INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/243

FRANCE

July 2018

2018 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 2018 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 July 25, 2018 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 July 25, 2018, following discussions that ended on June 4, 2018, 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 July 11, 2018.
- 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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July 26, 2018

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IMF Executive Board Concludes 2018 Article IV Consultation with France

On July 25, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

Near-term growth prospects remain favorable, although less buoyant than in 2017. Real GDP growth is projected to reach 1.8 percent this year and 1.7 percent in 2019, supported by robust investment and solid consumption. While the contribution of net exports turned slightly positive in 2017 and the current account deficit shrunk, France's external position is assessed to be moderately weaker than implied by economic fundamentals and desirable policy settings. Job growth has picked up and the unemployment rate has declined to around 9 percent. Inflation is expected to reach 1.8 percent this year, spurred by energy prices and a gradual increase in core inflation. The fiscal deficit fell to 2.6 percent in 2017, below the EDP limit of 3 percent for the first time in a decade, largely driven by the improved macroeconomic outcomes.

The government has initiated an ambitious reform strategy aimed at addressing France's structural challenges and bolstering the economy's resilience. Key labor market and tax reforms have been enacted, which should help enhance labor market flexibility and better align labor costs with productivity. Upcoming structural reforms focus on revamping France's vocational training and professional development and improving the business environment, which should help bolster the employment prospects of low-skilled workers and further support competitiveness. As to fiscal policy, the government aims to reduce the fiscal deficit and debt in the medium term by reforming public spending. On the financial sector front, the authorities have activated macroprudential policies to prevent the buildup of imbalances.

The medium-term outlook is predicated on the full implementation of ongoing reforms. Output growth is projected to gradually converge towards its long-run potential of around 1½ percent, supported by labor and product market reforms that help boost labor force participation and productivity. Spending reforms are expected to rebuild room for fiscal maneuver, while the preemptive use of macroprudential policies will further strengthen the resilience of the financial sector and its ability to support long-run growth.

[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 noted that France experienced a broad-based cyclical recovery and a pick-up in job growth in 2017, supported by structural reform implementation and a favorable global conjuncture. Directors welcomed the substantial track record of reform implementation that the government established in its first year in office.

Looking forward, Directors considered that the outlook remains positive, but downside risks have risen, in particular, related to trade tensions, geopolitical uncertainty, and other political risks in Europe, which could weigh on investment and growth prospects. Directors recommended taking advantage of the favorable outlook to press ahead with the reform agenda to further increase the economy's resilience and to address remaining structural challenges: high structural unemployment, weak competitiveness, and high public and private debt burdens.

Directors welcomed the recent labor code and taxation reforms that are aimed at enhancing labor market flexibility and better aligning labor costs with productivity. They supported the authorities' plans to reform training and apprenticeship systems to reduce structural unemployment and improve job opportunities for disadvantaged groups. Directors noted that these reforms would need to be closely and continuously monitored for their effectiveness. Should the reforms not produce the desired effects, there would be a need to reinforce them with further measures to increase flexibility in wage setting, reinforce training for young workers, and strengthen work incentives in the unemployment benefit system.

Directors considered that complementary product market measures will be essential to foster growth and competitiveness, in addition to labor market and tax reforms. In this regard, they welcomed the recent reform of the railway sector and the planned legislation which aims to facilitate business growth, innovation, and employment. Directors also underscored the need for further efforts to liberalize regulated professions.

Directors stressed that putting public debt on a firm downward path requires further efforts to permanently reduce public spending. They noted that spending reforms at all levels of the government will be needed to support the authorities' appropriately ambitious debt and deficit-reduction objectives. This is also an opportunity to reevaluate how public services are provided and to modernize and enhance their efficiency. To enhance the strategy's credibility, Directors recommended that the reform measures be specified early, starting with the 2019 budget.

Directors noted that the banking sector is now stronger, and has been able to support the recovery. However, vulnerabilities remain, especially related to elevated debt levels in parts of the corporate sector against a backdrop of global interest rate normalization. Directors welcomed the recent macro-prudential measures aimed at reducing imbalances and underlined the need for continued monitoring of vulnerabilities and building bank buffers against shocks, including through the implementation of ongoing international regulatory changes.

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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, 2016–19

	2016	2017	Projections 2018	Projections 2019
Real economy (change in percent)				
Real GDP	1.1	2.3	1.8	1.7
Domestic demand	1.6	2.2	1.3	1.6
Private consumption	2.1	1.0	1.1	1.6
Public consumption	1.4	1.3	0.8	0.3
Gross fixed investment	2.8	4.5	2.9	3.0
Foreign balance (contr. to GDP growth)	-0.5	0.1	0.4	0.0
Exports of goods and services	1.5	4.5	4.4	4.7
Imports of goods and services	3.0	4.0	3.0	4.4
Nominal GDP (billions of euros)	2,229	2,292	2,364	2,441
CPI (year average)	0.3	1.2	1.8	1.7
GDP deflator	0.3	0.5	1.4	1.6
Gross national savings (percent of GDP)	21.9	22.9	22.9	23.0
Gross domestic investment (percent of GDP)	22.7	23.5	23.7	23.7
Public finance (percent of GDP)				
General government balance	-3.4	-2.6	-2.4	-2.6
Revenue	53.0	53.8	53.5	52.2
Expenditure	56.6	56.4	55.9	54.9
Structural balance (percent of pot. GDP)	-2.8	-2.4	-2.2	-2.7
Primary balance	-1.8	-0.9	-0.6	-0.8
General government gross debt	96.6	96.8	96.2	95.8
Labor market (percent change)				
Employment	0.6	0.6	0.6	0.5
Labor force	0.3	-0.1	0.0	0.1
Unemployment rate (percent)	10.1	9.4	8.9	8.5
Total compensation per employee	1.1	2.5	...	...
Credit and interest rates (percent)				
Growth of credit to the private non-financial sector	3.8	5.6	4.7	4.5
Money market rate (Euro area)	-0.3	-0.4	...	...
Government bond yield, 10-year	0.5	0.8	...	...
Balance of payments (percent of GDP)				
Current account	-0.8	-0.6	-0.8	-0.6
Trade balance of goods and services	-0.8	-0.9	-0.9	-0.7
Exports of goods and services	31.7	32.1	31.3	32.3
Imports of goods and services	-32.4	-33.0	-32.3	-33.1
FDI (net)	1.1	0.3	0.5	0.6
Official reserves (US$ billion)	56.1	54.8	...	...
Current account	-0.8	-0.6	-0.8	-0.6
Exchange rates				
Euro per U.S. dollar, period average	0.90	0.89	...	...
NEER, ULC-styled (2000=100)	98.7	100.0	...	...
REER, ULC-based (2000=100)	92.3	92.6	...	...
Potential output and output gap				
Potential output (change in percent)	1.2	1.4	1.5	1.5
Memo: per working age person	0.8	0.9	1.0	1.1
Output gap	-1.0	-0.1	0.1	0.3

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

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

July 11, 2018

KEY ISSUES

Context: In a favorable global conjuncture, France has benefitted from a broad-based recovery last year, with robust growth and improving labor market trends, which have led to a decline in the fiscal deficit below 3 percent of GDP last year. But structural challenges persist, with still high unemployment, weak competitiveness, and high private and public debt burdens, which are hampering economic performance.

Outlook: Near-term prospects remain positive, with growth expected around 1.8–1.7 percent this year and next. However, risks have risen and are tilted to the downside, particularly related to increasing trade tensions, geopolitical uncertainty, and risks related to the euro area.

Policies: Taking advantage of the recovery, policies should focus on addressing remaining structural challenges in order to boost jobs and make the recovery more durable, while also building up resilience to shocks. Policy priorities include:

- Lowering structural unemployment and increasing opportunities for vulnerable workers by finalizing and implementing the planned reforms of professional training and apprenticeship and reinforcing them with additional measures if their expected effects do not materialize;

- Improving the business environment and strengthening competition in service sectors by continuing to reduce the administrative burden, supporting innovation and start-ups, and taking additional steps to further liberalize regulated professions;

- Putting public debt on a sustained downward path by reducing spending at all levels of government, while making it more efficient, with specific plans starting already with the 2019 budget;

- Further strengthening financial sector resilience by implementing ongoing international regulatory changes, and continuing to use macroprudential policies pre-emptively.

Approved By
Enrica Detragiache (EUR) and Vikram Haksar (SPR)

Discussions took place from May 22–June 4, 2018. The staff team comprised D. Velculescu (mission head), L. Antoun de Almeida, N Batini, T. Tressel, and S. Voigts (all EUR) and was assisted at headquarters by T. Mohd Nor and K. Vanegas. E. Detragiache (EUR) participated in some of the discussions. Staff met with the Minister of State reporting to the Minister of Finance and the Economy Gény-Stephann; Central Bank Governor Villeroy de Galhau; senior officials in the President and Prime Minister's offices, various ministries, the Banque de France, and the Cour des Comptes; financial sector interlocutors, think tanks, and academics; and trade union and employer association representatives. A press conference was held at the end of the mission.

CONTENTS

CONTEXT: A ROBUST RECOVERY 4

OUTLOOK: POSITIVE PROSPECTS AMID GROWING RISKS 8

THE POLICY AGENDA: GROWTH, JOBS, RESILIENCE 9

A. Structural Reforms: Supporting Employment and Competitiveness 10

B. Fiscal Policy: Credibly Reducing Spending and Public Debt 14

C. Financial Sector Policies: Bolstering Private-Sector Balance Sheets 19

STAFF APPRAISAL 21

BOXES

1. Estimating France's Output Gap 23
2. Inequality and Labor Market and Fiscal Policies in France 25
3. Large Fiscal Consolidations: How Successful Have They Been? 27

FIGURES

1. High Frequency Indicators 29
2. Labor Market Developments 30
3. External Sector 31
4. Corporate Debt 32
5. Banking Sector: Key Indicators 33

TABLES

1. Selected Economic and Social Indicators, 2014–23 34
2. General Government Accounts, 2014–23 35
3. Balance of Payments, 2014–23 36

4. Vulnerability Indicators, 2010–17 ____ 37
5. Core Financial Soundness Indicators, 2012–17 ____ 38
6. Encouraged Financial Soundness Indicators, 2012–17 ____ 39

ANNEXES

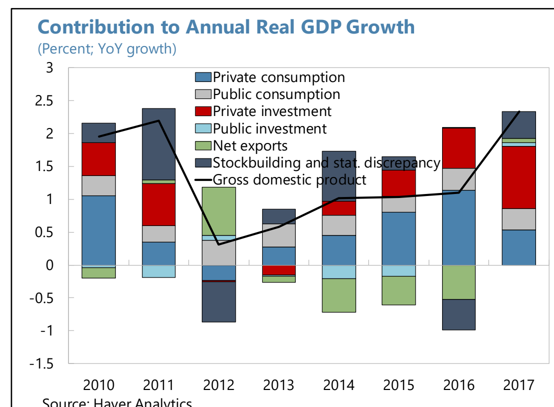
Annex I. Authorities' Response to Past IMF Policy ____ 40
Annex II. External Sector Assessment ____ 41
Annex III. Risk Assessment Matrix ____ 42
Annex IV. Debt Sustainability Analysis ____ 43

CONTEXT: A ROBUST RECOVERY

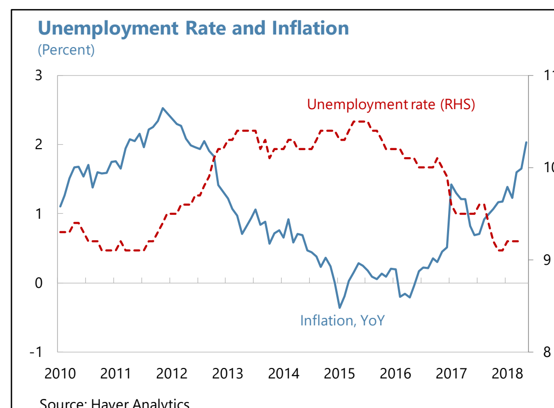
France has benefitted from a broad-based recovery...

1. Growth accelerated in 2017, reaching 2.3 percent, 1.2 percentage points higher than in 2016 (Figure 1).[1]

- *Private investment* was a key driver of growth, supported by an improved business climate, strong bank credit growth (5.6 percent y-o-y) and corporate bond issuance, boosted by the ECB's accommodative policy.

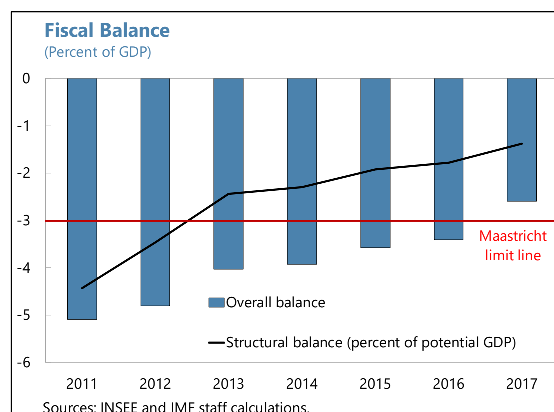


- *Exports* performed well (y-o-y growth of 4.5 percent), buoyed by increased global demand and a recovery of tourism (Figure 2). However, the net impact of external demand on growth was modest, as imports also accelerated (y-o-y growth of 4 percent).



- *Labor market* conditions improved, supporting private consumption (Figure 3). After hovering around 10 percent for several years, the headline unemployment rate declined to just over 9 percent in 2018:Q1, reflecting a pickup in private sector employment (y-o-y growth of 1 percent in 2018:Q1). Wages have grown in line with the euro-area average.

- *CPI Inflation* has been on the rise, reaching 2.1 percent y-o-y at end-June 2018, reflecting an acceleration of energy, food, service, and tobacco prices. Core inflation has also increased slightly (1 percent s.a. in May 2018), although this reflects in part the effects of higher green taxes.



- *The fiscal deficit* fell to 2.6 percent of GDP in 2017, below the EDP limit of 3 percent for the first time since 2007, largely driven by stronger revenues associated with the better growth and employment outcomes.[2]

[1] Growth figures are reported on a seasonal and work-day adjusted basis.

[2] In May 2018, the European Commission proposed France's exit from the EDP.

...supported by past and ongoing domestic reforms.

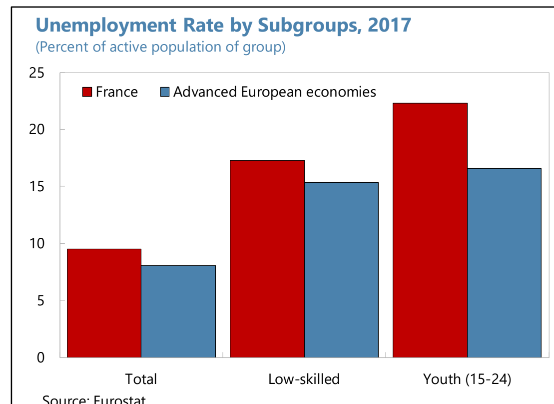
2. The government implemented key labor market and tax reforms over the last year. These reforms, which come on the heels of previous liberalization measures, have decentralized collective bargaining toward the firm level, simplified social dialogue, reduced judicial uncertainty around dismissals, lowered the tax wedge while supporting investment, and restructured the railway sector, are broadly in line with staff's past recommendations (Annex I).

Recent and Upcoming Reforms

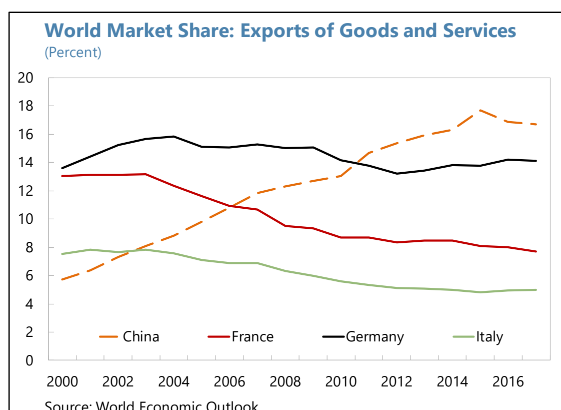
What has been done recently	*What is underway*
Structural reforms	
• ***Labor market***: enhanced firm-level flexibility by expanding the areas negotiated at the firm level (but excluding base wages), and simplifying social dialogue within firms (September 2017). • ***Labor market***: reduced judicial uncertainty regarding dismissals by capping compensation for unfair dismissals, reducing time for labor court appeals, and simplifying the rules for collective dismissals (September 2017). • ***Product and service markets***: reduced administrative burden (July 2017; January 2018); reformed the railway company to open up to competition (June 2018).	• ***Labor market***: enhance apprenticeship and professional training systems by better linking to business needs and centralizing financing and monitoring; also measures to strengthen the unemployment system (mid-2018). • ***Product market***: continue to reduce the administrative burden for firms and facilitate firm creation, continue to privatize state-owned enterprises, enhance innovation policy incentivize more flexible compensation schemes linked to firm performance, and support directing savings toward equity financing (end-2018). • **Education:** reform of primary, secondary and tertiary education (2018–20).
Fiscal reforms (2018 budget)	
• ***Labor tax wedge***: replaced part of the employee social contributions with a hike in a general income tax; transformed a tax credit (CICE) into a permanent employer social contribution deduction. • ***Corporate income and capital taxation***: Lowered the CIT rate gradually from 33 to 25 percent by 2022, and redesigned taxation of capital to incentivize investment.	• ***Public administration***: reduce public employment through voluntary departures and reliance on fixed term contracts; introduce merit-based pay system (2019–22). • ***Local governments***: negotiate limits on local government spending through contractual approach including sanctions for non-compliance (mid-2018). • ***Pension and health sector reforms:*** unify pension regimes, increase efficiency of health spending (2019–22).

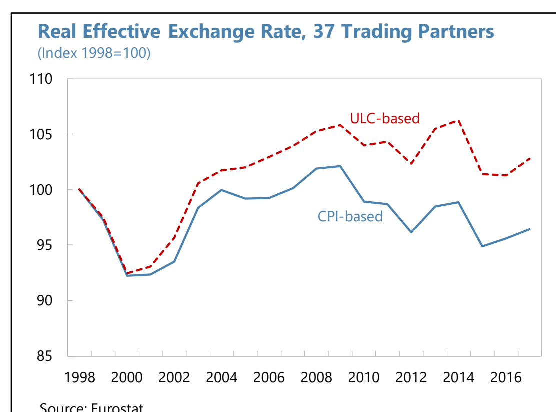
But deep-rooted structural problems persist, and some new challenges are emerging…

3. France's economic performance has long been hampered by an inflexible labor market and high structural unemployment. These reflect entrenched rigidities, including: (i) inability of the education and training systems to match quickly and well individuals' skills with changing business needs, which creates imbalances between the demand and supply of labor; (ii) elevated minimum wages relative to median wages, which hinder access to work for the young and the low skilled; and (iii) limited incentives to work, reflected in relatively generous unemployment benefits and a still elevated labor tax wedge relative to peers, even after the recent tax reforms. Some socio-economic groups have been particularly affected by these rigidities, notably the youth, the low-skilled and non-EU immigrants, which consequently exhibit higher unemployment rates and higher incidence of poverty compared to other groups.[3]



4. Competitiveness has remained weak. France lost about a third of its world market share since the early 2000s, largely due to wages growing faster than productivity in the mid-2000s, with both the ULC and CPI-based real exchange rate (REER) appreciating during this period, but also due to non-price specific factors.[4] Unlike some of its peers (e.g. Germany, Spain), and despite some improvement in the REER indicators over the last decade, France was not able to recover the loss in market share, given the economy's specialization in medium to low-tech sectors that are relatively more exposed to price competition. Consequently, the current account balance has been in deficit in the last decade. The deficit, although it has declined in recent years, reaching 0.6 percent of GDP at end-2017, remains moderately weaker than the level implied by medium-term fundamentals and desirable policy settings (Annex II).

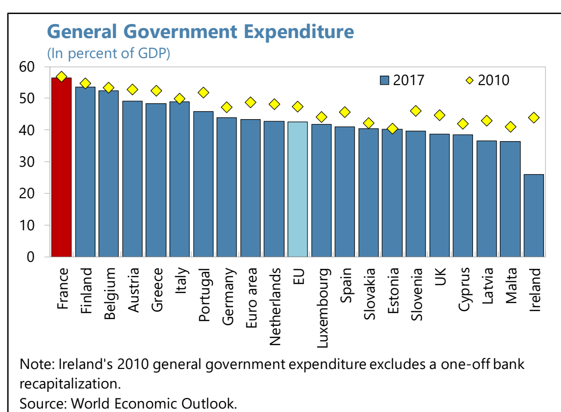


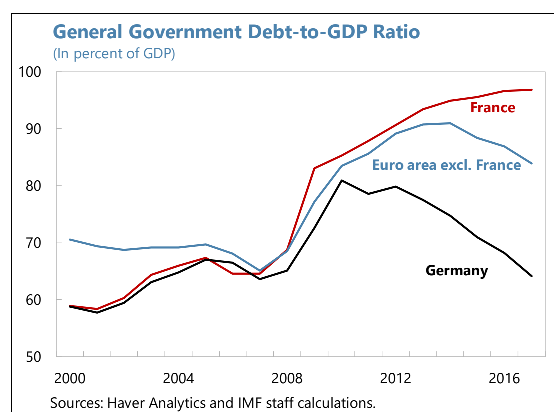


[3] See N. Batini, W. Gbohoui, C. Mumssen, "Explaining Unemployment in the Euro Area: A Cross-Country Analysis of Vulnerable Groups Using Micro Data," 2018.

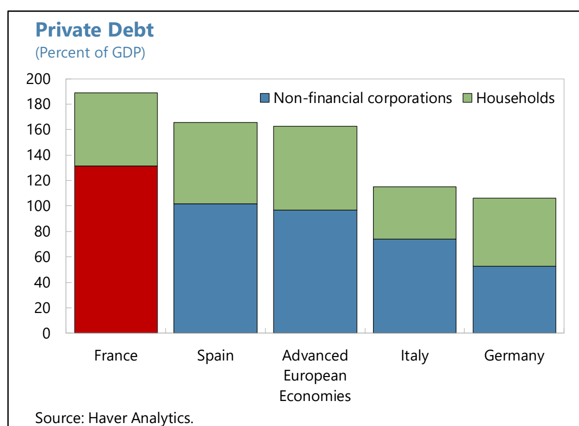
[4] See "Revisiting the Competitiveness Problem," IMF Country Report 17/289.

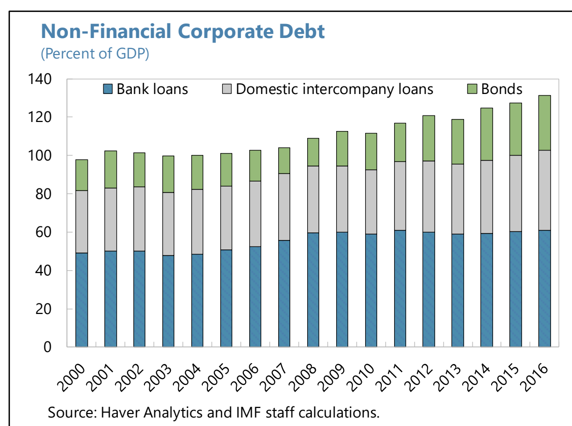
5. Large fiscal imbalances persist. France's persistent fiscal deficits have been driven by high spending growth, especially related to social benefits, transfers, and local governments. As a result, at 56.4 percent of GDP at end-2017, France's public spending was the highest in Europe. Revenue-based consolidation efforts undertaken during the recent global crisis reached a limit and were subsequently followed by tax relief legislated with the 2018 budget. More recent efforts aimed at expenditure-based fiscal consolidation since 2014 relied mainly on across-the-board nominal spending growth restraint (e.g. legislated spending freezes) and have not delivered much real spending reduction, because of weak price growth. Consequently, public debt continued to rise, reaching 97 percent of GDP at end-2017, among the highest in Europe.





6. Private debt has also been rising. At around 180 percent of GDP, gross private sector debt is high relative to peers. This is largely due to high and rising corporate debt, which has reached 130 percent of GDP (unconsolidated), reflecting a combination of bank credit, corporate bond issuance, and intercompany loans (Figure 4). While consolidated corporate debt is lower (close to 80 percent of GDP), the debt burden is concentrated in a few network sectors (e.g. transportation, utilities), and among relatively few large firms. Should interest rates normalize faster than expected, indebted corporates and sectors could face an increasing debt-service burden, which could have repercussions across the economy, weigh on investment, and affect banks' balance sheets, further constraining growth (although firms have also increased liquid assets, which can provide a cushion).





OUTLOOK: POSITIVE PROSPECTS AMID GROWING RISKS

7. **Near-term growth prospects remain positive, although less buoyant than the 2017 peak.** Growth is projected to fall to 1.8 percent this year, supported by continued robust investment and exports, reflecting favorable domestic financing conditions and stable global growth. After a weak Q1 outturn (growth of 0.2 percent q-o-q), activity is expected to rebound, as private consumption picks up on the back of legislated tax cuts entering into effect in the second half of the year and exports and investment rebound. Next year, growth is projected at 1.7 percent, as a slowdown in public consumption and higher imports more than offset an expected increase in private consumption linked to further expected tax cuts. Credit growth is expected to continue to support investment, growing in line with GDP in the medium term. Inflation is projected to increase to 1.8 percent this year, spurred by higher energy prices and a gradual increase in core inflation. The output gap should be largely closed this year, consistent with high capacity utilization and emerging difficulties to fill vacancies in the labor market (Box 1).

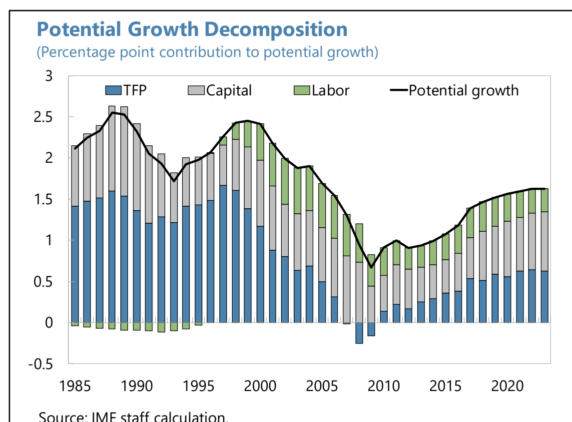
France: Selected Economic Indicators, 2017–23

	2017	2018	2019	2020	2021	2022	2023
Real GDP (change in percent)	2.3	1.8	1.7	1.7	1.6	1.6	1.6
CPI (year average)	1.2	1.8	1.7	1.7	1.8	1.9	1.9
Unemployment rate (percent)	9.4	8.9	8.5	8.1	7.8	7.6	7.4
General government balance (percent of GDP)	-2.6	-2.4	-2.6	-2.0	-2.2	-2.3	-2.6
Structural balance (percent of pot. GDP)	-2.4	-2.2	-2.7	-2.2	-2.4	-2.6	-2.8
General government gross debt (percent of GDP)	96.8	96.2	95.8	94.6	93.6	92.8	92.2
Current account (percent of GDP)	-0.6	-0.8	-0.6	-0.4	-0.2	-0.1	0.1
Potential output (change in percent)	1.4	1.5	1.5	1.6	1.6	1.6	1.6
Output gap (percent of pot. GDP)	-0.1	0.1	0.3	0.4	0.4	0.4	0.4

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

8. **The medium-term outlook is predicated on the implementation of ongoing and planned reforms**. Output growth is projected to moderate and gradually converge towards its long-run potential level of around 1½ percent, supported by solid domestic demand and continued positive export prospects. The contributions of capital and labor to potential output are expected to remain stable, at around ¾ and ¼ percent, respectively, while TFP growth is expected to rise and return to its historical average (1998-2017) of about ½ percent. These trends will be critically affected by ongoing and planned tax, labor-market, and product-market reforms (as discussed in the next sections) which are expected to boost labor force participation and productivity, boosting potential growth by around

Potential Growth Decomposition
(Percentage point contribution to potential growth)



Source: IMF staff calculation.

½ percentage points in the medium run.[5] Potential growth estimates remain surrounded by uncertainty, given possible structural breaks in the trends of factor inputs and TFP following the recent global financial crisis, and difficulties in predicting the effects of recent structural reforms. The current account is expected to return to balance in the medium run, supported by structural and fiscal reforms.

9. Risks have risen and remain firmly tilted to the downside (Annex III). Domestic downside risks include a less ambitious implementation of reforms or lower-than-expected reform gains, which could slow the growth and employment momentum, and derail the planned fiscal consolidation, with second-round effects on confidence and activity. Externally, a further escalation of trade tensions between the US and its global trading partners could affect negatively euro area and global growth, which in turn would impact France's exports and growth. Geopolitical uncertainty related to the Brexit negotiations and a rekindling of financial market volatility in Europe (including related to developments in Italy) could affect France through confidence, trade, and financial sector channels. Finally, a faster-than-expected normalization of interest rates could weigh on public and private balance sheets.

Authorities' Views

10. The authorities' near-term growth projections in their Stability Program were slightly above staff's. They projected growth to remain around 2 percent in 2018–19, and to stabilize to around 1.7 percent in the medium run, on account of strong private consumption, exports, and to a lesser extent, investment, and notwithstanding a net structural fiscal adjustment of around 1½ percent of GDP in the medium term. The Central Bank expected growth to reach around 1.8 percent in the near term. The Stability Program projected inflation to reach 1.4 percent in 2018, and to gradually converge to 1.8 percent in the medium term. The authorities saw risks as balanced. On one hand, stronger growth in the eurozone, a possible depreciation of the euro given rapidly rising U.S. interest rates, and larger effects from domestic reforms would be positive for France. On the other hand, an intensification of trade tensions, uncertainty related to Brexit negotiations, or political risks in the euro-zone could impact negatively France's growth.

THE POLICY AGENDA: GROWTH, JOBS, RESILIENCE

11. The overarching priority is to ensure that the recovery is job rich and long lasting, while building buffers against shocks. Over the last year, France has made substantial progress in this regard, and the reform agenda ahead is equally ambitious, placing France in the lead on reforms in the eurozone at the current juncture. Looking forward, the authorities should continue to pursue the following priorities:

- *Lowering structural unemployment and improving opportunities for disadvantaged groups* by finalizing and implementing the reform overhauling the apprenticeship and

[5] Also see OECD, "France: Structural Reforms: Impact on Growth and Options for the Future," 2014.

professional-training systems. The authorities should stand ready to reinforce recent labor-market reforms with additional measures if needed to ensure that wages evolve in line with productivity, the unemployment system provides adequate incentives to work, and training can reach those most in need, especially the youth.

- *Improving the business environment and strengthening competition in service sectors* by continuing to reduce the administrative burden, supporting innovation and start-ups, and taking additional steps to further liberalize regulated professions.

- *Putting public debt on a sustained downward path* through spending reforms at all levels of government, including social benefits, the public administration, pensions, healthcare, and local governments. In view of the sizeable effort needed to attain the authorities' medium-term objectives, the authorities should specify early on, starting with the 2019 budget, the spending reforms that can help achieve their fiscal goals.

- *Further supporting the financial sector's resilience* by implementing ongoing international regulatory changes and continuing to actively use macroprudential policies pre-emptively.

12. The ongoing recovery provides a favorable window to press ahead with these reforms. The government should take advantage of its strong reform mandate and majority in parliament to advance with the reform agenda and address remaining domestic structural challenges. A strong and resilient French economy is also important to help the whole euro area emerge from the legacies of the crisis and catalyze broader EU-wide reforms.

A. Structural Reforms: Supporting Employment and Competitiveness[6]

13. Last fall, the authorities enacted a first stage of labor market and tax reforms aiming at supporting investment, employment, and growth. A collective-bargaining system largely dependent on decisions taken at the branch level, compounded by a complex social dialogue process, has supported higher overall wages, but at the cost of lower and more precarious employment, by preventing firms (especially small ones) not represented in the negotiations from being able to adjust labor costs during downturns or given firm-specific circumstances. Legal uncertainties regarding dismissals have further discouraged open-ended labor contracts, exacerbating duality, while a relatively high tax wedge has further dis-incentivized employment and hampered competitiveness. The new reforms, which build on steps taken by previous governments, aim at addressing these problems:

- *Collective bargaining:* The labor-code reform aims to better align wages and other non-wage costs with productivity at the firm level by limiting the automatic extension of branch-level agreements on remuneration, working time and mobility of employees, while expanding the areas negotiated at the firm level (but excluding basic wages). It also facilitates social dialogue

[6] See N. Batini and S. Voigts, "Structural Reforms in France: Where Do They Stand?", *Selected Issues Paper*, International Monetary Fund, 2018.

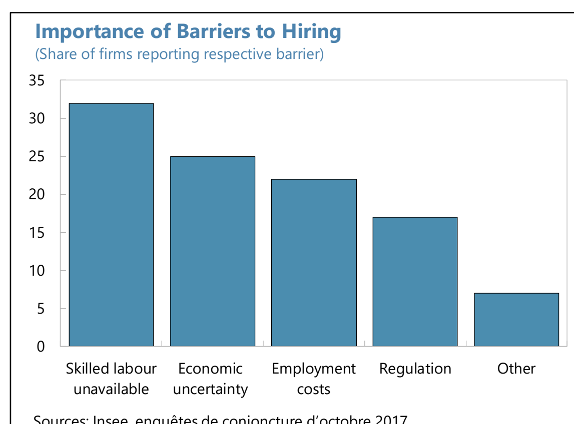
by merging representative bodies and reducing the number and scope of company consultations. The reform is expected to support competitiveness and employment, particularly in smaller firms, by promoting competition and firm entry, while minimizing firm closures during downturns. The measures are expected to especially benefit lower-skilled employees, who tend to lose jobs relatively faster during downturns.

- *Employment protection:* The new reform introduces mandatory caps for compensation for unfair dismissals and limits the time for labor-court appeals, even as severance pay was increased. Besides facilitating firms' response during downturns, this reform is expected to remove remaining legal uncertainties that were reported as major impediments for firms to hire under permanent contracts, thus supporting employment and reducing labor-market duality.

- *The tax reforms* enacted with the 2018 budget reduced the labor tax wedge by replacing the employee social contribution for health and unemployment insurance with an increase in a general tax, and by converting the CICE tax credit given to firms into a permanent cut in employers' social contributions for low wage earners.[7] These measures, together with a reduction in the corporate income tax from 33 to 25 percent until 2022 and reforms simplifying capital taxation, should help support employment, stimulate investment, and boost cost competitiveness.

14. A second stage of labor-market reforms expected this summer should improve the employment prospects of low-skilled workers. The reforms focus on addressing the skills mismatches that have hampered the labor market in France, affecting in particular the young and disadvantaged groups. At the root of the problem has been a costly but inefficient training system, where individuals had limited decision power regarding their career improvement, while firms, especially smaller ones, had equally limited say in the design of training programs and the financing and governance of the system was complex and non-transparent. An educational system that results in weaker average performance relative to peers and higher drop-out rates from tertiary education without alternative professional options for those left out has compounded the problem.

- *The reforms of the apprenticeship and professional-training systems* aim to better match training to firms' needs by putting companies more at the center of training provision, strengthen individuals' rights through "portable training accounts," and provide stronger incentives for young apprentices (e.g. higher pay, tax-free overtime work, career coaching). They also aim to enhance governance by establishing a new

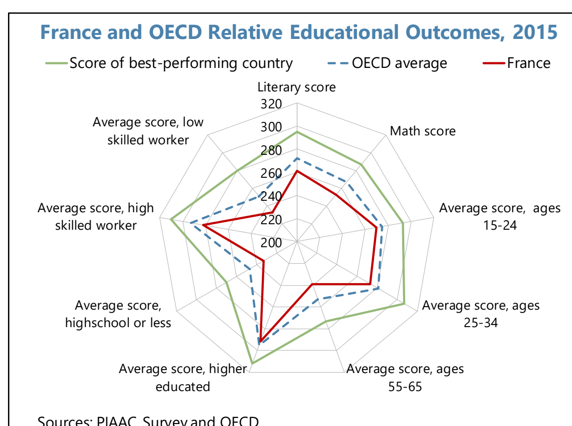


Sources: Insee, enquêtes de conjoncture d'octobre 2017.

[7] These measures are estimated to reduce France's standard measure of the tax wedge by up to 8 percentage points (for workers at the lower side of the wage distribution). From an economic standpoint, however, the reduction in labor costs is smaller (around 1.5 percent), as the CICE conversion is globally neutral for firms' effective labor costs.

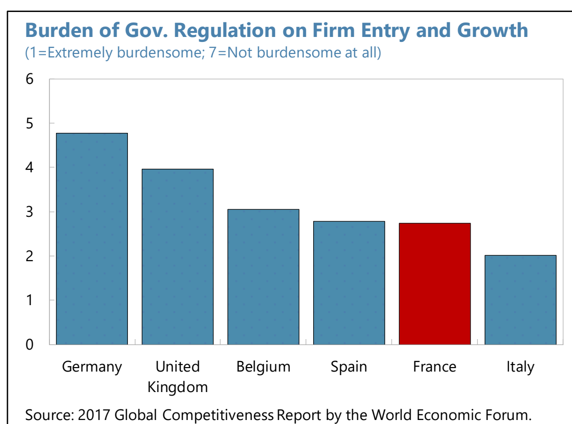
national regulatory agency in charge of verifying the quality of training and by simplifying and centralizing the management of training funds raised through social security contribution. Given that the new training systems will take time to be fully operational, the government has also dedicated specific funds (€15 billion) to use during 2018–22 for the training of 1 million youth and 1 million long-term unemployed. These measures are expected to support employment, reduce labor market duality, and provide opportunities for disadvantaged groups, reducing pockets of inequality (Box 2).

- *Ongoing education and other reforms* will reduce class size in primary schools in disadvantaged areas and overhaul access to higher education by reforming the baccalaureate system and better linking university entry with qualifications. These reforms should improve educational outcomes and reduce drop-out rates, thus fostering a better matching of individual qualifications with educational opportunities, which can help facilitate integration of youth into the labor force. Together with the primary school measures, they are also expected to help provide better opportunities and chances of employment for vulnerable groups in disadvantaged areas. Planned changes to the unemployment insurance system aimed at strengthening sanctioning and monitoring may also help to raise incentives to better utilize training opportunities and return to work.



Sources: PIAAC Survey and OECD.

15. Complementary product- and service-market reforms will generate synergies and boost competitiveness and long-run growth. The recent reform restructuring the public railway company and improving its financial viability, which is similar to previous reforms in Germany and Italy, will be important to support competition and improve services while lowering costs for consumers. Building on previous governments' reforms and other recent measures, the authorities are working on a new reform to support the business environment (expected by end-2018) aiming to: (i) facilitate firm creation and firm growth by continuing to simplify administrative burdens, introducing a one-stop shop for firm registration, and simplifying debt-restructuring procedures for small firms; (ii) facilitate compensation schemes linked to firm performance, which can help provide further flexibility to firms to adjust compensation depending on economic performance; (iii) further privatize state-owned firms (e.g. Paris Airport, Engie, state lotteries) not only to enhance economic efficiency, improve quality and lower costs, but also to help finance programs to support innovative technologies; and (iv) raise incentives to save for retirement and reduce obstacles to job mobility by increasing the portability of pension products and favoring equity finance.



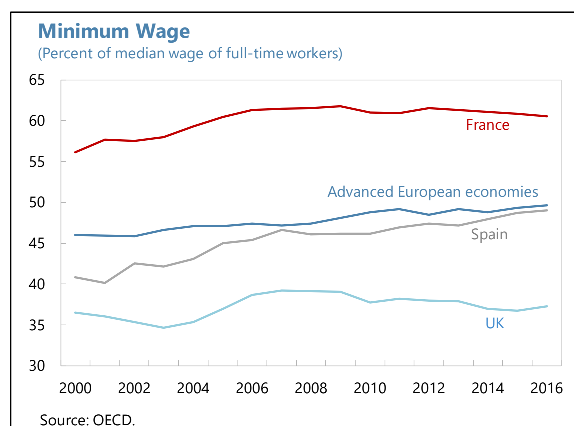
Source: 2017 Global Competitiveness Report by the World Economic Forum.

16. While these reforms can support an improvement in competitiveness, they will need to be implemented resolutely, monitored carefully, and reinforced as needed. The above-mentioned reforms should boost competitiveness and exports and help bring the current account to around balance in the medium term, narrowing the gap relative to France's estimated norm (of a 1 percent of GDP surplus). Since some of these reforms will take time to become fully operational (e.g. training and educational reforms), while others depend on distinct decisions and take up by individual firms (collective bargaining), continuous monitoring of their effectiveness will be key going forward. The authorities could also consider further measures to support growth, especially if the envisaged reforms not produce the desired effects, which could include:

- ***Better integrating apprenticeship and education reforms*** to improve the quality of education in vocational high-schools and pre-apprenticeship programs for vulnerable groups, two areas that are not significantly impacted by the ongoing reform. Raising the quality of education and training in vocational schools and better combining it with apprenticeships in firms (as in Austria, Germany, or Switzerland) would help align the skills of young workers with business needs and incentivize the firms providing the training to hire the apprentices once they graduate.

- ***Expanding firm-level flexibility in setting base wages,*** which for now have been excluded from the current reform. Since base wages are the main component of total compensation, this measure can further help firms to tailor wage costs to cyclical and individual firm conditions, while protecting employment, particularly for disadvantaged groups, whose wages are closer to the base level.

- ***Re-evaluating and restricting the scope of the minimum-wage mechanism.*** The current mechanism links the minimum wage to both inflation and the average wage of less skilled workers, making France unique among OECD countries in this regard (of the 27 OECD countries that have a minimum wage, only four have a mechanism governing its evolution, three of which link it only to inflation, while France links it to both inflation and wages). Delinking the minimum wage from the evolution of wages, which are in turn affected by minimum wages, and if necessary, also fully or partially from inflation, can help bring France closer in line with peers and support long-run competitiveness.



- ***Re-examining the level and accumulation rate of unemployment benefits.*** While the initially planned unemployment benefit measures aimed to tighten monitoring, they did not intend to address the relatively generous benefit level, which dis-incentivizes employment. Should unemployment not decline as a result of current and planned labor market reforms, further measures, along the lines of the reforms undertaken in Germany, Norway, or Sweden, could

include: (i) lengthening the work period that entitles one to claim unemployment benefits; (ii) reducing the maximum benefit level, which is currently the highest among peers; and (iii) avoiding the possibility to cumulate unemployment benefits over discontinued unemployment spells, which currently incentivizes both workers and employers to use precarious contracts.

Selected Features of Unemployment Benefits

	Minimum qualification period (months)	Contribution period divided by benefit period	Benefit cap (euro/month)
Belgium	12	n/a	1,603
France	**4**	**1:1**	**7,134**
Germany	6	2:1	2,483
Italy	3	2:1	1,300
Netherlands	6	1:1	3,212
Spain	12	3:1	1,397
United Kingdom	6	n/a	380

Source: 2016 France Selected Issues Paper, IMF Country Report 16/228.

- ***Further reducing restrictions and barriers to competition in regulated professions.*** For example, pharmacies continue to retain a monopoly on the sale of basic drugs and are subject to strict restrictions on ownership and size, capital, distribution chains, and on-line sales. Removing these restrictions could reduce costs for consumers and boost productivity.

Authorities' Views

17. The authorities reiterated their commitment to the planned structural reforms, which they saw as essential to support employment, growth, and competitiveness. Their strategy has been focused on a labor market, tax, and product market reforms that started last year and are now continuing, focused on helping firms expand, hire, and invest, including in new technologies, as well as on empowering individuals to improve their education and skills and improve their standard of living through better labor market prospects. They agreed that evaluating and monitoring reforms will be essential going forward. While they considered that the benefits from further reforms would be limited at this stage, they were open to further measures to support competitiveness in the future, if current reforms do not deliver the expected benefits.

B. Fiscal Policy: Credibly Reducing Spending and Public Debt

18. The fiscal deficit is projected to remain below 3 percent of GDP, while public debt will exceed 90 percent in the medium run, pointing to limited fiscal space to react to shocks under the EU rules. Tax reduction measures costing about 1 percent of GDP in net terms by 2020 have been enacted (or announced, in the case of a further reduction of the accommodation tax), which, together with a normalization of tax bases, are expected to lead to a decline in revenues in the medium run. Further spending reductions are projected to broadly offset the expected revenue decline in the medium term, on account of: (i) measures legislated in the 2018 budget law (0.6 percent of GDP); (ii) further announced measures expected to be included in the 2019 budget (also 0.6 percent of GDP, see text table); and (iii) an already legislated contractual approach with local governments, limiting their nominal spending growth to 1.2 percent per year through 2022 and allowing the state to apply sanctions in case of non-compliance (further savings of some 0.8 percent of GDP by 2022). In this context, public debt is expected to decline only gradually

relative to GDP, reaching 92 percent by 2023, and to remain vulnerable to shocks, especially if historical macro-fiscal trends materialize (Annex IV). France still has some fiscal space to respond to shocks, but once EU rules are taken into account, the fiscal space is limited, as the deficit could again approach the 3 percent limit if downside risks materialize.

Baseline Expenditure and Tax Measures [1/]

(Cumulative, in percent of GDP)

	2018	2019	2020	2021	2022	2023
Spending reduction measures [2/]	**0.6**	**1.2**	**1.5**	**1.8**	**2.0**	**2.3**
Transfers to enterprises		0.0	0.1	0.1	0.2	0.2
Contrats aides	0.2	0.4	0.4	0.4	0.4	0.4
Housing benefits	0.0	0.1	0.1	0.1	0.1	0.1
Local government current spending [3/]	0.2	0.3	0.5	0.7	0.9	1.1
Health (ONDAM at 2.3 percent 2018-2019)	0.1	0.2	0.2	0.2	0.2	0.2
Wage scale frozen nominally 2018-2019	0.1	0.3	0.3	0.3	0.3	0.3
Main tax measures [4/]	**-0.3**	**-0.6**	**-1.1**	**-1.1**	**-1.1**	**-1.1**
Elimination of accomodation tax	-0.1	-0.3	-0.7	-0.7	-0.7	-0.7
PIT exemption on overtime pay	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Reduction in CIT rate	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4
Tax on dividends	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Narrowing of wealth tax base	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2
Flat tax on financial savings	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Green taxes	0.2	0.2	0.3	0.4	0.5	0.5
Taxes on cigarettes	0.0	0.1	0.1	0.1	0.1	0.1

Sources: Rapport Economique, Social et Financier 2018; Loi de Programmation des Finances Publiques 2018; and IMF staff estimates.

1/ Measures are shown relative to a scenario with constant current primary spending net of unemployment benefits and tax credits, in percent of GDP.

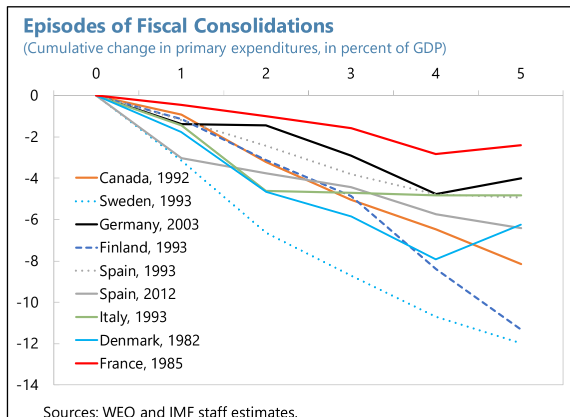
2/ Measures for 2018 are legislated in Loi de Programmation des Finances 2018–2022. Measures from 2019 onward are assumed to be legislated in the 2019 budget, except the contractual approach with the state, which is fully legislated through 2022.

3/ Nominal growth rate according to *2018 Loi de Finances* for 2018 (1.4 percent), 2019 (2.2 percent), and 1.2 percent from 2020.

4/ Measures legislated in Loi de Programmation des Finances 2018–2022, and an additional (announced but not yet legislated) elimination of the accomodation tax for the 20 percent wealthiest households. Not shown are the replacement of part of SSC for employees with a generalized tax cut (starting in 2019) and the elimination of the CICE tax credit (in 2020) with a reduction in the employers' SSC (in 2019), which are budget neutral in the medium run.

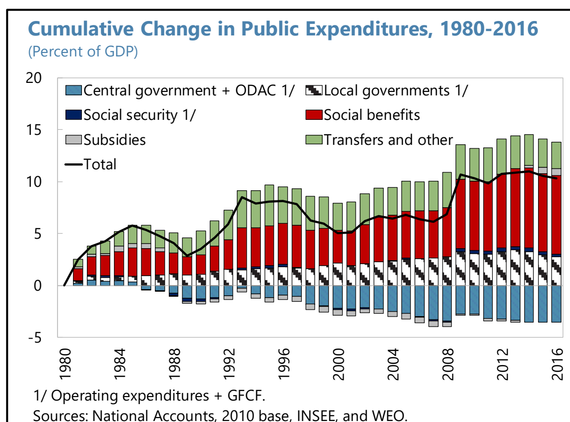
19. **The authorities aim to reduce debt below 90 percent of GDP and the structural deficit to 0.4 percent by 2023 through spending reforms, but have yet to specify them.** The high level of public debt could weigh on medium-term growth prospects and allows little room for maneuver in case of shocks. A lower fiscal deficit would not only help to generate fiscal space but also contribute to reduce the external imbalance. Thus, putting debt on a sustained downward path is a policy priority, and requires tackling the root cause of the problem, which has been the large and growing level of public spending. To this end, the authorities have launched: (i) discussions on a *civil service reform* including increased reliance on fixed-term contracts, a plan for voluntary departures, enhanced mobility options, and a merit-based pay system; (ii) consultations on a *pension reform* simplifying and unifying different special regimes; and (iii) a *spending review* by an expert-led Commission expected to identify further efficiency gains. However, fiscal risks remain significant, as remaining reforms will likely take time to be fully specified and legislated, and the legislated contractual approach with local governments may not be able to be fully enforced.

20. The needed spending reduction to place debt on a firm downward path is sizeable. To achieve the government's debt and structural deficit objectives, spending as a ratio to GDP will need to decline by some 4.2 percent between 2017 and 2023 (4½ percent in primary terms, excluding the conversion of the CICE into a tax cut). While this effort is larger than what France has achieved in the past, international experience indicates that such spending-based consolidations are not unprecedented (Box 3). Several other countries have managed similar or larger spending reductions through rationalization of wages and social benefits and containment of spending at the central and local government level. However, these efforts have been supported by strong growth (and full exchange rate flexibility), pointing to the importance of maintaining the structural reform momentum.



21. The credibility of the fiscal strategy hinges on the ability of the government to specify reforms early and implement them firmly. Staff recommends a spending reduction that is relatively frontloaded, amounting to around 1 percent of GDP in spending measures per year during 2019–20, with the effort gradually declining in the outer years. This implies an average real spending reduction (excluding tax credits) averaging 0.3 percentage points per year during 2019–22, compared to growth of 0.5 percentage points during 2012–16. It corresponds to a structural adjustment of around 0.4 percent of GDP per year in 2019–20 (net of the effect of the CICE reform), and of around 0.3 percent thereafter. Clarifying the plans for spending reforms early, starting with the 2019 budget, will be essential to support the credibility of the strategy and facilitate economic planning for economic agents. Given the size of the required adjustment, the authorities should resist pressures to reduce taxes further, especially housing taxes on more affluent households, which are neither supportive of growth nor of social objectives, and they should stand ready to take compensatory measures in case of overruns.

22. Spending reforms should focus on areas that can lead to the highest efficiency savings, while modernizing and improving the quality of spending. Spending reforms will also need to take a long-term perspective, in view of the challenges expected to be posed by population aging on pension and health spending, as the workforce financing these items will shrink. Specifically:[8]

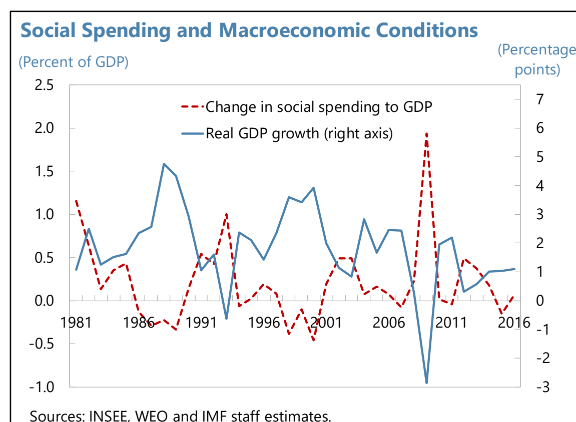


[8] For an earlier in-depth analysis identifying areas of spending efficiency gains, see: J. Hallaert and M. Queyranne, "From Containment to Rationalization: Increasing Public Expenditure Efficiency in France", IMF Working Paper 16/07, 2015. See also OECD 2017 Economic Report on France.

Projected Fiscal Outturns
(In percent of GDP, unless otherwise noted)

		2017	2018	2019 1/	2020	2021	2022	2023
Baseline projections	Revenues	53.8	53.5	52.2	51.7	51.2	51.0	50.9
	Spending	56.4	55.9	54.9	53.7	53.5	53.3	53.5
	Real spending growth (excl CICE)	1.3	0.5	-0.5	1.2	1.2	1.3	2.1
	Fiscal balance	-2.6	-2.4	-2.6	-2.0	-2.2	-2.3	-2.6
	Structural fiscal balance	-2.4	-2.2	-2.7	-2.2	-2.4	-2.6	-2.8
	Change in structural fiscal balance (excl. CICE)	0.4	0.2	0.4	-0.4	-0.2	-0.1	-0.3
	Real GDP growth	2.3	1.8	1.7	1.7	1.6	1.6	1.6
	Potential output growth	1.4	1.5	1.5	1.6	1.6	1.6	1.6
	Output gap	-0.1	0.1	0.3	0.4	0.4	0.4	0.4
	Public debt	96.8	96.2	95.8	94.6	93.6	92.8	92.2
	Current account balance	-0.6	-0.8	-0.6	-0.4	-0.2	-0.1	0.1
Recommended policies	Revenues	53.8	53.5	52.2	51.7	51.2	50.8	50.8
	Spending	56.4	55.9	54.9	53.1	52.2	51.6	51.3
	Real spending growth (excl CICE)	1.3	0.5	-0.5	-0.3	-0.2	0.3	1.0
	Fiscal balance	-2.6	-2.4	-2.6	-1.4	-1.1	-0.8	-0.5
	Structural fiscal balance	-2.4	-2.2	-2.7	-1.4	-1.0	-0.7	-0.4
	Change in structural fiscal balance (excl. CICE)	0.4	0.1	0.4	0.4	0.4	0.3	0.3
	Real GDP growth	2.3	1.8	1.7	1.4	1.4	1.5	1.5
	Potential output growth	1.4	1.5	1.6	1.6	1.7	1.7	1.7
	Output gap	-0.1	0.1	0.3	0.0	-0.2	-0.4	-0.5
	Public debt	96.8	96.2	95.7	94.2	92.3	90.0	87.5
	Current account balance	-0.6	-0.8	-0.6	-0.1	-0.1	0.0	0.0
Authorities' projections (2018 Stability Programme)	Revenues	53.9	53.7	52.6	52.4	52.2	52.0	.
	Spending	56.5	56.0	54.9	53.3	52.5	51.7	.
	Nominal spending growth (excl tax credits)	2.5	1.8	1.4	1.7	2.0	1.9	.
	Fiscal balance	-2.6	-2.3	-2.4	-0.9	-0.3	0.3	.
	Structural fiscal balance (excl. CICE conversion)	-2.0	-1.9	-1.6	-1.4	-1.0	-0.6	.
	Change in structural fiscal balance (excl. CICE)	0.5	0.1	0.3	0.3	0.4	0.4	.
	Real GDP growth	2.3	2.0	1.9	1.7	1.7	1.7	.
	Potential output growth	1.3	1.3	1.3	1.3	1.3	1.4	.
	Output gap	-0.9	-0.2	0.4	0.9	1.3	1.6	.
	Public debt	97	96.4	96.2	94.7	92.3	89.2	.

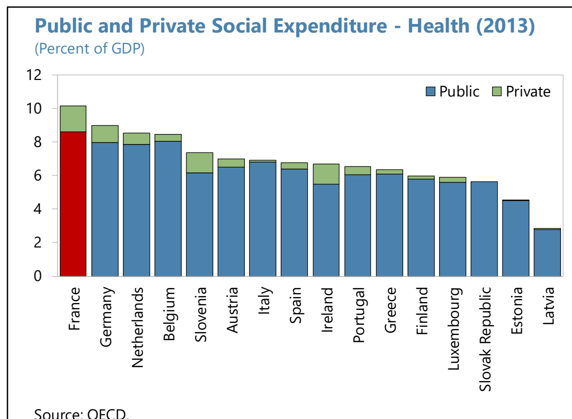
Sources: IMF staff estimates and 2018 France Stability Programme.
Note: Recommended policies scenario assumes full implementation of spending reforms yielding total savings of about 4 percent of GDP (excluding CICE conversion) by 2022 and of additional labor and product market reforms broadly aligned with staff advice.
1/ The conversion of the CICE (tax credit) into a tax cut reduces both taxes (sarting 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.



Sources: INSEE, WEO and IMF staff estimates.

- ***Social benefits***: While France has the highest level of social expenditure among OECD countries, outcomes in terms of reduction in inequality due to transfers are about the EU average. Moreover, social benefits in percent of GDP tended to evolve asymmetrically over the cycle during successive governments: they increased during downturns but did not decline as much in upturns. This suggests that there is scope to better target social benefits to those who need it when they need it, including through better means-testing (e.g. housing, family benefits). Efficiency savings could also be obtained by addressing the fragmentation of social programs across levels of government.

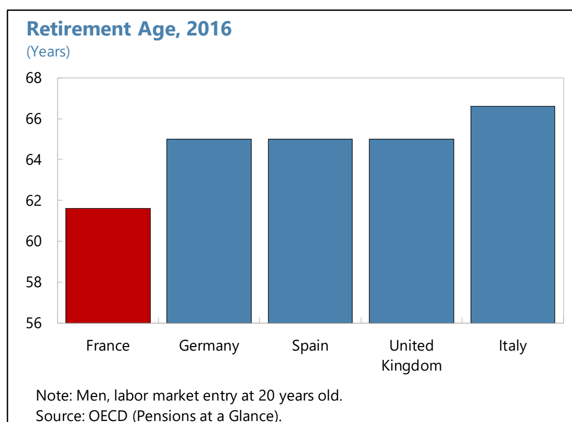
- ***Health system*: ** Health spending in France is high compared to peers, and population aging poses further challenges going forward. In this context, it will be important to achieve efficiency savings, including by further centralizing health procurement, enhancing the use of generic medicines, rationalizing hospital and primary care, better integrating various levels of care, and strengthen cost-effectiveness evaluation.



Source: OECD.

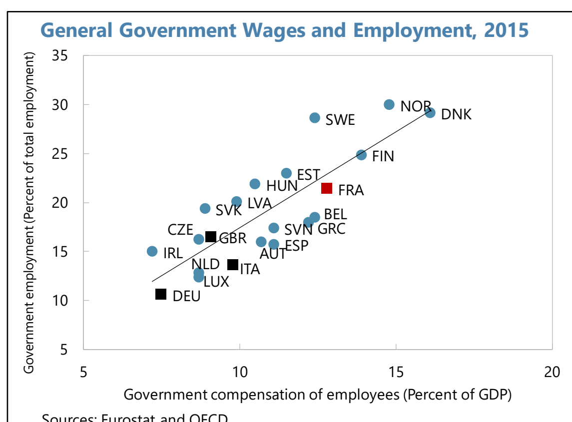
- ***Tax expenditures*:** Firms and individuals benefit from sizeable tax exemptions/rebates for investments, including for real estate, life insurance, and other savings plans. Such tax expenditure benefits, which may create distortions in the allocation of savings toward most productive uses, could be rationalized and be made more efficient.[9]

- ***Pension system*:** The pension system is complex (42 different mandatory retirement schemes), generous (high replacement rates compared to peers), and retains one of the lowest statutory retirement ages in Europe.[10] The planned reform unifying different regimes and simplifying the system could also consider progressively raising the effective retirement age in line with longevity and closer to that of European peers either by raising the statutory age, or by providing actuarial incentives to increase the effective retirement age.



Note: Men, labor market entry at 20 years old.
Source: OECD (Pensions at a Glance).

- ***Civil service*:** The public-sector wage bill is sizeable, at about 13 percent of GDP, among the highest in Europe, largely due to a relatively high level of public employment (20 percent of the labor force). While public sector wages are not high compared to the private sector (for highly educated employees the wage gap is negative), mobility is low, and civil servants benefit from job protection through their special statute. The government's



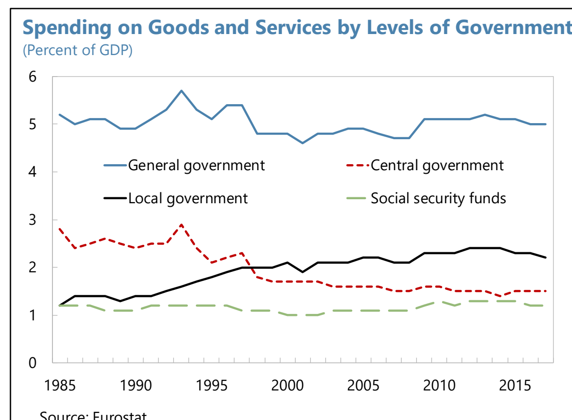
Sources: Eurostat and OECD.

[9] See in particular "*Fiscalité de l'Epargne Financière et Orientation des Investissement—Adapter les Mecanismes Actuels aux Besoins de Financement à Long-Terme*", *France Stratégie*, 2018.

[10] "*Les Retraites en France,*" *Conseil d'Orientation des Retraites*, 2018.

planned reform, which aims to address these problems by facilitating mobility, relying on fixed contracts, and introducing a merit-based pay system, could be complemented by additional targeted reductions in the number of civil servants through attrition, for example by not replacing all retiring civil servants.

- ***Local governments*****:** Spending in local governments, has continued to rise, while some functions are duplicated between the state and local governments. In addition to current plans to introduce a ceiling on operating expenditures growth, merging small municipalities and eliminating overlaps between local and central government's functions, such that the state retains control over setting policies and their control, while local governments focus on implementation, could generate efficiency savings.



Authorities' Views

23. The authorities reiterated their commitment to improve the efficiency of spending through comprehensive reforms, which would help achieve their medium-term debt and deficit objectives. They pointed to the positive fiscal developments in 2017, which are expected to pave the way for a decision on France's exit from the Excessive Deficit Procedure (EDP) this summer. For the short term, they reiterated their commitment to maintain the deficit below the EDP limit. In the medium run, they acknowledged additional structural spending reforms would be needed at all levels of government to contain spending and reduce the deficit and debt, stressing that the focus will be on reviewing the role of the state and on efficiency savings, while preserving social protection. They welcomed staff's suggestions on spending reforms and looked forward to the recommendations of the expert-led spending review to formulate further reforms.

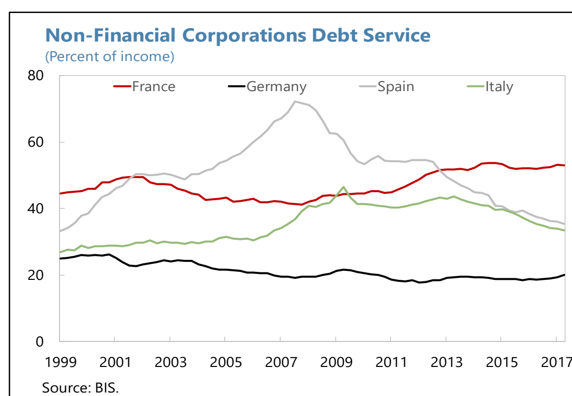
C. Financial Sector Policies: Bolstering Private-Sector Balance Sheets

24. While banks have improved financial buffers and supported the recovery, areas of vulnerability remain (Figure 5). The large banks have bolstered capital ratios and maintained profitability in line with peers, notwithstanding lower net interest margins (partly linked to regulated deposit rates). But cost efficiency and liquid-assets to short-term liability ratios are lower than the euro-area median, and French banks remain dependent on wholesale funding (including in the USD market), making them vulnerable to maturity mismatches and exchange rate risks.[11] Pressures on profits, which could also result from the rise of Fintech or from declining margins on mortgage portfolios refinanced at low fixed rates, may lead to more risk taking. Moreover, overall credit

[11] Also see Chapter 2 of the Selected Issues Paper for the 2016 France Article IV Consultation and the Spring 2018 and 2019 Global Financial Stability Reports.

growth has been broad-based and higher than nominal GDP, leading to an increase in corporate debt and debt-service ratio, which could pose stability risks to banks and the economy if interest rates normalize faster than expected.[12]

25. The authorities' recent decisions to activate macroprudential measures to prevent the buildup of imbalances are welcome. The decision, effective July 1, 2018, to lower banks' exposures to large indebted corporates to 5 percent of banks' capital is specifically aimed at protecting banks from potential risks arising from overindebted corporates and at limiting further growth of bank credit to these corporates (this measure has been unique in the Eurozone in addressing such potential risks). Similarly, the authorities' recent decision to activate a ¼ percent countercyclical capital buffer can help slow down the increase in debt, mitigate incipient systemic risk build-up, and help banks build buffers that could be released in the downward phase of the financial cycle to support activity. Going forward, the authorities should remain vigilant, monitor risks closely, and build on these measures if warranted. Further actions to incentivize equity rather than debt financing could also be considered, such as removing remaining tax deductions associated with interest payments.



26. Looking forward, efforts should continue to monitor risks and strengthen banks' resilience through the implementation of ongoing international regulatory changes. The recent Basel requirements to set output floors for internal ratings-based credit-risk measures and implementation of the *Minimum Requirement for own funds and Eligible Liabilities* (MREL) will help strengthen bank balance sheets. Thanks to a recent law that introduced a new class of senior non-preferred bail-in-able debt, French banks are on track to comply with new EU regulatory requirements. The authorities' recent decision to allow for a formula-based alignment of the regulated savings rate to inflation and market interest rates from 2020 onwards is expected to improve banks' net interest margins. Continued efforts to reduce administrative costs through consolidation of bank branches should further support profitability.[13]

Authorities' Views

27. The authorities agreed with the assessment. They noted that the French banking system is sound and has improved its capitalization and funding structure, which should help it weather shocks. This being said, they concurred with the need to continue to implement ongoing global and EU-wide regulatory changes to further build buffers, noting that French banks are well on track with

[12] See L. Antoun de Almeida and T. Tressel, "Corporate Debt in France", *Selected Issues Paper*, International Monetary Fund, 2018.

[13] Also see E. Detragiache, T. Tressel, and R. Turk, "Where Have All the Profits Gone? European Bank Profitability Over the Financial Cycle," 2018.

their MREL commitments. The authorities also agreed with the relevance of the countercyclical buffer's activation as a preventive measure in the context of robust growth, which they forecasted to continue over the next quarters, and in response to the loose financing conditions and to the buildup of private debt. They noted that the various measures being implemented or being considered have a medium-term perspective, and that coordination with the relevant European authorities is important in the development and effectiveness of macroprudential policy.

STAFF APPRAISAL

28. France has benefitted from a broad-based recovery. Importantly, job growth is picking up, and the fiscal deficit has fallen below the 3 percent-of-GDP threshold for the first time in a decade. Growth is expected to remain robust in the near term, albeit less buoyant than its peak in 2017, on the back of strong investment, consumption, and exports. Past and ongoing reforms are expected to support the economy's long-term growth potential.

29. But structural challenges persist and risks are rising. Domestically, the economy still suffers from high structural unemployment, weak competitiveness, and high public and private debt burdens. These not only limit improvements in living standards but also hamper the economy's ability to respond to external shocks, at a time where risks are rising, linked to increasing trade tensions, geopolitical uncertainty, and other political risks in Europe.

30. Thus, reform efforts need to continue to ensure the recovery is long lasting and the economy is resilient to shocks. The government has established a substantial initial track record of reforms, and the policy agenda ahead is equally ambitious. Looking forward, the reforms will need to focus on durably addressing remaining challenges. Strong, job-rich, and inclusive growth can also support the reduction of private and public debt burdens.

31. Further labor market reforms are key to reducing unemployment. Building on the recent important reforms of the labor code and taxation, the authorities need to implement the remaining planned reforms of the training and apprenticeship systems to reduce skills mismatches, lower structural unemployment, and improve job opportunities for disadvantaged groups. Further measures could be considered, especially if envisaged reforms do not produce the desired effects, to facilitate wage setting in line with productivity, reinforce training for the youth, and strengthen the work incentives of the unemployment system.

32. Lowering regulatory barriers would help firms to support growth and increase employment. In addition to the recent reform restructuring the railway sector and opening it up to competition, the authorities need to implement further planned measures (*Loi Pacte*) to support business growth and innovation. Going further in liberalizing regulated professions (e.g. pharmacies) can reduce costs and improve quality and consumer choice.

33. Putting public debt on a firm downward path requires further efforts to permanently reduce public spending. Spending reforms at all levels of the government will be needed to support the authorities' appropriately ambitious debt and deficit-reduction objectives. This can also

be an opportunity to reevaluate how public services are provided and modernize and enhance their efficiency. To support the credibility of the strategy, reforms will need to be specified early, starting with the 2019 budget.

34. Efforts should continue to strengthen private-sector balance sheets. While the banking system is now stronger, and has been able to support the recovery, vulnerabilities remain, especially associated with the increase in private sector debt, particularly in the corporate sector. In this regard, recent macro-prudential measures aimed at reducing imbalances are welcome. Looking forward, efforts should continue to monitor vulnerabilities and build bank buffers against shocks, including through the implementation of ongoing international regulatory changes.

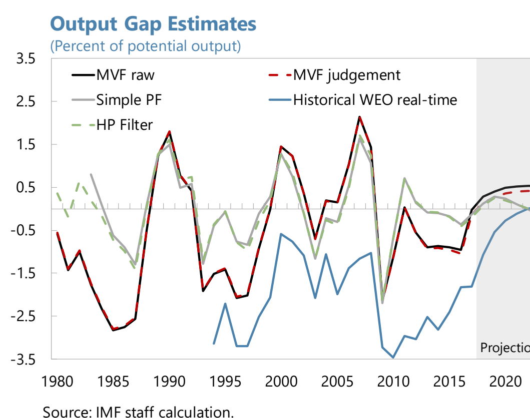
35. These policy efforts would also reduce France's external vulnerabilities. France's external position is assessed to be moderately weaker than that implied by fundamentals and desired policies. Recent and planned labor and product and service market reforms enhancing firms' productivity and facilitating an adjustment of labor costs in line with productivity, together with recent tax reforms reducing the labor tax wedge should help increase France's competitiveness. Together with planned fiscal consolidation, they can help reduce external imbalances further.

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

Box 1. Estimating France's Output Gap

Staff relies on a combination of analytical tools and judgement to assess the output gap. The main analytical tool employed by staff is a multivariate filter (MVF), which is a time-series model of output, potential output, the unemployment rate and the NAIRU, and is estimated using Bayesian techniques. The model embeds a Phillip's curve relating the inflation process to the output gap to better identify demand shocks, as well as an Okun's law relationship allowing deviations of actual unemployment from the NAIRU to inform the output gap estimates. While the MVF is a key tool for the assessment of the output gap, staff also takes into account other measures of the economy's cyclical position, which include indicators for economic slack (e.g. capital utilization, survey data on hiring difficulties, or underemployment rates), as well as estimates obtained from other statistical approaches, as e.g. the Hodrick Prescott filter (HP filter) applied directly to output, or filters applied to the key labor, capital, and productivity inputs using a production function approach (PF).[1]

Output Gap Estimates
(Percent of potential output)



Source: IMF staff calculation.

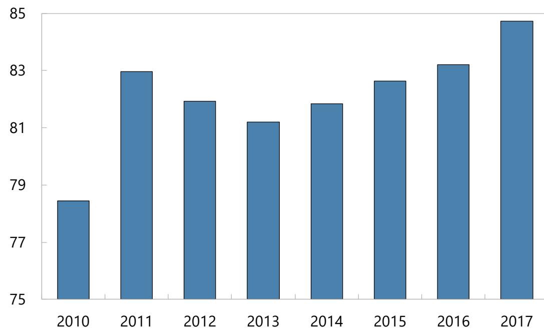
An ex-post evaluation of historical real-time estimates for European countries and found a tendency toward negative output gaps. Staff's analysis is based on estimates published in vintages of the IMF's World Economic Outlook (WEO) from 1994 to the Fall 2017. For France, the analysis shows that real-time output gap estimates have been generally large and negative over prolonged periods of time, averaging -2 percent of GDP during 1994–2015. This stands in contrast to current estimates obtained from applying the MVF to the latest (Fall 2017) data vintage, which average -1 percent. This tendency for negative output gaps in real-time estimates is not unique to France, but is observed across euro area countries, is particularly prominent among high-debt countries, and persists even when the global financial crisis is excluded from the sample. Staff's analysis suggests that it is to a large part explained by two factors: (i) an optimistic bias in the medium-term forecast used to extend the MVF's sample period, and (ii) judgmental deviations from MVF estimates motivated by a broader assessment of a country's cyclical position.

The output gap for France has been reassessed to have been largely closed in 2017. This reassessment takes into account the tendency observed in real-time estimates for negative estimates. But an equally important part of this reassessment has been a careful analysis of economic indicators that could shed light on the cyclical situation and the size of the output gap. Specifically, capital utilization has increased steadily since 2013, and the share of firms reporting that their current staff size constraints them in raising output reached its highest level since 2002. Across all sectors, hiring difficulties started to become more pronounced since 2016, and have reached their 2007 levels in the industry and service sectors. This was mirrored by a reduction in underemployment, suggesting that firms increase hours at the intensive margin. Taken together, these indicators and the results of the multivariate filter suggest that the output gap was largely closed in 2017, which is broadly in line with the authorities' assessment.

[1/] For a more detailed description of the methodology, see "Potential Output in France, Germany, and Spain: A Re-Assessment," IMF Country Report No. 15/233.

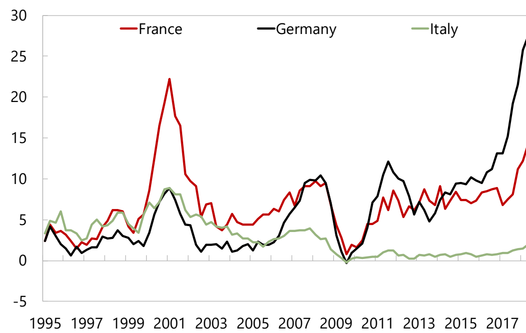
Box 1. Estimating France's Output Gap (concluded)

Industry Capital Utilization
(Percent)



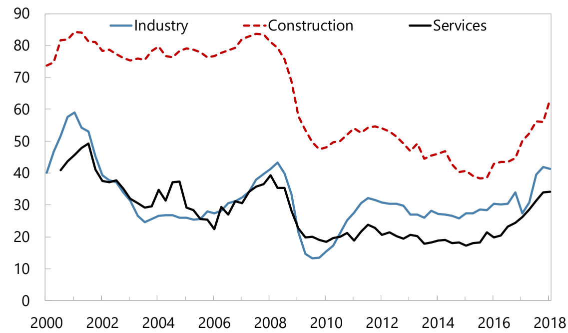
Source: European Commission.

Share of Companies Constrained by Staff Size
(Percent of industrial firms reporting lack of manpower limiting expansion)



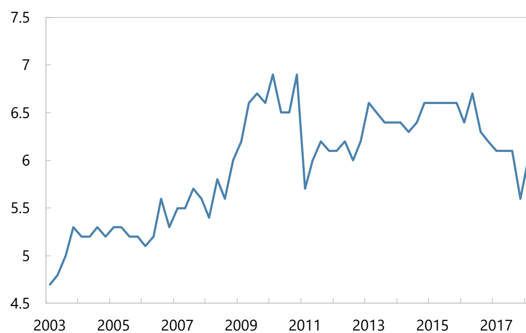
Source: Eurostat (DG ECFIN).

Difficulties to Recruit
(Percent of companies reporting)



Source: Haver Analytics (INSEE, Quarterly Business Survey).

Underemployment rate
(Percent of underemployed in total employment)



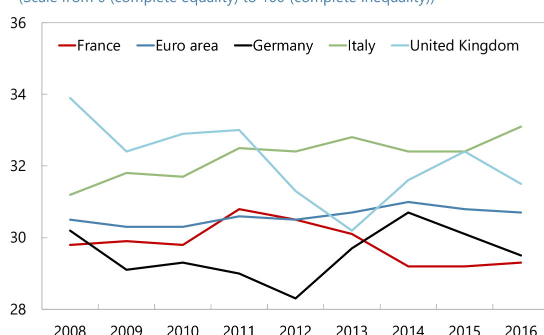
Source: INSEE, Enquête Emploi.

Box 2. Inequality and Labor Market and Fiscal Policies in France

France's aggregate income inequality is around the OECD average. After having increased during the crisis, inequality has returned to its pre-crisis level, and is at similar levels as in Germany. However, this aggregate picture masks important differences across generations and socio-economic groups, which have been linked to labor market rigidities and have been exacerbated by the recent crisis.

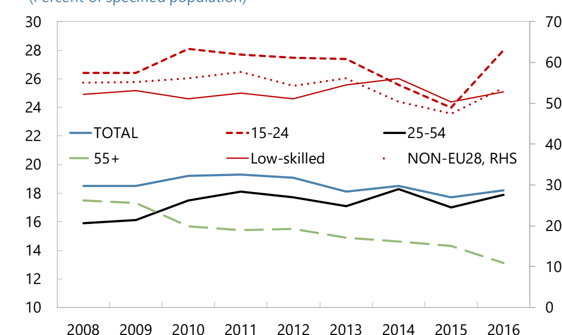
Relative youth poverty is much higher than that of the elderly, and has gone up more recently, while elderly poverty declined steadily. Like elsewhere in the Europe, this reflects a rising gap between the incomes of the elderly, which have been better protected during the crisis by the generous pension system, and those of young workers, who have suffered from relatively higher unemployment rates or, if employed, from lower wages, given reliance on temporary and part-time work contracts (see IMF, 2018. Inequality and Poverty Across Generations in the European Union. SDN/18/01).

Gini Coefficient of Equivalised Disposable Income
(Scale from 0 (complete equality) to 100 (complete inequality))



Source: Eurostat.

People at Risk of Poverty or Social Exclusion by Age
(Percent of specified population)



Source: Eurostat.

Along with the youth, the low-skilled, and non-EU immigrants have had a lower labor market performance compared to prime-age native workers, which has been exacerbated by the crisis.[2] Specifically, workers with low educational attainment (below upper secondary) have tended to be between 30–50 percent less likely to find a job compared to more educated groups, while non-EU migrants face even worse job prospects (probability almost three times as large as the probability of being unemployed faced by prime-age native workers).[1] As a result, these vulnerable socio-economic groups have fallen into the lower percentiles of the income distribution and are experiencing a higher relative risk of poverty than other groups. Specifically, the relative poverty risk for non-EU immigrants is about three times as large than that of prime age workers, while the relative poverty for the low-skilled is about 50 percent higher than for other groups.

Unemployment probability[1] (In percentage point)	France 2005-07	France 2012-14	Crisis-Resilient Comparators[2] 2005-07	Crisis-Resilient Comparators[2] 2012-14	Crisis-Impacted Comparators[3] 2005-07	Crisis-Impacted Comparators[3] 2012-14
Age						
25-54 years (base)	6.3	7.8	3.3	4.2	6.4	13.7
15-24 years	5.4	4.7	2.3	3.0	3.3	6.4
Country of birth						
Native (base)	6.0	7.1	3.0	3.8	6.0	12.6
Non-EU born	6.0	7.1	5.1	4.8	3.0	5.7
Education						
Lower secondary (base)	9.0	11.0	5.4	6.8	7.6	18.0
Tertiary	-4.5	-5.6	-3.4	-4.0	-3.3	-9.2
Job sector						
Services (base)	6.2	7.4	3.5	4.4	5.9	12.1
Manufacture	1.3	2.0	0.0	0.1	2.2	5.8
Years of residency						
Less than 1 year (base)	18.2	29.8	7.7	8.9	8.6	22.8
4 years or more	-11.8	-22.1	-4.2	-2.4	-2.4	-9.5
Headline employment rate	**63.9**	**63.9**	**69.0**	**69.4**	**63.9**	**58.3**

[1] Coefficients indicate the margins (change in the probability of being unemployed) compared to the base category, for rows of base categories where they represent the probabibility to be unemployed. All probabilities are 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.

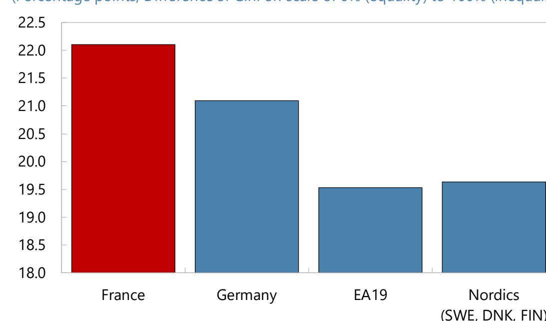
1/ The probability of finding a job is computed as the ratio of marginal probabilities of being unemployed relative to the marginal probability for the base (25–54 years).
2/ Also see N. Batini, W. Gbohoui, C. Mummsen, "Explaining Unemployment in the Euro Area: A Cross-Country Analysis of Vulnerable Groups Using Micro Data," 2018.

Box 2. Inequality and Labor Market and Fiscal Policies in France (concluded)

In a Euro Area cross-country comparison, the weak labor market performance of vulnerable groups has been shown to be linked with labor market rigidities. These rigidities include a higher labor tax wedge and a relatively higher minimum wage, which penalize the youth, migrants, and low skilled.[2] Against this background, the recent and upcoming labor market reforms could help address these pockets of inequality. For example, the reform of professional training and apprenticeship promises to enhance the incentives given to businesses to hire youngsters in such neighborhoods could boost their income prospects and raise social mobility over time. In the interim, the government aims to invest €15 billion in the training of one million youngsters neither in education nor in employment and one million long-term unemployed. These measures could have a more immediate effect in reducing the dispersion of market income for these vulnerable groups, to the extent that they can permanently affect the employability of these groups.

On the fiscal front, France's tax and benefit system is relatively more effective at redistributing market income as Germany's or the Nordic countries'. Reforms passed in 2014–2016, such as the increase in the tax rebate for couples, the introduction of new mean-tested benefits and better targeting of family allowances are expected to reduce France's net income inequality.[3] More recent fiscal reforms replacing part of the employee social contributions with an increase in a general income tax on both workers and retirees could also help to address intergenerational inequality and mitigate the negative impact on inequality of other recent tax measures, such as the reduction in wealth taxes.

Difference in Gini Before and After Taxes and Transfers
(Percentage points; Difference of Gini on scale of 0% (equality) to 100% (inequality))



Note: For total population, 2015 data.
Source: OECD (Income Distribution Database).

[3]/ Also see Euromod, 2017, https://www.euromod.ac.uk/.

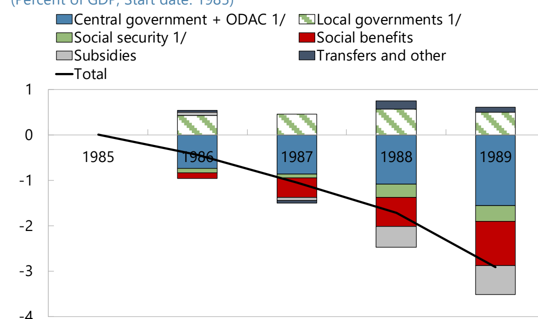
Box 3. Large Fiscal Consolidations: How Successful Have They Been?

Experience with spending-based fiscal consolidations in France has been mixed.[1] In the three notable adjustment episodes since 1980, two were relatively more successful, with spending reductions of around 2.5–2.8 percent of GDP, while the latter episodes were not able to achieve their objectives. Specifically:

- *Virage de la rigueur*. Launched in 1983, it took place in the context of a rapid deterioration of the fiscal position, inflationary pressures, and a large deterioration of the current account. The measures taken included broad-based spending restraints, including the wage bill, at the central government level and social security administrations, and restraint in social benefits. Primary expenditures to GDP were reduced by 2.8 percentage points between 1985 and 1989.
- *EMU entry*. In 1994, a five-year Guidance Law on Public Finance Control was adopted, including multi-year objectives, such as a real primary spending targets. While objectives were not met initially, spending restraint was successful starting 1996, thanks to a mix of declines in capital spending, a freeze of the pay scale of civil servants, and cuts in defense spending and social transfers. As a result, the ratio of primary expenditures to GDP declined by 2.5 percentage points between 1996 and 2000.
- *EDP-related fiscal consolidations (2003–07)*. To keep the fiscal deficit below the 3 percent EDP target, France undertook measures involving a legally binding zero real spending growth at the central government level, as well health and pension reforms. However, overall spending did not decline, as restraint at the central government level was offset by overruns at the local level, and in social benefits**.**

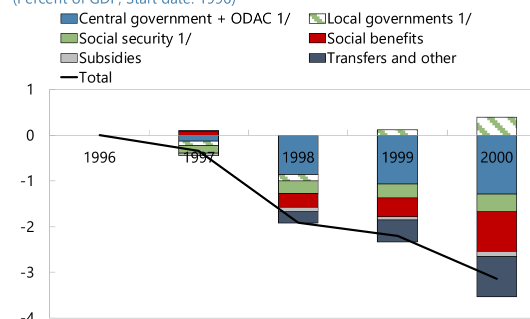
France's Consolidation Episodes: Contributions to Spending Restraints (from peak year)

Virage de la rigueur



1/ Operating expenditures + GFCF.
Sources: National Accounts, 2010 base, INSEE, and WEO.

EMU entry



1/ Operating expenditures + GFCF.
Sources: National Accounts, 2010 base, INSEE, and WEO.

In international comparison, large fiscal consolidations are not unprecedented. Blöchliger, H., D. Song and D. Sutherland (2012), identify eight consolidation episodes involving a reduction in primary expenditures of at least 4 percent of GDP within 5 years starting from a peak year.[2,3] The average primary spending reduction across these eight episodes averaged 7.2 percent of GDP. A notable feature of these episodes is that they were accompanied by relatively strong real GDP growth (averaging almost 3 percentage points) and full exchange rate flexibility. The three largest spending reductions were those of Sweden, Finland and Canada:

[1/] E. Martin, I. Tytell, and I. Yakadina, "France: Lessons from Past Consolidation Plans," IMF Working Paper WP/11/89, 2011.
[2/] H. Blöchliger, D. Song, and D. Sutherland, "Fiscal Consolidation: Part 4. Case Studies of Large Fiscal Consolidation Episodes," OECD Economics Department Working Papers, No. 935, 2012.
[3/] Also see V. Aussilloux, C. Gouardo, and F. Lenglart, "*Baisser le Poids des Dépenses Publiques: les Leçons de l'Experience des Pays Européens*", Note d'Analyse N.67, *France Stratégie*, 2018, which assess spending-based consolidation episodes of at least 3 percent of GDP.

Box 3. Large Fiscal Consolidations: How Successful Have They Been? (concluded)

- *Sweden, (1993):* the spending based consolidation (12 percent of GDP) followed a sharp recession. Current central government spending was frozen for three years and transfers to local governments were frozen at their nominal 1994 level until 2000 and local government borrowing was barred. Various social benefits were reduced and eligibility tightened. The consolidation was achieved in the context of average real growth of about 3 percentage points.
- *Finland, (1993):* the fiscal consolidation (11 percent of GDP) followed a financial crisis. The strategy involved substantial cuts in the government wage bill, social security payments and transfers to local governments. Real growth averaged close to 5 percent during this period.
- *Canada, (1992):* The consolidation (8 percent of GDP) followed a deterioration in growth and fiscal positions, and was based on reducing spending both at the central and local government levels by reducing the wage bill, reforming unemployment insurance and reducing benefits reduced, and improving control of inter-governmental transfers. Real growth was around 3 percentage points.

Episodes of large fiscal consolidations

	Reduction in primary expenditures, in percent of GDP [1/]	Annual real primary spending growth [2/]	Annual real GDP growth
Sweden, 1993	-12.0	-0.8	3.3
Finland, 1993	-11.3	1.5	4.7
Canada, 1992	-8.2	-1.0	3.1
Spain, 2012	-6.4	-1.3	1.9
Denmark, 1982	-6.2	0.4	3.2
Spain, 1993	-4.9	0.7	3.4
Italy, 1993	-4.8	0.0	1.8
Germany, 2003	-4.0	-1.1	1.9
Average	-7.2	-0.2	2.9
Median	-6.3	-0.4	3.2
Staff recommended policies scenario	-4	-0.1	1.6

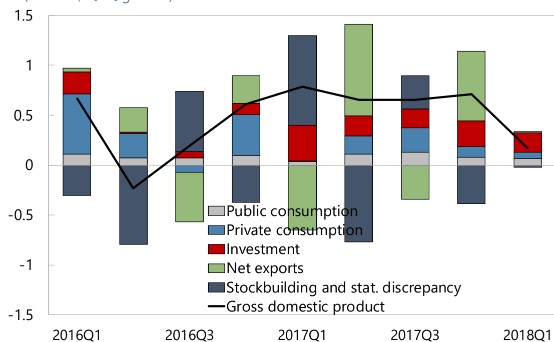
Sources: WEO and IMF staff calculations.
1/ Reduction over 2017-2023, excluding CICE tax credit.
2/ Excluding CICE tax credit.

The needed reduction in spending to achieve France's medium-term objective and put debt on a sustained downward part is significant. It is estimated at 4.2 percent of GDP, excluding the conversion of the CICE, and 4½ percent in primary spending terms (excluding tax credits), which is larger than previous consolidations in France, but still below the median in the cross-country sample analyzed. However, the expenditure restraint is expected to take place in lower real growth environment compared to all of these episodes. This underscores the importance of deepening growth-enhancing structural reforms, which can reinforce the success of the fiscal strategy in reducing public debt.

Figure 1. High Frequency Indicators

After four strong quarters of growth, activity softened in Q1, on the back of slower domestic demand....

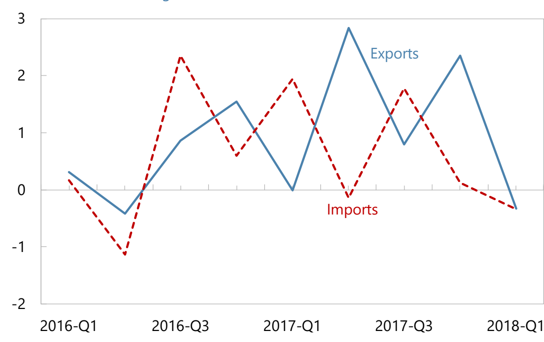
Contribution to Real GDP Quarterly Growth
(Percent; QoQ growth)



Source: Haver Analytics.

...and lower exports and imports...

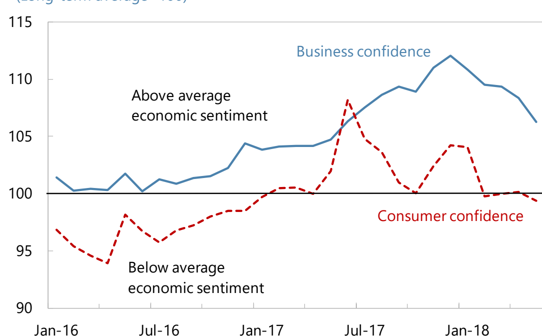
Exports and Imports of Goods and Services
(Q-o-Q Percent Change)



Source: Haver Analytics (France National Accounts).

Business confidence remains upbeat, albeit on a declining trend..,

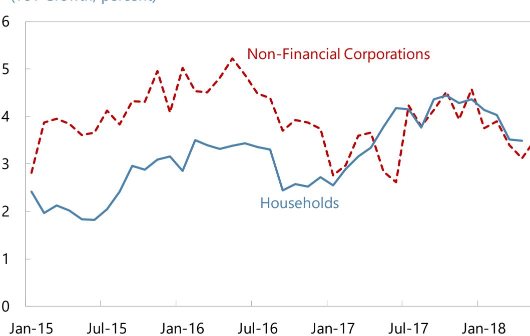
Business and Household Confidence
(Long-term average=100)



Source: Haver Analytics (INSEE).

...and bank credit is strong...

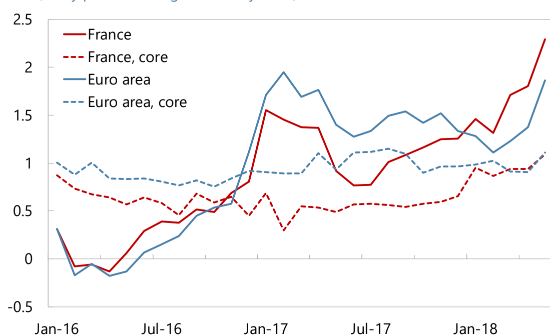
Real Bank Credit Growth
(YoY Growth, percent)



Source: Haver Analytics.

HICP inflation and core inflation have accelerated, either exceeding or catching up to the Euro Area trends.

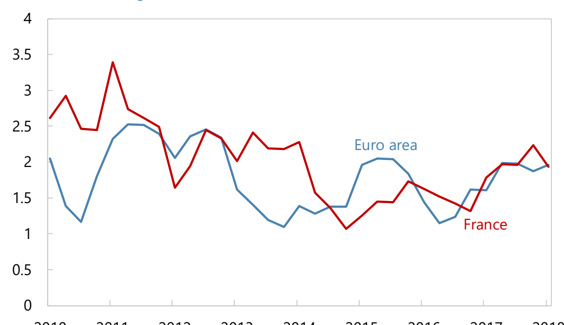
Harmonized Consumer Price Index
(Y-o-y percent change, until May 2018)



Source: Haver Analytics.

While wage growth is broadly in line with the EA average.

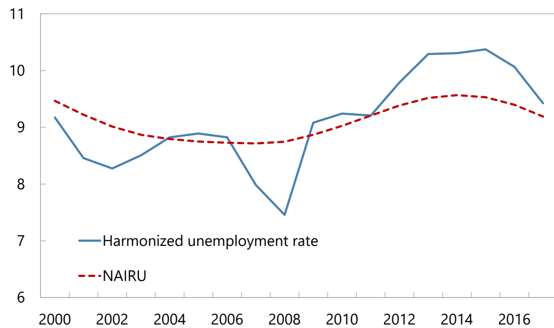
Hourly Wages: Industry, Construction and Services
(YoY Percent Change)



Source: Haver Analytics (Eurostat).

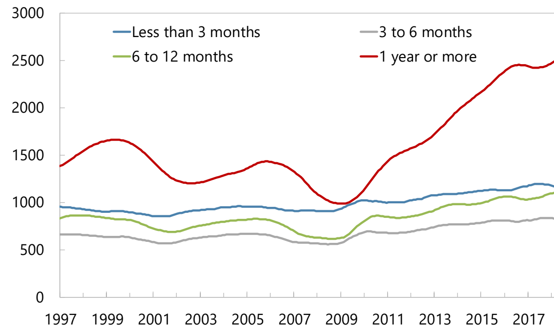
Figure 2. Labor Market Developments

Structural unemployment is declining but remains high…



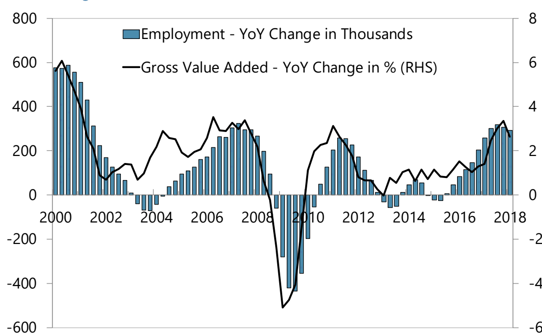
Sources: Haver Analytics and IMF staff calculations.

…as long-term unemployment decelerated but continues to trend upward.



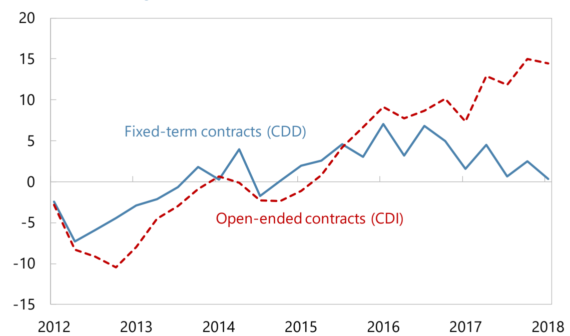
Source: France Ministry of Labor.

The drop in unemployment reflects a virtuous cycle between firming activity and employment growth.



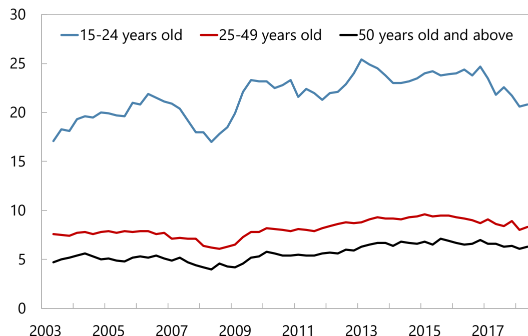
Source: Haver Analytics (INSEE).

Job creation is accompanied by an increase in open-ended contracts…



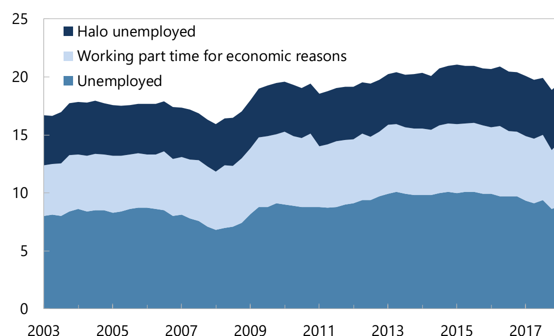
Source: Haver Analytics (ACOSS Economic Barometer).

Unemployment remains high for youths…



Source: Haver Analytics (INSEE).

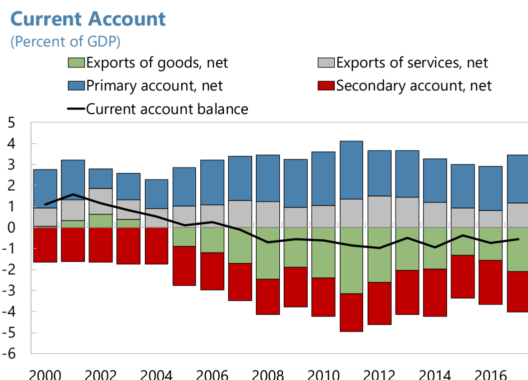
…while underemployment has declined in recent years



Source: Haver Analytics (INSEE).

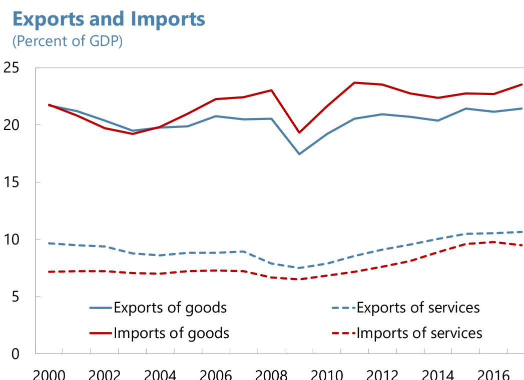
Figure 3. External Sector

The CA turned negative after the crisis…



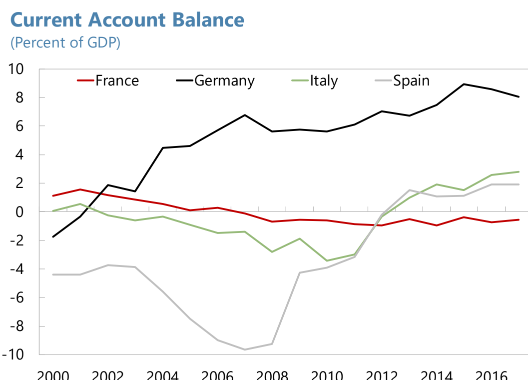
Source: Haver Analytics.

As goods exports grew less than goods imports.



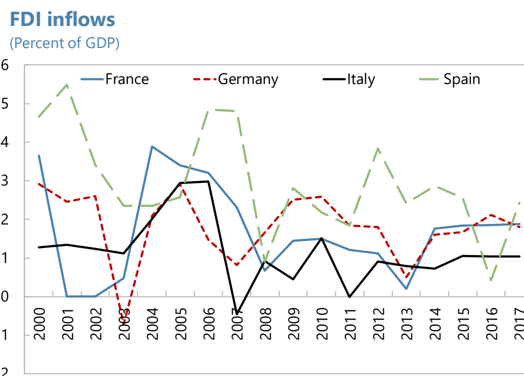
Source: Haver Analytics (France BoP).

France is the only large EA country with a negative CA.



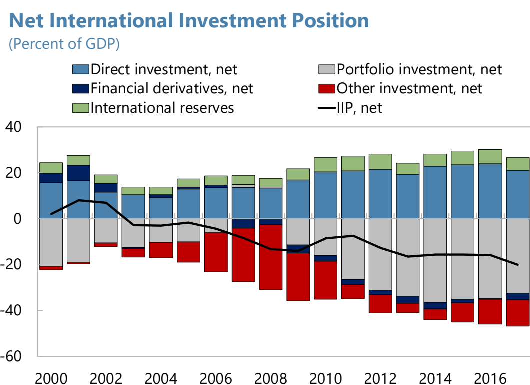
Source: Haver Analytics.

FDI inflows have increased in recent years but remain below pre-crisis levels.



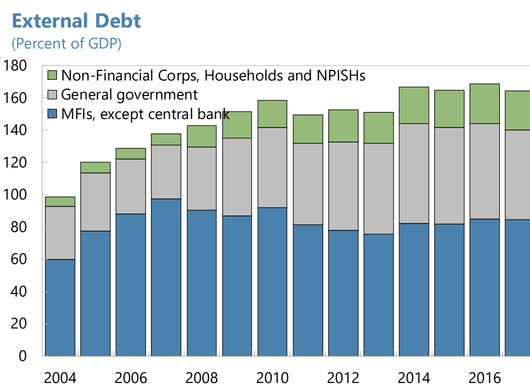
Sources: World Economic Outlook; and IMF staff calculations.

The NIIP deteriorated on the account of increasing external debt …



Source: IMF BOP.

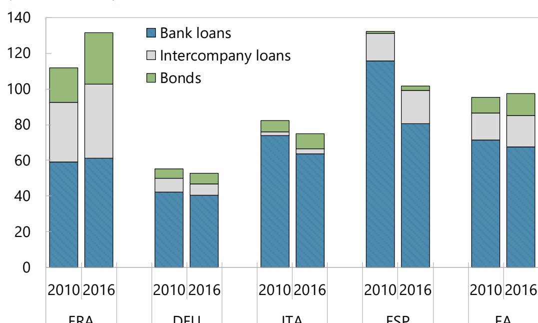
…concentrated in banks and the government.



Source: IMF BOP.

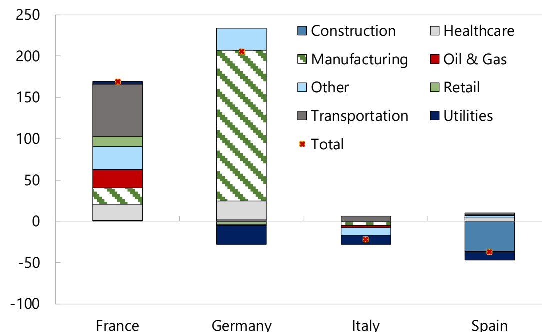
Figure 4. Corporate Debt

France's corporate debt is high and has increased significantly, driven by intercompany loans and bonds.



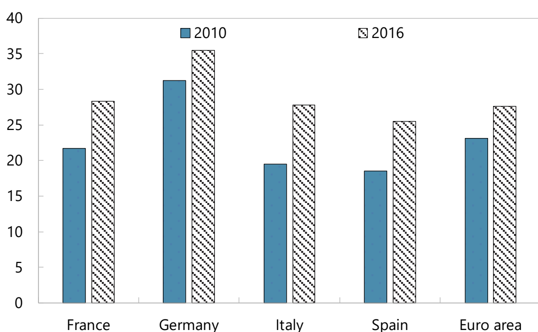
Source: ECB Sector Accounts.

The debt increase, when consolidated at the firm level, is concentrated in a few sectors, notably transportation.



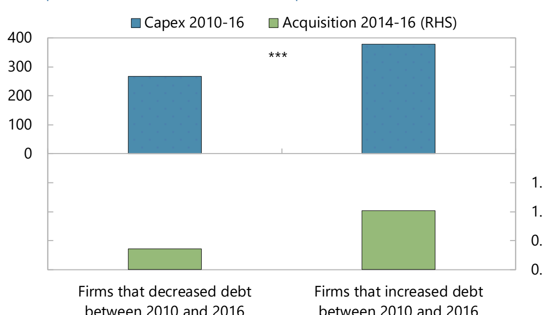
Source: Worldscope.

Firms have used the financing to increase cash buffers…



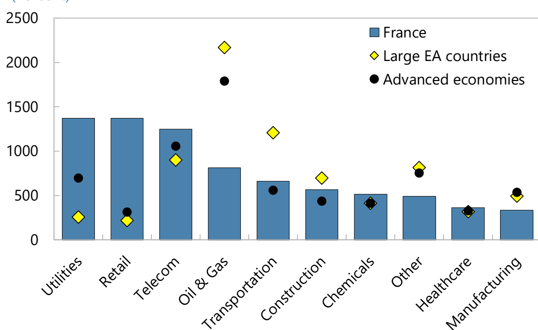
Source: ECB Sector Accounts.

… and also for fixed investment and acquisitions.



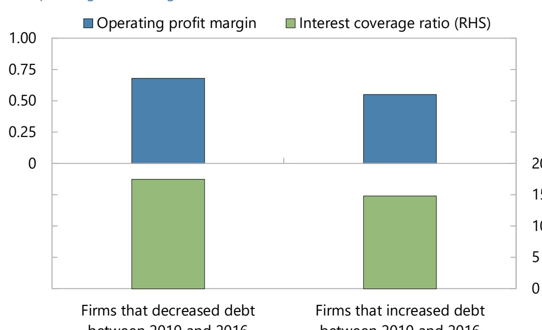
Note: *** denotes significant difference in means at a 1% level.
Source: Worldscope.

While debt to income ratios are high in some sectors,



Sources: Worldscope and IMF staff calculations.

… profits and capacity to repay debt were not affected.



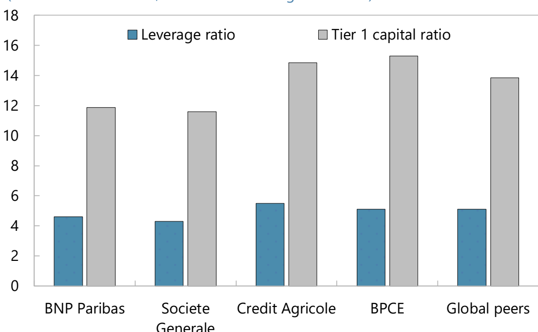
Source: Worldscope.

Figure 5. Banking Sector: Key Indicators

French large banks have improved capitalization ….

Leverage and Tier 1 Capital Ratios, 2017

(Percent of total assets; Percent of risk-weighted assets)

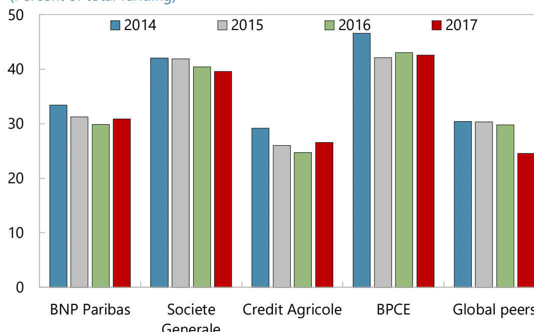


Source: SNL.

But are reliant on wholesale funding ….

Wholesale Funding Share

(Percent of total funding)

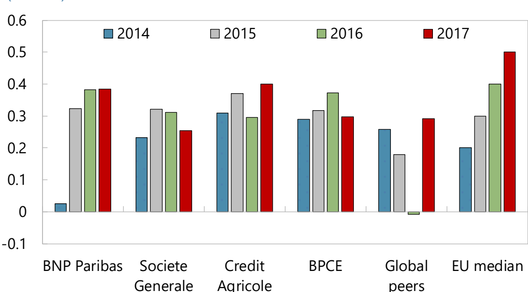


Source: SNL.

Profitability is broadly in line with peers….

Profitability: Return on Assets

(Percent)

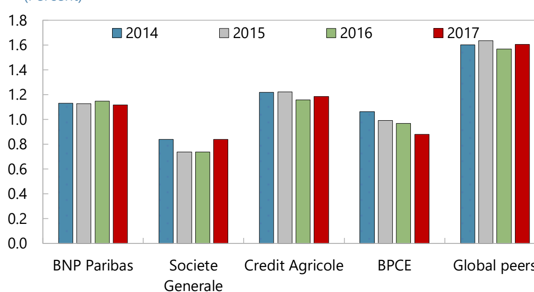


Global peers: Banco Santander, BBVA, Barclays, Credit Suisse, Deutsche Bank, HSBC, ING, Lloyds, RBS, UBS, and UniCredit.
Sources: SNL and 2017 EBA transparency average.

…But net interest margins are below EU peers' average….

Net Interest margins

(Percent)

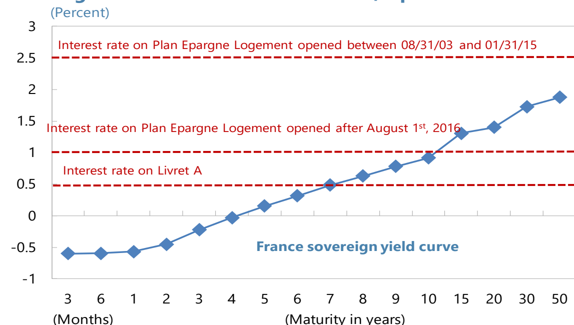


Note: Net interest margin is interest income as a percent of average interest earning assets minus interest expenses as a percent of interest bearing liabilities
Source: SNL.

..partly due to regulated rates on deposits …

Regulated Interest Rates in France, April 2018

(Percent)

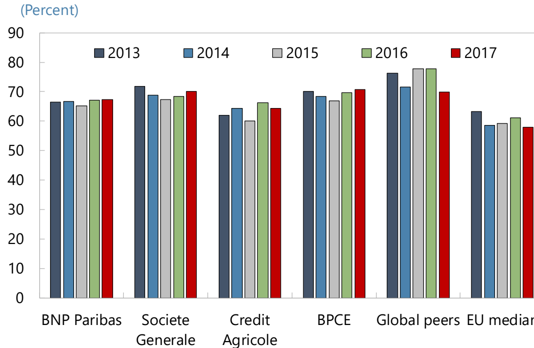


Sources: SNL, Agence France Trésor, and IMF Staff calculations.

…and relatively lower cost efficiency …

Cost-to-Income Ratio

(Percent)



Sources: SNL and EBA transparency reports 2016 and 2017.

Table 1. France: Selected Economic and Social Indicators, 2014–23

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Projections					
Real economy (change in percent)										
Real GDP	1.0	1.0	1.1	2.3	1.8	1.7	1.7	1.6	1.6	1.6
Domestic demand	1.5	1.5	1.6	2.2	1.3	1.6	1.7	1.6	1.6	1.6
Private consumption	0.8	1.5	2.1	1.0	1.1	1.6	1.6	1.4	1.4	1.3
Public consumption	1.3	1.0	1.4	1.3	0.8	0.3	0.5	0.6	0.7	1.0
Gross fixed investment	0.0	1.0	2.8	4.5	2.9	3.0	3.2	3.2	2.9	2.8
Foreign balance (contr. to GDP growth)	-0.5	-0.4	-0.5	0.1	0.4	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	3.3	4.6	1.5	4.5	4.4	4.7	3.9	3.8	3.7	3.6
Imports of goods and services	4.9	5.9	3.0	4.0	3.0	4.4	3.8	3.6	3.4	3.4
Nominal GDP (billions of euros)	2,150	2,198	2,229	2,292	2,364	2,441	2,525	2,614	2,705	2,801
CPI (year average)	0.6	0.1	0.3	1.2	1.8	1.7	1.7	1.8	1.9	1.9
GDP deflator	0.5	1.2	0.3	0.5	1.4	1.6	1.7	1.8	1.8	1.9
Gross national savings (percent of GDP)	21.8	22.3	21.9	22.9	22.9	23.0	23.3	23.6	23.8	24.1
Gross domestic investment (percent of GDP)	22.7	22.7	22.7	23.5	23.7	23.7	23.7	23.8	23.9	24.0
Public finance (percent of GDP)										
General government balance	-3.9	-3.6	-3.4	-2.6	-2.4	-2.6	-2.0	-2.2	-2.3	-2.6
Revenue	53.3	53.2	53.0	53.8	53.5	52.2	51.7	51.2	51.0	50.9
Expenditure	57.2	56.8	56.6	56.4	55.9	54.9	53.7	53.5	53.3	53.5
Structural balance (percent of pot. GDP)	-3.3	-2.9	-2.8	-2.4	-2.2	-2.7	-2.2	-2.4	-2.6	-2.8
Primary balance	-1.9	-1.8	-1.8	-0.9	-0.6	-0.8	-0.1	-0.2	-0.2	-0.3
General government gross debt	94.9	95.6	96.6	96.8	96.2	95.8	94.6	93.6	92.8	92.2
Labor market (percent change)										
Employment	0.6	0.4	0.6	0.6	0.6	0.5	0.5	0.4	0.4	0.4
Labor force	0.5	0.5	0.3	-0.1	0.0	0.1	0.1	0.1	0.1	0.1
Unemployment rate (percent)	10.3	10.4	10.1	9.4	8.9	8.5	8.1	7.8	7.6	7.4
Total compensation per employee	1.1	0.7	1.1	2.5	...	...	...	...	...	...
Credit and interest rates (percent)										
Growth of credit to the private non-financial sector	2.2	3.7	3.8	5.6	4.7	4.5	4.3	3.9	3.5	3.5
Money market rate (Euro area)	0.1	-0.1	-0.3	-0.4	...	...	...	...	...	...
Government bond yield, 10-year	1.7	0.8	0.5	0.8	...	...	...	...	...	...
Balance of payments (percent of GDP)										
Current account	-1.0	-0.4	-0.8	-0.6	-0.8	-0.6	-0.4	-0.2	-0.1	0.1
Trade balance of goods and services	-0.8	-0.4	-0.8	-0.9	-0.9	-0.7	-0.5	-0.3	-0.2	0.0
Exports of goods and services	30.4	31.9	31.7	32.1	31.3	32.3	32.5	32.8	32.8	32.7
Imports of goods and services	-31.2	-32.3	-32.4	-33.0	-32.3	-33.1	-33.0	-33.2	-33.0	-32.8
FDI (net)	1.7	0.3	1.1	0.3	0.5	0.6	0.7	0.8	0.9	1.0
Official reserves (US$ billion)	49.5	55.2	56.1	54.8	...	...	...	...	...	...
Exchange rates										
Euro per U.S. dollar, period average	0.75	0.90	0.90	0.89	...	...	...	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	101.9	97.9	98.7	100.0	...	...	...	...	...	...
REER, ULC-based (2005=100, +=appreciation)	98.4	92.8	92.3	92.6	...	...	...	...	...	...
Potential output and output gap										
Potential output (change in percent)	1.0	1.1	1.2	1.4	1.5	1.5	1.6	1.6	1.6	1.6
Memo: per working age person	0.6	0.7	0.8	0.9	1.0	1.1	1.2	1.2	1.2	1.6
Output gap	-0.9	-1.0	-1.0	-0.1	0.1	0.3	0.4	0.4	0.4	0.4

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

Table 2. France: General Government Accounts, 2014–23

(In percent of GDP unless otherwise indicated)

	2014	2015	2016	2017	2018	2019[4/]	2020	2021	2022	2023
						Projections				
General government										
Revenue	53.3	53.2	53.0	53.8	53.5	52.2	51.7	51.2	51.0	50.9
Tax revenue	45.7	45.6	45.6	46.4	46.1	44.8	44.3	43.8	43.5	43.5
Nontax revenue	7.7	7.6	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Expenditures	57.2	56.8	56.6	56.4	55.9	54.9	53.7	53.5	53.3	53.5
Primary exp.	55.1	54.8	54.7	54.5	54.0	52.90	51.7	51.3	51.0	51.2
Debt service	2.2	2.0	1.9	1.9	1.9	2.0	2.1	2.1	2.2	2.4
Balance 1/	-3.9	-3.6	-3.4	-2.6	-2.4	-2.6	-2.0	-2.2	-2.3	-2.6
Primary balance	-1.9	-1.8	-1.8	-0.9	-0.6	-0.8	-0.1	-0.2	-0.2	-0.3
Structural balance 2/	-3.3	-2.9	-2.8	-2.4	-2.2	-2.7	-2.2	-2.4	-2.6	-2.8
Central government balance 1/	-3.5	-3.3	-3.3	-2.8	-2.9	-3.1	-2.3	-2.4	-2.4	-2.6
Social security balance 1/	-0.4	-0.2	-0.1	0.2	0.4	0.3	0.2	0.1	0.1	0.1
Local government balance 1/	-0.2	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.0
ODAC balance 1/	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross debt 3/	94.9	95.6	96.6	96.8	96.2	95.8	94.6	93.6	92.8	92.2
Memorandum items:										
Nominal GDP (in billion of Euros)	2,150	2,198	2,229	2,292	2,364	2,441	2,525	2,614	2,705	2,801
Potential nominal GDP (in billion of Euros)	2,170	2,220	2,252	2,295	2,360	2,434	2,516	2,603	2,694	2,790
Real GDP growth (in percent)	1.0	1.0	1.1	2.3	1.8	1.7	1.7	1.6	1.6	1.6
Nominal expenditure growth	1.5	1.5	1.0	2.5	2.4	1.3	1.3	3.0	3.2	4.0
Real expenditure growth (in percent)	1.1	1.4	0.7	1.3	0.5	-0.4	-0.4	1.2	1.3	2.1
of which : primary	1.4	1.7	0.8	1.3	0.3	-0.6	-0.7	1.0	1.0	1.9
of which : structural primary	1.5	1.6	0.8	1.1	0.4	-0.1	-0.5	1.0	1.0	1.9

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 3. France: Balance of Payments, 2014–23

(In percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Projections					
Current account	-1.0	-0.4	-0.8	-0.6	-0.8	-0.6	-0.4	-0.2	-0.1	0.1
Net exports of goods	-2.0	-1.3	-1.6	-2.1	-2.2	-2.1	-1.9	-1.8	-1.7	-1.6
Exports of goods	20.3	21.4	21.1	21.4	21.0	21.7	21.7	22.0	22.0	21.9
Imports of goods	22.3	22.7	22.7	23.5	23.2	23.7	23.7	23.8	23.7	23.5
Net exports of services	1.2	0.9	0.8	1.2	1.2	1.3	1.4	1.5	1.5	1.6
Exports of services	10.0	10.5	10.5	10.7	10.4	10.7	10.7	10.8	10.8	10.8
Imports of services	8.9	9.6	9.7	9.5	9.1	9.3	9.3	9.4	9.3	9.3
Income balance	2.1	2.1	2.1	2.3	2.0	2.0	2.0	2.0	2.0	2.0
Current transfers	-2.3	-2.0	-2.1	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Capital and financial account										
Capital account	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-0.4	0.0	-0.6	-1.4	-0.8	-0.6	-0.4	-0.2	0.0	0.1
Direct investment	1.7	0.3	1.1	0.3	0.5	0.6	0.7	0.8	0.9	1.0
Portfolio investment	-0.8	1.8	1.0	0.9	1.3	1.5	1.8	2.0	2.3	2.5
Financial derivatives	-1.1	0.6	-0.7	-0.1	-0.3	-0.6	-0.8	-1.1	-1.3	-1.6
Other investments net	-0.1	-3.0	-2.1	-2.4	-2.3	-2.2	-2.2	-2.1	-2.0	-2.0
Reserve assets	0.0	0.3	0.1	-0.1	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions	0.6	0.4	0.1	-0.9	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 4. France: Vulnerability Indicators, 2010–17

(In percent of GDP unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017
External Indicators								
Exports (annual percentage change, in U.S. dollars)	6.7	15.8	-3.1	5.6	2.0	-10.4	0.4	6.3
Imports (annual percentage change, in U.S. dollars)	8.1	17.1	-5.4	3.9	2.7	-11.6	1.5	6.9
Terms of trade (annual percentage change)	-1.4	-2.4	-0.3	1.2	1.2	3.2	0.7	-1.3
Current account balance	-0.6	-0.9	-1.0	-0.5	-1.0	-0.4	-0.8	-0.6
Capital and financial account balance	-0.1	-2.8	-1.9	-0.7	-0.4	-0.1	-0.5	-1.3
Of which								
Inward portfolio investment (debt securities, etc.)	4.3	3.6	1.0	4.9	4.1	0.2	0.9	1.2
Inward foreign direct investment	1.5	1.5	1.2	1.1	0.2	1.8	1.8	1.9
Other investment (net)	4.4	9.2	-0.1	3.5	-0.1	-3.0	-2.1	-2.4
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	55.8	48.6	54.2	50.8	49.5	55.2	56.1	54.8
Euros per U.S. dollar (period average)	0.8	0.7	0.8	0.8	0.8	0.9	0.9	0.9
Market Indicators								
Financial Markets								
Public sector debt 1/	85.3	87.8	90.6	93.4	94.9	95.6	96.6	96.8
3-month T-bill yield (percentage points)	0.4	0.7	0.0	0.0	0.1	-0.2	-0.6	0.0
3-month T-bill yield in real terms (percentage points)	-1.4	-1.8	-1.3	-0.7	0.00	-0.38	-1.17	-1.19
US 3 month T-bill	0.1	0.1	0.1	0.1	0.0	0.0	0.3	0.0
Spread with the US T-bill (percentage points)	0.2	0.6	0.0	0.0	0.03	-0.25	-0.87	0.00
10-year government bond (percentage points)	3.1	3.3	2.5	2.2	1.7	0.8	0.5	0.8
10-year government bond (United States)	3.2	2.8	1.8	2.4	2.5	2.1	1.8	0.0
Spread with US bond (percentage points)	-0.1	0.5	0.7	-0.1	-0.9	-1.3	-1.4	0.8
Yield curve (10 year - 3 month, percentage points)	2.7	2.6	2.5	2.2	1.6	1.0	1.0	0.8
Stock market index (period average, 1995=100)	200.3	192.1	179.0	211.1	231.7	258.2	236.1	276.7
Real estate prices (index, Q1-10=100, period average)	103.5	109.6	109.1	106.8	104.9	102.9	103.9	107.1
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	5.6	4.4	2.0	0.5	0.5	2.5	4.3	4.6
Bank credit to households	6.2	4.8	2.3	2.7	1.9	3.3	3.3	5.6
Housing Loans	8.2	6.1	3.2	3.8	2.2	4.0	3.5	6.1
Bank credit to nonfinancial enterprises	1.5	4.5	0.4	-0.3	2.6	4.3	4.3	5.8
Sectoral risk indicators								
Household sector								
Household savings ratio	16.0	15.9	15.3	14.6	15.0	14.5	14.2	14.4
Household financial savings ratio	6.6	5.9	6.2	4.7	5.2	4.9	4.4	4.4
Real estate household solvency ratio (index, 2001=100) 2/	99.4	100.9	98.2	98.5	…	…	…	…
Corporate sector								
Gross margin ratio	31.4	31.1	30.3	29.7	30.3	32.0	31.8	31.7
Investment ratio	22.1	22.7	22.7	22.6	22.8	22.8	23.2	23.8
Savings ratio	20.7	20.3	19.0	20.8	20.9	22.2	19.7	19.6
Self-financing ratio	93.7	89.4	83.6	91.8	91.7	97.5	84.3	82.1
Banking sector								
Share of housing loans in bank credit to the private sector	40.2	40.8	41.2	42.6	41.3	41.6	41.8	42.4
Share of nonperforming loans in total loans	3.5	3.5	4.0	4.5	4.0	3.9	3.9	3.1
Ratio of nonperforming loans net of provisions to capital	10.0	9.2	10.7	11.4	9.6	9.1	9.2	15.0
Liquid assets to total short-term liabilities 3/	144.4	136.3	164.0	165.2	178.5	17.5	19.9	20.7
Return on assets	0.6	0.4	0.3	0.4	0.4	0.6	0.5	0.4
Return on equity	11.8	8.2	6.6	8.1	6.2	9.2	8.4	6.3
Regulatory capital to risk-weighted assets	12.5	12.2	14.0	15.1	15.3	16.6	17.4	18.9

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 5. France: Core Financial Soundness Indicators, 2012–17

	2012	2013	2014	2015	2016	2017
Deposit-taking institutions 1/						
Regulatory capital to risk-weighted assets 2/	14.0	15.1	15.3	16.6	17.4	18.9
Regulatory Tier I capital to risk-weighted assets 2/	13.3	13.2	13.6	13.8	14.5	15.3
Nonperforming loans net of provisions to capital 3/	10.7	11.4	9.6	9.1	9.2	15.0
Bank provisions to Nonperforming loans 3/	106.7	104.7	103.8	104.2	103.0	50.6
Nonperforming loans to total gross loans 3/	4.0	4.5	4.0	3.9	3.9	3.1
Sectoral distribution of loans to total loans, of which						
Deposit-takers 3/	40.7	39.2	39.1	38.5	38.6	3.0
Nonfinancial corporation 3/	18.8	19.0	19.5	18.8	19.1	16.3
Households (including individual firms) 3/	28.9	30.3	29.8	28.1	28.1	25.7
Nonresidents (including financial sectors) 3/	5.6	5.4	5.5	5.3	5.3	37.5
ROA (aggregated data on a parent-company basis) 3/ 4/ 5/	0.2	0.4	0.2	0.3	0.7	0.4
ROA (main groups on a consolidated basis) 2/ 5/	0.3	0.4	0.4	0.6	0.5	0.4
ROE (aggregated data on a parent-company basis) 3/ 4/ 5/	5.5	10.1	4.4	7.7	14.8	6.4
ROE (main groups on a consolidated basis) 2/ 5/	6.6	8.1	6.2	9.2	8.4	6.3
Interest margin to gross income 3/	41.4	43.7	44.1	41.3	41.3	33.8
Noninterest expenses to gross income 3/	63.2	66.5	67.8	65.5	65.3	74.5
Liquid assets to total assets 6/	26.2	30.6	27.1	12.5	12.6	13.9
Liquid assets to short-term liabilities 6/	164.0	165.2	178.5	17.5	19.9	20.7

Sources: Banque de France, ACPR.

1/ These may be grouped in different peer groups based on control, business lines, or group structure.

2/ Consolidated data for the five banking groups (IFRS).

3/ 2017 uses consolidated data, and thus not comparable with previous years' unconsolidated data.

4/ All credit institutions' aggregated data on a parent-company basis.

5/ ROA and ROE ratios are calculated after taxes (same calculation as the ECB consolidated data ratios).

6/ 2015-17 data is based on new methodology which is not comparable to older figures.

Table 6. France: Additional Financial Soundness Indicators, 2012–17
(In percent unless otherwise indicated)

	2012	2013	2014	2015	2016	2017
Corporate sector						
Total debt to equity	86.0	79.3	86.0	85.7	93.2	88.3
Return on equity	7.8	7.0	6.8	6.7	6.5	6.4
Interest paid to financial firms 1/	…	…	…	…	…	…
Corporate net foreign exchange exposure to equity	…	…	…	…	…	…
Number of enterprise bankruptcies (thousands)	61.1	62.5	62.4	63.0	57.9	54.6
Number of enterprise creations (thousands)	550.0	538.2	550.8	525.1	554.0	591.3
Deposit-taking institutions						
Capital (net worth) to assets 2/	4.8	5.5	5.8	6.3	6.4	6.6
International consolidated claims of French banks, of which						
(BIS data, as percent of total international claims)						
Advanced countries	78.0	78.6	77.6	77.5	77.0	76.1
Developing Europe	7.1	6.8	6.7	6.6	6.5	6.5
Latin America and Caribbean	1.5	1.4	1.5	1.8	1.7	1.7
Africa and Middle East	5.2	4.2	4.3	4.4	4.7	4.6
Asia and Pacific Area	4.1	4.8	5.6	4.6	4.8	5.6
Offshore Financial Centers	4.1	4.2	4.4	4.1	4.3	4.7
Gross asset position in financial derivatives to capital 2/	346.2	205.8	238.2	190.2	175.3	138.7
Gross liability position in financial derivatives to capital 2/	346.0	206.8	238.7	188.1	174.1	145.9
Large exposures to capital 2/	7.6	5.4	5.5	6.1	6.1	14.9
Trading income to total income 2/	6.4	10.6	-0.1	-6.7	-7.6	9.6
Personnel expenses to noninterest expenses 2/	36.0	32.7	35.1	34.2	44.0	48.6
Spread between reference lending and deposit rates	217.2	217.7	229.9	228.0	…	…
Spread between highest and lowest interbank rate	…	…	…	…	…	…
Customer deposits to total (noninterbank) loans 2/	67.9	70.1	82.6	84.5	82.0	56.0
FX loans to total loans 3/	8.4	7.6	8.0	8.4	8.7	7.8
FX liabilities to total liabilities 3/	13.9	14.3	16.2	17.6	19.4	17.6
Net open position in equities to capital	…	…	…	…	…	…
Market liquidity						
Average bid-ask spread in the securities market 4/	…	…	…	…	…	…
Average daily turnover ratio in the securities market	…	…	…	…	…	…
Other financial corporations						
Assets to total financial system assets	16.2	17.1	17.3	17.2	17.3	17.2
Assets to GDP	182.1	194.8	205.7	208.9	215.2	219.7
Households						
Household debt to GDP	54.5	54.9	55.2	56.1	57.1	58.5
Household debt service and principal payments to income	12.2	12.7	11.2	9.8	11.1	9.7
Real estate markets						
Real estate prices	-0.5	-2.1	-1.8	-1.9	0.9	3.0

Sources: Banque de France, ACPR and BIS.

1/ In percent of financial firms' gross operating surplus.

2/ 2017 uses consolidated data, and thus not comparable with previous years' unconsolidated data.

3/ Data cover interbank and customer lending to residents and nonresidents on a metropolitan basis.

4/ Or in other markets that are most relevant to bank liquidity, such as foreign exchange markets.

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2017 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Identify and implement deep structural spending reforms at all levels of government, including by reducing the wage bill, consolidating local governments, improving the targeting of social benefits, and making health spending more efficient.	The authorities have set nominal spending growth ceilings for local authorities and health spending. However, structural spending reforms needed to put debt on a firm downside path still need to be specified. The government has commissioned a new comprehensive spending review by an expert committee (CAP 2022), but the conclusions of this report are not yet available.
Structural Reforms	
Enhance firm-level flexibility in wage negotiations, reform the mechanism governing the minimum wage, strengthen job search requirements for those receiving unemployment insurance, and better link education systems to labor market needs.	The 2017 ordinances ended the automatic extension of branch agreements and gave primacy to firm-level agreements in some areas (e.g., non-wage remuneration and working time, but not in what concerns base wages). The authorities also strengthened the monitoring and sanctions of those receiving unemployment insurance, although they have expanded coverage. Reforms of the education system are ongoing, and a reform of training and apprenticeship is in the works.
Simplify business regulations, address disincentives to company growth, and enhance competition in services.	The authorities have legislated a restructuring of the public railway company and further simplified regulations. The *Loi Pacte* which is expected to be passed in 2019, will simplify further administrative burdens for firms, particularly for smaller firms.
Financial Sector	
Closely monitor financial risks, in particularly the rise in corporate debt.	The authorities introduced a macroprudential policy limiting banks' exposures to large individual indebted corporates and a countercyclical capital buffer was activated.
Review guaranteed interest rates under the regulated savings schemes.	The authorities have allowed for a formula-based alignment of regulated savings sates to inflation and market interest rates starting in 2020.

	France
Foreign asset and liability position and trajectory	**Background**. After averaging near balance in 2000–2005, the net international investment position (NIIP) deteriorated during the global financial crisis, and has remained below -13 percent of GDP since 2013, reaching a low of -20 percent of GDP in 2017, largely driven by increases in public sector external debt and by banks' net external liabilities. The moderately negative net position masks large gross positions, particularly for financial (bank and non-bank) institutions, reflecting their global activities. Specifically, the gross asset position has been rising and stood at 289 percent of GDP in 2017, of which banks' non-FDI related assets account for about a third, and other non-bank financial institutions close to another third. More than three-quarters of French bank's foreign assets are in advanced economies (40 percent in other eurozone economies) and 7 percent in large emerging markets. Gross liabilities have also increased, and stood at 309 percent of GDP in 2017, of which external debt is estimated at 194 percent of GDP (of this, the public-sector accounts for 55 percent of GDP, and banks for 87 percent of GDP). Target 2 balances were at -€9.4 billion (-0.4 percent of GDP) at end-2017. **Assessment**. The NIIP is negative but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities due to external public debt and banks' financing on the liability side, given significant bank debt maturing in 2018 (€60 billion, or 2.6 percent of GDP) and sizeable financial derivatives (about 30 percent of GDP).
Current account	**Background**. The current account (CA) fell from a surplus before the global financial crisis to a deficit of 0.6 percent of GDP in 2017. The CA deficit reflects a persistent trade deficit (of around 1 percent of GDP, on average, since 2012), which has outweighed a positive (but declining) income balance. Over the last year, the CA balance improved by 0.2 percent of GDP on the account of a strong service export growth. **Assessment**. The 2017 cyclically-adjusted CA deficit is estimated at 0.6 percent of GDP, compared to an EBA-estimated norm of a surplus of 0.9 percent. On this basis, staff assesses that the CA gap in 2017 was between -2 to -1 percent of GDP. The CA gap is projected to narrow further over the medium run, as recent and planned structural and fiscal reforms are expected to help reduce the trade and fiscal deficits.
CA Assessment 2017	Actual CA: -0.6	Cycl. Adj. CA: -0.6	EBA CA Norm: 0.9	EBA CA Gap: -1.6	Staff Adj.: 0.0	Staff CA Gap: -1.6
Real exchange rate	**Background**. The ULC-based REER for the whole economy (based on a broad set of trading partners) appreciated by around 3–11 percent since the late 1990s. As a result, France has lost about a third of its export market share in the 2000s, and has not been able to regain it since. These developments suggest that France has lost competitiveness, notwithstanding relatively stable CPI-based REER indices over this period. Both the ULC-based REER and CPI-based REER indicators appreciated by around 0.3–0.9 percent during 2017, and an additional 1.5–2.9 percent through May 2018 (relative to the 2017 average). **Assessment**. The CPI-based index and level REER EBA models do not point to REER overvaluation (the REER gap ranges between -1.5 to 4.0 percent), while The EBA CA gap model points to an overvaluation of around 4–8 percent (given an elasticity of 0.25 percent). Staff's assessment, which is based on estimates of the EBA CA model but also other approaches, is an REER overvaluation in the range of 0 to 8 percent.
Capital and financial accounts: flows and policy measures	**Background.** The CA deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Financial derivative flows have grown sizably both on the asset and the liability side since 2008. The capital account is open. **Assessment**. France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sector.
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.

Overall Assessment

Overall Assessment:

The external position in 2017 was moderately weaker than that implied by medium-term fundamentals and desirable policy settings. Recent measures to improve competitiveness, including labor tax wedge cuts, CIT tax cuts, and labor and product market reforms are expected to strengthen the external position over the medium term.

Potential policy responses:

Steady fiscal consolidation and steadfast implementation of planned structural reforms (e.g. apprenticeship and vocational training reforms, as well as other product and service market reforms) would help improve competitiveness, reduce external imbalances, and support long-run growth.

Annex III. Risk Assessment Matrix[1]

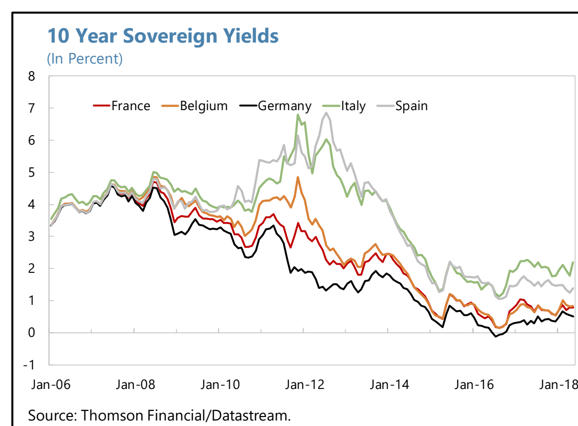
Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Response
Retreat from cross-border integration	**Medium** Protectionism and economic isolationism could reduce global and regional policy collaboration with negative consequences for trade, capital and labor flows, sentiment and growth	**High** • A retaliatory cycle of trade restrictions could hurt France's exports and investment impairing the growth momentum. • A rise in euro skepticism could lead to a resurfacing of populism sentiment in France, leading to political opposition to the current government which is largely pro-Europe.	• Continued support for the multilateral rules-based trading system, trade liberalization and free-trade agreements. • Re-double efforts to secure the benefits of economic integration and cooperation across the EU. • Strong collaboration to ensure smooth and predictable transition to a new economic relationship between the U.K. and the EU.
Policy and geopolitical uncertainties.	**Medium** Two-sided risks to U.S. growth with uncertainties about the positive short-term impact of the tax bill on growth and the extent of potential medium-term adjustment to offset its fiscal costs; uncertainty associated with negotiating post-Brexit arrangements; and evolving political processes, including elections in several large economies.		
	High Intensification of the risks of fragmentation/security dislocation in parts of the Middle East, Africa, Asia, and Europe, leading to socio-economic disruptions.	**High** • Continued slow implementation of the modest EU-level agreements on relocating refugees could deepen political division. • Lack of integration of migrants could raise unemployment, put pressure on national budgets and put social cohesion at risk. • Border controls could restrict movement of goods, services and labor in the single market.	• Refugees should be rapidly integrated into host country labor markets. • Temporary costs related to refugee expenditures should be accommodated within current fiscal targets on a case-by-case basis. • A new system to relocate refugees is needed to reduce the burden on frontline countries.
Tighter global financial conditions.	**High** An abrupt change in global risk appetite (e.g., due to higher-than-expected inflation in the U.S) could lead to sudden, sharp increases in interest rates and a tightening of financial conditions.	**High** • Less favorable borrowing conditions could weigh on private-sector and public-sector balance sheets, with implications for growth.	• To build buffers against adverse shocks, the government must press on expeditiously with structural reforms, strengthening balance sheets, and fiscal consolidation.
Further pressure on traditional bank business models.	**Medium** Loss of confidence if profitability challenges to banks are not addressed could increase the risk of distress at one or more major banks.	**Medium** Given insufficient progress in balance sheet repair in some countries and broader profitability concerns, such an event could reverberate through the entire financial sector and widen sovereign yield spreads within the banking union.	• The ECB's new guidance on NPL management should be followed with strict supervisory monitoring of all banks. • Insolvency reform, further development of distressed debt markets, cost-cutting, and banking system consolidation would facilitate the sector's adjustment.
Weakening of reform implementation in France, including due to increased resistance.	**High** Non-implementation of remaining structural and fiscal reforms could undermine confidence and lead to higher financing costs.	**High** • Lower medium-term growth due to weaker investment and persistent unemployment. • Further deterioration in public finances and private balance sheets.	• Accelerate structural reforms to spur investment, productivity and competitiveness, and strengthen private-sector balance sheets
Structurally weak growth in other key advanced economies relative to baseline.	**High** Low productivity growth, a failure to fully address crisis legacies and undertake structural reforms, as well as persistently low inflation undermine medium-term growth.	**High** • Lower medium-term growth due to weaker investment and persistent unemployment. • Further deterioration in public finances and private balance sheets.	• Early identification of deep spending reform to put debt solidly on a downward path, increase economic resilience.
Significant slowdown in China and its spillovers.	**Low-Medium** Too fast an adjustment and improper sequencing of actions in China to "de-risk" the financial system may adversely affect near-term growth (low likelihood). Over the medium term, overly ambitious growth targets lead to unsustainable policies, reducing fiscal space, further increasing financial imbalances. A sharp adjustment would weaken domestic demand, with adverse international spillovers (medium likelihood).	**Medium** • Slower export growth, higher output gap. • Lower growth and inflation weakens public debt sustainability and private balance sheets.	• Accelerate structural reforms to spur investment, productivity and competitiveness, and strengthen private-sector balance sheets.

[1] The Risk Assessment Matrix shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the 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.)

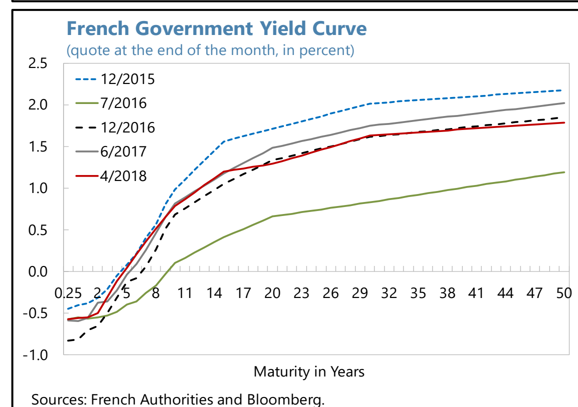
Annex IV. Debt Sustainability Analysis

Under the baseline scenario, the debt-to-GDP ratio is projected to moderately decline to 92.2 percent of GDP by 2023 from 96.8 percent in 2017, on the back of solid growth and an expected improvement in the primary balance. Due to the maturity structure of the French debt, gross financing needs are expected to peak at 8.2 percent of GDP in 2020.[1] *Public debt remains high and could be vulnerable, in particular if historical macro-fiscal trends materialize.*

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 led to an increase in the debt-to-GDP ratio by 32 percentage points in ten years, to 96.8 percent at end-2017.



Source: Thomson Financial/Datastream.



Sources: French Authorities and Bloomberg.

Owing to the sharp decline in interest rates and inflation,[2] 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 2017.[3]

Despite the increase in debt, yields remain at a historical low. The benchmark yield (10 years) has declined from 4.7 percent in end-June 2008 to 0.79 percent end-May 2018. The spreads over German Bunds, which had increased to almost 190 basis points in November 2011, were at 27 basis points end-May 2, 2018.

2. Baseline. Staff projects the debt-to-GDP ratio to gradually decline to 92 percent by 2023, thanks to measures to contain expenditures initiated in the 2018 budget and continued expected growth. Under the baseline, the gross financing needs of the government would peak at 8.2 percent in 2020 and gradually decline to 7.2 percent in 2023. The effective interest rate is projected to moderately increase after 2020 to around 2.6 percent in 2023 as long-term yields normalize. As a result, interest payments are projected to increase to 2.4 percent of GDP by 2023.

- **Macroeconomic assumptions.** The economy grew by 2.3 percent in 2017 compared with 1.1 percent in 2016, and growth is expected to remain solid, around 1.8 percent in 2018 and 1.7 percent in 2019, and to gradually stabilize to its medium-term level of 1.6 percent.

[1] Financing needs are projected to increase in 2020 due to a large planned amortization of medium to long-term debt.

[2] About 12 percent of French debt is indexed on inflation (at end-March 2018, 62 percent of inflation-linked debt was indexed on euro area inflation and 38 percent on domestic inflation).

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

- **Fiscal outlook.** Structural adjustment has averaged 1 percentage point per year in 2011–13, slowed to 0.2 percentage points per year in 2014–16, and reached 0.4 percentage points in 2017. It is projected, to average 0.1 percent during 2018–20 as planned spending cuts broadly offset tax cuts, and -0.2 percentage points in 2021–23 as no new spending consolidation measures are implemented.[4] The primary balance would remain above its debt stabilizing level.

3. **Realism of Projections.** The median forecast error for real GDP growth during 2008–16 is -0.7 percent (with a 42nd percentile rank) suggesting there is an upward bias in staff projections. This is associated with a median forecast error of 0.6 percent for the primary balance and a -0.24 percent median forecast bias for inflation. Cross-country experience suggests that 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 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 1.3 percent of GDP, well below than the threshold of 3.5 percent of GDP.

4. **Alternative scenarios.** Under the scenario of a constant primary balance, public debt would remain high at around 95 percent of GDP, and gross financing needs would be 7–9 percent of GDP. Under the historical scenario of real GDP growth, real interest rates and primary balance at their 2006–2016 historical average, gross public debt would be on a rising path, approaching 108 percent of GDP by 2023, while gross financing would reach 11.5 percent of GDP.

5. **Shocks and Stress Tests.** The DSA framework suggests that France's government debt-to-GDP ratio would stay on a downward path, although it would peak at an elevated level (101.4 percent of GDP) and remain high during the projection horizon.

- **Growth shocks.** Under this scenario, real output growth rates are lower by one standard deviation over 2019–20, i.e. 1.4 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 101.2 percent of GDP in 2020 but decline 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 2019–23. Under this scenario, the debt-to-GDP ratio would decline at a slower place, with an impact on the debt-to-GDP ratio of 1.6 percent of GDP in 2023.

[4] The conversion of the CICE (tax credit) into a tax cut reduces both taxes (starting in 2019) and expenditures (starting in 2020), resulting in a temporary worsening of the balance in 2019.

- **Interest rate shock.** This scenario assumes an increase of 287 basis points increase in the cost of debt throughout the projection period.[5] The deterioration of public debt and gross financing needs are back-loaded as old debt gradually matures and new debt is contracted at higher interest rate.[6] In 2023, the impact on the gross financing needs is 0.9 percent of GDP and 1.9 percent of GDP for the debt-to-GDP ratio.

- **Real exchange rate shock.** This scenario assumes a 13 percent devaluation of the real exchange rate in 2019 and examines the impact on debt through the inflation channel. Under this scenario, the debt-to-GDP ratio would remain very close to the baseline.

- **Combined macro-fiscal shock.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance. Under this scenario, debt would reach 101.4 percent of GDP in 2020, gradually declining to 95.7 percent of GDP in 2023. The gross financing needs would peak at 11.5 percent of GDP in 2020.

6. Heat map. Risks levels from the debt level are deemed high given that France's debt is above the threshold of 85 percent 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 share of public debt held by non-residents has been declining since the euro area crisis. As of end-March 2018, non-residents held 55.1 percent of French debt, a level substantially lower than the peak of 70.6 percent reached early 2010 and also lower than the end-2016 level of 58.5 percent.

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

[6] As of end-April 2018, the average maturity of debt is 7 years and 322 days.

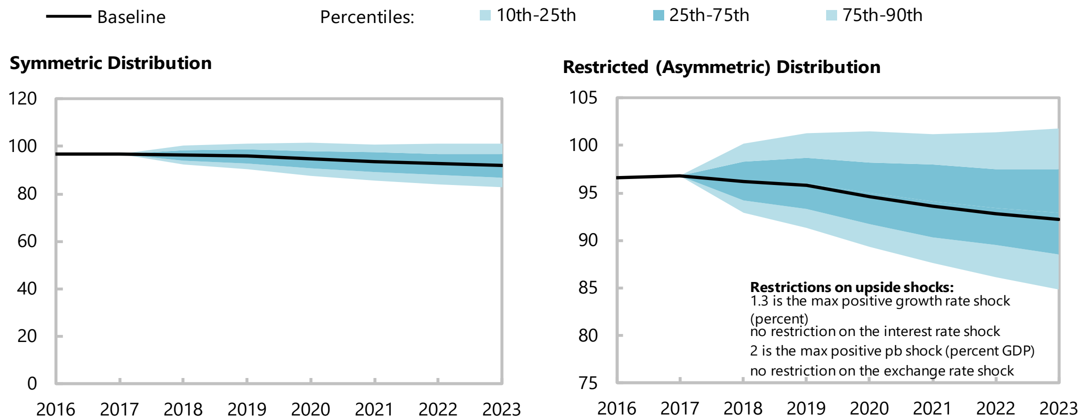
Figure 1. France Public DSA Risk Assessment

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

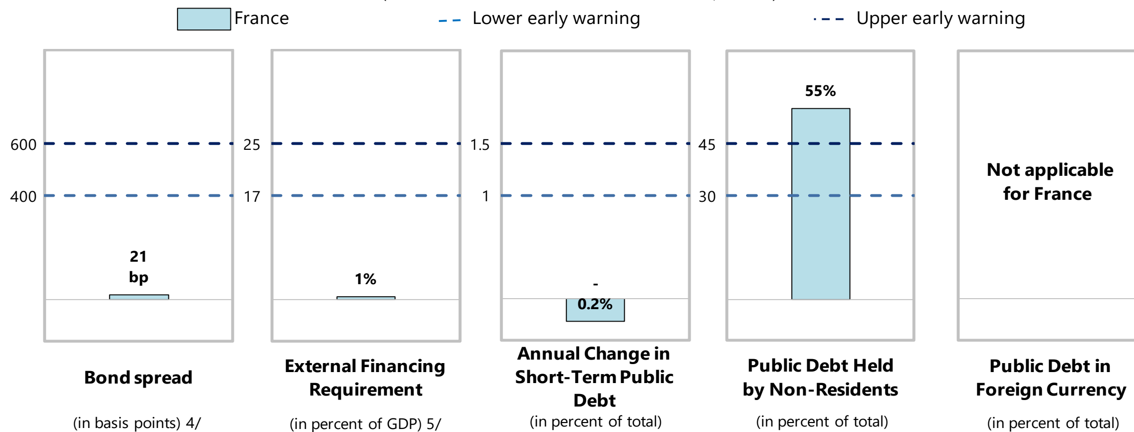
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



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:

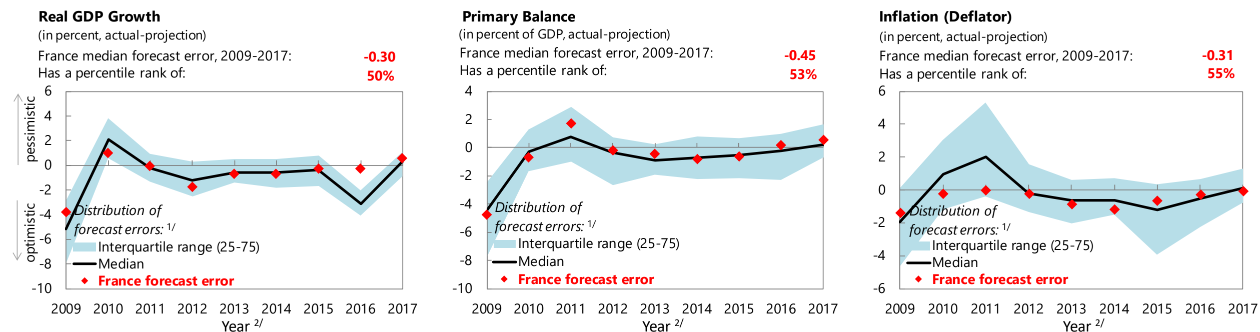
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 01-Mar-18 through 30-May-18.

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.

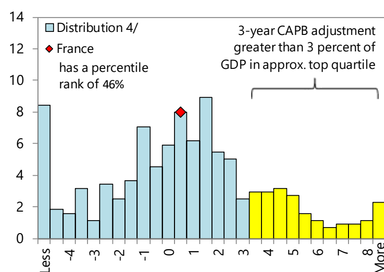
Figure 2. France Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

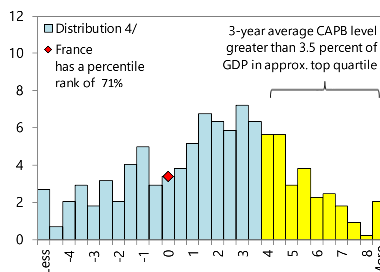


Assessing the Realism of Projected Fiscal Adjustment

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

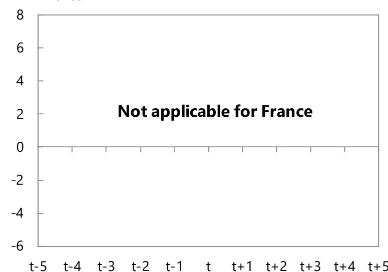


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)
France



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.

Figure 3. France Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

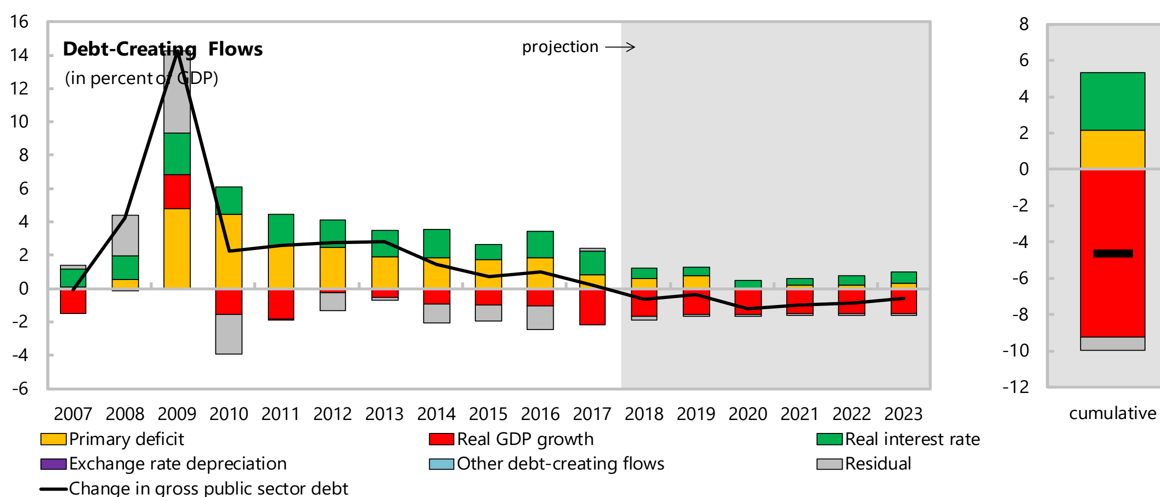
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	84.9	96.6	96.8	96.2	95.8	94.6	93.6	92.8	92.2
Public gross financing needs	8.9	8.8	8.0	6.8	8.2	8.8	7.4	6.8	7.2
Real GDP growth (in percent)	0.8	1.1	2.3	1.8	1.7	1.7	1.6	1.6	1.6
Inflation (GDP deflator, in percent)	1.2	0.3	0.5	1.4	1.6	1.7	1.8	1.8	1.9
Nominal GDP growth (in percent)	2.0	1.4	2.8	3.1	3.3	3.5	3.5	3.5	3.5
Effective interest rate (in percent) [4/]	3.2	2.0	2.0	2.1	2.1	2.2	2.3	2.5	2.6

As of May 30, 2018		
Sovereign Spreads		
EMBIG (bp) 3/	35	
5Y CDS (bp)	27	
Ratings	Foreign	Local
Moody's	Aa2	Aa2
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	3.4	1.0	0.2	-0.6	-0.4	-1.2	-1.0	-0.8	-0.6	-4.6	
Identified debt-creating flows	3.2	2.4	0.1	-0.4	-0.3	-1.1	-0.9	-0.7	-0.5	-3.9	
Primary deficit	2.3	1.8	0.9	0.6	0.8	0.1	0.2	0.2	0.3	2.2	-0.8
Primary (noninterest) revenue and gra	51.3	52.9	53.7	53.4	52.1	51.6	51.1	50.8	50.8	310.0	
Primary (noninterest) expenditure	53.6	54.7	54.5	54.0	52.9	51.7	51.3	51.0	51.2	312.1	
Automatic debt dynamics [5/]	1.0	0.6	-0.8	-1.0	-1.0	-1.1	-1.1	-0.9	-0.8	-6.0	
Interest rate/growth differential [6/]	1.0	0.6	-0.8	-1.0	-1.0	-1.1	-1.1	-0.9	-0.8	-6.0	
Of which: real interest rate	1.6	1.6	1.4	0.6	0.5	0.4	0.4	0.6	0.7	3.2	
Of which: real GDP growth	-0.6	-1.0	-2.2	-1.7	-1.5	-1.6	-1.5	-1.5	-1.5	-9.2	
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/]	0.2	-1.4	0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.8	



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).

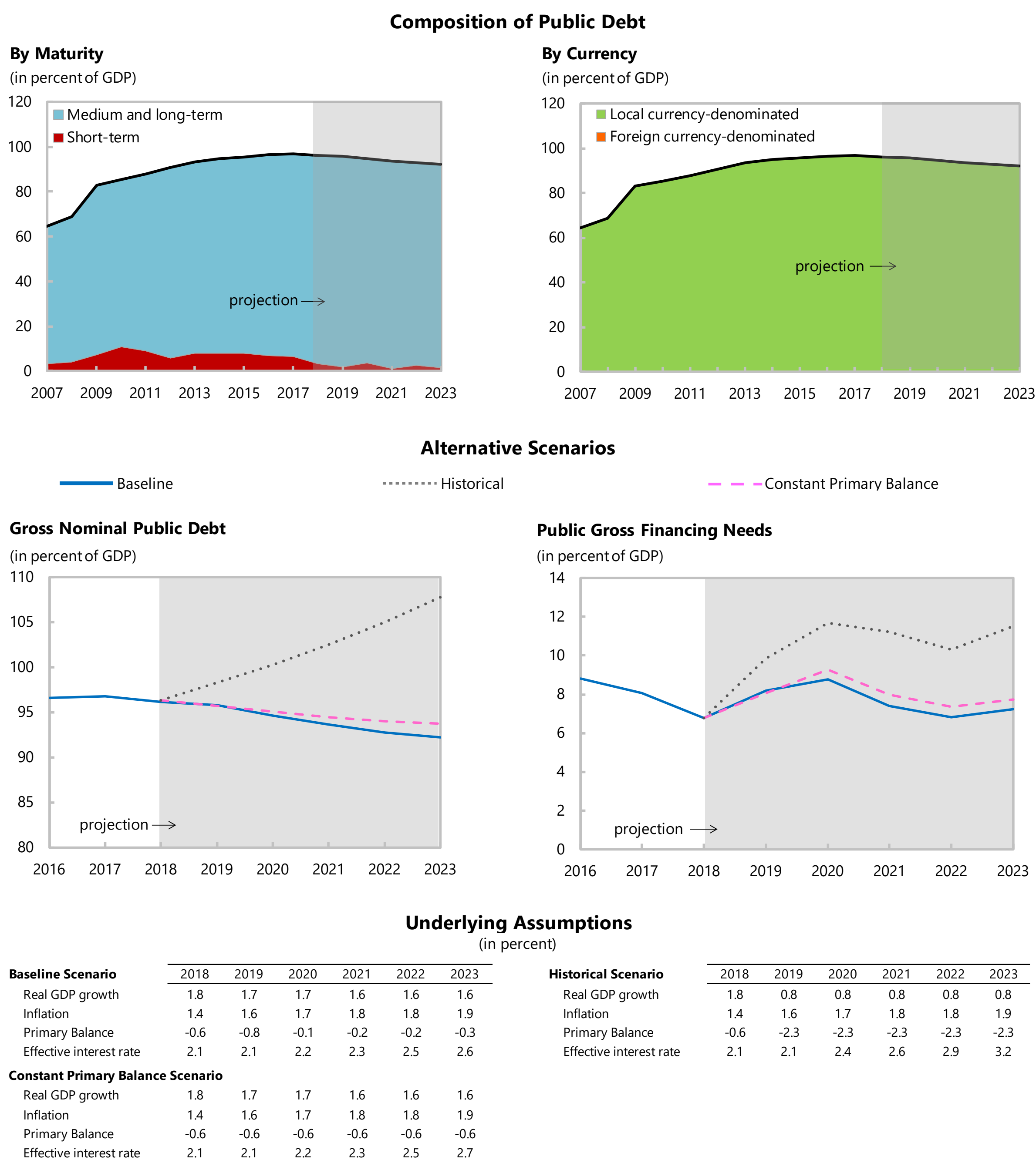
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

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.

Figure 4. France Public DSA—Composition of Public Debt and Alternative Scenarios



Underlying Assumptions
(in percent)

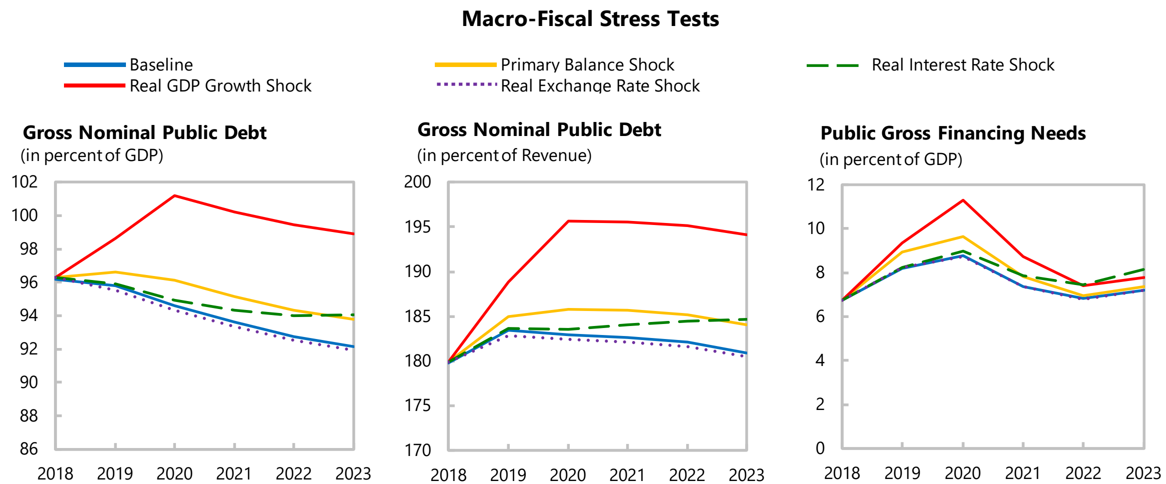
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.8	1.7	1.7	1.6	1.6	1.6
Inflation	1.4	1.6	1.7	1.8	1.8	1.9
Primary Balance	-0.6	-0.8	-0.1	-0.2	-0.2	-0.3
Effective interest rate	2.1	2.1	2.2	2.3	2.5	2.6
Constant Primary Balance Scenario						
Real GDP growth	1.8	1.7	1.7	1.6	1.6	1.6
Inflation	1.4	1.6	1.7	1.8	1.8	1.9
Primary Balance	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Effective interest rate	2.1	2.1	2.2	2.3	2.5	2.7

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	1.8	0.8	0.8	0.8	0.8	0.8
Inflation	1.4	1.6	1.7	1.8	1.8	1.9
Primary Balance	-0.6	-2.3	-2.3	-2.3	-2.3	-2.3
Effective interest rate	2.1	2.1	2.4	2.6	2.9	3.2

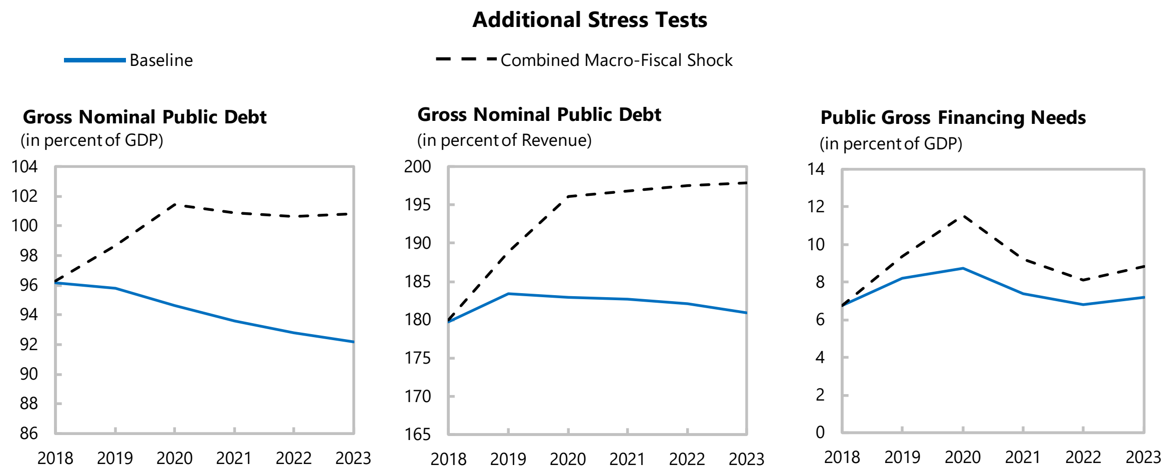
Source: IMF staff.

Figure 5. France Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2018	2019	2020	2021	2022	2023
Primary Balance Shock						
Real GDP growth	1.8	1.7	1.7	1.6	1.6	1.6
Inflation	1.4	1.6	1.7	1.8	1.8	1.9
Primary balance	-0.6	-1.5	-0.8	-0.2	-0.2	-0.3
Effective interest rate	2.1	2.1	2.3	2.4	2.5	2.7
Real Interest Rate Shock						
Real GDP growth	1.8	1.7	1.7	1.6	1.6	1.6
Inflation	1.4	1.6	1.7	1.8	1.8	1.9
Primary balance	-0.6	-0.8	-0.1	-0.2	-0.2	-0.3
Effective interest rate	2.1	2.1	2.5	2.7	3.1	3.4
Combined Shock						
Real GDP growth	1.8	0.2	0.2	1.6	1.6	1.6
Inflation	1.4	1.2	1.4	1.8	1.8	1.9
Primary balance	-0.6	-1.8	-2.0	-0.2	-0.2	-0.3
Effective interest rate	2.1	2.1	2.5	2.8	3.2	3.5

	2018	2019	2020	2021	2022	2023
Real GDP Growth Shock						
Real GDP growth	1.8	0.2	0.2	1.6	1.6	1.6
Inflation	1.4	1.2	1.4	1.8	1.8	1.9
Primary balance	-0.6	-1.8	-2.0	-0.2	-0.2	-0.3
Effective interest rate	2.1	2.1	2.3	2.4	2.6	2.8
Real Exchange Rate Shock						
Real GDP growth	1.8	1.7	1.7	1.6	1.6	1.6
Inflation	1.4	2.0	1.7	1.8	1.8	1.9
Primary balance	-0.6	-0.8	-0.1	-0.2	-0.2	-0.3
Effective interest rate	2.1	2.1	2.2	2.3	2.5	2.7

Source: IMF staff.

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 11, 2018

Prepared By | European Department

CONTENTS

FUND RELATIONS ____ 2

STATISTICAL ISSUES ____ 8

FUND RELATIONS

(As of May 31, 2018)

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)	18,552.72	92.05
Reserve Tranche Position	1,602.44	7.95
Lending to the Fund		
New Arrangements to Borrow	1,004.55	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	8,011.07	79.05

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				
	2018	2019	2020	2021	2022
Principal					
Charges/Interest	9.81	19.72	19.73	19.71	19.72
Total	**9.81**	**19.72**	**19.73**	**19.71**	**19.72**

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 September 20, 2017. The associated Executive Board assessment is available at https://www.imf.org/en/News/Articles/2017/09/21/pr17364-imf-executive-board-concludes-the-2017-article-iv-consultation-with-france and the staff report at https://www.imf.org/~/media/Files/Publications/CR/2017/cr17288.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, 10/29/03
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) Plus. 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 participates to the G-20 Data Gaps Initiative, which aims at implementing twenty key recommendations aimed at addressing the data gaps identified after the global financial crisis and promote the regular flow of timely and reliable statistics for policy use. For example, with regard to Recommendation on Sectoral Accounts, all target requirements (dissemination of both annual and quarterly nonfinancial and financial accounts and balance sheets) have been met through the recent transmission of additional data to the OECD.

***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 (SDDS) Plus and has transmitted 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. 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. **Financial Sector Surveillance:** France provides financial soundness indicators (FSIs), both the core and some of the encouraged indicators, on a timely basis. **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 June 2018)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	06/18	06/18	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	05/18	06/18	Monthly	Monthly	Monthly
International Investment Position	Q1:2018	Q2:2018	Quarterly	Quarterly	Quarterly
Reserve/Base Money	05/18	06/18	Monthly	Monthly	Monthly
Broad Money	05/18	06/18	Monthly	Monthly	Monthly
Central Bank Balance Sheet	05/18	06/18	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	05/18	06/18	Monthly	Monthly	Monthly
Interest Rates[2]	06/18	06/18	Daily	Daily	Daily
Consumer Price Index	05/18	06/18	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2017	05/18	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	05/18	07/18	Monthly	Monthly	Monthly
Stock of Central Government Debt	05/18	06/18	Monthly	Monthly	Monthly
External Current Account Balance	05/18	06/18	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	05/18	06/18	Monthly	Monthly	Monthly
GDP/GNP	Q1:2018	Q2:2018	Quarterly	Quarterly	Quarterly
Gross External Debt	Q1:2018	Q2:2018	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 July 25, 2018

On behalf of our authorities, we thank staff for their report and constructive policy discussions during the Article IV mission. Since the last review, the macroeconomic situation of France improved markedly. Growth reached 2.3 percent in 2017 – its highest level since 2007 – and the rebound has been broad-based, notably driven by strong investments and a positive contribution of exports. The current account deficit decreased slightly and the public deficit decreased significantly further both in nominal and structural terms. Such positive developments result from both the impact of structural reforms, leading notably to the restoration of firms' profit margins, as well as from a more benign external environment.

Against this backdrop, our authorities are dedicated to implementing a comprehensive and far-reaching structural reforms agenda to be rolled-out over the five-year presidential mandate with the overarching goal of transforming the French economy and modernizing its social protection system.

In the current context of rising international tensions, France remains a strong proponent of multilateralism and international cooperation, notably in the domains of trade, tax, financial regulation and sustainable financing of development. My authorities also strongly support a further deepening of the European Union integration as well as of the European Monetary Union in order to enhance both their resilience and the convergence of their members. The joint statement of Meseberg by the French and German heads of state puts forward major proposals to progress further in this direction. Importantly, France remains committed to achieve its carbon emission reduction objective, consistent with the Paris agreement on climate change.

The pace and reach of the structural reforms currently implemented in France is without precedent over past decades.

A comprehensive and far-reaching set of reforms aiming at strengthening growth, enhancing job creation and restoring competitiveness has been adopted and is already implemented. The impact of structural reforms and will materialize progressively, but the first effects have already been felt, notably in terms of business confidence and international investors' perception.

- Labour market reforms. Unemployment decreased further in 2017 and during the first two quarters of 2018. The reform, adopted in the very first months of the mandate, aims at enhancing job creations by addressing long-standing issues. It will notably increase the flexibility of the labour market functioning and its predictability for firms. One important aspect of the reform, among many others, is the decentralization at the firm level of significant aspects of collective bargaining that were discussed at the branch-level so far (notably on some parts of the compensation packages and on working hours). This will increase the ability of firms to react to changing economic conditions.

Moreover, dismissal procedures have been simplified and their cost reduced which will provide greater security to firms in their hiring decisions and decrease the duality of the labor market.

- Tax reforms. A major set of tax measures have been adopted to support firms' investments and enhance the attractiveness of the French economy, as well as channeling savings towards productive investments and reducing the debt bias. The Budget for 2018 provides for a gradual reduction of the corporate income tax rate from 33 percent to 25 percent by 2022. A comprehensive flat tax of 30% applies to all capital income earned by individuals as from January 1st, 2018 (to be compared with a total rate of taxation on capital income that could reach 60% under the previous regime). The personal wealth tax is from now on limited to real estate assets incentivizing productive investments and risk-taking. Moreover, employees' social contributions to health insurance is eliminated to reduce the labor wedge and compensated by an increase in the broad-base part of the personal income tax (CSG), rewarding labor income for workers and reducing labour cost for firms.

- Education reform. Improving human capital is a key pillar of our authorities' strategy to adapt the French workforce to a fast-changing environment, enhance productivity and increase equality of opportunities for all. The University reform tackles the long-standing issue of the transition from secondary to tertiary education. It does so by strengthening the guidance of students towards the curricula with higher subsequent chances of hiring and it improves the matching between students' choices and universities' curriculum through a set of explicit qualification criteria. In primary education, 1st years classroom size has been halved in the most vulnerable neighborhoods, a measure with already-assessed strong impact on students' performances.

Our authorities reaffirm their willingness to keep up the pace of reform aiming at modernizing the French economy, enhancing the growth potential and strengthening the training system.

France reform momentum continues in 2018:

- Draft law PACTE, approved by the Cabinet in June, will be adopted by the end of the year 2018. It addresses a wide range of issues aiming at spurring investments, promoting innovation and improving the business environment. It notably entails a simplification of the different regulatory thresholds applying to SMEs and a streamlining of the rules related to firms' creation. Savings will be increasingly channeled towards productive investing through a modification of the regulatory framework of both supplementary pensions savings and life insurance savings. It will also facilitate employees' incentive compensation scheme in firms smaller than 250 employees. Firms' insolvency regime will also be streamlined (through the introduction of *cross class cram down* in the regulatory framework).

- CICE (so far, a tax credit reducing the labor cost at the lower end of the wage distribution) will be transformed in a permanent cut in social contributions in order to enhance transparency as regards the effective tax wedge. Over the past decades, the tax wedge has continuously declined at the minimum wage level. Therefore, rather than comparing minimum wage (SMIC) to median wages ratios, we reiterate our call for staff to compare the total labor cost at the minimum wage level with the total labor cost at the median wage level. Otherwise, the impact of the continuous decrease of the tax wedge at the SMIC level is not taken into consideration and the assessment of the impact of the SMIC indexation formula can be misguided. The ratio of the total labor cost at the minimum wage level to the total labor cost at the median wage level dropped below 50% in 2014 and remained below that level since then. The conversion of the CICE into a social contribution cut will exacerbate the decrease of labor cost at the minimum wage. More generally, apart from the crisis period in 2008-2010, France's real wages have evolved in line with productivity both pre- and post-crisis (real unit labor cost being flat both between 2000-2008 and between 2010-2017). Moreover, most of the gap between labor cost and productivity growth that appeared during the crisis has been reduced by the CICE and other measures that have reduced social contributions. As clearly stated in last year's Article IV selected issues paper on French competitivity, France's nominal unit labor cost has been in line with the average of the euro area since early 2000. The ULC gap with Germany which increased between 2000-2008 due to wage moderation in Germany is now, even if gradually, closing thanks to a more vibrant wages dynamic in Germany and price competitivity measures implemented in France.
- The draft law on professional and vocational training is currently examined by the Parliament. It is a major milestone in the revamping of France's social model aiming at equipping all individuals with the necessary skills to find a job and reaping the full benefit of the current technological revolution. It will simplify and increase the rights to training of professional, while rationalizing the governance structure of the system and simplifying its financing. To address the fragmented nature of training supply and enhance its quality, a new agency will certify that the training programs impart genuine and appropriate skills, otherwise financing will be discontinued.
- A profound reform of the rail transportation system has been adopted in June 2018. It modernizes French National Railways (SNCF) and aims at ensuring its profitability over the medium-term by modifying its status (transformation into a public limited company). By doing so, it will also level the playing field to new competitors, consistently with the European regulatory framework.

Increasing social mobility, portability of social rights and inclusiveness.

Compared to European peers, France has a relatively low level of inequality of disposable income and a low poverty rate (13.6 percent in 2016 against 17.3 percent in EU). The tax-and-transfer system strongly reduces market income inequality as well as the risk of poverty (the poverty rate would be 10 percent higher without social transfers). Against this background, our

authorities are of the view that the priority is to enhance equality of opportunity for all in France.

- A reform of the educational system has been launched. Improving the acquisition of basic knowledge is one of its main objectives. The reduction of class sizes for children in the first year of primary school in most vulnerable neighborhoods (corresponding to 12 or 13 students per class in the 2,500 classes concerned) will be extended in the coming years to the second year of school and more geographical areas. Many other will be implemented such as lowering the compulsory school attendance age to three years in 2019 and the reform of the baccalauréat in 2021.
- As in many other economies, France has to deal with the hysteresis effect of the crises on the unemployment rate. This is why, beyond the draft law on professional and vocational training, 15 billion euros will be dedicated to the training of the low-skilled workers and long-term unemployed over 5 years. Additionally, while the average replacement rate for unemployed people is not out of line with the European average replacement rates, some features of the unemployment insurance system encourage regular rotations between short-term contracts and unemployment, contributing to the segmentation of the labour market. Social partners are therefore currently discussing on a potential reform of the unemployment insurance system.
- A wide consultation has been initiated on a reform of the French pay as you go pension system. The main aim of the reform, as presented during the presidential campaign, is to increase the transparency of the system for future pensioners, as well as its equity by ensuring that one euro of contribution opens the right to the same level of pension for all. Regarding the financial sustainability of existing pension regimes, the last report of the independent authority in charge of financial projections of the pension regime (*Conseil d'Orientation des Retraites*) concludes that the sustainability of the system is assured over the long term. This is notably due to the impact of past reforms, in particular, the automatic increase of the minimum number of quarters necessary to retire with a full-rate pension (to reach 43 years for individuals born from 1973 onwards).

Putting public finances on a stronger footing through the modernization of public administration and by curtailing public spending trends relative to growth.

Due to the measures taken immediately after the presidential election, notably on housing subsidies and subsidized jobs, and in a context of accelerating growth, the public deficit fell to 2.6 percent of GDP, well below the 3 percent European threshold. Consequently, France has exited the excessive deficit procedure under the European rules. Even with the one-off fiscal impact of the transformation of CICE into permanent social contributions cuts in 2019, France will remain below the 3 percent threshold. For the first time since the global financial crisis, the debt to GDP ratio is on a downward trend and it will continuously decrease until 2022 according to our authorities' last projections. Looking forward, our authorities remain committed to their medium term targets whose broad objective is to put public finances on a

stronger footing by 2022: (i) public spending will be reduced by 3 points of GDP over five years; (ii) overall, tax revenues will be reduced by one point of GDP over five years; (iii) the debt to GDP ratio will decrease by 5 points by 2022.

For these objectives to be met, the choice has been made to curtail public spending growth so as to create the conditions for a lasting decline of the ratio of public spending to GDP. The expenditure reduction strategy relies on structural choices and transformative reforms of the administration (at all its levels) and of our social protection model. Our authorities are firmly convinced that such an approach is both more sustainable and politically acceptable than pursuing across the board cuts. Furthermore, in a context of rising external risks, a gradual fiscal consolidation appears well suited not to endanger the ongoing recovery. Concretely, this strategy is translated at all administrative levels:

(i) As regards to the central government spending, in real terms, total spending will increase by 1.7 percent in 2018, a significant slow-down compared to the growth level in 2017 (+ 3.7 percent).

(ii) An innovative mechanism has been created to contain the increase of local authorities spending. The main local authorities subscribed, through a contractual pact cosigned with the government, to an engagement to limit the growth of their operating expenses.

(iii) Efforts to contain the increase of social protection spending will be pursued. The objective for the health sector (ONDAM) has been set at 2.3 percent for 2018, significantly below the natural growth rate of health expenditures, and will be contained thereafter.

Moreover, our authorities are determined to pursue the modernization of the administration so as to improve the quality of the public services as well as their efficiency. The work of "Action Publique 2022" Committee included avenues for reforms, which were submitted to the government and discussed among its members. The government is designing its strategy in order to curtail public spending on the basis of this report. Two measures have already been put forward. On the one side, public services broadcasters will be modernized and streamlined. One the other side, the digitalization of the tax administration, will allow to reduce the number of public agents dedicated to those tasks. A large consultation has also been initiated regarding the evolution of the civil service with the view to enhance internal and external mobility and to better link compensation levels with merit. Further reforms will be announced in the coming months.

The financial sector resilience has been significantly reinforced since the global financial crisis.

The international standards adopted since the Global Financial Crisis haven been diligently implemented in France, partly through the European regulatory framework. Since the creation of the Single Supervision Mechanism, the ECB and Banque de France jointly exert a close supervision on the banking sector. The capitalization of the banking sector increased significantly since the global financial crisis (from around 10 percent of RWAs before the crisis

to almost 19 percent in 2017). Moreover, the French banking system is well advanced in the issuance of bail-inable instruments (MREL requirements) that would allow for the implementation of resolution plans if need be. The non-performing loans ratio is low and on a downward trend (at 3.1 percent in 2017).

Against this sound background, our authorities remain nonetheless vigilant to potential risks. They activated the counter-cyclical buffer in July 2018 in a context of dynamic lending to non-financial corporates. In this regard, my authorities thank staff for the selected issues paper dedicated to the corporate debt in France. To replace this issue in a broader context, it is worth noting that while corporate debt has been overall dynamic, the increase is much more moderate when debt is consolidated among non-financial corporations due to the magnitude of intercompany loans. Additionally, it is worth recalling that household debt level is significantly lower in France than in many European peers (at 58.5 percent of GDP in 2018). Finally, there is no concern regarding the short-term liquidity in US dollar of the French banks. The LCR in USD for the top 5 French banks (which represent 99 percent of USD liabilities) was on average close to 80 percent in 2017 and reached 109 percent at the end of May 2018.