	0.5	0.4	0.4
Labor force	0.6	0.7	0.3	0.3	0.0	0.0	0.1	0.1	0.1	0.1
Unemployment rate (percent)	10.3	10.3	10.4	10.0	9.5	9.0	8.7	8.3	8.0	7.8
Total compensation per employee	1.3	0.9	1.0	1.1	...	...	...	...	...	...
Credit and interest rates (percent)										
Growth of credit to the private non-financial sector	1.3	1.9	3.2	4.1	5.2	5.8	6.1	6.4	6.7	7.7
Money market rate (Euro area)	0.1	0.1	-0.2	...	...	...	...	...	...	...
Government bond yield, 10-year	2.2	1.7	0.8	0.5	...	...	...	...	...	...
Balance of payments (percent of GDP)										
Exports of goods	20.7	20.4	21.0	20.7	21.0	20.6	20.9	21.3	21.8	22.1
Imports of goods	-22.7	-22.3	-22.1	-21.9	-22.4	-21.7	-21.8	-22.0	-22.5	-22.8
Trade balance	-2.8	-2.6	-1.9	-2.0	-2.3	-2.0	-1.8	-1.6	-1.6	-1.6
Current account	-0.9	-1.3	-0.4	-1.0	-1.1	-0.8	-0.5	-0.2	-0.1	-0.1
FDI (net)	-0.5	1.7	-0.1	0.1	0.2	0.4	0.5	0.6	0.8	0.9
Official reserves (US$ billion)	50.8	49.5	55.2	56.1	...	...	...	...	...	...
Exchange rates										
Euro per U.S. dollar, period average	0.75	0.75	0.90	0.90	...	...	...	...	...	...
NEER, ULC-styled (2000=100)	102.1	101.9	97.9	98.7	...	...	...	...	...	...
REER, ULC-based (2000=100)	99.7	98.2	92.7	92.0	...	...	...	...	...	...
Potential output and output gap										
Potential output (change in percent)	1.0	1.0	1.0	1.0	1.1	1.3	1.4	1.4	1.5	1.5
Memo: per working age person	0.6	0.6	0.6	0.6	0.6	0.8	1.0	1.0	1.1	1.1
Output gap	-2.4	-2.5	-2.4	-2.2	-1.8	-1.3	-0.8	-0.3	0.0	0.3

Sources: Haver Analytics, INSEE, Banque de France, and IMF Staff calculations.

Table 4. France: General Government Accounts, 2013–2022
(In percent of GDP unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019[4/]	2020	2021	2022
					Projections					
General government										
Revenue	52.9	53.2	53.1	53.0	53.1	52.5	51.7	51.3	51.2	50.9
Tax revenue	45.3	45.5	45.5	45.5	45.5	44.9	44.1	43.7	43.6	43.3
Nontax revenue	7.6	7.6	7.6	7.5	7.6	7.6	7.6	7.6	7.6	7.6
Expenditures	57.0	57.1	56.7	56.4	56.2	55.6	54.8	53.1	52.4	51.7
Primary exp.	54.7	54.9	54.7	54.5	54.4	53.9	53.0	51.4	50.6	49.9
Debt service	2.3	2.2	2.0	1.9	1.8	1.7	1.8	1.8	1.8	1.8
Balance 1/	-4.0	-3.9	-3.6	-3.4	-3.0	-3.0	-3.2	-1.8	-1.2	-0.8
Primary balance	-1.9	-1.9	-1.7	-1.7	-1.4	-1.4	-1.5	-0.1	0.5	0.9
Structural balance 2/	-2.4	-2.3	-2.0	-1.9	-1.8	-2.2	-2.6	-1.6	-1.2	-1.0
Central government balance 1/	-3.3	-3.5	-3.3	-3.3	-2.9	-3.0	-3.2	-1.8	-1.3	-0.9
Social security balance 1/	-0.4	-0.4	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.1	0.1
Local government balance 1/	-0.4	-0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
ODAC balance 1/	0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Gross debt 3/	92.3	94.9	95.6	96.3	96.8	97.0	97.0	95.6	93.6	91.2
Memorandum items:										
Nominal GDP (in billion of Euros)	2,115	2,148	2,194	2,229	2,283	2,351	2,429	2,513	2,601	2,692
Potential nominal GDP (in billion of Euros)	2,167	2,203	2,248	2,280	2,325	2,382	2,449	2,521	2,600	2,683
Real GDP growth (in percent)	0.6	0.9	1.1	1.2	1.6	1.8	1.9	1.9	1.9	1.8
Nominal expenditure growth	1.6	1.7	1.4	1.1	2.0	1.9	1.9	0.3	2.0	2.1
Real expenditure growth (in percent)	0.9	1.3	1.3	0.7	0.9	0.6	0.3	-1.3	0.3	0.3
of which: primary	1.5	1.6	1.6	1.0	1.1	0.7	0.1	-1.5	0.2	0.2
of which: structural primary	1.5	1.7	1.4	1.0	1.3	0.8	0.2	-1.4	0.2	0.3

Sources: INSEE and IMF Staff calculations.
1/ Maastricht definition.
2/ In percent of potential GDP.
3/ The debt figure, based on Maastricht definition, does not include guarantees on nongeneral government debt.
4/ The conversion of the CICE (tax credit) into a tax cut reduces both taxes (starting in 2019) and expenditures (starting in 2020). In 2019, firms will receive both a tax credit based on 2018 employment and the tax cut on current employment leading to a one off effect.

Table 5. France: Balance of Payments, 2013–2022
(In percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
							Projections			
Current account	-0.9	-1.3	-0.4	-1.0	-1.1	-0.8	-0.5	-0.2	-0.1	-0.1
Net exports of goods	-2.0	-2.0	-1.1	-1.2	-1.4	-1.1	-0.9	-0.7	-0.7	-0.7
Exports of goods	20.7	20.4	21.0	20.7	21.0	20.6	20.9	21.3	21.8	22.1
Imports of goods	22.7	22.3	22.1	21.9	22.4	21.7	21.8	22.0	22.5	22.8
Net exports of services	0.9	0.7	0.4	0.2	0.3	0.4	0.5	0.6	0.6	0.6
Exports of services	9.0	9.6	9.9	9.9	10.0	9.7	9.9	10.0	10.3	10.5
Imports of services	8.1	8.9	9.5	9.7	9.7	9.4	9.4	9.5	9.7	9.8
Income balance	2.3	2.2	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Current transfers	-2.1	-2.2	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Capital and financial account										
Capital account	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	-0.7	-0.4	-0.6	-0.9	-1.0	-0.7	-0.4	-0.1	0.0	0.0
Direct investment	-0.5	1.7	-0.1	0.1	0.2	0.4	0.5	0.6	0.8	0.9
Portfolio investment	-2.8	-0.8	2.1	1.6	1.1	1.1	1.1	1.0	0.7	0.4
Financial derivatives	-0.8	-1.1	0.5	0.6	0.8	0.9	1.0	1.1	1.3	1.4
Other investments net	3.5	-0.1	-3.4	-3.3	-3.3	-3.2	-3.1	-3.0	-2.9	-2.8
Reserve assets	-0.1	0.0	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions	0.1	0.8	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Haver Analytics, Banque de France, and IMF Staff calculations.

Table 6. France: Vulnerability Indicators, 2009–2016

(In percent of GDP unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016
External Indicators								
Exports (annual percentage change, in U.S. dollars)	-19.6	7.0	15.9	-3.4	5.1	2.1	-12.1	0.6
Imports (annual percentage change, in U.S. dollars)	-19.7	8.1	16.7	-5.3	4.0	2.7	-13.6	1.4
Terms of trade (annual percentage change)	2.6	-1.4	-2.4	-0.3	1.1	1.2	3.1	0.8
Current account balance	-0.8	-0.8	-1.0	-1.2	-0.9	-1.3	-0.4	-1.0
Capital and financial account balance	-1.0	-1.2	-2.5	-1.8	-0.6	-0.3	-0.5	-0.8
Of which								
Inward portfolio investment (debt securities, etc.)	16.2	4.3	3.6	1.0	4.9	4.1	0.2	2.3
Inward foreign direct investment	0.7	1.4	1.5	1.2	1.1	0.2	1.8	1.4
Other investment (net)	7.9	4.0	8.4	-0.1	3.5	-0.1	-3.4	-3.3
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	46.6	55.8	48.6	54.2	50.8	49.5	55.2	56.1
Euros per U.S. dollar (period average)	0.7	0.8	0.7	0.8	0.8	0.8	0.9	0.9
Market Indicators								
Financial Markets								
Public sector debt 1/	78.9	81.6	85.2	89.5	92.3	94.9	95.6	96.3
3-month T-bill yield (percentage points)	0.6	0.4	0.7	0.0	0.0	0.1	-0.2	-0.6
3-month T-bill yield in real terms (percentage points)	-0.3	-1.4	-1.8	-1.3	-0.7	0.00	-0.38	-1.17
US 3 month T-bill	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.3
Spread with the US T-bill (percentage points)	0.5	0.2	0.6	0.0	0.0	0.03	-0.25	-0.87
10-year government bond (percentage points)	3.6	3.1	3.3	2.5	2.2	1.7	0.8	0.5
10-year government bond (United States)	3.3	3.2	2.8	1.8	2.4	2.5	2.1	1.8
Spread with US bond (percentage points)	0.4	-0.1	0.5	0.7	-0.1	-0.9	-1.3	-1.4
Yield curve (10 year - 3 month, percentage points)	3.0	2.7	2.6	2.5	2.2	1.6	1.0	1.0
Stock market index (period average, 1995=100)	178.6	200.3	192.1	179.0	211.1	231.7	258.2	236.1
Real estate prices (index, Q1-10=100, period average)	98.5	103.5	109.7	109.1	106.8	104.9	102.9	103.9
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	-0.7	5.6	4.4	2.0	0.5	0.5	2.5	4.3
Bank credit to households	2.9	6.0	5.8	2.1	2.4	-1.9	2.6	3.5
Housing Loans	3.7	8.2	6.2	3.0	4.0	-2.7	3.4	4.7
Bank credit to nonfinancial enterprises	-2.1	1.4	4.7	-0.2	-1.1	2.7	3.5	4.2
Sectoral risk indicators								
Household sector								
Household savings ratio	16.2	15.8	15.7	15.1	14.3	14.7	14.3	14.0
Household financial savings ratio	7.1	6.5	6.1	5.6	5.3	6.1	…	…
Real estate household solvency ratio (index, 2001=100) 2/	102.0	99.4	100.9	98.2	98.5	…	…	…
Corporate sector								
Profitability of business sector (financial margin)	37.3	37.9	37.4	36.5	35.9	35.7	…	…
Investment ratio	20.0	20.4	21.0	21.0	21.1	21.4	…	…
Savings ratio	16.7	18.9	18.2	16.4	16.8	17.3	…	…
Self-financing ratio	77.7	85.6	80.3	72.3	73.7	74.9	…	…
Banking sector								
Share of housing loans in bank credit to the private sector	39.2	40.2	40.8	41.2	42.6	41.3	41.6	41.8
Share of nonperforming loans in total loans	3.6	3.5	3.5	4.0	4.5	4.0		…
Ratio of nonperforming loans net of provisions to capital	10.8	10.0	9.2	10.7	11.4	9.6	9.1	…
Liquid assets to total short-term liabilities 3/	150.1	144.4	136.3	164.0	165.2	178.5	17.5	…
Return on assets	0.3	0.6	0.4	0.3	0.4	0.4	0.6	…
Return on equity	6.4	11.8	8.2	6.6	8.1	6.2	9.2	…
Regulatory capital to risk-weighted assets	12.4	12.5	12.2	14.0	15.1	15.3	16.6	…

Sources: French authorities; INSEE; BdF; ECB; Haver; Credit Logement; IMF, International Financial Statistics; and Bloomberg.

1/ The debt figure does not include guarantees on non-general government debt.

2/ This index combines the effect of real disposable income, repayment conditions for loans, real estate prices, and interest subsidies.

3/ 2015 data is based on new methodology which is not comparable to older figures

Table 7. France: Core Financial Soundness Indicators, 2009–2016

	2009	2010	2011	2012	2013	2014	2015	2016 Estimate
Deposit-taking institutions 1/								
Regulatory capital to risk-weighted assets	12.4	12.5	12.2	14.0	15.1	15.3	16.6	17.4
Regulatory Tier I capital to risk-weighted assets	10.2	10.7	10.9	13.3	13.2	13.6	13.8	14.5
Nonperforming loans net of provisions to capital	10.8	10.0	9.2	10.7	11.4	9.6	9.1	9.2
Bank provisions to Nonperforming loans	109.5	112.0	115.3	106.7	104.7	103.8	104.2	103.0
Nonperforming loans to total gross loans	3.6	3.5	3.5	4.0	4.5	4.0	3.9	3.9
Sectoral distribution of loans to total loans, of which	0.0	0.00	0.0	0.0	0.0	0.0	0.0	0.0
Deposit-takers	5.0	36.5	40.2	40.7	39.2	39.1	38.5	38.6
Nonfinancial corporation	17.5	20.5	19.2	18.8	19.0	19.5	18.8	19.1
Households (including individual firms)	24.5	30.5	28.7	28.9	30.3	29.8	28.1	28.1
Nonresidents (including financial sectors)	4.6	6.1	5.9	5.6	5.4	5.5	5.3	5.3
ROA (aggregated data on a parent-company basis) 2/	0.4	0.3	0.0	0.2	0.4	0.2	0.3	0.7
ROA (main groups on a consolidated basis) 3/	0.3	0.6	0.4	0.3	0.4	0.4	0.6	0.5
ROE (aggregated data on a parent-company basis) 2/	8.2	7.9	1.2	5.5	10.1	4.4	7.7	14.8
ROE (main groups on a consolidated basis) 3/	6.4	11.8	8.2	6.6	8.1	6.2	9.2	8.4
Interest margin to gross income	34.9	49.4	51.5	41.4	43.7	44.1	41.3	41.3
Noninterest expenses to gross income	63.1	65.7	67.4	63.2	66.5	67.8	65.5	65.3
Liquid assets to total assets 4/	18.3	23.0	24.1	26.2	30.6	27.1	12.5	12.6
Liquid assets to short-term liabilities 4/	150.1	144.4	136.3	164.0	165.2	178.5	17.5	19.9

Sources: Banque de France, ACPR

1/ These may be grouped in different peer groups based on control, business lines, or group structure.
2/ All credit institutions' aggregated data on a parent-company basis.
3/ Consolidated data for the seven main banking groups (2005, IFRS).
4/ 2015-16 data is based on new methodology which is not comparable to older figures

Table 8. France: Encouraged Financial Soundness Indicators, 2009–2016

(In percent unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015	2016 Estimate
Corporate sector								
Total debt to equity	79.2	73.8	80.0	86.0	79.3	86.0	89.4	90.3
Return on equity	8.3	7.9	8.8	7.8	7.0	6.8	6.7	6.5
Interest paid to financial firms 1/	...	...	...	...	...	...	...	...
Corporate net foreign exchange exposure to equity	...	...	...	...	...	...	...	...
Number of enterprise bankruptcies (thousands)	63.2	60.3	59.5	61.1	62.5	62.4	63.2	58.1
Number of enterprise creations (thousands)	580.2	622.0	549.8	550.0	538.2	550.8	525.1	554.0
Deposit-taking institutions								
Capital (net worth) to assets	4.5	4.6	5.5	4.8	5.5	5.8	6.3	6.4
International consolidated claims of French banks, of which (BIS data, as percent of total international claims)								
Advanced countries	83.3	79.8	79.4	78.0	78.6	77.6	77.5	77.0
Developing Europe	4.6	5.7	6.0	7.1	6.8	6.7	6.6	6.5
Latin America and Caribbean	1.2	1.4	1.4	1.5	1.4	1.5	1.8	1.7
Africa and Middle East	3.5	4.4	5.1	5.2	4.2	4.3	4.4	4.7
Asia and Pacific Area	2.9	4.0	3.6	4.1	4.8	5.6	4.6	4.8
Offshore Financial Centers	4.4	4.7	4.6	4.1	4.2	4.4	4.1	4.3
Gross asset position in financial derivatives to capital	362.7	286.2	388.8	346.2	205.8	238.2	190.2	175.3
Gross liability position in financial derivatives to capital	361.9	286.7	388.0	346.0	206.8	238.7	188.1	174.1
Large exposures to capital	4.1	14.1	26.9	7.6	5.4	5.5	6.1	6.1
Trading income to total income	16.4	10.3	-13.2	6.4	10.6	-0.1	-6.7	-7.6
Personnel expenses to noninterest expenses	61.1	44.9	42.1	36.0	32.7	35.1	34.2	44.0
Spread between reference lending and deposit rates	236.4	244.4	224.7	217.2	217.7	229.9	228.0	
Spread between highest and lowest interbank rate	...	...	...	...	...	...		
Customer deposits to total (noninterbank) loans	85.3	79.5	78.4	67.9	70.1	82.6	84.5	82.0
FX loans to total loans 2/	10.4	9.8	8.9	8.4	7.6	8.0	8.4	8.7
FX liabilities to total liabilities	15.3	16.4	15.4	13.9	14.3	16.2	17.6	19.4
Net open position in equities to capital	...	...	...	...	...	...		
Market liquidity								
Average bid-ask spread in the securities market 3/	...	...	...	...	...	...		
Average daily turnover ratio in the securities market	...	...	...	...	...	...		
Other financial corporations								
Assets to total financial system assets	16.5	16.8	15.7	16.2	17.1	17.3	17.0	17.2
Assets to GDP	176.5	183.5	172.0	182.1	194.8	205.7	205.8	212.2
Households								
Household debt to GDP	51.8	53.0	54.1	54.5	54.9	55.2	55.9	57.0
Household debt service and principal payments to income	10.6	12.9	12.7	12.2	12.7	11.2	9.9	11.6
Real estate markets								
Real estate prices	-4.1	7.6	3.7	-2.1	-1.8	-2.5	-0.5	1.6

Sources: Banque de France ; ACPR ; BIS

1/ In percent of financial firms' gross operating surplus.
2/ Data cover interbank and customer lending to residents and nonresidents on a metropolitan basis.
3/ Or in other markets that are most relevant to bank liquidity, such as foreign exchange markets.

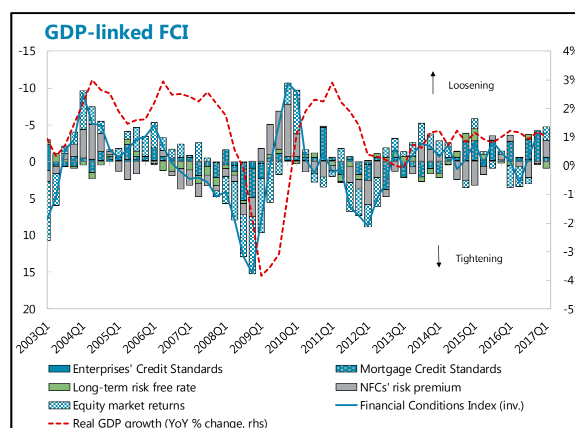
Annex I. External Sector Assessment

	France	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. After broad balance in the four years before the global crisis, the net international investment position (NIIP) has deteriorated to around -20 percent of GDP by 2016Q3. The deterioration in NIIP has been mainly driven by increases in public sector liabilities, reflecting rising public debt held by foreigners. In fact, TARGET2 liabilities are small, reaching €14 billion (0.6 percent of GDP) by end-2016. However, the net position masks large gross positions, particularly for financial institutions, reflecting their global activities. The gross asset position has been increasing since 2014, and stood at over 300 percent of GDP in 2016. More than three-quarters of French bank exposures are to advanced economies, with the share of major emerging market exposures now reaching 8 percent of total foreign claims. The value of emerging market exposures could fall in the medium-term, causing a moderate decline in the gross asset position and in the net IIP. Public external debt accounts for about 19 percent of the gross liability position. **Assessment**. The NIIP is negative but its size and trajectory do not raise sustainability concerns. However, there are vulnerabilities due to the external public debt and bank funding on the liability side.	**Overall Assessment** *The external position in 2016 was weaker than the level consistent with medium-term fundamentals and desirable policy settings*. The weakening of the external position since the late 1990s has been associated with an increase in fiscal deficits, a decline in private net savings, robust real wage growth, and a strong appreciation of the euro in the pre-crisis years. However, recent developments suggest that the external position is strengthening. **Potential Policy Responses** Continued wage moderation (especially of the minimum wage), additional reforms of the labor market, and productivity-enhancing measures (increasing competition in product markets and further regulatory simplification) would help strengthen competitiveness. Along with the planned gradual elimination of the fiscal deficit over the medium term, these measures should help correct the external imbalance (as well as promote growth).
Current account	**Background**. The current account (CA) has deteriorated from a surplus of almost 4 percent of GDP in the late 1990s to an estimated deficit of 1.0 percent in 2016 (the cyclically-adjusted deficit is estimated at 1.7 percent of GDP), driven by a progressive weakening of the goods balance and growing deficits in net current transfers between residents and non-residents (net secondary income). This deterioration was associated with declines in both private net savings and an increase in government deficits. Exports in 2016 were particularly weak, although this partly reflected temporary factors including a drop in tourism revenues following the terror attacks, and lower exports of grains and wine due to unfavorable weather. The CA is projected to deteriorate in 2017 to -1.1 percent of GDP, reflecting the adverse effect of higher oil prices. This effect is expected to dominate the positive combined effect of the unraveling of the 2016 one-off shocks and of the strengthening of global demand. **Assessment**. The staff assesses the 2016 cyclically-adjusted CA to be 1.8 to 3.8 percent of GDP below its norm. This is consistent with the EBA model estimate that the cyclically-adjusted CA is about 2.8 percent of GDP weaker than the value consistent with medium-term fundamentals and desirable policy settings. 1/ Recent developments, including the depreciation of the euro, more favorable terms of trade, and a gradual rebound from one-off shock, suggest some moderate strengthening of the external position after 2017. Over the medium term, the CA deficit is projected to gradually move into balance as exports grow along with external demand, imports pick up in line with private domestic demand, while the fiscal deficit narrows.	
Real exchange rate	**Background**. Following a gradual decline after the global financial crisis that amounted, cumulatively, to about 10 percent, the REER, measured on both ULC and CPI bases, appreciated modestly in 2016, by about ½ percent compared to 2015. **Assessment**. The EBA Level REER regression model estimates a 6.9 percent overvaluation, while the overvaluation suggested by the staff's assessment of the CA gap is a range of about 8 to 14 percent using standard trade elasticities. The EBA Index REER model, on the other hand, estimates an undervaluation of -2.3 percent. Taking into account the superior fit of the CA model for France, as well as the evidence from ULC and the Level regression model, the staff assessment is that the REER is 8–14 percent overvalued. 2/	
Capital and Financial accounts: flows and policy measures	**Background**. The current account deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Flows in financial derivatives have grown sizably on both the asset and liability side since 2008. The capital account is open. **Assessment**. France remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities.	
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.	
Technical Background Notes	1/The new assessed CA gap midpoint of -2.8 percent (about 1.9 percentage points wider than last year) reflects proportionally a wider estimate of the gap from the EBA model, given a larger cyclically-adjusted deficit and broadly unchanged fundamentals. 2/ The ULC-based REER has appreciated slightly in recent quarters, adding to past competitive losses. Taking all these inputs into account, staff assesses the 2016 REER to be 8–14 percent overvalued.	

Annex II. Incorporating Macro-Financial Linkages into Forecasts Using Financial Conditions Indices[1]

Information on financial conditions can be used to improve macroeconomic projections in the case of France. We investigate this question by constructing country-specific financial conditions indices (FCIs) that are tailored to movements in GDP, investment, private consumption and exports respectively.

1. Main conclusions. Financial conditions are captured by a combination of the equity market return, the risk-free rate, a sector-specific interest rate premium, and credit standards.



- Financial conditions, especially stock market returns and credit spreads, are strong leading indicators and have an effect primarily on enterprise investment, and to a lesser extent on exports. By contrast, households' consumption is contemporaneously impacted by changes in financial conditions, perhaps because of wealth effects, the impact on wealth expectations, or common shocks on consumer and market sentiment.

- Even though bank lending is the predominant form of financing in France, equity market returns are the strongest leading indicator across all three macroeconomic components and GDP itself, likely capturing investor sentiment and market expectations of future economic activity, rather than a direct impact of greater ease of financing through the stock market.

- Interest rates, spreads, and credit standards provide additional early information on short-term economic prospects. Bank credit growth turns out to be a lagging indicator of economic activity—in fact, our main FCI helps predict not only economic activity but also credit growth.

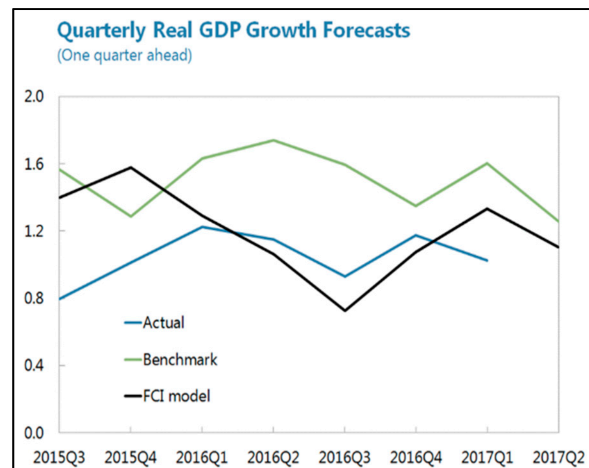
2. Methodology. Our FCI is constructed in a two-step vector autoregressive (VAR) approach to construct each FCI:

- We select the components of each FCI that can best predict in a VAR each of the four macroeconomic aggregates (GDP, consumption, investment and exports) based on statistical criteria and sign restrictions that are consistent with economic theory. The weights of these financial variables in each specific FCI are directly linked to the impact they have on the growth rate of the targeted macro variable.

[1] Prepared by Thierry Tressel (EUR). Based on Piyabha Kongsamut, Christian Mumssen, Anne-Charlotte Paret, and Thierry Tressel, 2017, "Incorporating Macro-Financial Linkages Into Forecasts Using Financial Conditions Indices—the case of France", forthcoming IMF WP.

- Once selected, we aggregate the variables into FCIs using weights derived from their historical co-movements and their cumulative impact on the targeted macroeconomic aggregates.

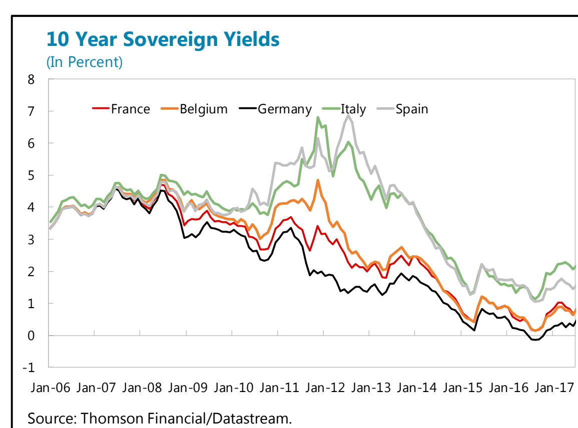
- Using another set of VARs, we show that each FCI can help improve predictions of future real GDP, consumption, investment and real exports one to three quarters ahead. Depending on which macroeconomic component is considered, these VARs take into account macroeconomic and price dynamics, as well as oil prices, world growth, the real effective exchange rate or the change in unemployed labor force. The FCIs also help improve monthly "now-cast" models of current quarterly macroeconomic variables using higher frequency information.



Appendix III. Debt Sustainability Analysis[1]

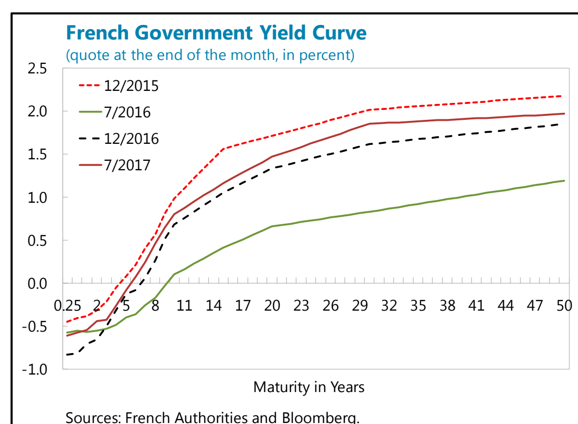
Under the baseline scenario, the debt-to-GDP ratio is projected to peak at 97 percent in 2019 and to decline to 91.2 percent by 2022 as economic recovery gains traction and the primary balance shifts to a surplus starting in 2021. Due to the maturity structure of the French debt, gross financing needs peaked at 9 percent of GDP in 2016.[2] The debt-to-GDP ratio in 2016 is better than forecast previously mainly due to the base effect of the downward revision of the 2015 debt ratios and high emission premium. Public debt is expected to be above 90 percent of GDP throughout the projection period and presents vulnerabilities as illustrated by the stress scenarios. The debt ratio would be bumped up significantly in the event of a growth shock. The impact of slower fiscal consolidation and higher interest rate remains comparatively more limited.

1. **Background.** The combined effect of low growth over several years and the persistence of high fiscal deficits, augmented by the fiscal stimulus of 2009, have increased the debt-to-GDP ratio by 32 percentage points in eight years, to 96.3 percent in 2016. Despite ongoing fiscal consolidation, the debt ratio is projected to continue to increase in the short term, peaking at 97 percent of GDP in 2019, and decline thereafter.



Source: Thomson Financial/Datastream.

Yields on French debt remain at a historical low. Despite a rebound since the trough of July 2016. the benchmark yield (10 years) has declined from 4.7 percent in end-June 2008 to 0.8 percent end-July 2017. The spreads over German Bunds, which had increased to almost 190 basis points in November 2011, were at 37 basis points on August 9, 2017.



Sources: French Authorities and Bloomberg.

Owing to the sharp decline in interest rates and inflation,[3] the rising debt has had a limited impact on the debt service. Interest payments were at the historically low level of 1.9 percent of GDP in 2016.[4]

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[1] Prepared by Jean-Jacques Hallaert (EUR).

[2] Financing needs would increase in 2019 due to the one-off fiscal impact of the conversion of the CICE from a tax credit to a tax cut.

[3] About 11 percent of French debt is indexed on inflation (at end-March 2017, 62 percent of inflation-linked debt was indexed on euro area inflation and 38 percent on domestic inflation).

[4] This is the lowest level since 1982 when the debt-to-GDP ratio was at 25 percent.

2. Baseline. Staff projects that the debt-to-GDP ratio will peak at 97 percent in 2019 and then decline to 91.2 percent in 2022. Effective interest rate is projected to decline further until 2018 before increasing to reach 2 percent in 2022. Thus, interest payments would remain at a historically low level but are projected to decline to 1.7 percent of GDP in 2018 and before stabilizing at 1.8 percent of GDP until 2022.

- **Macroeconomic assumptions.** Recent growth performance has been affected by the weak external environment and the drag caused by large structural fiscal adjustment in 2011–13. Though growth remains mediocre, the recovery is solidifying: the economy grew by 1.2 percent in 2016, and growth is expected to rebound to 1.6 percent in 2017 and then rise to about 1.9 percent by the end of the projection period, with the output gap closed in 2021.

- **Fiscal outlook.** The pace of structural adjustment has slowed and is now near zero. Reaching 1 percentage point per year in 2011–13, it has slowed to 0.2 percentage point per year in 2014–16, and is projected, in the baseline, to average 0.1 percent during 2017–22. Primary balance would be above its debt stabilizing level starting in 2020 and shift to a surplus in 2021.

- **Debt levels and gross financing needs.** The gross financing needs remain below the 20 percent threshold even under the stress tests. Part of the increase in the debt ratio reflects financial support to other Euro area countries which grew from 0.2 percent of GDP in 2010 to 3.2 percent of GDP in 2014.[5] This support started to decline in 2015 and amounted to 3.0 percent of GDP in 2016.

3. Realism of Projections. The median forecast error for real GDP growth during 2008–16 is -0.70 percent suggesting there is an upward bias in staff projections. The median forecast bias for inflation stands at -0.24 percent suggesting again a slight upward bias in staff projections. At -0.61 percent, the median forecast error for primary balance suggests that staff projections have proved somewhat optimistic.

The debt-to-GDP ratio in 2016 is lower by 0.8 percentage point than forecast in the Staff report for the 2016 Article IV Consultation. Most of the impact is explained by high emission premium[6] but also by the base effect of a downward revision of the debt ratio in 2015 that more than offset real GDP growth and higher primary deficit.

4. The projected fiscal adjustment appears feasible. Cross-country experience also suggests that fiscal adjustment projections are realistic. The projected adjustment and level of the CAPB are below the thresholds that would cast doubt on the feasibility of the adjustment, based on high debt country experience. More specifically, at 1.9 percent of GDP, the largest projected adjustment over

[5] Bilateral loans (direct and through the EFSF to Greece, Ireland, and Portugal) and contributions to the ESM.

[6] The interest rates on state auctioned debt were higher than the market rates. As a result, the debt was purchased at a higher value than its reimbursement value, which is used to calculate the debt under the Maastricht rules. High emission premium is the main reason why, in 2016, the increase in debt was 1.2 percent of GDP lower than the general government fiscal deficit.

any three years during the projection is below the threshold of 3 percent of GDP. In addition, the maximum average level of the cyclically-adjusted primary deficit for any consecutive 3-year period during the projection horizon reaches 0.5 percent of GDP, well below than the threshold of 3.5 percent of GDP.

5. Heat map. Risks levels from the debt level are deemed high given that the relevant threshold to which France's values are compared is 85 percent and this threshold is breached under baseline and all stress test scenarios. In contrast, France's gross financing needs remain below the benchmark of 20 percent of GDP in the baseline and all stress test scenarios. The debt profile remains below relevant thresholds except for the share of public debt held by non-residents. As of end-March 2017, non-residents held 57.7 percent of French debt, a level substantially lower than the peak of 70.6 percent reached early 2010 and lower than the end-2016 level of 58.5 percent.

6. Shocks and Stress Tests. The DSA framework suggests that France's government debt-to-GDP ratio would not exceed 105 percent and its gross financing needs would not exceed 12½ percent of GDP under different standard macroeconomic and fiscal shocks.

- **Growth shocks.** Under this scenario, real output growth rates are lower by one standard deviation over 2018–19, i.e. 1.5 percentage points relative to the baseline scenario. The assumed decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth) and the interest rate is assumed to increase 25 basis points for every 1 percent of GDP worsening of primary balance. Under this scenario, the debt-to-GDP ratio would increase to 104 percent of GDP in 2019 and declines thereafter.

- **Primary balance shock.** This scenario examines the implications of a dual shock of lower revenues and rise in interest rate, leading to a cumulative 1.5 percent deterioration in the primary balance over 2018–22. Under this scenario, the debt-to-GDP ratio would increase to 98.9 percent of GDP in 2019 and declines thereafter.

- **Interest rate shock.** This scenario assumes an increase of 280 basis points increase in the cost of debt throughout the projection period.[7] The deterioration of public debt and gross financing needs are back-loaded as old debt gradually matures[8] and new higher interest rate debt is contracted. In 2022, the impact on the gross financing needs is 0.9 percent of GDP and 2.1 percent of GDP for the debt-to-GDP ratio.

- **Real exchange rate shock.** This scenario assumes 13 percent devaluation of the real exchange rate in 2018 and examines the impact on debt through the inflation channel. Under this scenario, the debt-to-GDP ratio would be marginally larger (0.3 percentage point at most) than in the baseline.

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[7] Interest rate is increased by the difference between average real interest rate level over the projection period and maximum real historical level.

[8] As of end-June 2017, the average maturity of debt is 7 years and 228 days.

- **Combined macro-fiscal shock.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance while taking care not to double-count the effects of individual shocks. Under this scenario, debt would reach 104.3 percent of GDP in 2019 and decline to 100.1 percent of GDP in 2022. The gross financing needs would peak at 12.5 percent of GDP in 2019, which remains below the 20 percent benchmark considered by the heat map.

7. Views of the authorities. The authorities project a debt profile broadly similar to staff's. They do not consider that the relatively large share of public debt held by non-resident to be a vulnerability as investors in French debt are both institutionally and geographically diversified. Moreover, the authorities noted that a significant share of non-resident holders are central banks, which are stable purchasers with limited sensitivity to change in interest rates.

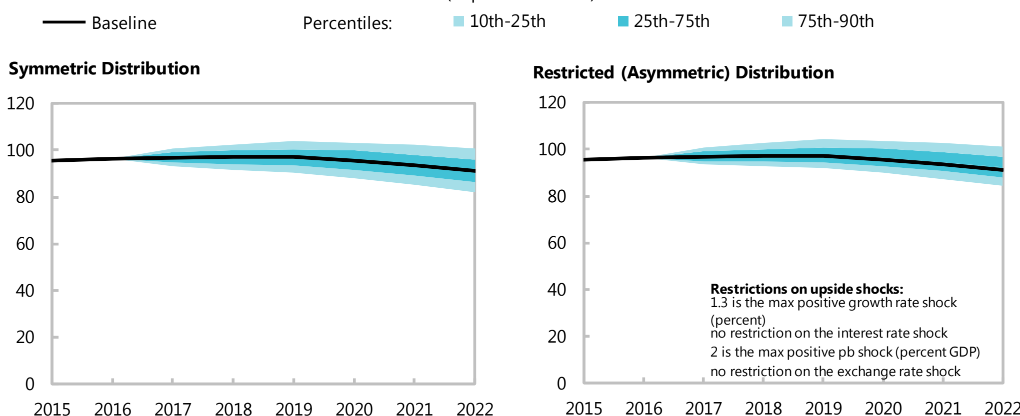
France Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

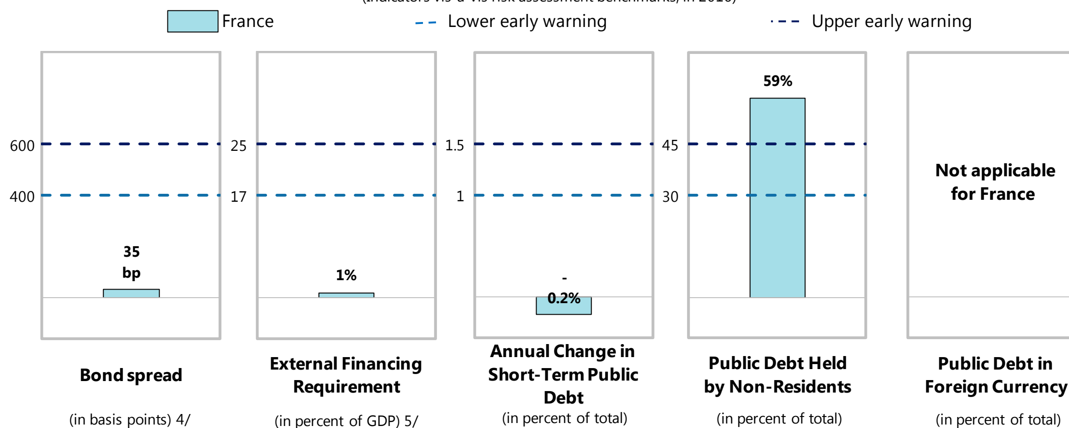
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

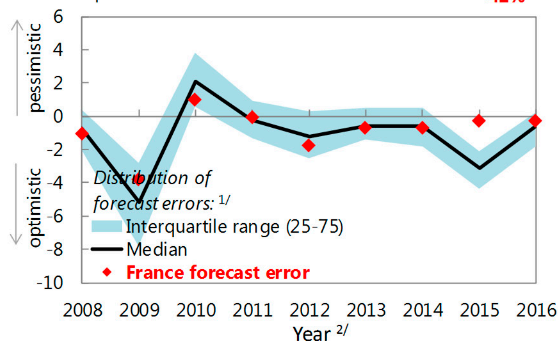
4/ Long-term bond spread over German bonds, an average over the last 3 months, 13-May-17 through 11-Aug-17.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

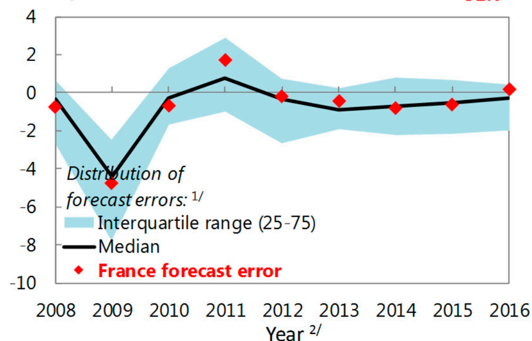
France Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

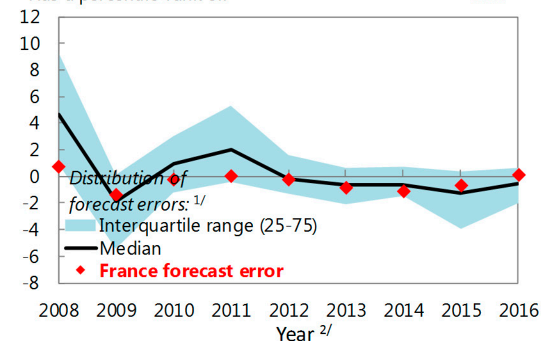
Real GDP Growth
(in percent, actual-projection)
France median forecast error, 2008-2016: **-0.70**
Has a percentile rank of: **42%**



Primary Balance
(in percent of GDP, actual-projection)
France median forecast error, 2008-2016: **-0.61**
Has a percentile rank of: **51%**

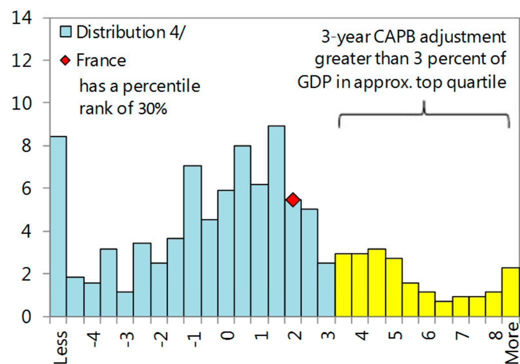


Inflation (Deflator)
(in percent, actual-projection)
France median forecast error, 2008-2016: **-0.24**
Has a percentile rank of: **50%**

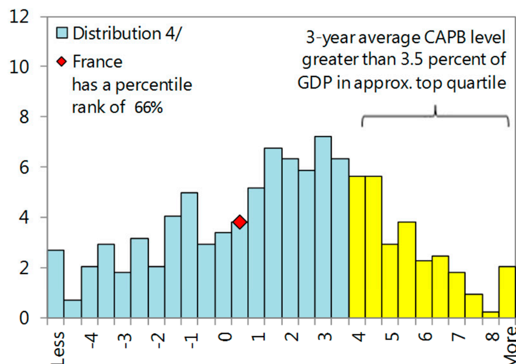


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

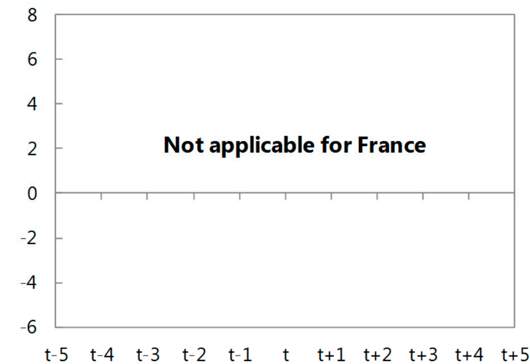


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for France, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

France Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

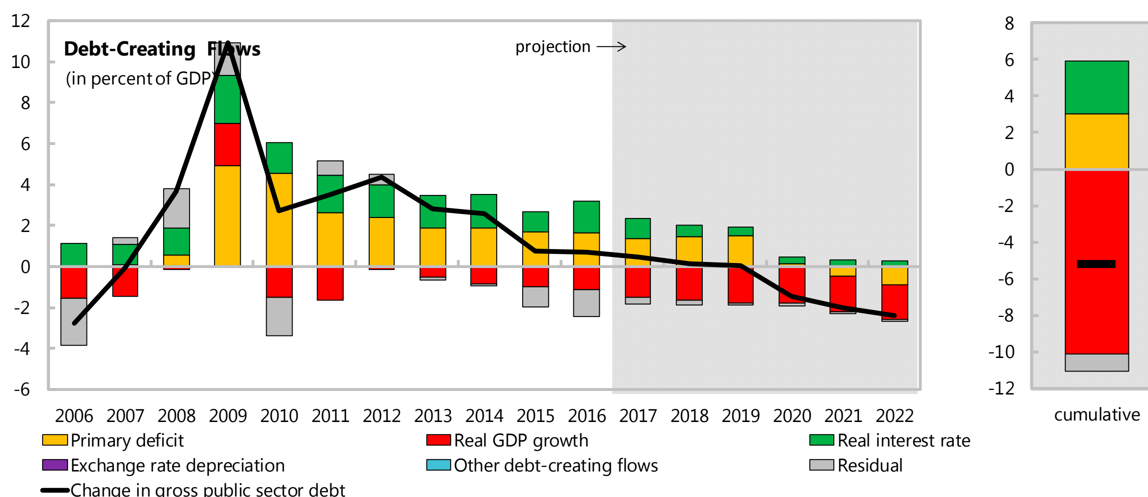
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	79.9	95.6	96.3	96.8	97.0	97.0	95.6	93.6	91.2
Public gross financing needs	8.8	8.9	9.0	8.2	8.9	9.7	7.5	5.5	4.4
Real GDP growth (in percent)	0.9	1.1	1.2	1.6	1.8	1.9	1.9	1.9	1.8
Inflation (GDP deflator, in percent)	1.3	1.1	0.4	0.8	1.2	1.4	1.5	1.6	1.7
Nominal GDP growth (in percent)	2.2	2.2	1.6	2.4	3.0	3.3	3.5	3.5	3.5
Effective interest rate (in percent) [4/]	3.4	2.2	2.0	1.9	1.8	1.9	1.9	1.9	2.0

As of August 11, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		30
5Y CDS (bp)		19
Ratings	Foreign	Local
Moody's	Aa2	Aa2
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	3.1	0.7	0.7	0.5	0.2	0.0	-1.4	-2.0	-2.4	-5.2	-1.4
Identified debt-creating flows	3.0	1.7	2.1	0.8	0.4	0.1	-1.3	-1.9	-2.3	-4.2	
Primary deficit	2.1	1.7	1.7	1.4	1.4	1.5	0.1	-0.5	-0.9	3.0	
Primary (noninterest) revenue and gra	50.7	53.0	52.9	53.0	52.4	51.5	51.2	51.1	50.8	310.1	
Primary (noninterest) expenditure	52.8	54.7	54.5	54.4	53.9	53.0	51.4	50.6	49.9	313.2	
Automatic debt dynamics [5/]	0.9	0.0	0.4	-0.5	-1.1	-1.4	-1.5	-1.4	-1.4	-7.2	
Interest rate/growth differential [6/]	0.9	0.0	0.4	-0.5	-1.1	-1.4	-1.5	-1.4	-1.4	-7.2	
Of which: real interest rate	1.6	1.0	1.5	1.0	0.6	0.4	0.3	0.3	0.3	2.9	
Of which: real GDP growth	-0.6	-1.0	-1.1	-1.5	-1.7	-1.8	-1.8	-1.7	-1.7	-10.1	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Eurc	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.1	-1.0	-1.3	-0.4	-0.2	-0.1	-0.1	-0.1	-0.1	-1.0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as $-g$.

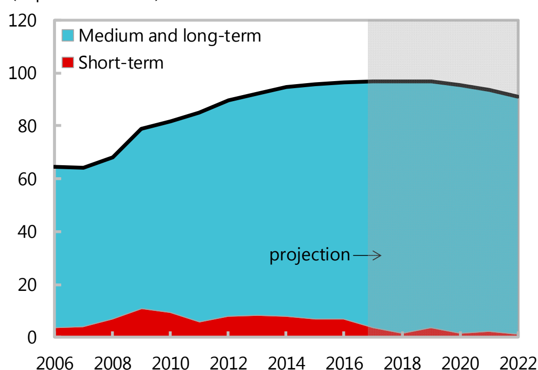
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

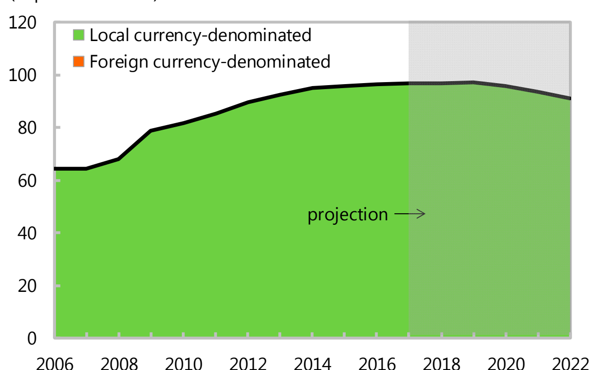
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

France Public DSA—Composition of Public Debt and Alternative Scenarios

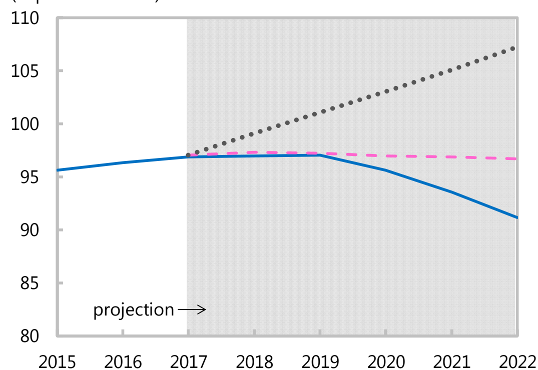
Composition of Public Debt

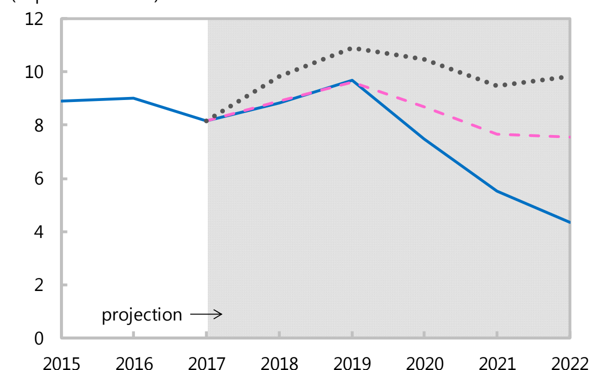




Alternative Scenarios

Baseline   Historical   Constant Primary Balance





Underlying Assumptions

(in percent)

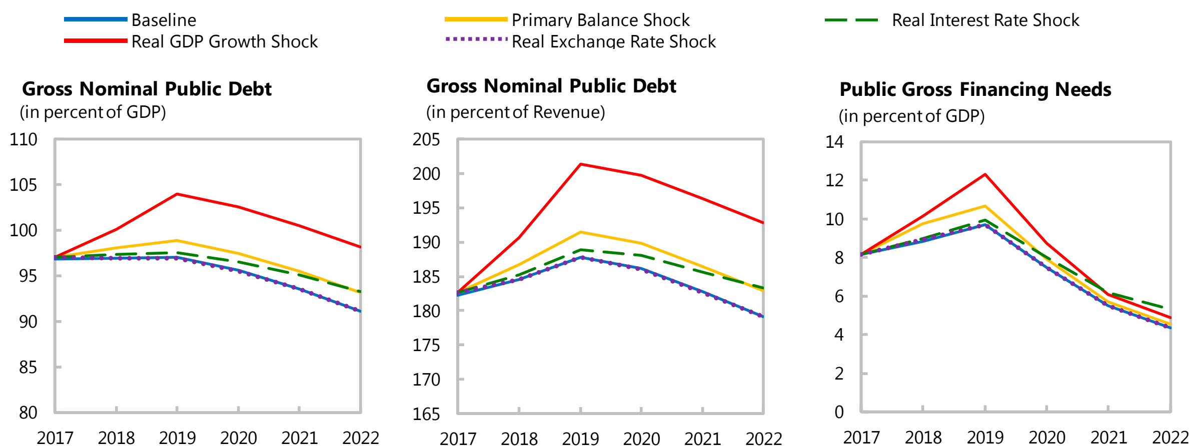
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.6	1.8	1.9	1.9	1.9	1.8
Inflation	0.8	1.2	1.4	1.5	1.6	1.7
Primary Balance	-1.4	-1.4	-1.5	-0.1	0.5	0.9
Effective interest rate	1.9	1.8	1.9	1.9	1.9	2.0
Constant Primary Balance Scenario						
Real GDP growth	1.6	1.8	1.9	1.9	1.9	1.8
Inflation	0.8	1.2	1.4	1.5	1.6	1.7
Primary Balance	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Effective interest rate	1.9	1.8	1.9	1.9	2.0	2.0

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.6	0.8	0.8	0.8	0.8	0.8
Inflation	0.8	1.2	1.4	1.5	1.6	1.7
Primary Balance	-1.4	-2.2	-2.2	-2.2	-2.2	-2.2
Effective interest rate	1.9	1.8	2.0	2.1	2.3	2.5

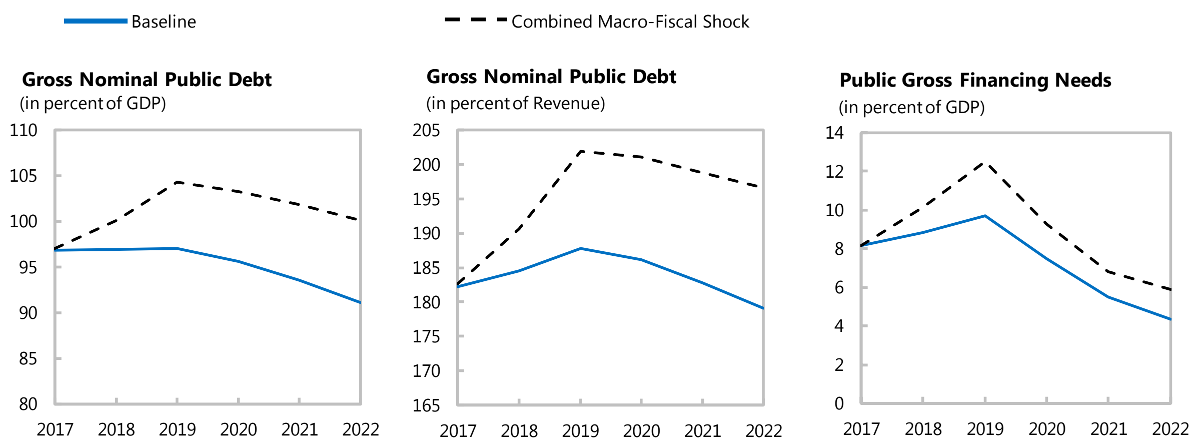
Source: IMF staff.

France Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.6	1.8	1.9	1.9	1.9	1.8
Inflation	0.8	1.2	1.4	1.5	1.6	1.7
Primary balance	-1.4	-2.2	-2.3	-0.1	0.5	0.9
Effective interest rate	1.9	1.8	1.9	1.9	2.0	2.1
Real Interest Rate Shock						
Real GDP growth	1.6	1.8	1.9	1.9	1.9	1.8
Inflation	0.8	1.2	1.4	1.5	1.6	1.7
Primary balance	-1.4	-1.4	-1.5	-0.1	0.5	0.9
Effective interest rate	1.9	1.8	2.1	2.3	2.5	2.7
Combined Shock						
Real GDP growth	1.6	0.3	0.4	1.9	1.9	1.8
Inflation	0.8	0.8	1.0	1.5	1.6	1.7
Primary balance	-1.4	-2.5	-3.5	-0.1	0.5	0.9
Effective interest rate	1.9	1.8	2.2	2.4	2.6	2.8

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.6	0.3	0.4	1.9	1.9	1.8
Inflation	0.8	0.8	1.0	1.5	1.6	1.7
Primary balance	-1.4	-2.5	-3.5	-0.1	0.5	0.9
Effective interest rate	1.9	1.8	1.9	2.0	2.1	2.1
Real Exchange Rate Shock						
Real GDP growth	1.6	1.8	1.9	1.9	1.9	1.8
Inflation	0.8	1.6	1.4	1.5	1.6	1.7
Primary balance	-1.4	-1.4	-1.5	-0.1	0.5	0.9
Effective interest rate	1.9	1.8	1.9	1.9	2.0	2.0

Source: IMF staff.

Annex IV. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Impact on France if Realized	Policy response
Policy and geopolitical uncertainties	**High** Global spillovers from difficult-to-predict US policies, and uncertainty regarding post-Brexit negotiation could exacerbate external imbalances, and capital flow volatility.	**Medium** France external position could deteriorate amidst worsened trade agreements within (notably vis-a-vis the UK) and outside the EU leading to lower growth and a slowdown of technological advances. Capital flows volatility could impact French banks which operate globally.	Continue to support trade liberalization and FTAs, and contribute to smooth and predictable Brexit, while re-doubling efforts to secure the benefits of economic integration and cooperation across EU.
Dislocation in labor flows, sharp rise in migrant flows, with negative global spillovers	**High** Sharp rise in migrant flows, with negative global spillovers.	**Medium** Potentially large medium-term fiscal impact depending on how fast migrants integrate into the workforce. Large flows can embolden populism and raise resistance to structural agenda.	Adopt proactive policies to integrate migrants, including active labor market policies, strengthening language and skill training.
Structurally weak growth in key advanced and emerging economies, notably China	**Medium** Weak demand and persistently low inflation in advanced economies could take a toll through trade, and confidence channels.	**Medium** Slower export growth and higher output gap can weaken public debt sustainability and private balance sheets.	Accelerate structural reforms that buttress competitiveness and productivity to lift potential growth and reduce structural unemployment.
Weak implementation of fiscal and structural policy commitments	**Medium** Political resolve for reform may wane in the face of protracted low growth and renewed popular discontent.	**Medium** Reversal of commitments could undermine investment and growth, adversely impact public debt dynamics, and eventually trigger adverse market reactions.	Opt for a policy strategy that involves an early locking in of reforms and a conservative fiscal path and effective implementation of anti-corruption measures.
Financial imbalances from protracted period of low interest rates	**Medium** Corporate leveraging increases, while margins of life insurers and mortgage lenders get squeezed. Search for yield results in asset price bubbles.	**Medium (over medium term)** Large refinancing of mortgages poses medium-term risk for bank profitability, while impact on life insurers may build over time (mitigated by annual adjustment of guaranteed rates of return).	Monitor lending standards and bank buffers and profitability. Monitor life insurance sector and take policy action as needed.
Unexpected financial regulatory changes	**Medium** Risks from regulatory uncertainty (e.g. on floors to internal risk models, leverage ratio)	**Medium (over medium term)** Banks could be required to raise more capital, reducing their profitability and ability to provide credit to the economy	Promote further restructuring and cost cutting efforts by banks.

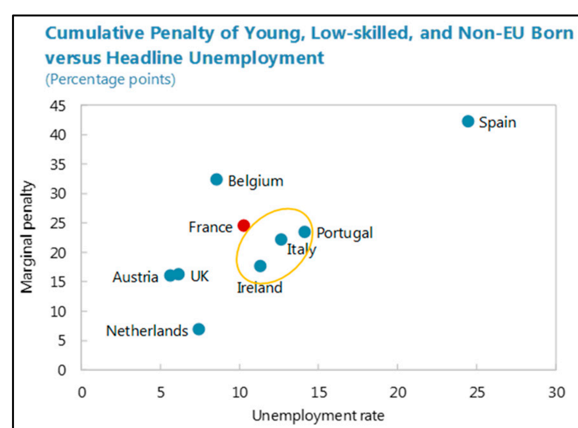
[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex V. Which Groups Are Most Vulnerable in France's Labor Market?[1]

1. **France's labor market is characterized by significant disparities across population subgroups, with some experiencing high and often long-term unemployment.** To better understand these phenomena, we estimated the relative likelihood of being out or in a job conditional on belonging to a certain socioeconomic group using a Probit regression model, with data is drawn from the micro census for France and other countries from the European Union Labor Force Survey (EU LFS). This methodology allows disentangling the impact on labor market performance of individual characteristics, for example, age, sex and country of birth. In addition, we use data from INSEE's Employment Survey (*Enquête d'emploi*) to analyze how these characteristics impinge on the duration of unemployment spells, as well as on the likelihood of exiting from a spell of unemployment.

2. **The results indicate that the young, low-skilled and immigrants from outside the EU are at a considerable disadvantage in finding a job.** Controlling for other personal characteristics, Table A1 shows probabilities of being unemployed or employed before and after the crisis, comparing France to other countries. The econometric analysis shows, for instance, that in 2012–14, young persons (15–24) had a 4.7 percentage point higher probability of being unemployed than prime age persons, controlling for other personal characteristics such as skill and immigration status. We also find that persons active in manufacturing are more likely to be unemployed compared to those active in services, although the difference is smaller than for the young, the low-skilled, and non-EU immigrants. These results broadly hold when considering conditional employment probabilities.

3. **The relative disadvantages of these subgroups are similar to countries that were strongly affected by the crisis, and higher than in other comparator countries.** For instance, for non-EU immigrants, the probability of being unemployed was 14.2 percent in 2012–14, twice as high as for natives in France. The percentage point difference in the unemployment probability of this sub-group was higher than in most other countries. The percentage point difference for the young and lower skilled was in between that of crisis-resilient and crisis-affected countries, while the relative disadvantage (i.e., the ratio of sub-group to base group probabilities) was high across all the three socio-economic groups. The combined probability of being unemployed for persons who are young, low-skilled, and not born in the EU is about 25 percentage points higher than for the non-vulnerable control group. This relative disadvantage is even higher than in countries that were harder hit by the crisis and thus have overall higher unemployment.



[1] Prepared by William Gbohoui (EUR).

4. Pre- and post-crisis comparisons suggest that the relative disadvantages of these subgroups are largely structural rather than crisis-induced. Compared to both crisis-resilient and crisis-affected comparator countries, (un)employment probabilities in France for the vulnerable socioeconomic groups have worsened by much less since the crisis. This suggests that the difficulties of these groups are mostly structural in nature, or at least more so than in other countries. In turn, this implies that vulnerable socio-economic groups may help explain why France has a relatively high level of structural unemployment. Based on a stylized calculation, policies that would reduce the probability of unemployment for the youth to the same level as for prime age persons could reduce the overall unemployment rate in France by about 2 percentage points. Similarly, better training or integrating lower skilled persons would also have an appreciable effect on overall unemployment, in particular on the structural component.

Table A1. Estimation Results

Dependent variable[1]:	Probability of being unemployed						Probability of being employed					
(In percentage point)	France		Crisis-Resilient Comparators[2]		Crisis-Impacted Comparators[3]		France		Crisis-Resilient Comparators		Crisis-Impacted Comparators	
	2005-07	2012-14	2005-07	2012-14	2005-07	2012-14	2005-07	2012-14	2005-07	2012-14	2005-07	2012-14
Age												
25-54 years (base probability)	6.3	7.8	3.3	4.2	4.8	13.7	87.0	85.6	91.4	90.4	88.3	78.7
15-24 years	5.4	4.7	2.3	3.0	2.6	6.4	-6.4	-7.0	-6.0	-6.7	-6.6	-17.9
55-64 years	-2.7	-2.6	-1.0	-1.0	-1.4	-3.7	-37.1	-25.7	-23.2	-20.4	-21.0	-15.4
Country of birth												
Native (base probability)	6.0	7.1	3.0	3.8	4.6	12.6	78.2	77.6	86.8	84.8	81.8	72.4
Non-EU born	6.0	7.1	5.1	4.8	2.2	5.7	-6.5	-7.7	-7.2	-7.0	-3.2	-4.8
Education												
Lower secondary(base probability)	9.0	11.0	5.4	6.8	6.1	18.0	72.4	70.5	81.3	78.2	77.8	64.6
Tertiary	-4.5	-5.6	-3.4	-4.0	-2.9	-9.2	10.9	12.6	9.4	10.5	10.0	15.5
Job sector												
Services (base probability)	6.2	7.4	3.5	4.4	4.5	12.1	78.5	77.8	86.3	84.2	82.0	72.8
Manufacture	1.3	2.0	0.0	0.1	1.0	5.8	-3.9	-4.4	-1.3	-1.3	-2.8	-7.3
Years of residency												
Less than 1 year (base probability)	18.2	29.8	7.7	8.9	7.0	22.8	41.5	38.3	72.4	70.6	74.0	52.0
4 years or more	-11.8	-22.1	-4.2	-2.4	-2.3	-9.5	36.3	38.8	17.9	14.0	7.7	19.8
Headline rate	**8.2**	**10.0**	**5.6**	**7.0**	**7.1**	**16.6**	**63.9**	**63.9**	**69.0**	**69.4**	**64.7**	**58.3**

[1] Coefficients indicate the margins (change in the probability of being (un)employed) compared to the base category, except for rows of base categories where they represent the probability to be (un)employed. All probabilities are conditional on the factors above and the following: gender, household composition, and vocational training status.

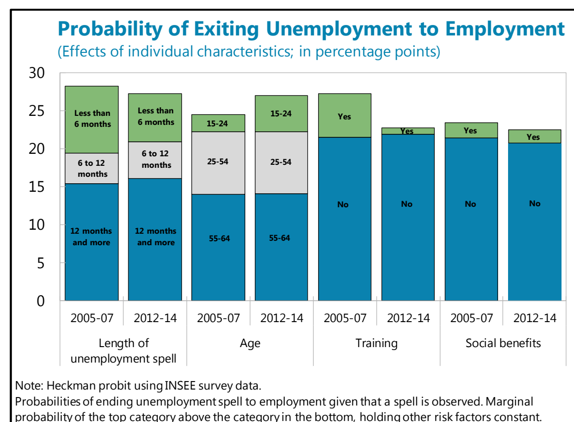
[2] Countries with mild labor market impact following the 2008 crisis: Austria, Belgium, Netherlands, and U.K..

[3] Countries with significant labor market impact following the 2008 crisis: Italy, Ireland, Portugal, and Spain.

5. Unemployment duration is estimated to be relatively high and has increased since the crisis, underscoring France's labor market inefficiencies in matching individuals to jobs, and difficulties to adapt to new economic conditions. On average, prime age workers, with less than lower secondary education, renting privately, with no previous work experience, no training, no social benefits stay unemployed for about 21 months (1 year and 9 months)—up from 16 months pre-crisis. Unemployment spells last longer if the worker is over 55 (unemployment spells for these workers last an additional 8 months, on average, compared to the 25–54, prime-age group), or low-

skilled (with spells lasting an additional 5 months for workers with no secondary education compared to those who reach tertiary education). Youth experience shorter spells (but still longer than 1 year) than prime age or over 55, reflecting primarily the greater share of fixed term contracts in use among the youth employment contracts.

6. Individual socio-economic factors are found to matter for the likelihood of finding a job. For instance, the longer workers have been unemployed, the lower the likelihood they will find a job, other things equal—plausibly reflecting gradual loss of motivation but also increasing loss of work skills. Youth are more likely to exit to employment, but their chance of returning to job has fallen since the crisis. The crisis has also worsened the chances of finding a job, after an unemployment spell, for the low-educated as for actives in construction and industry. Ignoring income, professional training pays off more than higher degrees in terms of returning to jobs after a spell of unemployment. By keeping workers in contact with the labor market, training and safety nets reduce the length of unemployment spells. Estimates show, however, that their effects are marginal and have been declining since the crisis.



Probability of Exiting Unemployment to Employment
(Effects of individual characteristics; in percentage points)

Note: Heckman probit using INSEE survey data.
Probabilities of ending unemployment spell to employment given that a spell is observed. Marginal probability of the top category above the category in the bottom, holding other risk factors constant.

7. Taken togeher, the analysis suggests that the vulnerabilities of key socio-economic groups can help partly explain why France has long experienced comparatively high structural unemployment. The relative labor market disadvantages of the young, the low-skiled, and immigrants from outside the EU are significant both before and after the crisis, exceeding those in countries with lower unemployment. This suggests that structural rigidities are particularly important for these groups. Hysteresis effects, in particular the observed correlation over time in the disadvantages of those who have experienced longer-term unemployment post crisis, may be another important factor explaining France's high level of structural unemployment. Addressing these rigidities through well-designed and targeted reforms—in particular professional training for the young and low-skilled, together with refomrs of the minimum wage formula and unemployment insurance—could be expected to help bring down structural unemployment by boosting employment rates among these vulnerable socio-economic groups.

INTERNATIONAL MONETARY FUND

FRANCE

September 5, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	The European Department

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FUND RELATIONS

(As of July 31, 2017)

Membership Status: Joined December 27, 1945; Article VIII.

General Resources Account	SDR Million	Percent of Quota
Quota	20,155.10	100.00
Fund Holding of Currency (Exchange Rate)	18,035.99	88.49
Reserve Tranche Position	2,119.12	11.51
Lending to the Fund		
New Arrangements to Borrow	1,408.69	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	7,757.84	76.55

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Sep 19, 1969	Sep 18, 1970	985.00	985.00
Stand-By	Jan 31, 1958	Jan 30, 1959	131.25	131.25
Stand-By	Oct 17, 1956	Oct 16, 1957	262.50	262.5

Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2017	2018	2019	2020	2021
Principal					
Charges/Interest	7.10	14.32	14.32	14.33	14.31
Total	**7.10**	**14.32**	**14.32**	**14.33**	**14.31**

Implementation of HIPC Initiative: Not applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not applicable

Implementation of Post-Catastrophe Debt Relief (PCDR): Not applicable

Exchange Arrangements:

- France's currency is the euro, which floats freely and independently against other currencies.
- France maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions imposed solely for the preservation of international peace and security. These restrictions which mostly involve some individuals and entities and target specified countries have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). In accordance with the relevant EU regulations and UNSC resolutions, certain restrictions are maintained on the making of payments and transfers for certain transactions with respect to the Democratic Republic of Congo, the former government of Iraq, the Democratic People's Republic of Korea, Guinea (republic of), Guinea Bissao, the former Government of Liberia, the former Government of Libya, the former Government of Tunisia, Transnistria, Eritrea, the former Government of Egypt, Somalia, Sudan and South Sudan, Syria, certain individuals associated with the murder of former Lebanese Prime Minister Rafiq Hariri, and, Central African Republic, Ukraine, Russia, Yemen, Zimbabwe. As regards the Islamic Republic of Iran, some restrictions still exist in accordance with the relevant United Nations Security Council Resolution 2224 (double use goods, ballistic and nuclear related goods) but the major part of the past restrictions (those imposed by the European Union on a bilateral way: oil, gold, minerals…) has been dropped, in early 2016, due to the Vienna Agreement.
- Measures have been taken to freeze accounts of listed persons and entities linked to terrorists pursuant to the relevant EU regulations (n°881/2002, n°2580/2001 and n°753/2011) and UN Security Council resolutions (resolutions 1267 and 1373 and subsequent resolutions).

Article IV Consultation:

The last Article IV consultation was concluded on July 11, 2016. The associated Executive Board assessment is available at http://www.imf.org/external/np/sec/pr/2016/pr16333.htm and the staff report at http://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2016/_cr16227.ashx. France is on the standard 12-month consultation cycle.

FSAP Participation and ROSC:

France–Report on the Observance of Standards and Codes (ROSC): Module I–Fiscal Transparency	October 17, 2000
Fiscal Transparency—Update	IMF Country Report No. 01/196, 11/05/01
Fiscal Transparency—Update	IMF Country Report No. 04/345, 11/03/04

Summary: The report found that France has achieved a high level of fiscal transparency and has introduced a number of improvements in coverage and presentation of fiscal information. Notable areas of progress include the development in the final accounts publication to include more complete information on government assets and liabilities as well as disclosure of contingent liabilities. Accounting standards have been changed to reflect accruals principles in a number of areas, and these standards are clearly explained. The staff suggested that further steps could be taken to identify and report quasi-fiscal activities in the budget presentation, provide a more consolidated picture of fiscal activity outside the appropriation process, and improve the reconciliation of stated policies with outcomes at the general government level.

These issues have been addressed in the *Loi organique aux lois de finance* (LOLF), which has become fully effective on January 1, 2006. In addition to the annual appropriations, the first multi-annual fiscal framework law was adopted in January 2009, and contains fiscal objectives for the period 2009–12. The budget is organized along missions and provides details on the level of appropriations for each mission and performance indicators by which the expected results of the mission will be assessed ex post. The State Audit Office has been given the new assignment of certifying the public accounts, and implementation of accruals basis accounting has been confirmed. Parliamentary oversight powers have been strengthened.

France–Report on the Observance of Standards and Codes (ROSC): Module II–Transparency in Monetary and Financial Policies	October 2000, corrected: 2/15/01
Transparency in Monetary and Financial Policies—Update	IMF Country Report No. 01/197, 11/05/01
Transparency in Monetary and Financial Policies—Update	IMF Country Report No. 02/248, 11/13/02

Summary: The 2000 ROSC noted that transparency of financial policies is accorded a high priority by all financial agencies assessed, and they are in observance of the good practices of the *Code of Good Practices on Transparency in Monetary and Financial Policies*. The major agencies disclose their objectives, their legal and institutional frameworks, and have open processes of policymaking and regulation. The principles of transparency are observed by dissemination of relevant information to the public and in the agencies' arrangements for internal conduct, integrity, and accountability. However, the staff noted that the framework for supervision and regulation applicable to mutual insurance firms is not as well defined and suggested to improve its transparency. The transparency of monetary policy was not assessed by the Fund team as the *Banque de France* is a member of the European System of Central Banks and no longer conducts independent monetary policy.

Subsequently, the framework for supervision and regulation applicable to a specific group of mutual insurance firms was modified in a number of steps. In August 2003, legislation created a single supervisory body, the *Commission de Contrôle des Assurances, Mutuelles et Institutions de Prévoyance* (CCAMIP) by merging the regular insurance supervisor (CCA) and mutualities' supervisor (CCMIP). Coordination with the banking sector supervisors was strengthened and the powers of the supervisory authorities extended. In 2010, supervision of the banking and insurance sectors was unified under the *Autorité de contrôle prudentiel (ACP)*, which subsequently also was granted resolution powers and was renamed the *Autorité de contrôle prudentiel et de résolution (ACPR)*.

France–Report on the Observance of Standards and Codes (ROSC): Data Module	IMF Country Report No. 03/339, 10/2903
Data Module—Update	IMF Country Report No. 04/345, 11/03/04
Data Module—Update	IMF Country Report No. 05/398, 11/07/05

Summary: The report found that France is in observance of the Fund's Special Data Dissemination Standard (SDDS). In particular, the mandate of INSEE and the *Banque de France* for the production of the six macroeconomic datasets is clearly defined, with the reporting burden and the confidentiality provisions given special consideration notably through the CNIS. Professionalism is central to the statistical operations of the two institutions, internationally and/or European accepted methodologies are generally followed, the degree of accuracy and reliability of the six datasets is remarkable, statistics are relevant and provided on a timely basis, and they are accessible to the public.

The report made a number of suggestions for further improvements: the responsibility of INSEE as the producer of government finance statistics should be clarified; data sharing between the *Banque de France* and the rest of the French statistical system improved; classification and valuation methods in balance-of-payments statistics reviewed; consistency between the current account of the balance of payments and the goods and services account in the national accounts improved; the timing of revisions in the quarterly and annual national accounts aligned; and identification of data production units of INSEE facilitated.

France continues to implement several of the 2003 ROSC Data Module recommendations, including by promoting a broader understanding of statistical data revisions, making greater use of firm-level data to improve the measurement of changes in stocks, and intensifying work on portfolio investment income with the objective of starting to record those transactions on an accrual basis.

***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 04/344, 11/03/04
FSAP Assessment and Reports on ROSCs	IMF Country Report No. 04/345, 11/03/04
FSAP Assessment	IMF Country Report No. 05/185, 06/08/05
Publication of FSAP—Detailed Assessment of Observance of Standards and Codes	IMF Country Report No. 05/186, 06/08/05
***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 12/341, 12/07/12
France: Financial Sector Assessment Program—Detailed Assessment of Observance of Standards and Codes	
Basel Core Principles for Effective Banking Supervision	*IMF Country Report No. 13/180, June 2013*
Insurance Core Principles	*IMF Country Report No. 13/181, June 2013*
IOSCO Objectives and Principles of Securities Regulation	*IMF Country Report No. 13/182, June 2013*
Securities Settlement Systems and for Central Counterparties	*IMF Country Report No. 13/183, June 2013*
Financial Sector Assessment Program—Technical Notes	
Housing Prices and Financial Stability	*IMF Country Report No. 13/184, June 2013*
Stress Testing the Banking Sector	*IMF Country Report No. 13/185, June 2013*

Summary: The 2004 report concluded that France's financial sector is strong and well supervised. No weaknesses that could cause systemic risks were identified. The strength of the system is supported by the financial soundness indicators and the strong conformity to the supervisory and regulatory standards approved by the Basel Committee, IAIS, IOSCO, FATF, and CPSS. The degree of observance of the transparency code is high in all relevant areas. The French banking sector has been modernized and restructured over the past two decades and is well capitalized. Systemic

vulnerabilities in the important insurance sector are well contained. Securities markets are large and sophisticated.

The FSAP Update undertaken in January and June 2012 confirmed the resilience of France's financial system to severe market pressures but also identified challenges faced by the system. While its structure has contributed to solid profit generation, the crisis exposed the risks posed by the banks' size, complexity, and dependence on wholesale funding. The larger banks have been actively restructuring their balance sheets—moving to more stable sources of funding; reducing their cross-border presence; and building up capital. They remain, however, vulnerable to sustained disruptions in funding markets and reduced profitability, which would cause delays in meeting capital-raising plans.

The 2012 report confirmed that the regulatory and supervisory regime for banks, insurance, and securities market was of a very high standard. Areas for improvement that emerged from the FSAP Update included greater de jure independence of supervisory authorities; disclosure of the capital treatment and related financial interactions within complex banking groups; a move toward a more economic risk-focused approach to insurance regulation and supervision; and enhanced supervision of investment service providers and financial advisors.

The 2012 report also found disclosure-related shortcomings. French banks and listed companies, more generally, make extensive public financial disclosures under IFRS, and as a result of bank regulations (Pillar III of Basel II). Nonetheless, disclosure of financial sector data falls short of international best practice and enhancements would be highly desirable. Market discipline would benefit from the publication of regular and comparable data on an institution-by-institution basis, as well as detailed official analyses of financial sector developments in France.

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: The economic database is comprehensive and of high quality, and data provision to the Fund is adequate for surveillance. The authorities regularly publish a full range of economic and financial data, and calendar dates of main statistical releases are also provided. France subscribes to the Fund's Special Data Dissemination Standard and is currently working on implementing the transmission of data to international agencies in electronic format using the Statistical Data and Metadata eXchange (SDMX) standard.
National Accounts: France adopted the *European System of Accounts 2010* (*ESA 2010*) in May 2014. The transition from the *ESA 1995* (*ESA95*) entailed a revision of national accounts data. New data sources have been incorporated in the revised estimates. As a result of these changes, the GDP level in 2010 has been revised upward by 3.2 percent. Historical data series are available from 1949.
Government Finance Statistics: Starting from September 2014, government finance statistics (GFS) data have been compiled and reported based on *ESA 2010* methodology. Revised time series for general government deficit and debt levels from 1995 onwards, based on the new methodology, were reported shortly thereafter. Although the source data are collected by the Ministry of Economy and Finance, INSEE is principally responsible for the compilation and dissemination of fiscal data in a framework that is consistent with ESA. **Monetary and Financial Statistics:** Monetary data reported for *International Financial Statistics* are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data. Statistics for *International Financial Statistics* on banking institutions and monetary aggregates are prepared on a monthly basis and are timely. Monetary data are also disseminated in the quarterly *IFS Supplement* on monetary and financial statistics. **External Sector:** Starting in June 2014, monthly balance-of-payments statistics are published using the guidelines set out in the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*) . Back casting of previous periods started with the publication of the Annual report of the balance of payments and the international investment position end June 2014. Currently, a consistent set of quarterly balance of payments and IIP data in *BPM6* format covering the period 1999:Q1 to date are published.

France: Table of Common Indicators Required for Surveillance (As of July 2017)					
	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	07/17	07/17	Monthly	Monthly	Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	06/17	07/17	Monthly	Monthly	Monthly
International Investment Position	Q1:2017	Q2:2017	Quarterly	Quarterly	Quarterly
Reserve/Base Money	06/17	07/17	Monthly	Monthly	Monthly
Broad Money	06/17	07/17	Monthly	Monthly	Monthly
Central Bank Balance Sheet	06/17	07/17	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	06/17	07/17	Monthly	Monthly	Monthly
Interest Rates[2]	07/17	07/17	Monthly	Monthly	Monthly
Consumer Price Index	06/17	07/17	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2016	07/17	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	06/17	07/17	Monthly	Monthly	Monthly
Stock of Central Government Debt	06/17	07/17	Monthly	Monthly	Monthly
External Current Account Balance	06/17	07/17	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	06/17	07/17	Monthly	Monthly	Monthly
GDP/GNP	Q2:2017	07/17	Quarterly	Quarterly	Quarterly
Gross External Debt	Q1:2017	Q2:2017	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] This information is provided on a budget-accounting basis (not on a national accounts basis).

Statement by Mr. de Villeroché, Executive Director for France,
Mr. Castets, Alternate Executive Director, and Mr. Sode, Advisor
September 20, 2017

We thank staff for a thorough and detailed set of papers on the economic situation of France. Candid and open discussions during the Article IV mission led to a comprehensive and fruitful engagement with my authorities. We note that staff is broadly in agreement with the overall economic strategy announced during the presidential campaign, whose implementation has already started, as well as on the positive impact of intended reforms on France's growth prospects.

My authorities intend to swiftly implement a bold and comprehensive strategy aiming at enhancing growth, increasing the competitiveness and the attractiveness of the French economy, ensuring the sustainability of public finances as well as inclusiveness and social mobility. This Article IV review offers an opportunity to present the main elements of this economic strategy.

Economic strategy

Unleashing creative forces.

The reform of the labor market, of the tax system as well as simplification measures will support economic actors' efforts to fully reap the benefit of the ongoing recovery, structurally reduce our unemployment rate and foster our long-term productivity.

A far-reaching reform of the rules governing the functioning of the labor market has already been put into motion. My authorities chose to move swiftly by using "ordonnances" (the Parliament authorized the government to adopt legislative measures without going through the whole formal legislative process). Five ordonnances have been communicated to Parliament on August 31st and will entry into force by the end of September 2017. The reform will significantly enhance the social dialogue, by decentralizing at the firm level significant aspects of collective bargaining that were discussed at the "branche" level so far (notably on some part of the compensation packages and working hours), and by doing so will enhance the ability of firms to better react to changing economic conditions. It will also substantially simplify the conditions of labor relations by merging the different personnel representative bodies. It will also significantly enhance the predictability for employers,

notably by setting a ceiling to termination benefits, reducing uncertainty related to layoffs as well as the period for disputing the economic ground for redundancy. The possibility to proceed to layoffs will be conditioned to economic difficulties at the national level and no more at the group level only as it is actually the case.

A tax reform will aim at encouraging risk-taking and productive investments and at supporting households' purchasing power while encouraging return to work. The corporate income tax will be further decreased (from 33.3 percent to 25 percent by 2022). We note staff's recommendation on the debt bias but would like to emphasize that the existing interest deduction allowance is already set at an elevated level (25 percent) compared with peer countries and that the programmed decrease in the corporate income tax rate will mechanically decrease the debt bias. On capital taxation, a tax set at unique rate (30 percent) will be introduced so as to prevent distortions and channel savings towards productive investments. In parallel, the wealth tax base will be limited to immovable assets to encourage risk-taking investments and enhance France's attractiveness for investors. Moreover, to improve its impact on job creation and simplify its functioning, the existing tax credit on wage bill ("*CICE"* – which represents around 1 point of GDP) will be converted into a permanent cut of employers' social contributions by 2019. My authorities also reaffirm their intention to maintain the public support to R&D spending (*"Crédit d'Impôt Recherche"*) as its positive impact on the level of private R&D spending has been documented by several studies.

Concerning households' taxation, the tax wedge will be reduced to encourage activity and return to employment. Employees' social contributions to health insurance will be eliminated to reduce the labor wedge and will be compensated by an increase in the broad-base part of the personal income tax (the "*CSG*"). Moreover, the in-work tax credit ("*prime d'activité*") will be increased to sustain low-skilled workers' remuneration while increasing incentives to work. To support middle-income households' purchasing power, the housing tax will be phased out over the next three years depending on revenue levels. The combination of labor market reforms and tax incentives for work will contribute to moderate the labor costs dynamic in particular at the lower end of the wage distribution. We take note of staff recommendation to review the minimum wage indexation but my authorities do not intend to modify the indexation formula at this stage since the ratio of labor costs at the minimum wage level to labor costs at the median wage level already decreased in recent years (below 50 percent since 2014).

Transforming our production capacities, investing into tomorrow's growth.

A set of measures will aim at strengthening the productive and innovative capacities of the French economy. Improving human capital is at the very core of my authorities' priorities. From this year onward, primary schools in deprived areas will benefit from an enhanced support (the number of students per class for the entry year of primary school has already been halved). A reform of the architecture of the vocational training system and a reform of universities is under preparation. Moreover, a sizable part of the investment plan (15 billion euros out of a total amount of 50 billion euros) will be dedicated to training for long term

unemployed people and youth without degrees. The investment plan will also complement structural reforms, notably by encouraging the digitalization of the economy, energy efficiency and upmarket moves of agriculture and industrial productions. Enhanced support will also be targeted on the development and diffusion of innovative technologies, notably through the creation of a dedicated Fund.

Put public finances on a more sustainable footing.

The fiscal strategy to be implemented over the five coming years will aim at balancing the fiscal deficit and will primarily rely on broad-based public spending containment and reduction measures. Public spending will be reduced by 3 points of GDP by 2022. Overall, tax revenues will be reduced by one point of GDP over five years. The sustainability of public finances will be strongly enhanced as the debt to GDP ratio will decrease by 5 points by 2022.

My authorities reaffirm the commitment expressed during the presidential campaign to bring the public deficit durably below 3 percent of GDP. A first set of measures aiming at curbing public expenditures have already been implemented to respect the 3 percent threshold in 2017 (notably a cut-down of housing allowances). Going forward, a comprehensive strategy aiming at putting the public finances on a more sustainable trajectory will be implemented. As acknowledged by staff, this strategy will rely on spending containment and reduction measures, including notably a reduction of the wage bill, further reforms of housing allowances, digital reform of public administrations, enhanced restraint on local administration spending and containment of health spending. Overall, my authorities have adopted a stricter fiscal trajectory than what is presented in staff's report and are confident that the public deficit will be below 3 percent of GDP for the fiscal years 2018 and 2019. They aim at a public deficit at 0.5 percent of GDP before the next general elections.

More specifically, we agree with staff that the conversion of the existing tax credit on wage bill ("*CICE*") into a permanent cut of employers' social contributions will imply a one-off fiscal impact in 2019. To ensure that the deficit will not go back over 3 percent, my authorities have already announced measures to limit the temporary impact of this conversion on public finances in 2019 (i.e. a decrease of the rate of CICE from 7 percent to 6 percent the year of the conversion).

As regards debt sustainability, we broadly share the DSA conclusions. One has to keep in mind that long term demographic trends as well as the impact of successive reforms of the pension system put France in a relatively better position than most of OECD peers regarding the impact of ageing on public finances. This is notably confirmed by the conclusions of the 2016 Ageing Report of the European Commission. Because of past reforms, the effective retirement age has continuously increased over the past years and will continue to do so going forward. My authorities have announced a pension reform that will aim at unifying the several pension regimes coexisting to enhance transparency and equity.

Macroeconomic outlook

Staff revised medium term growth projections upwards taking into consideration the expected impact of the comprehensive set of structural reforms to be implemented over the coming years. Positive key structural factors - such as a well-educated workforce (the share of young professional -25-34 years old- who completed upper secondary education amounts

to 44.7 percent), relatively high level of productivity, positive demographics trends and high quality infrastructures -, ongoing effect of recent reforms and the ambitious set of reforms to be implemented will reinforce each other in supporting France's growth prospects. In this regard and with a longer term perspective, potential output has also been modified upward by staff.

The program of economic reforms will strengthen further the ongoing recovery. In 2016, growth slightly picked-up to reach 1.2 percent. It was mainly driven by domestic demand (+1.9 percent) and notably by dynamic private investment (+2.9 percent). Unemployment remained on a downward trend and net job creations in the private sector accelerated in 2017 (totaling 525 000 private sector jobs created since 2014Q4).

Regarding the outlook for 2017 and 2018, growth is expected to firm further. Staff revised its projections upwards since July 2017 to 1.6 percent in 2017 and 1.8 percent in 2018. Staff's growth forecasts are largely in line with my authorities' projections for the two coming years. The carryover at the end of 2017Q2 is already at + 1.4 percent. We also note that staff anticipates a gradual elimination of the current account deficit (at 1 percent in 2016) by 2022. This reduction of the current account deficit would be driven by an improvement of the trade balance due to the impact for planned reforms on competitiveness.

The public deficit stands at 3.4 percent for 2016 and remains on a steady downward trend (decreasing for the seventh consecutive year). Efforts to decrease public spending have been maintained leading to a further decline of the public expenditures to GDP ratio (-0.3 percent of GDP compared to 2015). We would like to recall that we diverge with staff on the appreciation of the level of structural effort which is linked to a too low assessment of the potential output (1 percent in 2016).

Financial sector

The resilience of the French banking sector increased significantly since the financial crisis. As noted in the report, own funds have increased, notably through the adaptation of business models and enhanced efficiency, and the reliance on wholesale funding decreased. The ratio of non-performing loans to total loans remained stable in 2016 at a low level (3.9 percent). Furthermore, French banks started to adapt to regulatory requirements aimed at enhancing resolvability, in particular TLAC and MREL requirements, by issuing a new category of loss-absorbing liabilities. We take note of staff's appreciation on the introduction of an output floor for banks using internal models but would like to recall the importance of maintaining risk-sensitive capital requirements.

While not a specificity of the French financial sector, we acknowledge that the persistent low interest rate environment takes its toll on banks' profitability. However, due to the diversification of French banks' activities, under the universal banking model, revenues are less dependent to interest margin profits than for more specialized banks.

Non-financial firms' indebtedness increased at a faster path than for European peers, as mentioned in the report. Nevertheless, the parallel increase in own funds levels led to a quasi-stable corporate leverage ratio, as noted by staff. Macroprudential authorities remain attentive and ready to take measures if it would be considered needed.