INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/15

FRANCE

January 2021

2020 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 2020 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 January 13, 2021 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 January 13, 2020, following discussions that ended on November 3, 2020, 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 December 17, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for France.

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

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Washington, D.C.

PRESS RELEASE

PR21/14

IMF Executive Board Concludes 2020 Article IV Consultation with France

FOR IMMEDIATE RELEASE

Washington, DC – **January 19, 2021:** On January 13, 2021, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

The French economy entered 2020 in a broadly balanced cyclical position, with a largely closed output gap and falling unemployment. However, several long-standing challenges persisted, including high public and private debt, sluggish productivity growth, and inequality of opportunities. The Covid-19 pandemic triggered a health and economic crisis which exacted a heavy health toll, leaving France among the most-affected countries in the world.

To contain the spread of the virus, the government introduced containment measures, including national lockdowns in Spring and Fall. GDP contracted by about 19 percent (y-on-y) in the first half of 2020. A rebound after the economy's first reopening was followed by a new dip under a second lockdown. Overall, growth is expected to have contracted by around 9 percent for the year. Inflation trended down, driven by the fall in oil prices and decelerating core inflation. The financial sector underwent a short period of turbulence in the first quarter of 2020 but has weathered the crisis well since then, supported also by a range of prudential and monetary measures.

To address the crisis, the government put in place a large fiscal package, including an expansion of the short-time work scheme, grants for small firms and self-employed, and public guarantees for bank loans to firms. Additional recovery measures over the coming years are focused on the green and digital transformation of the economy, employment support, and boosting firms' competitiveness.

Growth in 2021 is forecast at 5½ percent, but medium-term output will remain below the pre-crisis trend as impaired balance sheets and higher unemployment weigh on activity. Risks to the forecast are large and dominated by the virus dynamics.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that France is among the countries most affected by the global pandemic. Directors commended the authorities for their swift and flexible policy response, which helped support households and firms and limited the economic burden of the crisis. They noted that the growth outlook

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[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.

[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.

remains highly uncertain, with risks tilted somewhat to the downside predominantly stemming from virus-related dynamics. Directors commended the authorities for their recovery plan (Plan de Relance), in particular for its job-rich green investment policies.

Directors recommended maintaining appropriate policy support in the near-term, guided by the evolution of health conditions. As the recovery gains traction, support should become more targeted on those most affected to facilitate economic restructuring and contain fiscal costs. While the exceptionally low interest rate outlook provides much-needed fiscal space, Directors noted that the medium-term fiscal trajectory is challenging, and called on the authorities to develop a credible consolidation plan now—to be implemented only once the recovery is solidly underway—to put debt on a firm downward path over the medium term.

Directors stressed that addressing risks from corporate insolvency will be critical to the economic recovery. They noted the spike in corporate debt, driven by the provision of state-guaranteed loans, and the sizeable corporate equity gap. In this regard, they welcomed the new equity support initiatives and encouraged the authorities to augment or adapt them as needed. As a complementary measure, Directors also recommended enhancing debt restructuring mechanisms.

Directors noted the resilience of the banking sector, which entered the crisis with comfortable buffers and facilitated the provision of credit to the economy. Nonetheless, they emphasized the need to closely monitor bank capital, as future corporate defaults could represent a risk to already limited bank profitability. Directors also welcomed the regulatory flexibility provided by the prudential authorities, including the release of the counter-cyclical capital buffer and measures to help banks extend loan moratoria, but emphasized that these should be temporary, and time bound. They supported broadly maintaining macroprudential measures for the household and corporate sectors given the need to mitigate the buildup of risks from these segments of the economy.

Directors noted the disproportionate impact of the crisis on lower-skilled workers and the young. In this context, they called for policies that boost employment particularly for vulnerable groups and facilitate new work relationships in dynamic sectors. Directors encouraged the authorities to continue their reform agenda to reduce structural unemployment and increase labor force participation, particularly of youths, over the medium term. Finally, as the recovery strengthens, Directors stressed the importance of continuing to implement green policies consistent with Paris Climate Agreement commitments and European initiatives, including by strengthening carbon pricing.

Table 1. France: Selected Economic Indicators, 2018-21

	2018	2019	Projections 2020	2021
Real economy (change in percent)				
Real GDP	1.8	1.5	-9.0	5.5
Domestic demand	1.4	1.7	-7.4	5.5
Foreign balance (contr. to GDP growth)	0.4	-0.2	-1.6	-0.1
CPI (year average)	2.1	1.3	0.5	0.7
GDP deflator	1.0	1.2	2.3	0.3
Public finance (percent of GDP)				
General government balance	-2.3	-3.0	-10.6	-7.7
Revenue	53.4	52.6	52.6	52.7
Expenditure	55.7	55.6	63.2	60.3
Primary balance	-0.7	-1.6	-9.3	-6.5
Structural balance (percent of pot. GDP)	-1.7	-2.0	-3.8	-4.7
General government gross debt	98.1	98.1	115.3	117.6
Labor market (percent change)				
Employment	0.6	0.7	-1.3	-1.0
Labor force	0.2	0.0	-1.0	0.9
Unemployment rate (percent)	9.0	8.5	8.7	10.4
Credit and interest rates (percent)				
Growth of credit to the private non-financial sector	5.5	5.3	8.0	3.4
Money market rate (Euro area)	-0.4	-0.4	...	...
Government bond yield, 10-year	0.8	0.1	...	...
Balance of payments (percent of GDP)				
Current account	-0.6	-0.7	-2.1	-1.6
Trade balance of goods and services	-1.0	-1.0	-1.8	-1.7
Exports of goods and services	33.0	32.8	28.0	27.2
Imports of goods and services	-34.0	-33.9	-29.8	-28.9
FDI (net)	2.4	0.2	0.6	0.8
Official reserves (US$ billion)	66.1	69.7	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.85	0.89	...	...
NEER, ULC-styled (2005=100, +=appreciation)	98.2	97.1	...	...
REER, ULC-based (2005=100, +=appreciation)	92.6	90.4	...	...
Potential output and output gap				
Potential output (change in percent)	1.0	1.0	-4.3	4.0
Memo: per working age person	1.1	1.1	-4.2	4.1
Output gap	-0.5	0.0	-4.9	-3.6

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

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

December 17, 2020

KEY ISSUES

Context: France is among the countries most affected by the global pandemic, both in terms of health and economic impact. Output is expected to have declined by around 9 percent in 2020. The authorities put in place a large emergency fiscal package to address the crisis, focused on preserving jobs and providing liquidity for households and firms, supplemented by additional stimulus measures to support the economic recovery in 2021 and beyond. The banking sector entered the crisis with comfortable buffers and, together with the support of the ECB's accommodative monetary policy, facilitated the provision of credit to the economy. The increased leverage, however, poses solvency risks to the corporate sector. A partial recovery with GDP growth at about 5½ percent is expected in 2021. Risks to the outlook are large, dominated by the virus dynamics and, together with other risks, tilted somewhat to the downside.

Policies: The overarching priority in the near term remains saving lives while mitigating the economic costs of the pandemic. The authorities should continue to be flexible and comprehensive in their policy response, adjusting and recalibrating as needed. The economic disruption of the pandemic is also an opportunity to reorient the economy, making it greener, more inclusive, and more productive. Key policy priorities are:

- *Maintaining adequate fiscal support*—Continued support to affected firms and individuals is warranted in the near term. Fiscal consolidation should not start until output has broadly recovered to its pre-crisis level and downside risks have abated, but the planning process should begin now.
- *Supporting firms and preserving financial stability*—The corporate and financial sectors have so far weathered the crisis, but continued vigilance is needed. Measures to support firms should include more equity-type instruments to help reduce risk from excessive leverage and support investment in the recovery phase.
- *Towards a sustained economic transformation*—As the recovery gains strength, support should turn to facilitating new work relationships in dynamic sectors, with an emphasis on retraining displaced workers. Incentivizing job-rich green investment will also help limiting unemployment while pursuing climate commitments. Fostering the digital transformation of the economy and continuing reforms to liberalize product and service markets can boost productivity and long-term growth.

Approved By
Enrica Detragiache (EUR) and Maria Gonzalez (SPR)

Discussions took place from October 19–November 3, 2020. The staff team comprised J. Franks (mission head), B. Gruss, M. Patnam, S. Weber (all EUR), and Jose Garrido (LEG), and was assisted at headquarters by K. Cerrato and Z. Jin. Arnaud Buisse (Executive Director) and Pierre-Eliott Rozan (Alternate Executive Director) joined the virtual mission. Staff met virtually with the Central Bank Deputy Governor Goulard; senior officials in the president and prime minister's offices, various ministries, and the *Cour des Comptes*; financial sector interlocutors, think tanks, and academics; trade union and employer association representatives; and had a conference call with the SSM. A press conference was held at the end of the mission.

CONTENTS

TABLES

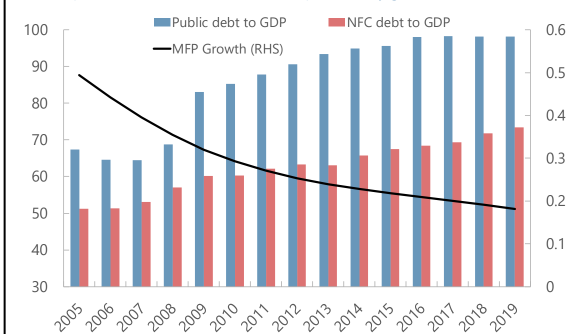
ANNEXES

CONTEXT: A CHALLENGING PRE-CRISIS LANDSCAPE

1. **The French economy entered the crisis in a broadly balanced cyclical position.** Growth momentum slowed slightly in 2019, as the cyclical recovery ran its course with a largely closed output gap. The labor market continued to improve, with employment creation leading to a decline in the unemployment rate. Inflation was somewhat below the ECB's target. The current account registered a small deficit but remained stable at around 0.7 percent of GDP between 2017–2019.

Debt and Productivity

(Debt as percent of GDP; Trend multifactor productivity growth)



Sources: Haver Analytics, OECD; and IMF staff calculations.
Note: NFC debt on a consolidated basis.

2. **A number of long-standing challenges, including high public and private debt, sluggish productivity growth, and inequality of opportunities weighed on the pre-crisis outlook.** The fiscal deficit declined modestly over 2017–19 but public debt remained at a historically high level (about 98 percent of GDP). While the banking sector retained comfortable capital buffers, profitability concerns lingered, including from continued low long-term interest rates. The fast expansion of bank credit to the private nonfinancial sector contributed to a sustained rise in corporate indebtedness, promoting the activation of macroprudential policies to address the buildup of systemic risks. Similar to other advanced economies, productivity growth has been declining over the past few decades in France. While income inequality is not elevated by advanced country standards, unequal education and training opportunities, weak intergenerational mobility, and lack of opportunities in disadvantaged regions have been a persistent challenge in France (IMF Country Report No. 19/245).

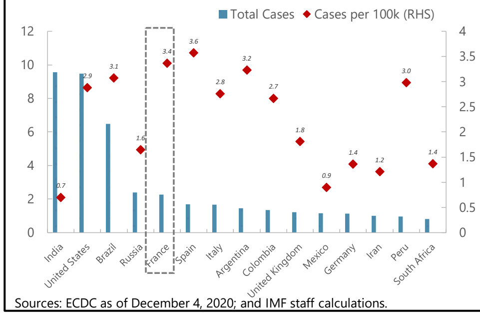
3. **Reform momentum stalled following earlier progress.** Early in President Macron's term in office, the authorities introduced key reforms to strengthen labor force participation, labor market flexibility, and inclusiveness, including a reform of the labor code, reductions in labor taxes, and reforms of the apprenticeship and professional-training systems. However, since then, opposition has built to the government reform agenda. This included the "yellow vest" protest movement in response to planned fuel tax increases and protests in December 2019 against the government's pension reform which contributed to its postponement. The reform program has been further challenged by the onset of the COVID-19 crisis and the ruling party's losses in the 2020 local elections. Presidential elections are scheduled for April 2022.

PANDEMIC IMPACT AND POLICY RESPONSE

A. Into the Storm: Impact of the Pandemic

4. **The COVID-19 infection swept rapidly and intensely through France, triggering an unprecedented health and economic crisis.** The first confirmed COVID-19 case was reported on January 24, 2020. Subsequently, the coronavirus spread quickly exacting a heavy toll, with France registering the highest cumulative case count in Europe and ranking among the top-five affected countries worldwide (text figure). In response, the authorities imposed a strict and lengthy lockdown, which resulted in a large economic contraction.

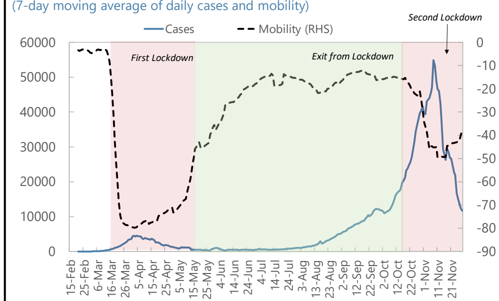
Covid-19 Cases in Selected Countries
(Total cases in million on LHS and cases per 100,000 on RHS)



Sources: ECDC as of December 4, 2020; and IMF staff calculations.

5. **The government instated several rounds of containment measures to arrest the spread of the virus.** Actions were taken at the national as well as regional level during the course of the infection's initial emergence and subsequent resurgence to abate its spread (see also Box 1):

Covid-19 Infections and Mobility
(7-day moving average of daily cases and mobility)



Source: Google Mobility (average of retail, workplace and transit), ECDC; and IMF staff calculations
Note: Shaded area is period of lockdown (red) and phased reopening (green). Mobility is percent deviation from normal.

- ***First Lockdown:*** In response to the initial spread of COVID-19 infections in early March, the government implemented a range of national containment measures to reduce transmission and preserve hospital capacity, including school closures and a ban on non-essential outings and long-distance travel. Compared to its European peers, France's lockdown was in place for a longer time, lasting over two months (March 17–May 10).

- ***Exit from the first lockdown:*** As the first wave of infections ebbed, the authorities reopened the economy swiftly, starting on May 11, with several sectors reopening simultaneously. By end-June 67 percent of containment restrictions were eased, including on travel, compared to 51 percent by peers.

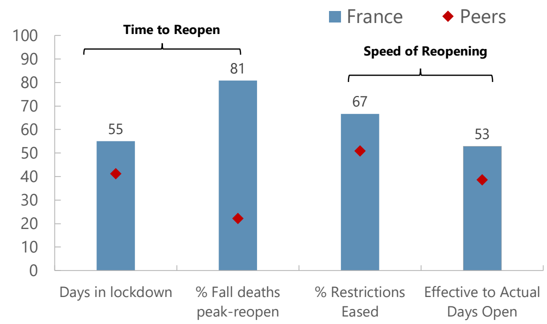
- ***Night curfews and second (partial) lockdown:*** The resurgence of infection since end-August prompted the government to first apply regional night curfews and eventually to introduce a second national lockdown on October 30. Schools remained open but non-essential stores, bars, and restaurants were ordered to close. People could leave their homes for essential reasons, but a self-declaration was needed, and circulation between France's regions was not allowed.

- ***Exit from the second lockdown:*** A progressive lifting of containment measures began at the end of November, with the opening of retail stores followed by a replacement of lockdowns with night curfews. Bars and restaurants are set to open in January.

Box 1. Re-Opening and Re-Locking in France

France eased containment measures more rapidly than other European countries after a more prolonged first lockdown. While many countries began to reopen in the second half of April 2020, France started in mid-May, a month after COVID deaths had peaked and declined by a considerable amount. Compared to its European peers, France was therefore a late reopener. In terms of the speed, reopening proceeded swiftly with several sectors reopened simultaneously, and about 67 percent of containment restrictions eased by mid-July (relative to 51 percent eased by peers). This contributed to making France one of the fastest reopeners among its peers. The late but quick reopening strategy, while contributing to the economic recovery, likely increased the risk of re-infections.[1]

France vs. Peers: Lockdown and Reopening Strategy

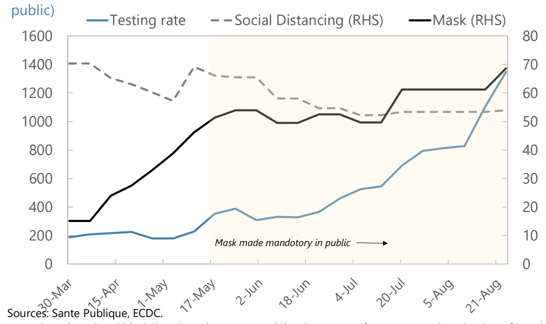


Sources: IMF Staff Estimates, Franks et. al. (2020)

Reopening was accompanied by an expansion in testing and mask mandates. The testing rate increased sevenfold from 200 tests per 100,000 people at the start of the pandemic to 1,400 by end-August (close to the European average). Masks mandates were applied at reopening, and were progressively tightened as infections began to rise, with the use of masks made obligatory in most public spaces and indoor areas (including schools and workplaces). The adoption of masks has been steadily rising, with 70 percent of survey respondents in France reporting the wearing of mask in public. The proportion of the population keeping social distance is around 65 percent and has been relatively stable since reopening.

Testing and Health Interventions

(Tests per 100 thousand; percent wearing masks and social distancing in public)

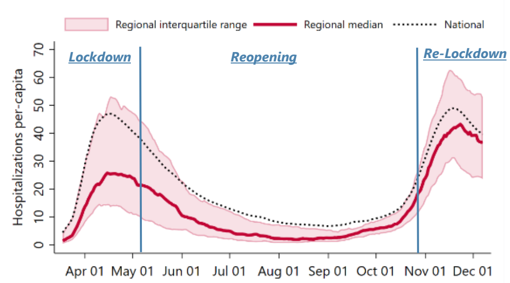


Sources: Sante Publique, ECDC.
Note: Gray dotted and black line show the (survey weighted) average of reponses on the adoption of keeping 1-3m distance and wearing masks in public.

However, infections and hospitalizations started to surge within a few months of the economy fully reopening, leading to the re-imposition of a national lockdown. As cases began to slowly rise again in August, the authorities imposed granular measures (e.g., time limits on bar openings), extending limits on large gatherings, and doubling testing capacity. However, infections surged at end-September, accompanied by a concomitant rise in hospitalizations. In contrast to the first wave of infections, the increase in hospitalizations was more generalized across regions during the second wave, limiting the possibility to reallocate patients, health personnel, and equipment across regions. These developments prompted the government to first apply regional night curfews and eventually a (partial) second lockdown on October 30.

Hospitalizations per-capita (Regional and National)

(Per 100 thousand population, 7-day moving average)



Source: Sante Publique.
Note: Regional hospitalizations are at the department level.

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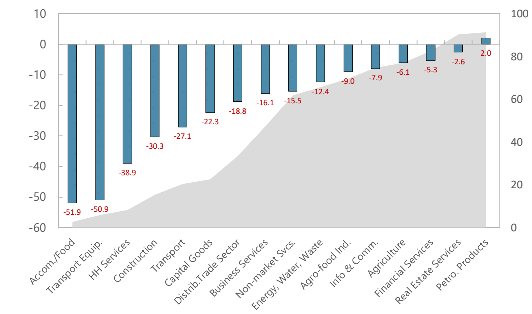
[1] See Franks et. al., 2020, "Exiting from Lockdowns: Early Evidence from Reopenings in Europe", IMF WP 20/218. The paper finds that a given reopening step is associated with worse reinfection outcomes for European countries that reopened earlier, or which opened all sectors at a fast pace in a relatively short time.

6. The pandemic and related lockdown measures produced the deepest post-war recession. Heterogeneity of output losses across sectors was large, with contact-based services and transport related activities persistently underperforming. Volatility of output within 2020 was also unprecedented with fluctuations mirroring lock-down and re-opening patterns.

Change in Real Gross Value Added by Sector
(Percentage change between 2020Q2 and 2019Q4, LHS; Cumulative shares in total GVA in 2019, RHS)



Sources: Haver Analytics; and IMF staff calculations.

- **Economic activity contracted by about 19 percent (y-on-y) in the first half of 2020,** one of the largest declines compared to peers. The drop was spread across all expenditure components with contributions from private consumption (-8.8 percent), public consumption (-3 percent),[1] investment (-4.5 percent) and net exports (-2.6 percent). Exports declined faster than imports on account of a sustained reduction in tourism, vehicle and aeronautics exports, and a temporary increase in health-related imports that more than offset the improvement in the oil trade balance. The accommodation, restaurant, and transport-related sectors registered the most severe declines (accounting together for more than 10 percent of the GVA), while agri-food, IT, banking and real estate services, were only marginally affected.

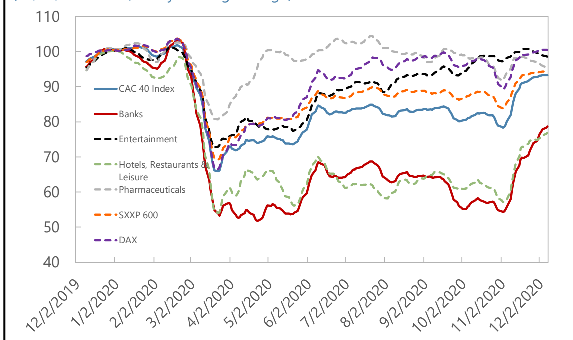
- **Activity rebounded by almost 19 percent in Q3:** The reopening of the economy was accompanied by a faster-than-expected rebound in domestic demand, particularly consumption, partly recovering the lost ground from the first half of the year. The rebound was strongest in sectors affected by the generalized lockdown but with limited physical contact (such as construction), while sectors such as transport and hotels remained heavily depressed even if (partly) reopened. Monthly activity indicators suggest that the recovery had lost steam already in September amidst concerns about a second wave of infections and petering out of pent-up demand.

- **Activity is expected to have contracted by roughly another 5½ percent in Q4**: With fewer sectors affected by the second lockdown, teleworking encouraged, and schools open, aggregate activity is estimated to have been 13 percent below normal in November compared to 30 percent in April during the first lockdown. Activity is expected to have rebounded slightly in December, following some easing of containment measures. Several sectors (mostly services) related to transport, restaurants and entertainment continue to operate 28 to 60 percent below their end-2019 levels.

[1] The drop in consumption reflects lockdown-related losses in value added as public services were not provided during the first lockdown.

7. Financial conditions tightened abruptly in March and have only partially recovered. Equities lost more than a third of their value, bond yields spiked, and acute pressure built in the wholesale funding markets at the onset of the pandemic. Bank equities were particularly affected, falling sharply at the end of February and March 2020, triggered by the increase in corporate credit risk and the deteriorating profitability outlook. The wholesale funding market also experienced acute stress for a short period, with a sharp drop in issuance and shortening of maturities. However, following monetary stimulus, funding stress[2] and financial conditions have eased, but remain slightly tighter than before the crisis. By mid-December, the French CAC40 remained around 7 percent below the pre-crisis value, lagging European peers.

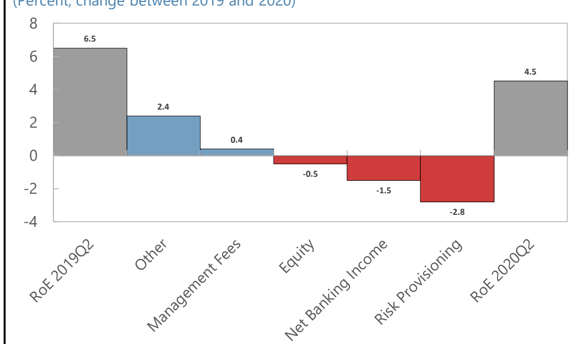
Stock Indexes by Sectors
(12/31/2019=100, 7 day moving average)



Sources: Bloomberg; and IMF staff calculations.

8. The banking sector incurred limited losses during the first half of this year. Faced with the uncertainty of the pandemic, banks increased the level of provisions, which led to a deterioration in profitability in the first half of 2020. The cost of risk for the six main French banks grew by 150 percent (y-o-y) in the first half of 2020, negatively impacting their return on equity (text figure). French banks' market valuation ratios also suffered a sharp drop in March 2020, setting them further apart from the European average and adversely affecting their funding costs.

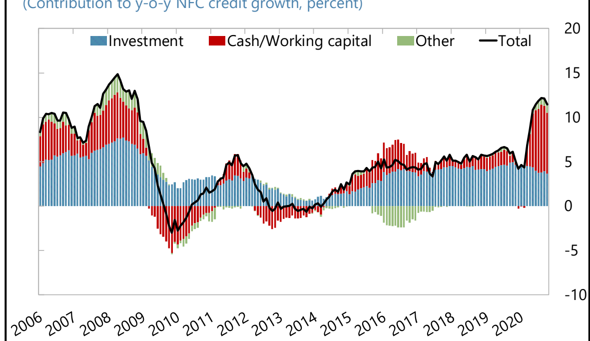
Banks Return on Equity
(Percent, change between 2019 and 2020)



Sources: Authorities data on six major French banks.

9. Bank credit to corporates surged amidst the crisis, spurred by the provision of state guaranteed loans. After a period of moderation, bank credit to corporates spiked, reaching growth rates seen prior to the global financial crisis. This increase was likely driven by the need for liquidity from the prolonged lockdown combined with state support for the provision of bank loans (see ¶12 and Annex V) which facilitated credit supply. The additional bank credit granted during this period was used

Bank Credit to Non-financial Corporations
(Contribution to y-o-y NFC credit growth, percent)



Source: Haver Analytics; and IMF staff calculations.

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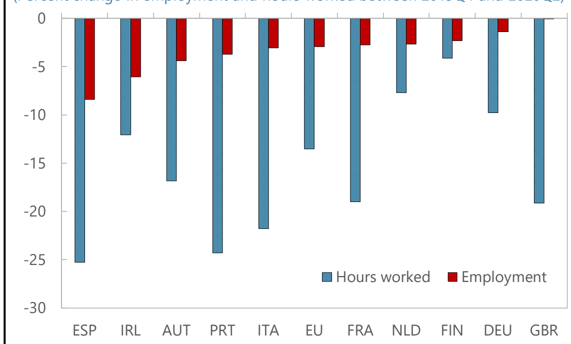
[2] The ECB's Pandemic Purchase Emergency Program and intervention in the commercial paper market helped increase corporate investment grade issuance and ease liquidity pressure for banks and non-financial corporations to get market funding.

by firms to finance working capital and build cash buffers. Some bank credit was also used to finance investment, but credit growth for investment purposes has declined in the last few months.

10. The unemployment response was initially muted due to a drop in the workforce and strong government support. The unemployment rate fell in 2020H1 by about 1 percentage point to 7.1 percent in 2020:Q2, as the first lockdown caused a large drop in the population actively searching for a job, and larger flows from employment to unemployment were prevented by the generous short-time work scheme (see ¶12, Box 2, and Annex V). Hours worked dropped by 15 percent while employment fell by only 2½ percent in 2020H1. Despite some employment recovery during the rebound in 2020:Q3, the unemployment rate jumped to 9 percent reflecting the recovery in the active labor force.

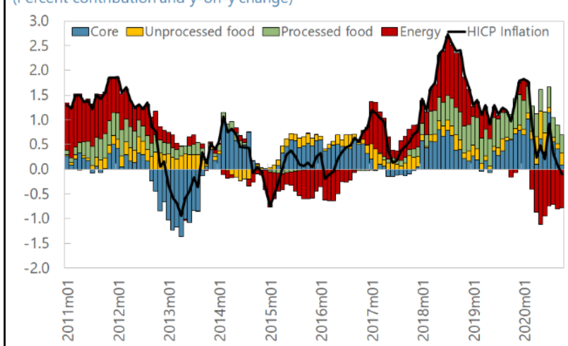
Extensive versus Intensive Margin: Peer Comparison
(Percent change in employment and hours worked between 2019Q4 and 2020Q2)



Sources: Eurostat, Haver Analytics; and IMF staff calculation.

11. Inflation has been trending down and has fallen again into negative territory. Headline inflation slowed from 1.6 percent (y-o-y) in February to 0 percent in September, (following two months of negative m-o-m inflation) and has remained close to zero, driven by the fall in oil prices and decelerating core inflation. Temporary increases in unprocessed food prices during the first lock-down, in April and May, and semi-durables in June have abated. In the near term, euro appreciation and remaining slack in the economy are likely to continue to exert downward pressure on inflation.

Contribution to Headline Inflation
(Percent contribution and y-on-y change)



Sources: Haver Analytics; and IMF staff calculations.

B. Weathering the Storm: Policy Response

12. In response to one of the deepest economic contractions among European countries, the authorities approved a large emergency fiscal package of close to 22 percent of GDP in 2020. The package included a wide set of measures (text table and Annex V) introduced over three amendments to the budget between March and July, during the pandemic's first wave, and further expanded in a fourth amendment presented in November to tackle the effects of the second wave:

- **Measures with effect on the fiscal deficit (3.8 percent of GDP)**—Above-the-line measures were largely aimed at preserving employment relationships and household incomes through the expanded Short-time Work (STW) scheme (see Box 2); providing grants to small and micro enterprises and self-employed through a solidarity fund (*Fonds de solidarité*) to cover turnover losses; and providing relief to heavily affected sectors (e.g. tourism and automobile) through subsidies and exoneration of social security contributions. These represent temporary measures, with no effect on the deficit beyond 2020.

- **Direct support for selected firms (0.9 percent of GDP**)—An envelope to provide direct assistance to firms through equity, quasi-equity, or debt securities was approved at the onset of the crisis, mostly aimed at large and strategic corporates. While these measures did not affect the fiscal deficit, they led to an increase in gross public debt (0.4 percent of GDP in 2020 and the rest in 2021).

- **Public guarantees and other contingent measures (14.5 percent of GDP**)—A program of public guarantees for bank loans (*Prêt garanti par l'État*, PGE), accounting for 90 percent of this envelope, was setup to provide liquidity to firms at the onset of the pandemic. As of end-November, about 42 percent of PGE availability had been used, making France one of the countries with the highest take-up rates of loan guarantees among peers[3]. The deadline to apply for these loans was extended to June 2021 in the context of the second-wave lockdown measures. To the extent that guarantees are not called, these schemes do not affect the fiscal deficit or public debt.

- **Other liquidity measures (2.4 percent of GDP**)—Deferrals for taxes and social contributions and accelerated refunds of tax credits provided additional liquidity relief to firms. These measures do not necessarily affect the fiscal deficit.[4]

13. The banking sector was supported by a range of prudential and monetary measures. In the emergency phase the supervisory authorities reduced the counter-cyclical bank capital buffer to zero, allowed banks to operate temporarily below the Pillar 2 Guidance, the capital conservation buffer, and the liquidity coverage ratio, and offered credit mediation to support renegotiation of SME bank loans. These measures allowed to reduce Tier 1 capital requirements by about 1.7 percentage points during the first half of the year. Some flexibility in the classification requirements and expectations on loss provisioning for non-performing loans was also provided. The ECB provided monetary policy support through expanded asset purchase programs, additional liquidity, and eased collateral requirements.

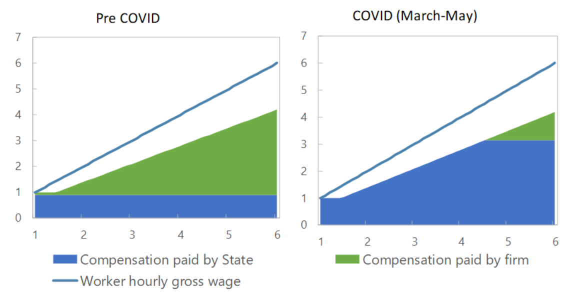
[3] Guaranteed loans have a grace period of up to two years and can be reimbursed over up to six years. See IMF, Global Financial Stability Report, October 2020 for a cross-country comparison of guaranteed loan take-up.

[4] The authorities provisioned about 0.2 percent of GDP in foregone revenues from deferred tax and social security payments, which is reflected in a higher deficit in 2020.

Box 2. France's Short-time Work (STW) Scheme

France's STW scheme (*activité partielle*) was set up in 2008, following Germany's Kurzarbeit model. The scheme is available to firms that experience a reduction in regular working hours or a temporary closing of all or part of their establishment. Workers under STW earn 84 percent of their net wages for reduced hours (compared to a replacement rate of about 65 percent for regular unemployment benefits), with a floor at the minimum wage, for a period of up to 6 months (renewable to one year). Under the regular STW scheme that prevailed before the COVID-19 crisis, firms were reimbursed a fixed amount per hour (about 90 percent of the minimum wage).

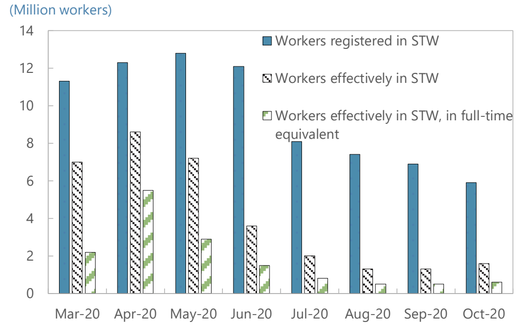
Compensation per Hour under STW Scheme
(In units of minimum wage)



Sources: DARES; and IMF staff calculations

The STW scheme was significantly expanded in March, leading to a historically large take-up. Eligibility to the scheme was extended to all contract types, with no condition on seniority, and the application process was significantly simplified. The scheme is very flexible, as firms can apply preemptively to have workers completely on STW for a prolonged period and then, depending on their need, claim reimbursement for the hours effectively cut, with a lag of up to one year. Most importantly, the reimbursement from the state was increased from a lump sum per hour to 100 percent of the labor cost of furloughed hours (up to a cap of about €30.3 per hour, equivalent to €4,608 at a monthly basis). As a result, the number of workers authorized for STW rose to 11.2 million workers in March and 12.7 million (or about 50 percent of total employees) in May. The *ex post* effective use was significantly lower though, at 7½ million workers on average over March-May (and 3½ million in full-time equivalent terms). In comparison, STW claims peaked at around 0.3 million workers in 2009:Q2, during the Global Financial Crisis. By September, the number of workers registered at STW had declined by almost half compared to the average over March-May level (and claims were down by 85 percent) but remained broadly constant in November reflecting the effects of the second lockdown on activity.

Short-time Work Scheme During Covid-19 Crisis
(Million workers)



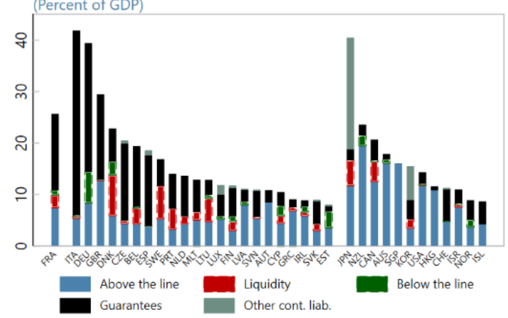
Sources: DARES; and IMF staff calculations.

As the economy emerged from the first lockdown, the parameters of the STW scheme were adjusted but remained generous by international standards. The replacement rate for firms was reduced to 85 percent in June—except for firms in heavily affected sectors (catering, hotels, tourism, events, sports, and culture) or affected by mandatory closures, for which the full compensation was extended until January 2021—and will decline further, to 60 percent, from early-2021 onward. However, firms that sign a collective agreement are eligible for a long-duration scheme (*activité partielle de longue durée*) under which they can register workers for 40 percent of their normal hours for a period of up to 24 months over a three-year window (effectively extending the scheme until 2023) and get reimbursed 85 percent of the cost. The combination of the replacement rate for workers, the share of cost reimbursed to firms, the cap to this compensation, and the extended duration, make the French long-duration STW program exceptionally generous in comparison to STW schemes in other European countries (see Annex VIII).

14. The swift and flexible support cushioned the income shortfall for households and firms. In the emergency phase, income of workers and self-employed were largely preserved by the STW scheme and the solidarity fund, as well as by the extension of expiring regular unemployment benefits. While output declined by 19 percent (y-o-y) in 2020:Q2, aggregate household disposable income dropped by only two percent (y-o-y) during that period. Given constraints on consumption, the preservation of income led to a surge in aggregate household savings (about 78 percent y-o-y).[5] Liquidity pressures on firms were also eased through a variety of measures. First, the expansion of the STW scheme enabled the state to absorb the labor cost of firms' reduced hours. Second, the liquidity injections through ECB's TLTRO III[6] enabled banks to largely fund the state-guaranteed loans, which firms used to build cash buffers and finance working-capital. Banks also agreed to establish moratoria covering around €20 billion in loans[7], taking advantage of the flexibility in the accounting and prudential treatment of claims restructured under debt moratoria. The expansion of emergency measures in response to the second lockdown is expected to have also preserved aggregate household and firm income in 2020:Q4.

15. The authorities' recovery plan (*Plan de Relance*) embedded in the 2021 budget law includes additional spending measures of 2.4 percent of GDP and permanent tax cuts worth 0.4 percent of GDP per year. The additional spending measures are largely focused on the green and digital transformation of the economy; employment support; and incentives to relocate production to France (text table). Part of this additional spending (1.6 percent of GDP) is expected to be financed by grants from the EU Recovery Fund. About 46 percent of the total additional spending (1.1 percent of GDP) is expected to be executed in 2021. The recovery plan also includes permanent cuts to distortionary production taxes (0.4 percent of GDP) per year and public guarantees (0.3 percent of GDP) to leverage private-sector funds providing quasi-equity financing for SMEs and mid-size firms through participatory loans (see ¶32). The 2021 budget also includes the increase in healthcare civil servant wages decided in the context of *Ségur de la santé* negotiations (about 0.3 percent of GDP).

Fiscal Package in Response to COVID-19
(Percent of GDP)



Sources: Fiscal Monitor database of Covid-19 measures (as of Nov. 6); and IMF staff calculations.

Note: Liquidity measures denote deferral of tax payments or accelerated refund of tax credits. Below-the-line measures include equity injections or asset purchases, government loans, debt assumptions, and nationalizations.

[5] An analysis of credit card transactions suggests that more than 70 percent of the excess savings during the lockdown accrued to the top two income deciles. In contrast, households at the bottom of the distribution, experienced both a decline in consumption and a decline in their net financial wealth (see Bounie et. al., 2020).

[6] ECB intervention in the corporate bond and commercial paper market also helped ease market funding stress for corporates.

[7] See Banque de France, June 2020 "Assessment of Risks to The French Financial System".

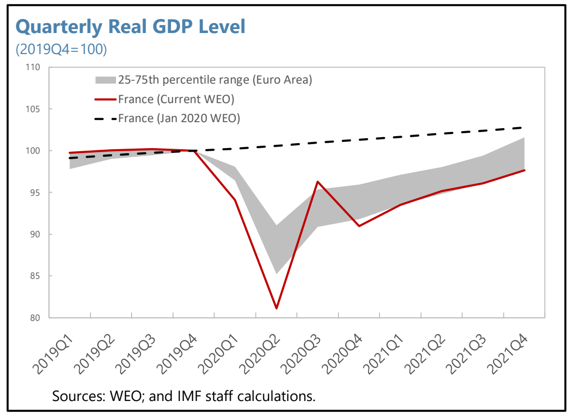
Text Table. Key Legislated and Announced Measures in Response to the Covid-Related Crisis (Percent of GDP)

Above the line measures (+ = deterioration in fiscal balance):	2020	2021	2022	2023	2024	2025
Total above the line measures	**3.8**	**1.6**	**1.3**	**0.7**	**0.6**	**0.5**
Amending Budget Laws (March-November 2020)	**3.8**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Revenue Measures						
Exoneration of SSC for tourism sector	0.4	0.0	0.0	0.0	0.0	0.0
Carry back for CIT	0.0	0.0	0.0	0.0	0.0	0.0
Spending Measures						
Short-time work scheme - expanded coverage	1.5	0.0	0.0	0.0	0.0	0.0
Direct transfers (Solidarity Fund)	0.9	0.0	0.0	0.0	0.0	0.0
Health spending (incl. expansion of health insurance)	0.5	0.0	0.0	0.0	0.0	0.0
Other	0.5	0.0	0.0	0.0	0.0	0.0
Recovery Plan ("Plan de Relance")		**1.6**	**1.3**	**0.7**	**0.6**	**0.5**
Revenue Measures						
Cut in production taxes		0.4	0.4	0.4	0.4	0.4
Spending Measures						
Short-time work scheme - expanded coverage		0.3	0.0	0.0	0.0	0.0
Hiring subsidies for youth		0.2	0.0	0.0	0.0	0.0
Training plans and other employment support		0.2	0.0	0.0	0.0	0.0
Energy renovation of buildings		0.1	0.2	0.0	0.0	0.0
Investment transport sector and green energy production		0.1	0.3	0.0	0.0	0.0
Other spending aimed at ecological transformation		0.0	0.1	0.0	0.0	0.0
Infrastructure and other spending in health sector		0.1	0.1	0.1	0.0	0.0
Incentives to relocate production to France		0.0	0.0	0.0	0.0	0.0
Other		0.2	0.3	0.2	0.2	0.0
Other measures with no impact on fiscal balance:	**18.2**					
Liquidity measures	**2.4**					
Postponement of social and fiscal deadlines	1.7					
Accelerated refund of tax credits	0.8					
Public guarantees (envelope approved)	**14.9**					
Bank loans (Prêt garanti par l'État)	13.3					
Reinsurance schemes	0.7					
Other guarantees 1/	0.6					
Direct equity support (envelope approved)	**0.9**					

Sources: IMF staff estimates.

1/ Includes program of public guarantees for participatory loans in the recovery plan.

OUTLOOK AND RISKS: A CLOUD OF UNCERTAINTY



16. **Staff estimates that output declined by around 9 percent in 2020 and expects the recovery in 2021 to be incomplete.** In the baseline, staff assumes widespread availability of an effective vaccine or treatment towards end-2021. The drop in output is largely a result of the two lockdowns, which triggered a domestic demand decline of around 7½ percent of GDP. In addition, the composition of France's exports (dominated by transport equipment and tourism) and its destination (largely oriented toward European countries) imply a stronger negative contribution from net exports compared to some European peers. For 2021, staff expect only a partial rebound, reflecting continued drag from the pandemic and continued uncertainty. Staff forecasts growth of almost 5½ percent, predicated on the absence of a third wave strong enough to trigger another lockdown. Key support is expected from the ECB's continued accommodative monetary policy and the government's recovery plan.

17. **Over the medium term, output is projected to grow above potential, but remain below the pre-crisis trend.** Assuming a sustained improvement in the health situation in 2022 and beyond, output is expected to grow above potential, as previously depressed sectors rebound and accumulated household savings support higher domestic demand. Nevertheless, impaired balance sheets are expected to curtail investment spending and innovation, which together with higher unemployment and gradual labor reallocation are expected to weigh on output over the medium term. Real output is expected to remain about 4 percent lower than its pre-COVID-19 trend by 2025 due to lasting damage from the crisis. This is broadly in line with the average projected output loss for euro area countries and at the lower end of average estimates for past crises in advanced economies, reflecting the strong policy response and comfortable financial sector buffers.

18. **The current account deteriorated significantly in 2020 and is projected to recover only gradually.** The current account deficit is estimated to increase to more than 2 percent of GDP in 2020 from 0.7 percent of GDP in 2019. The deterioration has both temporary and longer-lasting components. The effects of larger imports of health equipment and a deteriorated business and tourism travel service balance should ease over time, while other factors—such as persistently subdued demand for aeronautic exports and lower investment income—are less likely to revert to pre-crisis levels over the medium term. The ULC-based real effective exchange rate appreciated by about 7½ percent, potentially weighing further on the current account going forward. As a result, France's external position in 2020 was preliminarily assessed to be weaker than implied by medium-term fundamentals and desirable policies (see Annex III). The current account is expected to improve only gradually over the medium term.

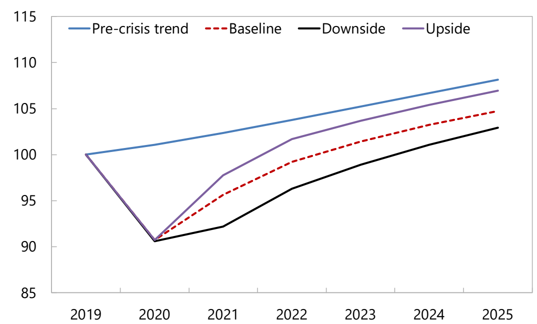
19. Risks to the outlook are unusually high (Annex IV). In the near-term, risks are dominated by the virus dynamics. Other downside risks include a renewed tightening of financial conditions, an increase in social tensions, and the acceleration of de-globalization developments (including from a no deal Brexit).

- ***Virus Risks:*** On the downside, extended or renewed containment efforts may be needed, if eradicating the disease takes longer. This would delay the recovery with a more adverse impact on fiscal sustainability. On the upside, earlier-than-expected availability of an effective vaccine with widespread immunization could bring back activity faster, limiting corporate balance sheet impairments and employment losses over the medium term. Encouraging early-stage results from some vaccine providers have brought these virus-related risks closer to balance.

- ***Other risks:*** A repricing of risks by credit markets and increased volatility in equity and bond flows could lead to a renewed sharp tightening of financial conditions. This could put pressures on bank balance sheets which, together with lower capital buffers, may reduce credit supply, exacerbating liquidity risk in the corporate sector. Corporate insolvency may worsen from complex interlinkages and reduced access to credit. Social discontent could also increase from the prolongation of pandemic containment measures. Difficulties in the international economic environment, from a no-deal Brexit outcome or other disruptions to international trade, could weigh on the outlook.

20. The outlook can deviate materially from the baseline forecast depending on the virus dynamics. In an illustrative downside scenario with worse health dynamics (reflecting either delays in widespread availability of vaccines or limited willingness to receive inoculation), social distancing and further lockdown measures (similar to those imposed in end-2020) would be needed again in 2021, delaying the recovery by one year. The resulting sustained increase in unemployment, as well as reduced investment and R&D spending, would weigh on medium-term output. Under an upside scenario, with faster and widespread availability of an effective vaccine leading to population immunity by mid-2021, output could rebound more quickly in the second half of 2021 and in 2022, reflecting a normalization of activity in contact-intensive sectors and more limited corporate balance sheet impairements.

Output Level
(2019=100)



Sources: IMF staff calculations.

Authorities' Views

21. There was broad agreement on the near-term outlook and risks, with the authorities expecting a slightly stronger contraction in 2020 and faster recovery in 2021. The authorities expect output to drop by almost 11 percent in 2020, reflecting the impact of the pandemic and lockdown measures. They were more optimistic on the outlook for next year and expected a faster rebound once containment measures are lifted, particularly in view of the strong rebound observed in the third quarter of 2020.[8] The authorities anticipate a stronger contribution from private investment and net exports to growth in 2021. There was agreement that downside risks from the virus are large, but the authorities emphasized that upside risks on health developments (quicker full containment of the infection, earlier-than-expected availability of an effective vaccine) or on consumption (out of the savings accumulated during the lockdown period) could significantly accelerate the economic recovery. While they viewed other risks as still relevant, they considered them to be relatively less important and neither very short term nor specific to France. The authorities shared the view that the current account weakness partly reflects an export structure disadvantaged by the asymmetric nature of the shock. They expect competitiveness gains from lower production taxes to contribute toward a gradual improvement in the current account.

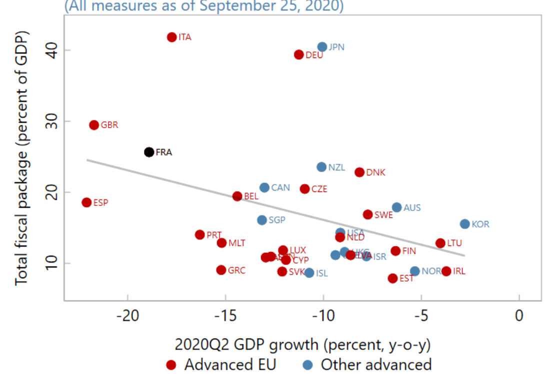
POLICY CHALLENGES: NAVIGATING HEADWINDS

22. Amidst a second wave of infections and high uncertainty, continued strong and flexible policy support is appropriate. In the near term, support to affected firms and individuals should continue to be scaled up as needed to protect the economy. While closely monitoring risks to financial stability, strengthening corporate balance sheets and addressing risks from insolvency will be critical to the recovery. The economic disruption of the pandemic represents an opportunity to reorient the French economy, and policies should aim at limiting the scarring effects from the crisis by boosting productivity and employment, while greening the recovery.

A. Fiscal Policies: Maintaining Adequate and Sustainable Fiscal Support

23. France's fiscal response to the crisis was timely, flexible, and appropriately calibrated to the size of the shock (Annex VII). About 80 percent of the overall fiscal package announced through November 2020 had already been legislated or announced by June. While the initial response included mostly contingent and liquidity measures, the composition of the fiscal package was flexibly adjusted, with additional spending and foregone revenue as the crisis unfolded. The magnitude of France's overall fiscal response also appears in line with the experience in other advanced economies when the magnitude of initial output losses is taken into account.

Size of Fiscal Package Against Output Contraction
(All measures as of September 25, 2020)



Sources: Fiscal Monitor database of Covid-19 measures (as of Nov. 6); and IMF staff calculations.

24. Continued strong fiscal support is warranted in the near term but should become increasingly targeted as the recovery firms while ensuring budget neutrality over the medium term. Despite its high level of debt, France has some fiscal space due to the ECB's accommodative

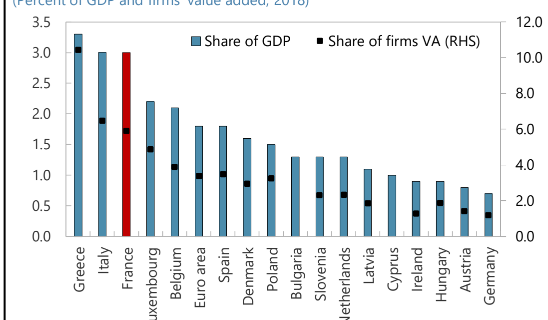
[8] The authorities revised down growth in 2020 in the context of the fourth budget amendment law. The forecast for 2021 was revised down after the mission, to 6 percent, from 8 percent in the draft 2021 budget law.

monetary stance, which is expected to keep financing costs low for long, and support from the Next Generation EU Recovery Fund. Given the extraordinary nature of the COVID economic shock, France should continue to use its fiscal space to provide sufficient support to affected firms and individuals. The size and composition of fiscal stimulus planned for 2021 and beyond appears appropriate to avoid cliff effects from expiring measures under the baseline. The reduction in above-the-line measures from 3.8 percent of GDP in 2020 to 1.6 percent of GDP in 2021 largely reflects the reduction in large emergency-related support (claims for STW and solidarity fund grants). The focus of the additional measures shifts further in 2022 from employment support to investment. If downside risks materialize, the policy response should be scaled up further through temporary measures to prevent a vicious cycle of falling demand and impairing of balance sheets and to avoid further increases in poverty and inequality. Given the scale of France's fiscal response to the crisis, it will be critical to monitor the effectiveness, transparency, and accountability of public spending, including by providing public access to procurement contracts related to crisis programs.[9]

25. As the recovery firms, a progressive targeting of support measures would help facilitate a healthy reallocation of resources while preserving fiscal buffers. The composition of the additional spending planned for 2021 and beyond is rightly focused on boosting investment on the ecological and digital transformation of the economy and on upgrading skills, while still preserving jobs by subsidizing the cost of reduced hours. As the recovery gains traction, however, broad-based emergency measures should give way to targeted support for the more dynamic parts of the economy, while providing a safety net for those affected by the transition. Regarding support for unemployed, it is crucial to continue compensating income shortfalls of workers affected by the pandemic, including those that had precarious work arrangements with limited access to standard benefits at the onset of the crisis. But maintaining current STW replacement rates for all sectors up to 2023, as currently planned, may prove insufficiently targeted and disincentivize the reallocation of workers across firms (Box 2 and Annex VIII).

26. While the cut in production taxes can boost competitiveness over the medium term, the reform should aim at simplifying France's complex system in a budget neutral way. France has a large and complex set of production taxes that levy close to 6 percent of firms' value added (compared to, e.g., 1.2 percent in Germany) and represent about 3 percent of GDP (a level only comparable to Greece and Italy).[10] The recovery plan includes a permanent reduction in three production taxes, with a cost of about 0.4 percent of GDP per

Taxes on Production
(Percent of GDP and firms' value added, 2018)



Sources: Eurostat and IMF staff calculation.
Note: Other taxes on productions (category D29 of the national accounts) excluding wage bill and payroll taxes.

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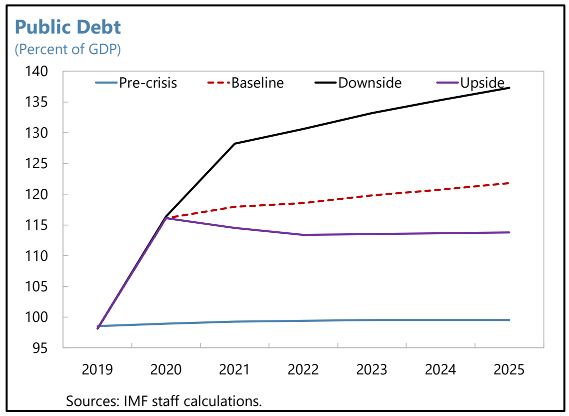
[9] Such efforts will also benefit the authorities' voluntary commitment to assess France's framework for dealing with bribery of foreign officials, as part of the IMF's 2018 Enhanced Framework on Governance.

[10] Production taxes are considered to be highly distortive and detrimental to aggregate productivity and competitiveness (Annex VII).

year.[11] However, the reform misses the opportunity to contribute towards simplifying France tax system. For instance, a similar envelope could be targeted by eliminating the C3S turnover tax (*Contribution sociale de solidarité des sociétés*), a highly distortive turnover tax that was scheduled to be abolished in 2017, and adjusting the cut in the CVAE accordingly (Annex VII). Moreover, because the tax cuts are permanent the reform should include offsetting measures (scheduled to enter into effect only when the recovery is firm), to avoid aggravating future fiscal consolidation needs. This could include, for instance, further streamlining tax expenditures, especially those that have detrimental environmental effects (see *Selected Issues Paper* on climate mitigation policies).[12]

27. The deficit is expected to remain elevated over the medium term given the permanent output loss and substantial tax relief legislated before the crisis. The deficit is projected to reach about 11 percent of GDP in 2020, and to decline to 7.2 percent of GDP in 2021 (text table). Under current policies and including the expected disbursement of grants from the EU Recovery Fund, staff projects the overall and primary fiscal deficit to remain high at around 4½ and 3½ of GDP, respectively, over the medium term. After reaching about 116 percent of GDP in 2020, public debt is projected to edge higher to close to 122 percent



Text Table. Projected Fiscal Outturns (in percent of GDP, unless otherwise noted)

	2019	2020	2021	2022	2023	2024	2025
Pre-Covid Projections							
Revenue	52.5	52.2	51.9	51.6	51.5	51.4	51.4
Expenditure	55.7	54.6	54.3	54.1	54.0	54.0	54.1
Primary fiscal balance	-1.8	-1.1	-1.3	-1.4	-1.5	-1.6	-1.6
Overall fiscal balance	-3.2	-2.4	-2.4	-2.5	-2.5	-2.6	-2.7
Public debt	98.5	99.0	99.3	99.4	99.6	99.5	99.6
Real GDP (percent change)	1.2	1.1	1.3	1.4	1.4	1.4	1.4
Current Projections							
Revenue	52.6	52.6	52.7	52.2	51.6	51.5	51.4
Expenditure	55.6	63.7	59.9	57.7	56.2	55.9	55.8
Primary fiscal balance	-1.6	-9.8	-6.0	-4.5	-3.8	-3.5	-3.4
Overall fiscal balance	-3.0	-11.0	-7.2	-5.4	-4.7	-4.4	-4.4
Public debt	98.1	116.1	117.9	118.6	119.8	120.7	121.8
Real GDP (percent change)	1.5	-9.2	5.4	3.7	2.2	1.8	1.4

Sources: IMF staff estimates.

[11] The taxes targeted by the reform are the CVAE (*cotisation sur la valeur ajoutée des entreprises*) and two taxes on the use of real-estate property (*cotisation foncière des entreprises*, CFE, and *taxe foncière sur les propriétés bâties*, TFPB).

[12] Total subsidies on fossil fuels accounted for more than €10 billion or close to 0.5 percent of GDP in 2018 (ranking fifth among EU countries), and more than €8 billion for oil fuels (EU 2020). Despite some reductions in the 2020 budget, fuel-related tax expenditures were projected at €8.2 billion in 2020.

of GDP over the medium term. If downside risks were to materialize, debt could reach close to 140 percent of GDP[13]. On the other hand, in an upside scenario debt could decline slightly to 114 percent of GDP but would still remain above pre-crisis levels. While the authorities will only provide a comprehensive reassessment of their medium-term fiscal projections next spring, the pluriannual forecasts included in the draft 2021 budget envisage the deficit to decline to about 3 percent of GDP by 2025, underpinned by a yet unspecified adjustment of about ½ percent of GDP starting in 2022.

28. Once the recovery is on firm ground, an expenditure-based consolidation effort will be needed to place debt on a downward path. France's public debt increased steadily over the past four decades, reaching almost 100 percent of GDP before the crisis, as successive governments did not take full advantage of good times to reverse spending increases undertaken during downturns (IMF Country Report No. 19/245). The exceptionally low interest rate outlook has provided some fiscal space during the crisis, but France's preexisting elevated debt level provides less room to maneuver over the medium term and increases fiscal risks. While fiscal policy needs to remain supportive until the economic recovery is secured, the authorities should develop a credible plan now to put debt on a firm downward path over the medium term. The timing and pace of fiscal consolidation should remain state contingent, starting only when output has broadly recovered to its pre-crisis level and downside risks to growth have abated. Continued implementation of the unemployment benefit reform once the crisis eases and pursuing the planned pension reform can help support consolidation efforts while also improving equity and boosting long-term growth. But further measures will be needed, focused on structural spending reforms that can sustainably reduce recurrent spending in a growth-friendly manner. A sufficiently ambitious plan should not only ensure debt remains sustainable, but also make space to reduce distortionary taxes further, and provide for critical investment to reorient the economy in the post-crisis environment. Previous analysis of areas where France's level of spending is high relative to peers and where efficiency gains could be achieved can help guide those efforts (IMF Country Report No. 19/245) but a reassessment of priorities, taking account the consequences of the pandemic, may be warranted.

Authorities' Views

29. The authorities agreed that while strong, flexible, and temporary additional fiscal support is warranted in the near term, there is need for a medium-term expenditure-based consolidation plan, to be implemented only once the recovery is on firm ground. In line with staff advice, the authorities' near-term priorities are focused on providing emergency support for affected firms and individuals as needed. They concurred that policy support can become more targeted as the recovery strengthens but were less concerned than staff about the potential costs that untargeted programs may have in terms of resource misallocation. They agree that permanent expansionary measures are not warranted at this juncture and that while fiscal consolidation should only start when the recovery is firm, it would be advisable to start planning now. However, the

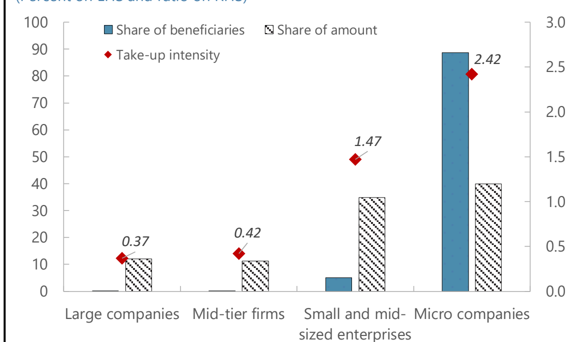
[13] The downside scenario assumes that 2.4 percent of GDP in public guarantees being called, bank recapitalization needs of 0.6 percent of GDP, and additional stimulus measures of 1.8 percent of GDP.

authorities believe that the growth dividend from the recovery plan will lessen consolidation needs. They reiterated their commitment to implement the unemployment benefit reform and pursue a reform of the pension system once the acute phase of the crisis is over, after a phase of consultation with social partners on possible adjustments to these reforms to take into account the crisis background. The authorities expressed commitment toward safeguarding public funds and noted that the information on public procurement contracts, including on the beneficial owners of companies that contract with the State, is publicly available.

B. Financial Sector: Preserving Stability and Supporting Firms

30. The corporate sector faces significant solvency risks from the lockdowns and unsteady recovery. Emergency policies, such as government guaranteed bank loans have so-far helped firms remain current on their obligations. This shielded banks' loan books by preventing immediate liquidity problems. The guaranteed loans were made widely available, with micro, small and mid-sized enterprises accounting for a large portion of the take-up, both in terms of beneficiaries and amounts. Some 5.4 percent of GDP in guarantees were granted by end-November, equivalent to 10 percent of total outstanding loans to non-financial corporates. Consequently, gross corporate debt, already on an increasing trajectory, grew by an additional 10 percentage points of GDP in 2020:Q2. As many firms used these loans mostly to build cash-buffers, net debt remained fairly stable so far. However, losses from depressed business activity are likely to be large for some sectors and delinquencies are expected to increase as the effect of fiscal deferrals, moratoria, and temporary flexibility provided by insolvency frameworks (see Annex V) fade out. Large inter-company exposures could also exacerbate solvency issues from individual corporate failures, though diversification within large groups may also provide some insurance given the asymmetric nature of the shock. Staff estimates an increase of firm insolvencies in France concentrated around service-sector and small-sized firms, leading to an equity gap of approximately 1.3 percent of GDP, which is the amount needed to resolve the financial difficulties of firms that were solvent before the crisis.[14] These equity needs are likely to increase with the second wave of infections and associated lockdown as well as under an adverse scenario of protracted recovery.

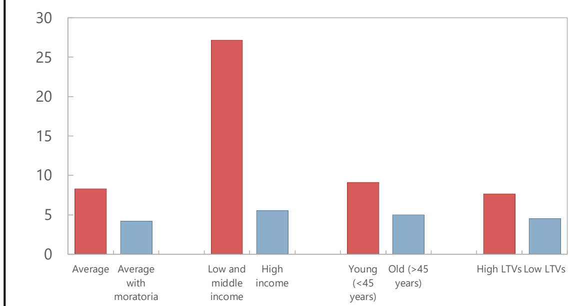
Take-up of State-guaranteed Loans by Firm Type
(Percent on LHS and ratio on RHS)



Sources: Banque de France.
Note: Take-up intensity is the ratio of amount share and the value-added share.

[14] See *Chapter 3, European Regional Economic Outlook, October 2020*. This is broadly in line with estimates from other studies (see for e.g., Euler Hermes, 2020 who estimate the equity need at 1.3 percent of GDP), and authorities' estimates which range between 0.7–0.9 percent of GDP (see Annexe au Projet de Loi de Finances pour 2021).

Probability of Default on Mortgages Upon Job Loss
(Within 5 years of job loss, with unemployment insurance, percent)



Sources: ECB Household Finance & Consumption Survey 2020, OECD; IMF staff estimates.
Note: Estimates from *Household Sector Micro-Macro Simulation and Policy Analysis Amid COVID-19*, Gross and Tressel (forthcoming).

31. Emergency fiscal support helped protect household balance sheets but future job losses could increase mortgage risk. A sharp rise in unemployment could lead to a deterioration in household solvency and increase credit risk on property loans. Staff stress test estimates suggest that losing a job (and receiving unemployment insurance) is associated, on average, with an 8 percent probability of default on mortgages (within 5 years). This risk is temporarily mitigated by moratoria policies, such as those that were in place during the emergency phase of the crisis. However, in an adverse scenario (without moratoria and with the unemployment increasing by about 2 percentage points) the overall mortgage default risk could increase by 20 basis points. The average default risk, however, conceals considerable disparities, with vulnerabilities concentrated amongst low- and middle-income households who face a five-fold higher default risk, upon job losses, compared to high income households.

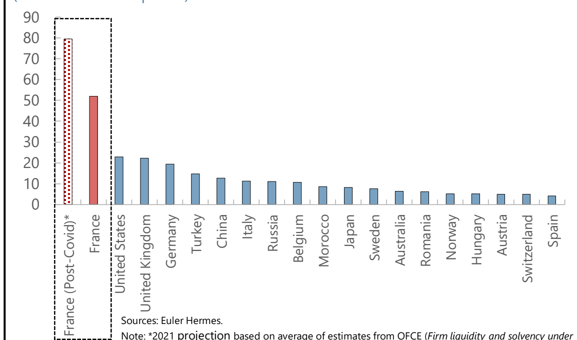
32. Strengthening corporate balance sheets and addressing risks from insolvency will be critical to the recovery. Once the acute phase of the crisis eases, the authorities should refocus measures away from government loan guarantees by scaling up equity-like financing targeted at crisis-affected viable enterprises to spur investment and business dynamism, while reducing risk from excessive leverage.[15] The authorities' recovery plan features selective measures on quasi-equity financing for SMEs and mid-caps. The main instrument—the *prêt participatif* (Annex V)—involves incentivizing the private sector to mobilize quasi-equity (subordinated loan) financing by providing public guarantees. While the scheme combines desirable features of market-led selectivity and limiting the administrative burden for the government, its complex design and pricing may preclude adequate take-up or prevent funds to be directed towards firms with equity needs (see Box 3). The envelope for equity-support initiatives may therefore need to be augmented and the instruments adapted if take-up is weaker than planned or equity needs persist, including from debt overhang issues. Support for large strategic companies through state equity and debt instruments should be used on a limited basis, within the budgeted envelope, and only to avoid protracted widespread damage to the recovery. Measures to further weaken tax incentives which favor debt over equity should be considered, in line with the 2019 FSAP recommendation, to support a healthier capital structure for firms.[16] Frequent and close monitoring of intragroup transactions within conglomerates should be prioritized to limit the amplification of corporate risks.

[15] In this regard, flexibility was provided by the European Commission on state aid rules (see EC C(2020) 3156). See *Selected Issues Paper* on the role of excessive debt in aggregate productivity dynamics during the GFC.

[16] See IMF Country Report No. 19/241. The recovery plan includes a few, temporary, equity enhancing tax incentives (Annex V).

33. Enhancing debt restructuring mechanisms can complement the efficacy of solvency support initiatives. France registers the highest rate of annual insolvencies worldwide, accounting for almost one third of total insolvencies in western Europe. An increase in insolvencies from the pandemic of about 50 percent (text figure) could overwhelm court capacity, risking indiscriminate firm liquidation. Temporarily increasing the administrative capacity of France's out-of-court restructuring mechanisms (*mandat ad hoc* and *conciliation*) in the near term could prevent this and enable viable firms to restore their financial health. It may also be useful to adopt corporate triaging, distinguishing between businesses that can and cannot be restructured based on transparent criteria and led by private-sector specialists[17], allowing the expeditious winding down of non-viable firms. This would facilitate capital reallocation towards viable firms and contribute to avoiding long-run scarring from debt overhang. Swift implementation of the EU Restructuring Directive (Directive 2019/1023) would also help increase the effectiveness of the corporate restructuring procedures at this critical juncture.

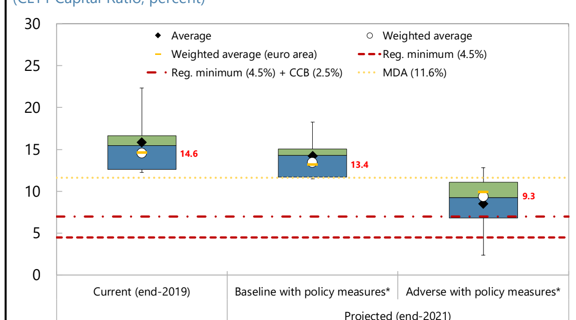
Annual Worldwide Insolvencies in 2019
(Thousands of companies)



Sources: Euler Hermes.
Note: *2021 projection based on average of estimates from OFCE (*Firm liquidity and solvency under the Covid-19 lockdown in France*, July 2020) and Euler hermes (*Calm before the storm: Covid-19 and the business insolvency time bomb*, July 2020)

34. Banks are adequately capitalized to withstand the baseline shock but may see material capital depletions in an adverse scenario. Banks entered the crisis with comfortable capital buffers (CET1 at 14.6 percent on average at end-2019), low NPL ratios (2.5 percent on average) and a liquidity coverage ratio of about 140 percent on average. Sovereign exposure of the banking sector was below the EU average as of end-2019[18]. Staff analysis, incorporating the increase in corporate insolvencies under the baseline (see ¶30), suggests that buffers are adequate. Downside risks remain elevated, as the increased provision of guaranteed loans could adversely affect banks' asset quality in the medium term from spillovers to the non-guaranteed portion of the corporate loan portfolio. In an adverse scenario with lower growth (-4.0 pp below the baseline in 2021) and increased corporate and mortgage defaults (see ¶31), French banks could see a depletion of CET1 ratio by 5.3 percentage points, taking into account existing policy measures (see text figure).[19] Other factors, such as high exposure to market risk, wholesale funding risk, interconnectedness risk, and risks

French Banks—Solvency Stress Test (Baseline & Adverse)
(CET1 Capital Ratio, percent)



Sources: EBA; ECB; ESRB; FitchConnect; and IMF staff estimates.
Note: The blue and green boxes show the inter-quartile range with whiskers at 5th/95th percentiles. CET1=common equity Tier 1 for 8 French banks. */ Debt repayment relief (moratoria) for businesses and households as well as credit guarantees. The analysis covers all three channels affecting the capital adequacy ratio under stress: profitability, nominal assets and risk exposure.

[17] See Liu, Garrido and DeLong, 2020, who discuss key operational features of a corporate triaging process, principles to guide selectivity and standardized approaches that can help accelerate the insolvency resolution for SMEs.

[18] See the EBA Spring 2020 EU-wide transparency exercise.

[19] The estimates are based on IMF, *forthcoming*, "The Impact of COVID-19 on European Banks," EUR Departmental Paper using the downside scenario described in ¶20, 27.

around a no-deal Brexit, could also weigh on the banking sector outlook. The health crisis amplified some of these risks and added new risks from exposures to previously more stable sectors that may undergo permanent transformation (e.g. retail and commercial real estate).

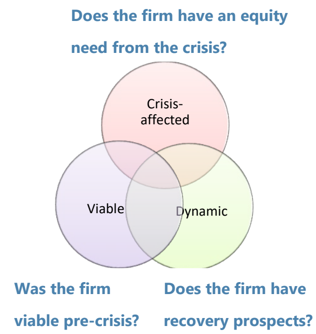
35. The insurance sector remains well capitalized, with robust credit fundamentals, but low policy rates may weigh on future profitability. French insurers are operating with a strong solvency capital requirement (SCR) coverage ratio (265 percent at end-2019 and declining slightly during the crisis). Insurers contributed to crisis support measures by, for instance, augmenting the fund for direct state aid and offering wage allowance payments to at-risk workers. Going forward, together with the exceptionally low interest rate environment, higher impairments and provisions are likely to dampen insurers' net profits. Given the scale of insurance commitments in a still uncertain and changing context, the prudential authorities should continue to collect data and provide special guidance to contain insurers' risk exposure, aimed at preserving their solvency.[20]

36. The macroprudential stance is broadly appropriate and minimum regulatory and supervisory standards should be maintained, given the uncertain financial outlook. The temporary reduction in capital and liquidity requirements and allowing for regulatory flexibility targeted at providing relief to solvent borrowers are appropriate, especially if stress returns in financial markets. Any regulatory flexibility should be temporary, and time bound; a permanent and significant relaxation of micro-prudential requirements or rules that assess banks' asset quality, which may compromise the long-term stability of the financial system should be avoided. Close monitoring of bank capital is warranted going forward, especially if the shock persists. In this context, the authorities should also continue to enhance financial integrity in the post-crisis environment, by maintaining efforts to upgrade the AML/CFT supervision of small banks rated as high-risk (see IMF Country Report No. 19/241 and Annex II). Maintaining limits on other macroprudential measures (borrower-based measures and the large exposure limit[21]) is adequate given the need to mitigate risks from corporate and household indebtedness. Guidance by the supervisory authorities to limit dividend payouts while certain support measures are in place is prudent and should continue until the shock is weathered. Once the recovery takes hold, the authorities could put in place a sectoral systemic risk buffer calibrated to corporate exposures, to be activated appropriately should systemic risks from corporate leverage intensify, in line with the 2019 FSAP recommendation. The development of concentration thresholds for direct exposures within conglomerates and common exposures among entities should also be considered to mitigate amplification risks from interconnectedness.

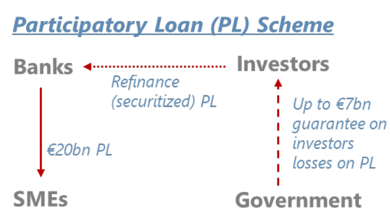
[20] For instance, the Autorité de contrôle prudentiel et de résolution (ACPR) initiated a thematic survey on business interruption coverage due to the pandemic and its consequences, as well as issued guidance to remind insurers not to make payments for losses falling outside of the scope of their coverage. Providing comprehensive coverage for all business interruption losses from the pandemic could entail absorbing losses 25 times higher than those incurred from a past single catastrophe event in France, far exceeding the amount of premiums collected (see OECD 2020).

[21] Recent data show that both the debt growth trend of large or heavily indebted firms as well as concentration of large exposures have been stable so far (see ESRB Notification, July 2020). Nevertheless, a recent study found that the new debt of large French groups was used to finance acquisitions that may suffer from earnings shortfalls given the crisis (see Charasson-Jasson, 2020).

Box 3. Considerations for Supporting Firm Financing Through Equity



Temporarily supporting firm financing needs through well-targeted equity-like instruments could help mitigate debt overhang. Broad-based liquidity credit support to companies may not be sustainable and would eventually need to be phased out. Given the uncertain outlook, private capital may not be readily available in sufficient quantities. During the recovery phase, state support for financing instruments with equity-like features could provide much needed support to firm balance sheets and lower the risk of costly defaults. The government could also gain some upside to compensate for the increased risk. The following design aspects for an equity-like financing program are key: (i) selectivity, ensuring problems related to adverse selection are mitigated, (ii) pricing of the financing instrument, so that take-up is adequate, and (iii) time-bound duration, involving a clear exit strategy for the government (see Bauer et. al., *forthcoming*, for governance aspects). In determining selectivity, consideration could be given to supporting crisis-affected firms having an equity need that were, viable before the crisis (e.g., by gauging balance-sheet metrics) and are dynamic (e.g., by assessing firms' submission of recovery feasibility plan).



France's equity initiatives through participatory loans combine desirable features of market-led selectivity but take-up is uncertain. Participatory loans (PL) are subordinated loan instruments that may include the possibility of having an interest rate indexed to the company's turnover or profit. However, the use of indexing has been historically rare and does not confer the instrument an equity status from either a legal or accounting perspective (see Wood, 2007). Furthermore, while the relatively long amortization period eases debt-servicing constraints, its potentially high cost of access can deter prospective borrowers. The government's *prêt participatif* program, incentivizing the private sector to mobilize quasi-equity financing (about €20 bn, consistent with the governments' equity-gap estimate) by providing public guarantees, mitigates adverse selection issues by relying on banks' expertise to select viable companies. However, the pricing (interest rate set on the loan) and complex nature of the scheme, contingent on the participation of two set of entities (banks and investors) could result in low take-up. Further, since the targeting mechanism relies on banks' discretion (within a fixed fund mobilization envelope), funds may be excessively directed toward firms that face limited solvency risk, leaving equity-gap needs of viable firms partially unfulfilled. Banks' risk exposure could also increase if they are unable to sell a large portion of the PLs granted. For those PLs granted directly by the state (Annex V, *FDES*), determining the viability and recovery prospects of the recipient enterprises remains key, and tools that help estimate SMEs' ability to repay the loan should be considered to safeguard public finances (see for e.g., methods proposed in Bustos-Contell et. al., 2019).

Adapting existing credit schemes, including by indexing them to fiscal claims and providing capital and investment subsidies, can provide targeted equity-like support for investment growth. Loan convertibility options linked to a higher future taxes could act like an equity injection (Blanchard, et. al., 2020). Tranching hybrid credit support involving junior claims, varying the amount a firm can borrow (e.g., progressively on pre-crisis tax returns), and dynamically adjusting the program as crisis conditions change, can enhance selectivity and reduce risks (Stein, 2020). Another option is to augment fiscal carrybacks or carryforwards to allow companies to effectively utilize losses for generating tax savings (see Banque de France, 2020). Providing tax subsidies for corporate capital (e.g. investor tax credits), or utilizing the guaranteed loan envelope for exclusively financing long-term investment, can further incentivize private equity and investment (see also Annex IX for cross-country examples).

Authorities' Views

37. **The authorities agreed with the need to strengthen corporate balance sheets and remain vigilant on the buildup of risks in the financial sector.** They highlighted the widespread take-up of the loan guarantee scheme that enabled firms to build cash-buffers and increase resilience to future shocks. The authorities view their equity support scheme, including through participatory loans, as adequate to fill equity financing gaps in a market-friendly manner. They were also of the view that intragroup transactions are sufficiently well monitored and noted that reporting will be enhanced in the near future. They expressed their commitment to timely implementation of the EU restructuring directive and noted their preparedness in the event that insolvency cases spike. They pointed out that some measures have already been taken in order to weaken the tax-equity bias. The authorities shared staff's assessment that buffers in the banking sector are appropriate but will need continued monitoring as the situation unfolds. They expressed some concern about banking and insurance sector's profitability in the low-interest environment and agreed on the need to remain vigilant regarding the possible build-up of risks in the commercial real-estate sector. They were open to evaluating the appropriateness of the sectoral systemic risk buffer once the crisis abates and the needed regulatory framework is in place.

C. Policies for a Sustained Economic Transformation

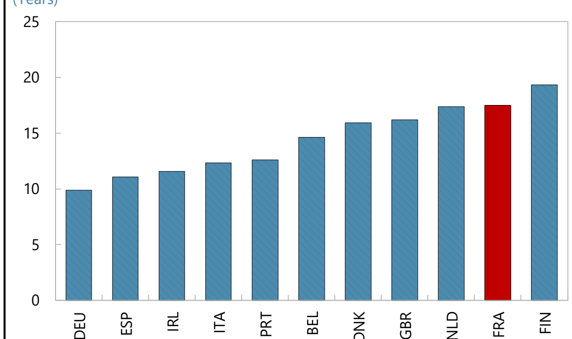
38. **Despite large scale support, the unemployment rate is projected to increase to about 10½ percent and decline only gradually over the medium term.** Following a sustained period of improvements in the labor market, the unemployment rate fell to 7.8 percent in 2020:Q1, the minimum attained in 37 years. This crisis brought this trend to an abrupt end, as unemployment increased to 9 percent in 2020:Q3. While the extension of the short-time work scheme provided some cushion, the renewed lockdown in 2020:Q4 is expected to have accelerated the rise in unemployment. Overall, employment is estimated to have fallen by just 1.3 percent in 2020. The limited decrease compared to the extent of the output contraction masks significant heterogeneity across age cohorts and contract types, with youth employment and people on temporary contracts disproportionately affected. Going forward, job creation is likely to remain weak amid continued depressed activity, especially in labor-intensive service sectors, pushing up the unemployment rate well into 2021.

39. **Policies should aim at boosting employment, particularly among vulnerable groups, by facilitating new work relationships in dynamic sectors.** Preserving the income of affected workers during the emergency phase and boosting resources for the training of existing and prospective workers, as envisaged in the recovery plan, is crucial. Once the recovery gains strength, there will be an increasing need to incentivize work by reorienting support to facilitate new work relationships in dynamic sectors. The requirement to sign collective agreements to be eligible for the long-duration STW scheme (see Box 2) can help aligning wage demands and the provision of training with the objective of preserving jobs. However, the scheme may still incentivize firms to operate below capacity and impede a necessary reallocation of workers toward more dynamic sectors. This could be addressed by gradually tightening the duration, generosity, and eligibility

parameters of the new scheme. The proposed hiring subsidies can boost job creation by firms whose demand is recovering but still face higher production costs or productivity losses from health measures. The subsidies are rightly focused on youth, the hardest hit segment of the labor market, but may need to be recalibrated based on the nature of the crisis and to avoid displacing other workers (e.g. workers above the subsidy threshold) in a labor market with limited job creation. Continuing the reform process to reduce structural unemployment and increase labor force participation, including by making recent collective bargaining reforms and training reforms fully effective (IMF Country Report No. 19/245), remain critical over the medium term.

40. Job-rich green investment policies, such as those in the *Plan de Relance*, should help limit the scarring effects from the crisis, while greening the recovery. The plan includes investment in public transport and in the building sector, where thermal retrofitting needs are significant, but investment amortization times are long. Building on the green budget initiative that France spearheaded, identified tax expenditures supporting fossil fuels should be phased out, using the resources to further narrow green investment gaps. As the recovery strengthens, France should implement additional green policies consistent with Paris Climate Agreement commitments and European initiatives to reduce emissions, including by pricing carbon adequately across sectors of the economy. This should be accompanied by mitigating measures for low-income households to ensure their social acceptance. With appropriate pricing and incentives, French firms' strong presence in fields such as automobiles, power generation, and aeronautics could be leveraged into a leading role in the emerging fields of green energy generation and storage and zero emission transportation.

Amortization Time of Investment in Renovation/Retrofit
(Years)



Sources: IMF (2020) based on BPIE; Central Statistics Office (Ireland); EEA; Eurostat (EU Building Stock Observatory); and IMF staff calculations.

41. The need to boost productivity—which predates the current downturn—will become increasingly important in the recovery phase, as the scarring effects of the crisis are likely to weigh on potential output. Labor productivity growth has declined during the past two decades in France, largely reflecting falling multi-factor productivity growth (see ¶2 and IMF Country Report No. 19/245). The government's proposals to boost the digital transformation of the economy in the *Plan de Relance* will be helpful in this regard, but further efforts will be needed in the coming years. Additional simplification and modernization of the tax system, including by further streamlining of distortionary production taxes, would improve efficiency. Further steps to liberalize product and service markets, such as measures fostering competition in regulated professions, retail trade, and the sale of medicines, can also help boost productivity. Market-based steps to boost the competitiveness of French firms in international markets are welcome, but the authorities should ensure that support for reshoring is strictly limited to addressing national security concerns.

Authorities' Views

42. The authorities shared the priorities for the economy's transformation and viewed the recovery plan as well-calibrated to address this challenge. There was agreement that boosting employment and preserving skills remain key to the recovery. The authorities also concurred with staff's view that labor policies should support workers without hindering a necessary reallocation or resources across firms. They believe that while the long-duration short-time work scheme is generous, the requirement to reach collective agreements and the provision of training support avoids excessive use while preserving skills. They also maintained that displacement effects from youth subsidies are likely to be minimal. The authorities concurred with reform focus on the green transformation of the economy and reducing emissions, which has been designated as a priority of the recovery plan, but considered that significant progress on carbon pricing can only be achieved by a coordinated policy action at the European level. They also emphasized the need to build social consensus as a key element for a successful implementation of these policies. The authorities underscored that support for reshoring is strictly limited to addressing strategic autonomy concerns.

STAFF APPRAISAL

43. France suffered one of the sharpest economic contractions among EU countries and the authorities have responded with strong and flexible support measures. The contraction reflected the severity of the pandemic, the breadth and duration of the lockdowns, and the large share of sectors most heavily affected. To address the impact of the crisis, the authorities put in place a large emergency support package which focused on supporting households and firms by preserving jobs and providing liquidity. The response was quick and flexible, with support subsequently scaled up as needed. The relief effort was effective in reaching its beneficiaries, with significant uptake of government guaranteed bank loans and of the short-time work scheme. The emergency package was complemented with a recovery plan rightly focused on supporting growth by upgrading skills and boosting investment on the ecological and digital transformation of the economy.

44. The economic outlook is highly uncertain, and risks are dominated by the virus dynamics. Economic activity will remain below pre-crisis levels in the near-term and the extent and pace of the recovery will depend upon the evolution of the pandemic and related containment measures. The external position is assessed to be weaker than implied by medium-term fundamentals and desirable policy settings, but this reflects partly the effect of one-off factors related to the COVID-19 crisis. Competitiveness gains from lower production taxes could contribute toward a gradual improvement in the current account. In the near-term, risks continue to be dominated by the virus dynamics. On the downside, a prolongation of the health crisis into 2021 could delay and weaken the economic rebound. On the upside, faster availability of an effective vaccine with widespread immunization could bring back activity significantly faster.

45. Given the unprecedented nature of the crisis and exceptional uncertainty, continued strong policy support is warranted but should be continuously reassessed and adapted as needed. In the near term, support to affected firms and individuals should be calibrated as the pandemic evolves, especially to avoid that the necessary health containment actions lead to increases in poverty and inequality. As fiscal space may become increasingly limited, focusing support at those most affected will ensure that they receive sufficient relief while preserving the sustainability of public finances. Once the health emergency is over and a recovery gains traction, the government should shift from providing broad-based emergency support to targeted support for the more dynamic parts of the economy, whilst buffering those most affected by the transition. The implementation and effectiveness of policy measures should be closely monitored and adjusted accordingly to maximize their impact.

46. Once the recovery is on firm ground, an expenditure-based consolidation effort will be needed to place France's high debt on a downward path. While the exceptionally low interest rate outlook has provided some fiscal space, France's elevated debt level provides less room to maneuver over the medium term and increases fiscal risks. The timing and pace of fiscal consolidation should depend upon the economic situation, starting only when output has broadly recovered to its pre-crisis level and downside risks to growth have abated. The planning process should, however, begin now in order to provide a credible medium-term fiscal path. The plan should be focused on structural fiscal reforms to streamline and boost the efficiency of recurrent expenditure. In this context, permanent tax cuts or expenditure hikes should be avoided or accompanied by specific compensatory measures so as to prevent the build-up of additional fiscal problems once the crisis eases.

47. Strengthening corporate balance sheets and continued vigilance on the buildup of risks in the financial sector will be critical. The sharp increase in additional borrowing by companies, as they deal with pandemic-induced cash shortages and income losses, may lead to debt overhang issues and hamper private sector recovery. Once the acute phase of the crisis eases, the authorities should pivot support away from government loan guarantees and scale up equity-like financing targeted at crisis-affected viable enterprises to spur investment and productivity. The authorities' market-led quasi-equity financing initiative is a welcome step in this direction, but it may need to be augmented or adapted if take-up is weak and equity needs increase. In addition, reinforcing insolvency frameworks will facilitate the efficient restructuring of viable firms and boost business dynamism. Despite still comfortable buffers, close monitoring of bank capital is required, as asset quality deterioration from future corporate defaults could represent a risk to already limited bank profitability, especially if the health crisis persists. The macroprudential stance is appropriate and should continue to be calibrated as systemic risks evolve. Regulatory flexibility, especially targeted at providing relief to solvent borrowers, has been appropriate but should be temporary and time bound.

48. Policies should also aim at boosting employment, particularly among vulnerable groups. Lower job creation as a result of uncertainty and continued depressed activity, especially in the labor-intensive service sector, is likely to push the unemployment rate up further. The proportionally stronger effect of the crisis on lower-skilled workers and the young could affect negatively their integration into the labor market, amplifying preexisting vulnerabilities. Once the recovery takes hold, there will be an increasing need to incentivize work by reorienting support to facilitate new work relationships in dynamic sectors. This could be achieved by tightening the eligibility and generosity of the short-time work scheme and facilitating retraining of existing workers. Continuing the government structural reform process to reduce structural unemployment and increase labor force participation remains critical over the medium term.

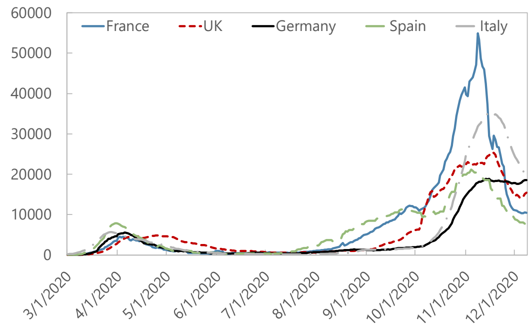
49. The economic disruption of the COVID-19 pandemic, and the associated massive fiscal response, represent an opportunity to reorient the French economy. Job-rich green investment policies, such as those in the *Plan de Relance*, are well placed to help limit the scarring effects from the crisis while greening the recovery. As the recovery strengthens, France should implement further green policies consistent with Paris Climate Agreement commitments and European initiatives, including by strengthening carbon pricing. The need to boost productivity—which predates the current downturn—will become increasingly important in the recovery phase, as the scarring effects of the crisis are likely to weigh on growth potential. Additional simplification and modernization of the tax system, and further steps to liberalize product and service markets can help boost productivity.

50. It is recommended that the next Article IV consultation take place on a standard 12-month cycle.

Figure 1. Covid-19 Developments

France was heavily affected by Covid-19 with daily cases per capita exceeding 50,000 at the peak of the second wave.

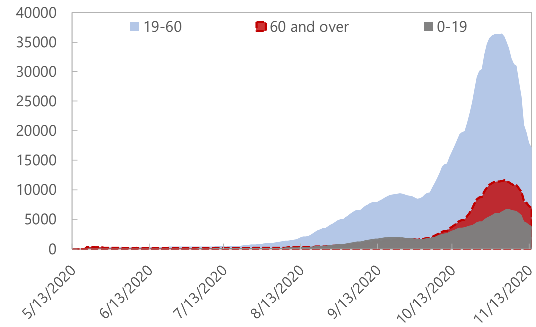
Cases 7-Day Moving Average
(Number of cases)



Sources: ECDC; and IMF staff calculation.

The second wave of inections was largely concentrated among young and the middle-aged.

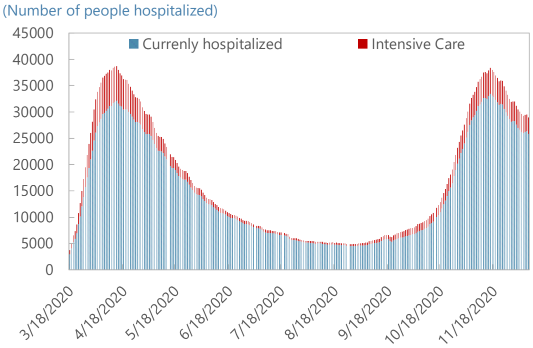
Cases by Age Category
(Number of postive tests)



Sources: National Authorities.

Despite higher caseload in the second wave, hospitalizations remained at par with the first wave levels, ...

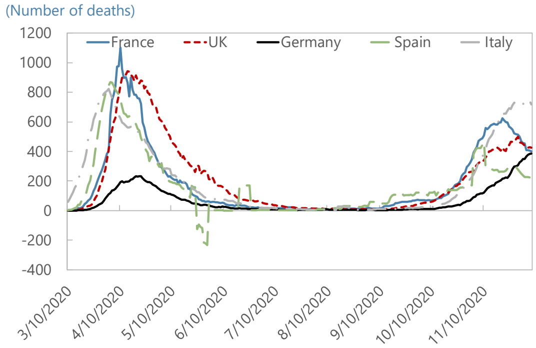
Covid-19 Daily Inflow of Hospitalized and Intensive Care
(Number of people hospitalized)



Sources: National Authorities.

... partly due to the shift in the demographics of cases, which also contributed to deaths being more contained during the second wave.

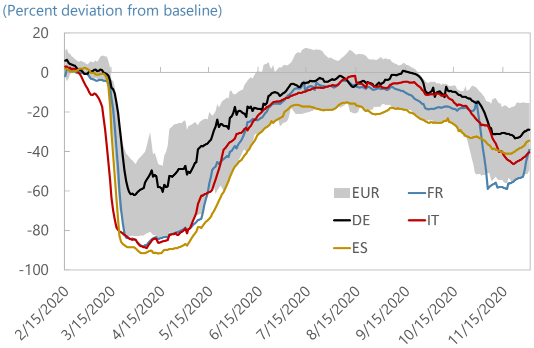
Deaths 7-Day Moving Average
(Number of deaths)



Sources: ECDC; and IMF staff calculation.

Activity plummeted as a result of containment measures, as reflected through the Google mobility index...

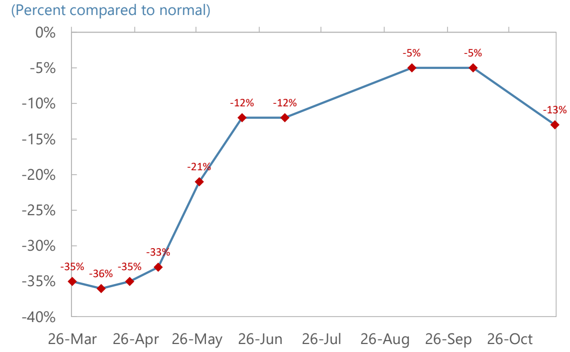
Mobility around retail shops
(Percent deviation from baseline)



Sources: Google. Note: 7-day moving average. Baseline=median value from same week days from Jan 3 - Feb 6 2020. EUR refers to 10-90pct range in EUR.

... with economic activity operating below normal by 36 percent at the height of the first lockdown.

INSEE Real-Time Estimate of Activity
(Percent compared to normal)



Sources: INSEE; Real-time estimate of activity (nowcast) is plotted per the date at which the nowcast was published.

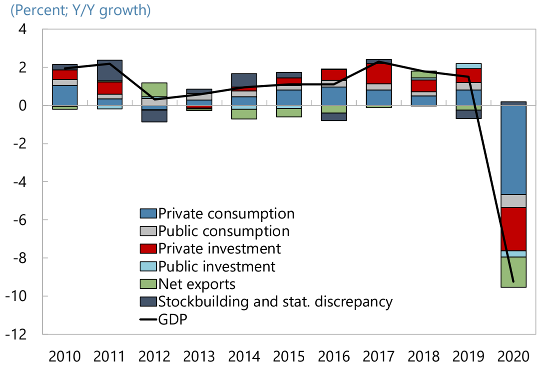
Figure 2. Real Sector Developments

Growth is expected to fall in 2020 by about 9 percent, with all components adding to the decline.

The significant decline in France reflects a worse decline in 2020H1 from the lock-down measures compared to most EA countries.

Contribution to Annual Real GDP Growth

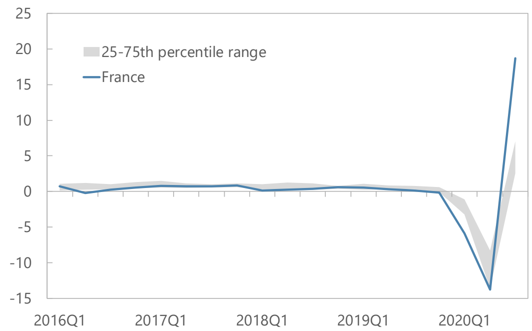
(Percent; Y/Y growth)



Source: INSEE (Haver Analytics), WEO and IMF staff calculations.

Real GDP

(Percent, Q-on-Q growth)



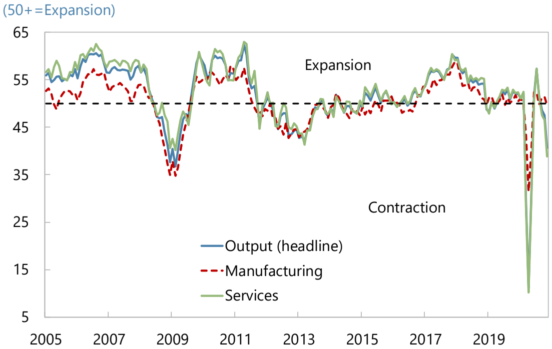
Sources: WEO and IMF staff calculation

Following a collapse especially for services during the first lock-down, PMIs rebounded in June but declined again in the second lockdown.

While business confidence suffered a stronger blow and temporarily recovered, consumer confidence has shown no signs of improvement.

Purchasing Managers' Indices

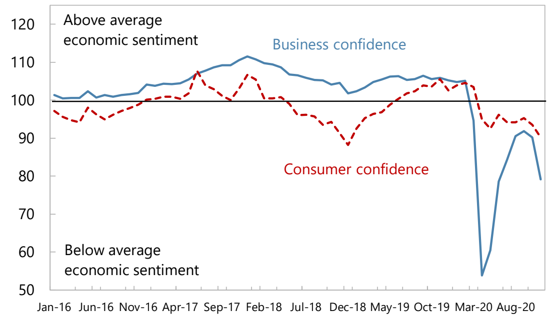
(50+=Expansion)



Source: CDAF/IHS Markit (Haver Analytics).

Business and Household Confidence

(Long-term average=100)



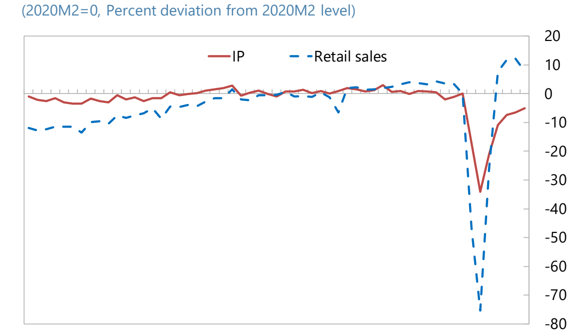
Source: INSEE (Haver Analytics).

IP recovery has weakened and remains depressed, while retail sales exceeded pre-crisis levels, reflecting pent-up demand.

Capacity utilization in industry recovered from its low of 26 percent below average in Q2, but remains 9 percent below average in Q3.

Industrial Production and Retail Sales Volume Indices

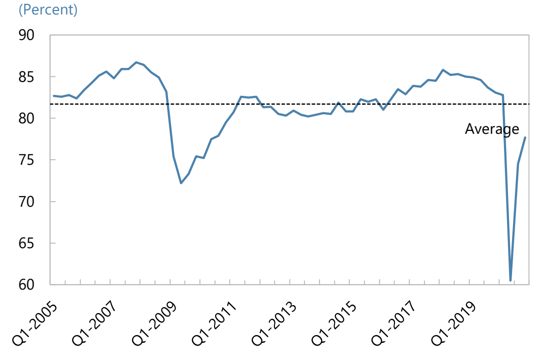
(2020M2=0, Percent deviation from 2020M2 level)



Sources: INSEE (Haver Analytics) and IMF staff calculations.

Capacity Utilization: Industry

(Percent)

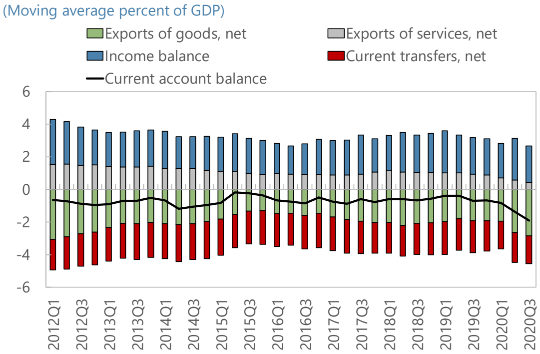


Sources: INSEE (Haver Analytics).

Figure 3. External Sector Developments

The current account deficit widened in 2020…

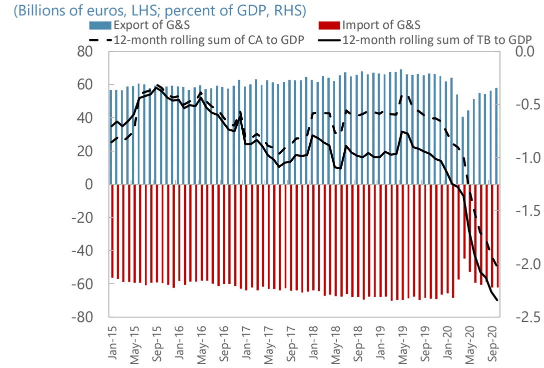
Quarterly Current Account
(Moving average percent of GDP)



Sources: Banque de France and INSEE (Haver Analytics).

…driven both by a widening of the trade deficit as well as the fall in primary income receipts.

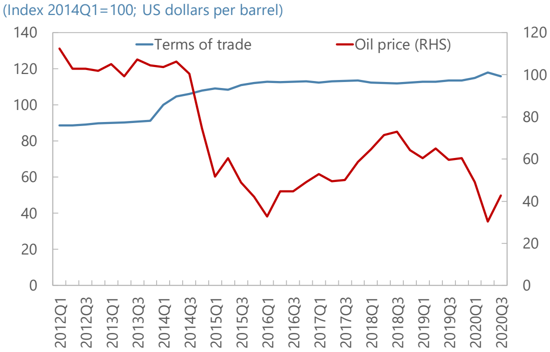
Current Account and Trade Balance
(Billions of euros, LHS; percent of GDP, RHS)



Sources: Haver Analytics

The oil price decline partly offset the non-oil goods and services trade deficit in the first half of the year.

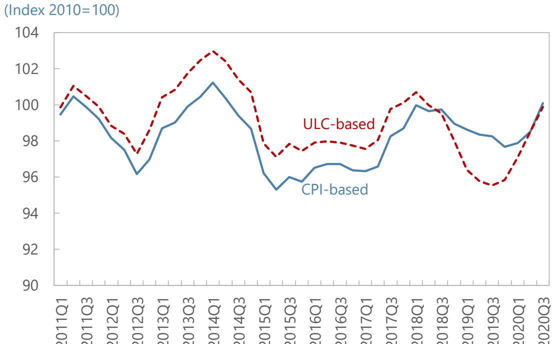
Terms of Trade and Oil Prices
(Index 2014Q1=100; US dollars per barrel)



Sources: WEO, Haver Analytics and IMF staff calculation

The ULC and CPI-based REER appreciated in 2020, driven by the appreciation of the euro against the dollar.

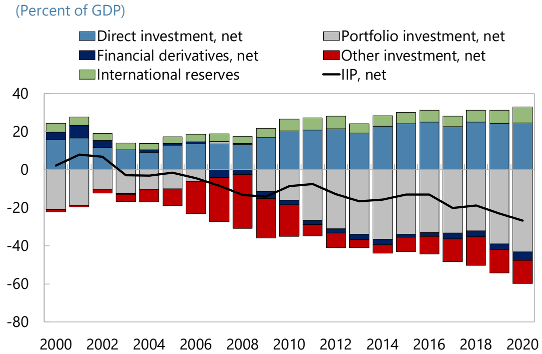
Real Effective Exchange Rate, 37 Trading Partners
(Index 2010=100)



Sources: Eurostat

The Net International Investment Position became more negative…

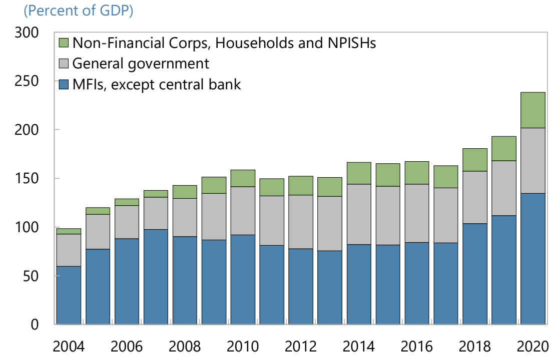
Net International Investment Position
(Percent of GDP)



Source: IMF BOP.

… with an increase in gross liabilities across all sectors of the economy.

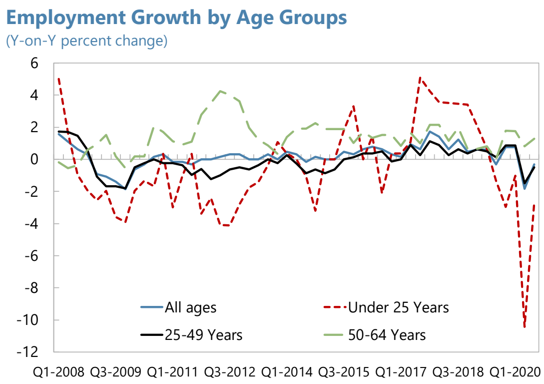
External Debt
(Percent of GDP)



Source: IMF BOP and Eurostat.

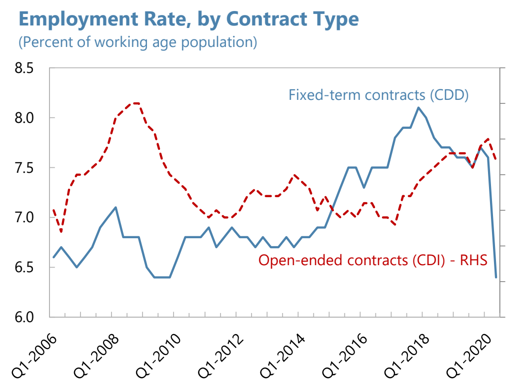
Figure 4. Labor Market Developments

Employment growth declined sharply in 2020:Q2, with a disproportionate strong effect on the younger age cohort.



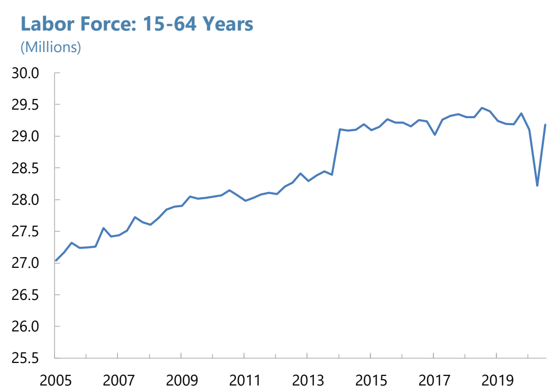
Source: Eurostat (Haver Analytics).

While employment relationships with open-ended contracts declined only marginally, fixed-term contracts collapsed.



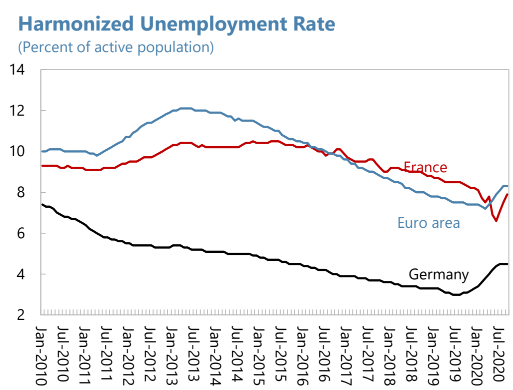
Source: INSEE (Haver Analytics).

The labor force fell as search activity came to a halt in the lockdown and subsequent summer period, but rebounded in 2020:Q3.



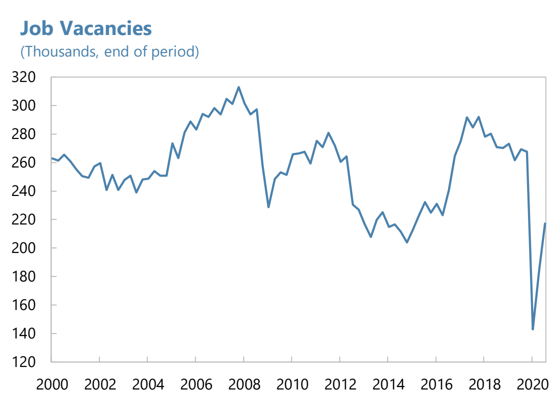
Source: European Commission (Haver Analytics).

As a result, the unemployment rate in France only started to increase in 2020:Q3.



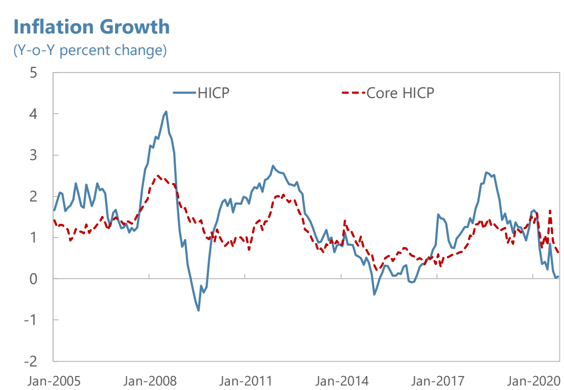
Source: Eurostat (Haver Analytics).

The number of job vacancies remains at a long-term low also after the first lock-down.



Source: INSEE (Haver Analytics).

And inflation shows continued trend weakening, which up to July was mostly driven by lower energy prices.

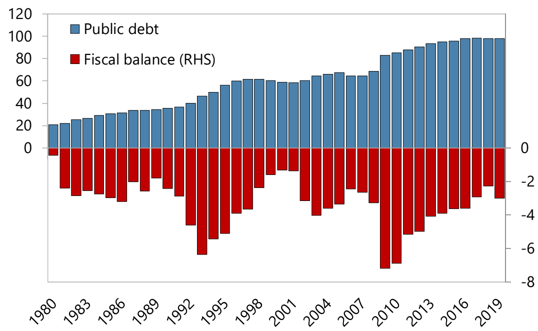


Sources: Haver Analytics

Figure 5. Fiscal Sector Developments

Following decades with sizable deficits, France entered the crisis with a high level of public debt, …

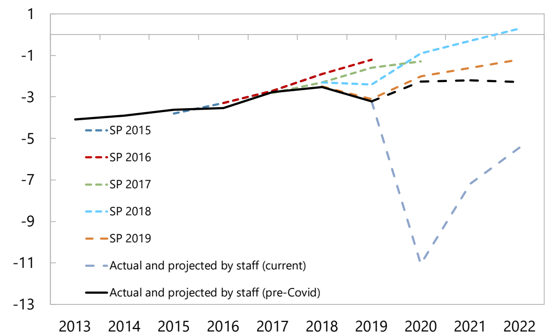
Public Debt and Fiscal Balance
(Percent of GDP)



Sources: INSEE and IMF staff calculations.

… as efforts to redress public finances tended to fall short of plans.

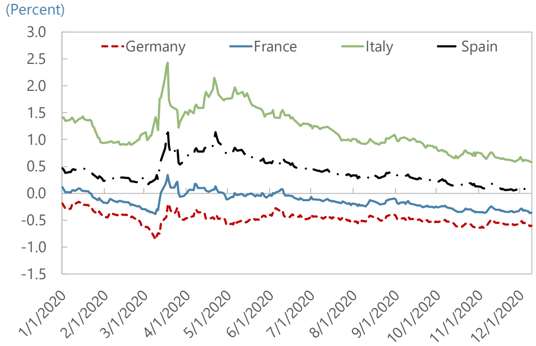
Government Balance Projections in Stability Programs
(Percent of GDP)



Sources: French authorities; and IMF staff calculations.

While low financing costs provide fiscal space needed to support affected individuals and firms, …

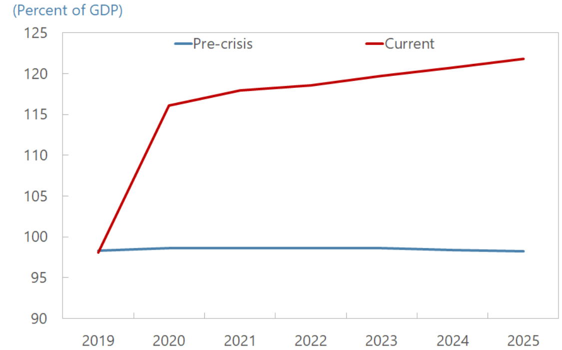
10Y bond Yield
(Percent)



Sources: Bloomberg

… fiscal restrain will be needed to put debt on a downward path over the medium term.

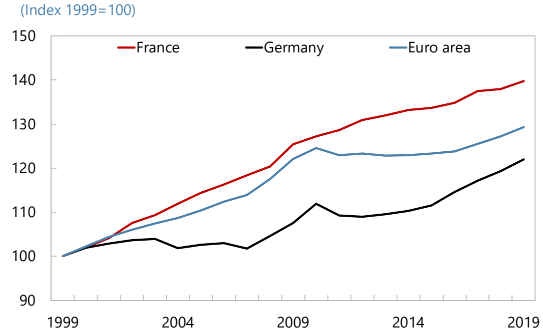
Public Debt
(Percent of GDP)



Sources: WEO and IMF staff calculations

France's fiscal effort should only start once the reocevery is secured and should be focused on reversing the trend in spending growth…

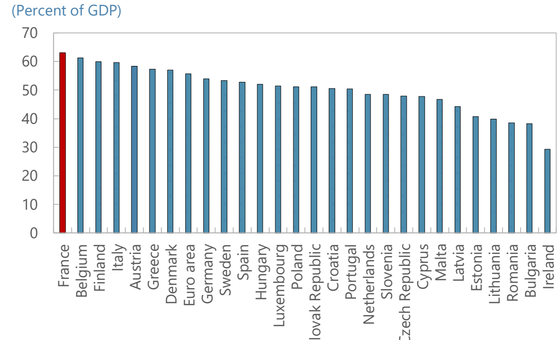
Real General Government Spending
(Index 1999=100)



Note: Deflated by GDP deflator.
Sources: WEO (peers' data is from October WEO) and IMF staff calculations.

… that led France to exhibit the largest spending-to-GDP ratio among peers.

General Government Expenditure, 2020
(Percent of GDP)

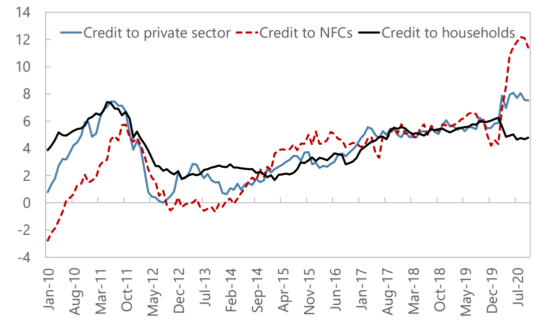


Sources: WEO (peers' data is from October WEO)

Figure 6. Financial Sector Developments

Credit to the private sector accelerated during the crisis, as the non-financial sector shored up liquidity.

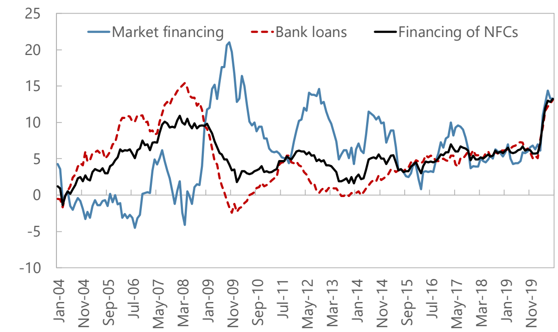
Non-financial private sector credit
(Percent, Y-on-Y)



Sources: Haver Analytics

NFC financing growth exceeded pre-GFC highs, supported by both bond and loan growth.

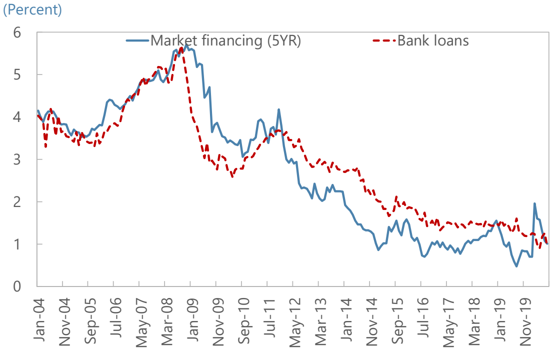
Annual Growth Rate, by Type of Financing
(Percent)



Sources: Banque de France

Interest rates on loans, as well as on market debt following a short peak, are close to historic lows.

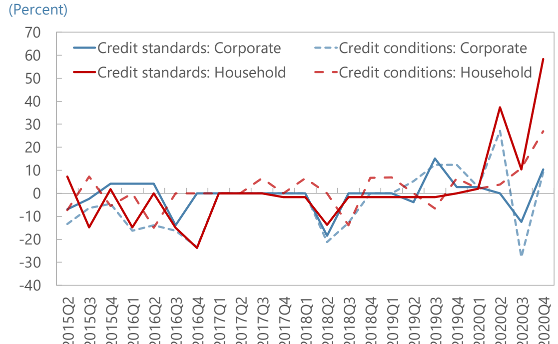
Average Cost of Financing
(Percent)



Sources: Banque de France

While credit standards and conditions for corporates eased, they started to become tighter for household credit in 2020:Q3.

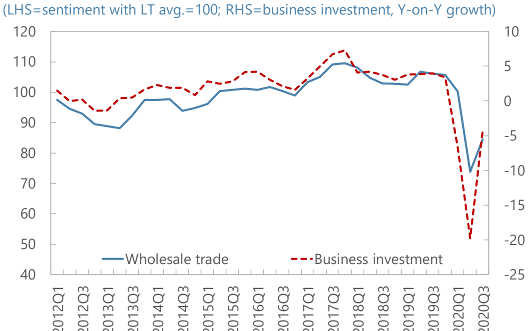
Bank Lending Survey: Credit Supply Indicators
(Percent)



Sources: BLS

Increased corporate leverage did not find its way to investment, which collapsed in 2020H1.

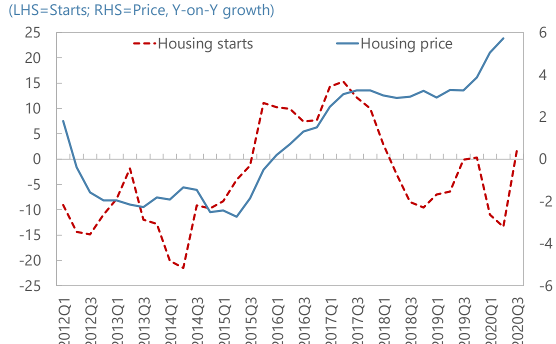
Wholesale Trade Sentiment and Buisness Investment
(LHS=sentiment with LT avg.=100; RHS=business investment, Y-on-Y growth)



Sources: Haver Analytics

Meanwhile, house prices accelerated amidst a sharp drop in lock-down-related construction activity.

Housing Price and Housing Starts
(LHS=Starts; RHS=Price, Y-on-Y growth)



Sources: Haver Analytics

Table 1. France: Selected Economic and Social Indicators, 2017–25

				Est.	Projections				
	2017	2018	2019	2020	2021	2022	2023	2024	2025
Real economy (change in percent)									
Real GDP	2.3	1.8	1.5	-9.2	5.4	3.7	2.2	1.8	1.4
Domestic demand	2.4	1.4	1.7	-7.6	5.3	3.8	2.1	1.4	1.2
Private consumption	1.5	0.9	1.5	-8.7	4.8	5.5	2.2	1.5	1.3
Public consumption	1.4	0.9	1.7	-2.9	3.7	-0.7	0.8	0.9	0.6
Gross fixed investment	4.7	3.2	4.3	-11.0	8.5	4.7	3.0	1.8	1.7
Foreign balance (contr. to GDP growth)	-0.1	0.4	-0.2	-1.6	0.0	-0.2	0.1	0.3	0.2
Exports of goods and services	4.4	4.4	1.9	-17.6	7.8	6.3	4.9	4.4	3.8
Imports of goods and services	4.5	3.1	2.5	-12.0	7.0	6.2	4.1	3.1	3.0
Nominal GDP (billions of euros)	2,297	2,361	2,426	2,251	2,380	2,493	2,579	2,664	2,746
CPI (year average)	1.2	2.1	1.3	0.5	0.7	1.0	1.2	1.5	1.6
GDP deflator	0.5	1.0	1.2	2.3	0.3	1.0	1.2	1.5	1.6
Gross national savings (percent of GDP)	22.7	23.3	23.5	21.1	22.2	22.5	22.7	23.0	22.9
Gross domestic investment (percent of GDP)	23.4	23.9	24.2	23.3	23.8	23.8	23.9	23.8	23.8
Public finance (percent of GDP)									
General government balance	-2.9	-2.3	-3.0	-11.0	-7.2	-5.4	-4.7	-4.4	-4.4
Revenue	53.5	53.4	52.6	52.6	52.7	52.2	51.6	51.5	51.4
Expenditure	56.5	55.7	55.6	63.7	59.9	57.7	56.2	55.9	55.8
Primary balance	-1.3	-0.7	-1.6	-9.8	-6.0	-4.5	-3.8	-3.5	-3.4
Structural balance (percent of pot. GDP)	-2.1	-1.7	-2.0	-3.8	-4.8	-4.5	-4.2	-4.3	-4.4
Nominal expenditure (change in percent)	2.5	1.3	2.6	6.4	-0.5	0.8	0.9	2.7	2.8
Real expenditure (change in percent)	1.3	-0.8	1.3	5.9	-1.2	-0.2	-0.3	1.2	1.2
General government gross debt	98.3	98.1	98.1	116.1	117.9	118.6	119.8	120.7	121.8
Labor market (percent change)									
Employment	1.1	0.6	0.7	-1.3	-1.0	0.8	0.7	0.4	0.4
Labor force	0.4	0.2	0.0	-1.0	0.9	0.1	0.0	0.1	0.0
Unemployment rate (percent)	9.4	9.0	8.5	8.7	10.4	9.8	9.3	8.9	8.6
Total compensation per employee	2.0	2.1	0.2	-8.3	-0.8	1.8	1.8	1.8	1.7
Credit and interest rates (percent)									
Growth of credit to the private non-financial sector	5.6	5.5	5.3	8.0	3.4	5.4	3.4	3.3	3.1
Money market rate (Euro area)	-0.4	-0.4	-0.4	...	...	...	...	...	...
Government bond yield, 10-year	0.8	0.8	0.1	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account	-0.8	-0.6	-0.7	-2.1	-1.5	-1.4	-1.2	-0.9	-0.9
Trade balance of goods and services	-0.9	-1.0	-1.0	-1.8	-1.6	-1.6	-1.4	-1.1	-0.9
Exports of goods and services	32.1	33.0	32.8	28.1	27.3	27.4	27.9	28.7	29.3
Imports of goods and services	-33.1	-34.0	-33.9	-29.9	-28.9	-29.0	-29.4	-29.8	-30.2
FDI (net)	0.4	2.4	0.2	0.6	0.8	0.9	1.0	1.0	1.0
Official reserves (US$ billion)	54.8	66.1	69.7	...	...	...	...	...	...
Exchange rates									
Euro per U.S. dollar, period average	0.89	0.85	0.89	...	...	...	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	97.1	98.2	97.1	...	...	...	...	...	...
REER, ULC-based (2005=100, +=appreciation)	91.4	92.6	90.4	...	...	...	...	...	...
Potential output and output gap									
Potential output (change in percent)	1.2	1.0	1.0	-4.4	3.9	1.5	1.3	1.3	1.2
Memo: per working age person	1.3	1.1	1.1	-4.3	4.0	1.5	1.4	1.3	1.2
Output gap	-1.3	-0.5	0.0	-5.0	-3.7	-1.6	-0.7	-0.2	0.0

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

Table 2. France: General Government Operations, 2015–25

(In percent of GDP unless otherwise indicated)

						Est.	Proj.				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Revenue	53.2	53.0	53.5	53.4	52.6	52.6	52.7	52.2	51.6	51.5	51.4
Taxes	28.7	28.7	29.4	30.0	30.4	30.1	29.5	29.3	29.2	29.2	29.2
Direct taxes	12.7	12.5	12.8	13.3	13.1	13.1	12.5	12.4	12.4	12.4	12.4
Indirect taxes	16.1	16.2	16.5	16.8	17.3	17.0	17.0	16.9	16.8	16.8	16.8
Social contributions	18.8	18.7	18.7	18.0	16.8	16.8	17.1	16.9	16.8	16.8	16.8
Other revenue	5.7	5.6	5.5	5.4	5.4	5.7	6.2	6.0	5.6	5.5	5.4
Expenditure	56.8	56.7	56.5	55.7	55.6	63.7	59.9	57.7	56.2	55.9	55.8
Expense	56.7	56.5	56.4	55.5	55.3	63.5	59.7	57.4	56.0	55.7	55.5
Compensation of employees	12.8	12.7	12.7	12.4	12.3	13.5	13.1	12.6	12.4	12.3	12.3
Goods and services	5.1	5.0	5.0	4.9	4.9	5.7	5.4	5.2	5.1	5.1	5.1
Interest	2.0	1.8	1.7	1.7	1.5	1.3	1.3	1.0	1.0	1.0	1.1
Social benefits	25.9	25.9	25.7	25.4	25.4	30.5	28.1	27.1	26.9	26.8	26.8
Other expense	10.9	11.0	11.3	10.9	11.3	12.4	11.9	11.4	10.6	10.5	10.3
Gross public investment	3.4	3.4	3.3	3.4	3.7	3.9	4.1	4.2	3.9	3.8	3.7
Net acquisition of nonfinancial assets	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2
Net lending / borrowing	-3.6	-3.6	-2.9	-2.3	-3.0	-11.0	-7.2	-5.4	-4.7	-4.4	-4.4
Primary balance	-1.8	-1.9	-1.3	-0.7	-1.6	-9.8	-6.0	-4.5	-3.8	-3.5	-3.4
Memorandum items:											
Structural balance (percent of potential GDP)	-2.2	-2.1	-2.1	-1.7	-2.0	-3.8	-4.8	-4.5	-4.2	-4.3	-4.4
Structural primary balance (percent of potential GDP)	-0.4	-0.4	-0.4	-0.1	-0.7	-2.6	-3.7	-3.6	-3.4	-3.4	-3.4
Change in structural primary balance	*0.2*	*0.0*	*0.0*	*0.3*	*-0.5*	*-2.0*	*-1.0*	*0.1*	*0.2*	*0.0*	*0.0*
Public gross debt (Maastricht definition)	95.6	98.0	98.3	98.1	98.1	116.1	117.9	118.6	119.8	120.7	121.8
Nominal GDP (in billion of Euros)	2,198	2,234	2,297	2,361	2,426	2,251	2,380	2,493	2,579	2,664	2,746
Real GDP growth (in percent)	1.1	1.1	2.3	1.8	1.5	-9.2	5.4	3.7	2.2	1.8	1.4
Nominal expenditure growth	1.5	1.4	2.5	1.3	2.6	6.4	-0.5	0.8	0.9	2.7	2.8
Real expenditure growth (in percent)	1.4	1.1	1.3	-0.8	1.3	5.9	-1.2	-0.2	-0.3	1.2	1.2
of which: primary	1.7	1.3	1.5	-0.8	1.7	6.5	-1.3	0.2	-0.3	1.2	1.0

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

Table 3. France: Balance of Payments, 2015–25
(In percent of GDP)

						Est.	Projections				
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Current account	-0.4	-0.5	-0.8	-0.6	-0.7	-2.1	-1.5	-1.4	-1.2	-0.9	-0.9
Net exports of goods	-1.3	-1.4	-2.0	-2.0	-1.9	-2.4	-2.4	-2.4	-2.3	-2.1	-2.0
Exports of goods	21.4	21.1	21.6	22.1	22.0	18.9	18.6	18.7	19.0	19.5	20.0
Imports of goods	22.7	22.5	23.6	24.2	23.9	21.3	21.0	21.1	21.3	21.6	22.0
Net exports of services	0.9	0.9	1.1	1.0	0.9	0.6	0.8	0.8	0.9	1.0	1.1
Exports of services	10.5	10.5	10.6	10.9	10.8	9.1	8.7	8.7	8.9	9.2	9.4
Imports of services	9.6	9.6	9.5	9.8	9.9	8.5	7.9	7.9	8.0	8.1	8.3
Income balance	2.1	2.2	2.1	2.4	2.2	1.6	1.8	1.9	1.9	1.9	2.0
Current transfers	-2.0	-2.1	-1.9	-2.0	-1.9	-1.9	-1.8	-1.7	-1.7	-1.7	-2.0
Capital and financial account											
Capital account	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	0.0	-0.8	-1.4	-1.0	-1.2	-2.0	-1.5	-1.3	-1.1	-0.8	-0.8
Direct investment	0.3	1.7	0.4	2.4	0.2	0.6	0.8	0.9	1.0	1.0	1.0
Portfolio investment	1.8	0.0	1.2	0.4	-3.8	-3.0	-1.5	-0.9	-0.6	-0.1	-0.1
Financial derivatives	0.6	-0.7	-0.1	-1.1	0.2	0.0	-0.1	-0.2	-0.2	-0.2	-0.2
Other investments net	-3.0	-1.8	-2.8	-3.2	2.2	0.2	-0.7	-1.2	-1.5	-1.6	-1.7
Reserve assets	0.3	0.1	-0.1	0.4	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Errors and omissions	0.4	-0.3	-0.6	-0.5	-0.6	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, 2012–19

(In percent of GDP unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019
External Indicators								
Exports (annual percentage change, in U.S. dollars)	-3.1	5.6	2.0	-10.4	0.3	6.8	10.4	-3.1
Imports (annual percentage change, in U.S. dollars)	-5.4	3.9	2.7	-11.6	0.8	8.1	10.5	-3.0
Terms of trade (annual percentage change)	-0.3	1.2	1.2	3.2	1.0	-1.3	-1.1	0.8
Current account balance	-1.0	-0.5	-1.0	-0.4	-0.5	-0.8	-0.6	-0.7
Capital and financial account balance	-1.9	-0.7	-0.4	-0.1	-0.7	-1.4	-0.9	-1.1
Of which								
Inward portfolio investment (debt securities, etc.)	1.0	4.9	4.1	0.2	1.6	1.2	0.8	6.0
Inward foreign direct investment	1.2	1.1	0.2	1.8	1.3	1.4	2.6	1.9
Other investment (net)	-0.1	3.5	-0.1	-3.0	-1.8	-2.8	-3.2	2.2
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	54.2	50.8	49.5	55.2	56.1	54.8	66.1	69.7
Euros per U.S. dollar (period average)	0.8	0.8	0.8	0.9	0.9	0.9	0.8	0.9
Market Indicators								
Financial Markets								
Public sector debt 1/	90.6	93.4	94.9	95.6	98.0	98.3	98.1	98.1
3-month T-bill yield (percentage points)	0.0	0.0	0.1	-0.2	-0.6	-0.6	-0.6	-0.6
3-month T-bill yield in real terms (percentage points)	-1.3	-0.7	0.00	-0.38	-1.17	-1.83	-2.21	-2.03
US 3 month T-bill	0.1	0.1	0.0	0.1	0.3	0.9	1.9	2.1
Spread with the US T-bill (percentage points)	0.0	0.0	0.02	-0.25	-0.88	-1.57	-2.56	-2.63
10-year government bond (percentage points)	2.5	2.2	1.7	0.8	0.5	0.8	0.8	0.1
10-year government bond (United States)	1.8	2.4	2.5	2.1	1.8	2.3	2.9	2.1
Spread with US bond (percentage points)	0.7	-0.1	-0.9	-1.3	-1.4	-1.5	-2.1	-2.0
Yield curve (10 year - 3 month, percentage points)	2.5	2.2	1.6	1.0	1.0	1.5	1.4	0.7
Stock market index (period average, 1995=100)	179.0	211.1	231.7	258.2	236.1	276.7	282.6	279.7
Real estate prices (index, Q1-10=100, period average)	106.0	103.8	101.9	100.0	100.9	104.0	107.1	110.7
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	2.0	0.5	0.5	2.5	4.3	4.6	6.3	5.3
Bank credit to households	2.3	2.7	1.9	3.3	3.3	5.6	5.3	6.0
Housing Loans	3.2	3.8	2.2	4.0	3.5	6.1	5.8	6.8
Bank credit to nonfinancial enterprises	0.4	-0.3	2.6	4.3	4.3	5.8	5.7	4.2
Sectoral risk indicators								
Household sector								
Household savings ratio	15.7	14.2	14.6	14.1	14.0	14.1	14.5	15.0
Household financial savings ratio	6.2	4.7	5.2	4.8	4.5	4.2	4.3	4.6
Real estate household solvency ratio (index, 2001=100) 2/	98.2	98.5	…	…	…	…	…	
Corporate sector								
Gross margin ratio	0.30	0.30	0.30	0.32	0.32	0.32	0.31	0.33
Investment ratio	0.23	0.23	0.23	0.23	0.23	0.24	0.24	0.24
Savings ratio	0.19	0.21	0.21	0.22	0.23	0.23	0.22	0.23
Self-financing ratio	0.84	0.92	0.92	0.97	0.99	0.96	0.91	0.95
Banking sector								
Share of housing loans in bank credit to the private sector	41.2	42.6	41.3	41.6	41.8	42.4	42.4	42.7
Share of nonperforming loans in total loans	4.0	4.5	3.9	3.9	3.9	3.1	2.8	2.5
Ratio of nonperforming loans net of provisions to capital	10.7	11.4	9.1	9.1	9.2	15.0	13.6	12.2
Liquid assets to total short-term liabilities 3/	164.0	165.2	…	17.5	17.5	20.2	20.7	20.1
Return on assets	0.3	0.4	…	0.6	0.5	0.4	0.4	0.4
Return on equity	6.6	8.1	…	9.2	8.4	6.3	6.7	6.4
Regulatory capital to risk-weighted assets	14.0	15.1	16.6	16.6	17.4	18.9	18.7	19.6

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

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

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

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

Table 5. France: Core Financial Soundness Indicators, 2015-19

	2015	2016	2017	2018	2019
Deposit-taking institutions 1/					
Regulatory capital to risk-weighted assets 2/	16.6	17.4	18.9	18.7	19.6
Regulatory Tier I capital to risk-weighted assets 2/	13.8	14.5	15.3	15.4	16.0
Nonperforming loans net of provisions to capital 3/	9.1	9.2	15.0	13.6	12.2
Bank provisions to Nonperforming loans 3/	50.6	51.0	50.6	50.4	49.9
Nonperforming loans to total gross loans 3/	3.9	3.9	3.1	2.8	2.5
Sectoral distribution of loans to total loans, of which					
Deposit-takers 3/	38.5	3.4	3.0	3.0	3.5
Nonfinancial corporation 3/	18.8	15.1	15.3	16.3	16.4
Households (including individual firms) 3/	28.1	28.1	25.7	25.5	25.9
Nonresidents (including financial sectors) 3/	5.3	40.5	37.5	40.4	37.9
ROA (aggregated data on a parent-company basis) 3/ 4/ 5/	0.3	0.4	0.4	0.4	0.4
ROA (main groups on a consolidated basis) 2/ 5/	0.6	0.5	0.4	0.4	0.4
ROE (aggregated data on a parent-company basis) 3/ 4/ 5/	7.7	6.8	6.5	6.4	6.0
ROE (main groups on a consolidated basis) 2/ 5/	9.2	8.4	6.3	6.7	6.4
Interest margin to gross income 3/	41.3	32.6	34.8	36.3	37.1
Noninterest expenses to gross income 3/	65.5	75.2	75.0	74.2	75.1
Liquid assets to total assets 6/	12.5	12.6	13.0	13.9	14.1
Liquid assets to short-term liabilities 6/	17.5	17.5	20.2	20.7	20.1

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/ 2017-18 based on 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/ 2015-18 data is based on new methodology which is not comparable to older figures.

Table 6. France: Additional Financial Soundness Indicators, 2014-19

(In percent unless otherwise indicated)

	2014	2015	2016	2017	2018	2019
Corporate sector						
Total debt to equity	90.0	86.0	88.9	86.4	90.8	87.6
Return on equity	5.9	5.7	5.7	5.6	5.6	5.5
Interest paid to financial firms 1/	...	...	...			
Corporate net foreign exchange exposure to equity	...	...	...			
Number of enterprise bankruptcies (thousands)	62.4	63.0	58.0	54.5	54.0	51.2
Number of enterprise creations (thousands)	550.8	525.1	554.0	591.3	691.3	815.3
Deposit-taking institutions						
Capital (net worth) to assets 2/	5.8	6.3	6.4	6.6	6.5	6.6
International consolidated claims of French banks, of which						
(BIS data, as percent of total international claims)						
Advanced countries	77.6	77.5	77.0	76.1	75.6	76.2
Developing Europe	6.7	6.6	6.5	6.5	6.5	5.9
Latin America and Caribbean	1.5	1.8	1.7	1.7	1.6	1.7
Africa and Middle East	4.3	4.4	4.7	4.6	4.8	4.8
Asia and Pacific Area	5.6	4.6	4.8	5.6	5.3	4.9
Offshore Financial Centers	4.4	4.1	4.3	4.7	5.4	5.7
Gross asset position in financial derivatives to capital 2/	238.2	190.2	175.3	138.7	126.7	131.2
Gross liability position in financial derivatives to capital 2/	238.7	188.1	174.1	145.9	131.3	134.1
Large exposures to capital 2/	5.5	6.1	6.1	14.9	14.4	20.4
Trading income to total income 2/	...	9.4	10.1	10.0	9.8	9.9
Personnel expenses to noninterest expenses 2/	35.1	34.2	44.0	40.6	40.0	43.1
Spread between reference lending and deposit rates	214.3	214.7	197.6	157.7	146.1	137.0
Spread between highest and lowest interbank rate	7.9	10.9	11.0	11.1	11.7	11.5
Customer deposits to total (noninterbank) loans 2/	82.6	84.5	82.0	77.1	81.5	78.5
FX loans to total loans 3/	8.0	8.4	8.7	7.8	8.0	17.9*
FX liabilities to total liabilities 3/	16.2	17.6	19.4	17.6	18.0	**
Net open position in equities to capital	...	...	...	0.2	0.2	0.2
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	16.7	16.4	16.4	16.1	15.6	15.4
Assets to GDP	203.4	205.2	214.4	219.3	208.8	219.6
Households						
Household debt to GDP	55.4	55.9	56.9	58.3	59.6	61.6
Household debt service and principal payments to income	12.3	12.4	15.0	14.7	15.0	15.3
Real estate markets						
Real estate prices	-1.8	-0.3	1.7	3.2	3.2	3.8

Sources: Banque de France ; ACPR ; 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.

* based on highest consolidated data level, not comparable to pre 2019 data

** data not available

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2019 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Undertake a structural fiscal consolidation to reverse the rising trend of public debt. Pursue planned fiscal structural reforms (civil service, pension system) that can help support consolidation efforts while improving spending efficiency and equity and boosting long-term growth. Complement these reforms with further spending efforts (including on tax expenditures, health, education, better targeting social benefits, and eliminating overlaps between central and local government functions).	The civil service reform was approved and implemented. The pension system reform faced obstacles for approval and a redesign of the reform's proposals has been postponed until the crisis dissipates. Some streamlining of tax expenditures was introduced in the 2020 budget (elimination of reduced tariffs for off-road diesel) but was postponed in a subsequent amendment in the context of the Covid-19 crisis.
Structural Reforms	
Fully implement unemployment benefit reform to reduce structural unemployment while helping to generate some fiscal savings. Continue implementation of apprenticeship and professional training reforms and adjust if outcomes fall short of objectives.	The unemployment benefits reform was approved but its implementation has been delayed because of the Covid-19 crisis.
Further liberalization of product and service markets.	The government implemented measures to liberalize personal transport (driving schools and auto parts) and online sales of medicines.
Financial Sector	
Bolstering the monitoring and oversight of financial conglomerates. Building resilience against cyclical risk, including related to corporate indebtedness. Engage with ECB and other EU agencies on use of Pillar II measures to address bank specific residual risk from concentration of exposures to large indebted corporates.	The authorities have continued to monitor financial risks and appropriately reduced the countercyclical capital buffer to 0 percent in response to the Covid-19 crisis. The limit on banks' exposure to the most heavily indebted companies was maintained, despite the crisis, for prudential reasons and to mitigate the increased risk associated with financially stressed non-financial companies (see also Annex II).

Annex II. 2019 Key FSAP Recommendations—Implementation Status

Recommendations	Agency	Timing*	Implementation Status D—Done / LD—Largely Done / PD—Partly Done / NA—No Action
Preemptive Management of Systemic Vulnerabilities			
Engage with ECB and other EU agencies on use of Pillar II measures to address bank-specific residual risk from concentration of exposures to large indebted corporates.	ACPR	I	**PD** Due to the context of the COVID-19 crisis, the ECB decided to implement a pragmatic SREP process (which assess the concentration risk of significant Institution) for the 2020 exercise, in line with EBA statement published on April 22nd. This exceptional approach leads to maintain P2 requirements unchanged in most cases.
Develop analytical framework for borrower-based measures for corporates. Consider a sectoral Systemic Risk Buffer (SRB) if risks intensify.	HCSF	NT	**LD** The HCSF has published in its 2020 annual report a review of the effect of the 2018 measure limiting banks' exposures to large indebted corporates. It has taken part in the EBA consultation on the updated sectoral risk buffer.
Evaluate options to further incentivize corporates to finance through equity rather than debt.	MoF	NT	**NA**
Ensuring Adequate Liquidity Management and Buffers			
Develop with the ECB options to manage any disruptions in wholesale funding markets. Consider, as appropriate, liquidity buffers to cover at least 50 percent of wholesale funding outflows over/up to five days horizon for all major currencies.	ACPR, ECB	NT	**NA** ECB and ACPR, in line with BCBS and EBA statements, have reminded banks and markets that liquidity buffers have been built to be used in case of a liquidity stress situation. However, banks currently prefer to maintain a significant liquidity buffer, above the 100% usual threshold. Therefore, at the current juncture of the COVID-19 crisis, there is no need to add liquidity buffer requirements. In addition, banks have to anticipate the NSFR entry into force in June 2021. This new prudential requirement will add liquidity constraints on wholesale funding resources.
Actively engage with the ESRB and others for a speedy development of liquidity and leverage related tools for insurers and investment funds.	BdF, HCSF, ACPR, AMF	NT	**PD** Work has been undertaken at national level (Banque de France, ACPR, AMF) to discuss the opportunity of macroprudential tools for investment funds. Such work also has to be done together with the HCSF. France also pushes for this topic at the ESRB level as far as it is possible, while not being responsible of the ESRB's policy agenda. Work is also undertaken at ECB-FSC level to discuss the funds related policies, as well as at EIOPA for insurance related policies and at international levels. Concerning insurance, the Banque de France and ACPR are actively taking part to all work led by the ESRB on insurance.
Further Integration of Financial Conglomerate Oversight			
Report intragroup exposures and transactions within conglomerates on a flow and stock basis at quarterly or regular frequency. Develop guidance to address direct and indirect, and common exposures of entities in the conglomerate.	ACPR, AMF	NT	**PD** As of this date, French conglomerates report intragroup exposures and transactions within conglomerates on a flow and stock basis at regular frequency (reporting CONGLOMER). This reporting will be enhanced in the near future by the entry in application of the Common reporting templates drafted by the JC of the ESAs.
Develop with the ECB and other EU agencies liquidity risk management requirements and stress testing at the conglomerate level.	ACPR, AMF	NT	**PD** No liquidity risk management requirement has been considered at this stage because the current supervisory framework coinciding with the prudential consolidation perimeter is deemed satisfactory. However, research projects have been launched on the conduct of stress testing at the conglomerate level.
Strengthen conglomerate oversight and work with the Joint Committee of the ESAs to finalize common reporting templates, and with the ECB on common supervisory guidance for conglomerates.	ACPR, AMF	NT	**PD** The ACPR maintained a high level of engagement in both arenas in order to strengthen conglomerate supervision. An ACPR's deputy Secretary General chairs the works of the JC of the ESAs on common reporting templates and the group should be in position to deliver the full set of reporting by end 2021. ACPR teams actively engaged with ECB staff members to develop the common supervisory guidance and remain involved in current initiatives to enhance the supervisory manual.
Enhancing Governance, Financial Policies and Financial Integrity			
The ACPR and AMF should have autonomy to determine their resource levels based on a forward-looking review of supervisory and monitoring needs.	ACPR, AMF, MoF	I	**NA (constitutional constraint)** The NSAs are free to allocate resources towards the most needed fields, but it is not constitutionally possible to let them determine their global resource level as these resources are fiscal by nature thus requiring a parliamentary decision. Note that the parliamentary decision is informed by an independent report from the NSA. The current arrangement with a vote on a resource threshold is guaranteeing a stable funding of the NSAs.
To avoid any perception of a potential conflict of interest and facilitate operationally independent functioning, the government should recuse itself from all supervisory decision-making committees at the ACPR and the AMF.	MoF	I	**NA (provides the legal underpinning to sharing confidential information)** The presence of the MoF as an observer at the NSAs' board does not prevent the decisions to be taken independently. On the contrary, the cross participation of the NSA and the attendance of a MoF representative on a non-voting basis give a robust legal framework for sharing information between the NSAs and with the MoF both on policy (where the MoF has regulatory responsibilities) and oversight issues (as it contribute to informative feedbacks) .
Reduce further the spread between market interest rates and the return on regulated savings products. Ensure timely and effective implementation of CDC governance reform under the Loi PACTE and undertake a full review of regulated savings framework at the appropriate time.	MoF	NT	**NA**
Enhance AML/CFT supervision of smaller banks rated as high-risk. (¶67) Explore ways to provide systematic guidance on detection of potential terrorist financing activities.	ACPR, Tracfin	I	**LD** Elaborating on its AML-CFT risk assessment methodology, the ACPR devised in late 2019 an AML-CFT supervisory approach that links the expected supervisory intensity to the banks' individual risk assessment (as well as other supervised entities, such as insurance companies and payment services and electronic money providers). The AML-CFT supervisory approach provides for different supervisory tools with different levels of intrusiveness, from the annual return and meetings to onsite visits and onsite inspections. The implementation of the 2020 supervisory plan was delayed because of the pandemic situation and the related lockdown, though onsite visits and inspections, which were partially suspended in early March, resumed in May.

Recommendations	Agency	Timing*	Implementation Status D—Done / LD—Largely Done / PD—Partly Done / NA—No Action
Reinforcing Crisis Management, Safety Nets, Resolution Arrangement			
Work toward an enhanced resolution framework for insurers by including wider powers to restructure liabilities (bail-in), and enhanced safeguards and funding.	ACPR	MT	**NA (EU single market issue)** The French authorities recognize that the resolution framework would benefit from additional tools, especially bail-in powers and adequate resolution funding arrangements. The French resolution regime will be strengthened following the ongoing revision of Solvency II Directive that should include provisions on these two aspects. The authorities consider an EU Directive as essential to further advance the recovery and resolution framework in the context of a level playing field for insurers in the European Union.
The eligibility of the FGDR's Supervisory Board membership, which is formed by bank executives in activity, should be changed to independent members only.	FGDR	MT	**NA**
Develop modalities for providing ELA in currencies other than euros and establish general rules that may assist banks in identifying assets, which might be proposed as ELA collateral and buttress their operational readiness to pledge them.	BdF, ACPR	MT	**PD** First, it must be recalled that the ELA framework is decided by the Governing council of the ECB. Regarding the provision of foreign currency, the ECB maintained its TAF facility in some currencies. An internal TF contemplated last year all the possibilities of sourcing foreign currency for ELA purposes. Regarding the collateral and other operational issues, Banque de France recently revised its internal procedures. On top of that, an internal framework is in place to determine in general terms what type of assets can be pledged.

** I= immediate (within one year), NT= near term (1–3 years), MT= medium term (3–5 years).*

Annex III. External Sector Assessment

<table>
<tr><td colspan="7">Overall Assessment: On a preliminary basis, recent developments suggest a shift in the overall assessment from “moderately weaker” in 2019 to “weaker” in 2020. However, this assessment is highly uncertain given the lack of full-year data for 2020 and the COVID-19 crisis. A complete analysis will be provided in the 2021 External Sector Report

Potential Policy Responses: In response to the COVID-19 pandemic, France deployed significant fiscal resources to bolster the health care system and provide targeted support to affected firms and individuals. In the near term, efforts should continue to focus on saving lives and supporting those most affected by the crisis. Uncertainty surrounding the medium-term outlook is unusually large. Assuming that imbalances that existed prior to the COVID-19 outbreak will continue to persist in the medium term, policies would need to continue focusing on further improving competitiveness by reinvigorating structural reforms and on rebuilding fiscal space once the recovery is secured. These could also help bring the CA more in line with medium-term fundamentals and desirable policies.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. The NIIP stood at –26 percent of GDP at 2020:Q2, below the range observed during 2014–19 (between –16 and –23 percent of GDP). The NIIP fell by about 3½ percent of GDP since end-2019, largely driven by an increase in banks’ and public sector gross debt (22 and 9½ percent of GDP, respectively). While the net position is moderately negative, gross positions are large. Gross assets stood at 360 percent of GDP in 2020:Q2, of which banks’ non-FDI-related assets account for about 44 percent, reflecting their global activities. Gross liabilities reached 387 percent of GDP in 2020:Q2, of which external debt is about 250 percent of GDP (53 percent accounted for by banks and 26 percent by the public sector). About ¾ of France’s external debt liabilities are denominated in domestic currency. The average TARGET2 balance in 2019 was only about €100 million.

Assessment. The NIIP is negative, but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities coming from large public external debt (58 percent of GDP) and banks’ gross financing needs—the stock of banks’ short-term debt securities was €83 billion at end-2019 (3.5 percent of GDP), and financial derivatives stood at about 35 percent of GDP.</td></tr>
<tr><td>2020:Q2 (% GDP)</td><td>NIIP: –26.4</td><td>Gross Assets: 360.3</td><td>Debt Assets: 207.3</td><td colspan="2">Gross Liab.: 386.7</td><td>Debt Liab.: 250.4</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. The CA deficit is projected to widen to 2.1 percent of GDP (compared with 0.7 percent in 2019). While the deterioration in the CA balance is partly explained by one-off factors (e.g., import of health sector equipment accounting for almost 0.2 percent of GDP) and temporary factors that are expected to gradually normalize (e.g., business and tourism travel service balance accounting for about 0.2 percent of GDP of the decline), it also reflects factors likely to weigh more lastingly on the external position (e.g., aeronautics net exports contracted by about ½ percent of GDP). Lower investment income reduced also the contribution of the income account (by about 0.4 percent of GDP). Over the medium term, IMF staff projects the CA deficit will narrow to about ¾ percent of GDP, as temporary factors dissipate and selected reforms to improve France’s competitiveness start to pay off.

Assessment. The 2020 cyclically adjusted CA deficit is estimated at -2.8 percent of GDP, compared with an EBA-estimated norm of a surplus of 0.5 percent. On this basis, the IMF staff assesses that the CA gap in 2020 was between –3.9 and –2.7 percent of GDP (compared to -1.6 to -0.6 percent of GDP in 2019). The model residual accounts for the bulk of the estimated gap (-3.1 percent of GDP) and its increase since 2019. This assessment is preliminary and subject to high uncertainty related to the effect of one-off factors related to the COVID-19 crisis. The CA gap is expected to narrow over the medium term as the effect of the crisis fades out.</td></tr>
<tr><td>2020 (% GDP)</td><td>Actual CA: –2.1</td><td>Cycl. Adj. CA: –2.8</td><td>EBA CA Norm: 0.5</td><td>EBA CA Gap: –3.3</td><td>Staff Adj.: 0.0</td><td>Staff CA Gap: –3.3</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. Following a depreciation of the ULC-based REER and the CPI-based REER of 3.3 and 1.7 percent, respectively, in 2019, largely exceeded the depreciation of the euro (the NEER depreciated by only about 1 percent in 2019), both REER measures appreciated strongly in 2020. Through October, the ULC-based REER has appreciated by 6.4 percent with respect to the 2019 average, while the CPI-based REER has appreciated by 2.1 percent. From a longer-term perspective, although both REER measures have depreciated by about 10 percent between 2008 and 2019, France has not managed to regain the loss of about one-third of its export market share registered in the early 2000s (while the export market share of the euro area remained broadly stable between 2000 and 2018).

Assessment. The EBA REER-index model points to an REER gap of –2.8 percent, while the EBA REER-level model points to an REER gap of 1.8 percent. Meanwhile, the CA gap points to an overvaluation of 9.9 to 14.4 percent.[1] In line with estimates derived from the preliminary CA assessment, staff assesses the REER gap to be in the range of 9.9 to 14.4 percent, with a mid-point of 12.2 percent. This assessment is subject to high uncertainty as indicated above.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. The CA deficit in 2020 was financed mostly by net portfolio debt inflows (about 2.6 percent of GDP). Outward direct investment flows increased from 2.1 to 2.4 percent of GDP between 2019 and 2020, increasing above inward flows (at about 1.8 percent of GDP). Financial derivative flows have grown sizably both on the asset and the liability side since 2008 but fell slightly in 2020 with asset- and liability-side flows decreasing 4.3 percent of GDP, each, from about 5.5 percent in 2019. The capital account is open.

Assessment. France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sectors.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">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.</td></tr>
<tr><td colspan="7">[1] The range of the REER gap (9.9 to 14.4 percent) is obtained from the range of the CA gap (–3.9 to –2.7 percent of GDP) and an estimated semi-elasticity of the CA balance to the REER of 0.27.</td></tr>
</table>

Annex IV. Risk Assessment Matrix[1]

Sources of Risk	Likelihood of Risk[1] (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Response
Unexpected shift in the Covid-19 pandemic. ▪ **Downside.** The disease proves harder to eradicate, requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes. ▪ **Upside.** Alternatively, recovery from the pandemic is faster than expected due to the wide availability of an effective vaccine and/or a faster-than-expected behavioral adjustment to the virus that boosts confidence and economic activity.	**High (downside):** The second wave of infections and uncertainty about the timing and extent of immunization increases the likelihood of further infection waves and more generalized shutdowns. **Low (upside):** Positive news on vaccine efficacy from select vaccine providers raise the possibility of a faster-than-expected achievement of immunization under sufficiently high take-up.	**High (downside):** Recovery will be more prolonged from continued uncertainty, limitations on production and consumption from physical distancing, impaired corporate balance sheets, and rising unemployment. Fiscal sustainability could also be jeopardized with falling revenues, materialization of contingent liabilities, and increased costs from support measures. **High (upside):** Faster-than expected restoration of confidence and activity that could ease production and the labor market frictions.	• Ramp-up the testing capacity to facilitate early detection of cases. Ensure hospitals are adequately resourced. • Provide fiscal support in a targeted manner for viable firms to avoid losses from liquidity risks and ensure the normalization of labor market activity.
Sharp tightening of financial conditions. Repricing of risks by credit markets and increased volatility in equity and bond flows.	**Medium:** Large international exposure of French banks, increased corporate debt and risk of default, together with the reliance on US dollar and wholesale funding, and sizeable complex market instruments, could amplify the effects of an abrupt tightening of global financial conditions. Likely extension of low policy rates will weigh further on the profits in insurance and banking sector.	**High:** Pressures on bank balance sheets, together with lower capital buffers, may reduce credit supply, exacerbating liquidity risk in the corporate sector. Corporate insolvency may worsen from complex interlinkages and reduced access to credit. Volatility of fund flows could also result in widespread dislocation of wholesale funding markets. Call on government contingent liabilities could increase refinancing risks. Tightening of credit conditions with increased unemployment could also pose risks to the real estate market.	• Monitor and support dislocations in all credit segments of the economy. • Recalibrate macroprudential policy as necessary to ensure the smooth flow of credit. • Prioritize government spending to limit the increase in government liabilities.
Widespread social discontent and political instability Social tensions erupt as the pandemic and inadequate policy response cause economic hardship and exacerbate preexisting socioeconomic inequities.	**High:** Rising unemployment and re-imposition of lockdown measures could increase public discontent, giving rise to protests, similar to the yellow-vest protests, and disrupt economic activity.	**Medium:** Growing need to adapt to the new economic environment with different sectoral allocations and higher unemployment, can lead to lower medium-term growth with weaker investment. Postponement of needed structural reforms leading to higher financing costs.	• Extend temporary support for most vulnerable groups • Accelerate policies to facilitate reallocation of factors of production. • Accelerate job-rich investment project financed by the EU Recovery Fund.
Accelerating de-globalization. Geopolitical competition, a no-deal Brexit, and fraying consensus about the benefits of globalization lead to further fragmentation. Reshoring and less trade reduce potential growth.	**High:** Additional import-related restrictions, disagreement on digital service taxation, and onshoring polices may increase in response to the pandemic. Intra-Europe border closures and regional quarantines can become more frequent and persistent in response to a rise in cases. A no-deal Brexit could further increase trade frictions.	**Medium:** A retaliatory cycle of trade restrictions could hurt France's exports and investment impairing the growth momentum. Border restrictions that are unevenly applied or a no-deal Brexit may increase euro skepticism leading to a resurfacing of populism sentiment in France, reducing growth both directly and through adverse confidence effects.	• Continue support for the multilateral rules-based trading system, and advocate trade liberalization. • Ensure cooperation within EU and avoid retaliatory policies.

[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 V. Policy Measures in Response to COVID-19

Measure	Description of Measure	Objective
Emergency Measures		
Public guarantees	• Public guarantees for bank liquidity loans (*Prêt garanti par l'État*, or PGE) were provided for firms in all sectors and regardless of size until December 31, 2020. The state guarantees between 70 to 90 percent of the loan amount (depending on firm size) and the loan is capped at 25 percent of 2019 turnover (or three months of 2019 sales or two years of payroll in some cases). PGE loans can be reimbursed over up to 5 years with no capital or interest payments due in the first year. Large companies need to commit (i) not to pay dividends in 2020 (ii) not to buy back shares during 2020. An envelope of €300 billion was approved for this scheme. The deadline was extended to June 30, 2021, in the context of the second lockdown, and the maximum duration was extended to 6 years, with a grace period of up to 2 years. • An envelope of €15 billion was also approved for guaranteeing loan insurance schemes, some especially for exporters.	Channel liquidity to firms and avoid any disruptions to credit supply.
Short-time work (STW) scheme	The coverage and generosity of France's STW scheme was significantly expanded in March, at the onset of the crisis. The generosity of the scheme was tightened in June, except for firms in vulnerable activities and is scheduled to be tightened further by early-2021. Since July firms can also apply for an alternative long-duration STW scheme, complemented with dedicated training, with high replacement rates for up to three years, conditional on signing collective agreements. See Box 2 and Annex VIII for more details.	Preserve employer-employee relationships, limit increases in unemployment and inefficient churning in the labor market and mitigate liquidity and solvency problems for firms.
Grants for very small enterprises (VSE), micro-entrepreneurs, self-employed, and highly affected firms (*Fonds de solidarité*)	VSE, self-employed, micro-entrepreneurs and liberal professions (at most 10 employees and turnover of less than €1 million), who suffered a loss of turnover during March and April 2020 were eligible to receive compensating transfers of up to €1500, extendable by up to €10,000 based on cash-flow considerations and sector vulnerability. The program was reintroduced in 2020:Q4, with eligibility expanded to include firms with up to 50 employees (and regardless of size for highly affected firms), covering monthly turnover losses with grants of up to €1500 or €10,000, depending on turnover loss thresholds, the sector of activity, and whether firms were affected by curfew or lockdown closures.	Mitigate liquidity and solvency problems for very small firms, self-employed, and highly affected firms.
Other liquidity measures	• All firms could request to postpone social security contribution payments to the second half of 2020. Deferral of direct taxes (tax on profits, territorial economic contribution, for example) could also be requested in some cases. • Firm could ask for an advance of tax credits that would have been otherwise paid later. • Postponement of the payment of rents, water, gas and electricity bills for smaller companies in difficulty; • Waiver of late penalties for all state and local government public contracts.	Mitigate liquidity problems for firms.
Direct support for companies	An envelope of €20 billion was approved to provide direct support to selected French large and strategic companies (e.g. Air France, Renault) through equity, quasi-equity, and debt securities. An envelope of €1 billion was allocated through *FDES* to grant direct support to firms that were declined PGE loans and whose economic fundamentals remain viable. After meeting additional eligibility criteria (e.g., firm size, justification of recovery prospects etc.), firms can receive participatory loans directly from the state.	Mitigate liquidity and solvency problems for firms.
Macroprudential, capital flow and other financial	• The counter-cyclical bank capital buffer was reduced to 0 percent (an increase from 0.25 percent to 0.5 percent was to become effective by April). In addition, the SSM provided regulatory flexibility aimed at relaxing banks; capital and liquidity buffers. • Liquidity to the financial system was channeled through the ECB's TLTRO operations. • A temporary ban on short-selling stocks was in place until May 18. • A public system for credit mediation was set up that helps any business that encountered difficulties with financial institutions (banks, lessors, factoring companies, credit insurers, etc.); business mediation in cases of conflict was also enabled through state ombudsmen. • Temporary amendments to insolvency law: suspension of the duty of directors to file for insolvency of the company; restricting access to the insolvency process; extension of filing deadlines. • The foreign direct investment screening procedure was updated to (i) include biotechnologies in the list of critical technologies and, (ii) temporarily lowering of the voting rights threshold from 25 to 10 percent (until Dec. 31, 2020).	Ensure smooth functioning of the banking and wholesale funding system, so that adequate credit supply is channeled into the economy. Avoid disruption to equity and bond markets. Mitigate credit resolution issues for firms.
Health-related measures	• Additional funding for hospitals to cover purchases of face masks, ventilators, etc. • Wage bonus for employees in the health sector. • Expanded health insurance coverage to take care of family members.	Strengthen the response of the health sector and protect affected households
Sectoral support plans	Apart from exceptional conditions for broad-based programs, such as credit guarantees and STW scheme, additional measures were targeted to the most affected sectors (including automobile, construction, local crafts, technology, and tourism). Measures include subsidies for purchase of electric/hybrid cars; subsidies for R&D and investment on green technology, including the production of electric car batteries; and investment fund to support R&D on greening of aviation industry.	Ensure support for vulnerable sectors, most hard-hit by the crisis, is not abruptly withdrawn and support their recovery.
Recovery Measures		
Green Transition	• Subsidies and public investment for thermal retrofitting of public and private buildings. • Direct support for projects aimed at the decarbonation of industry. • Additional infrastructure to develop everyday green mobility (cycling and public transportation). • Direct support to develop railway transportation, including freight. • Direct support for projects to develop green hydrogen.	Support the recovery of firms and jobs through a green transformation of the economy.
Competitiveness	• Permanent reduction in selected corporate production taxes (representing about €10 billion per year). • Measures to incentivize the relocation of industrial production in France. • Support for digital transformation of SMEs, VSEs, and mid-size companies. • Equity/quasi-equity public guarantees for (i) a special financial investment portfolio that selects relevant funds directed towards long-term financing for SMEs and mid-cap companies, (ii) investor's refinancing of banks' participatory loans to SMEs (*prêt participatif*). • Temporary tax incentives for the revaluation of enterprise assets and facilitation of leaseback operations to strengthen equity.	Enhance the competitiveness of French firms and reducing production related inefficiencies. Support firm balance sheets by strengthening equity.
Skills, social and territorial cohesion	• Additional investment in healthcare infrastructure • Expanded training of young people in strategic sectors • Hiring subsidies targeted at young and disabled people • Additional funding for life-long training (digitalization, modernization) • Expanded funding for long-duration STW and dedicated training. Support local authorities' public investments (including on green transition) and dedicated measures to support the most vulnerable individuals and households.	Support the recovery of jobs by incentivizing hiring and enabling efficient reallocation of resources.

Annex VI. Debt Sustainability Analysis (DSA)

A. Public Debt Sustainability Analysis

The economic contraction due to the COVID-19 pandemic and the fiscal response that followed led to a sizable increase in public debt that is expected to persist, with a consequent increase in France's public debt sustainability risk. Under the baseline scenario, the debt-to-GDP ratio is projected to increase by 18 percentage points, to about 116 percent of GDP in 2020, to continue increasing throughout the projection horizon, and to reach about 122 percent of GDP by 2025. The materialization of contingent liabilities or a combined shock to public finances and growth could add 6 to 9 percent of GDP to public debt over the medium term.

1. Background. After increasing by 33 percent of GDP between 2007 and 2016 on the back of persistently high fiscal deficits, the debt-to-GDP ratio stabilized at around 98 percent of GDP over 2017–19. The rising debt has had a limited impact on the debt service due to the sharp decline in interest rates. The benchmark yield (10 years) declined from 4.2 percent in 2008 to 0.1 percent in 2019 and, as a result, interest payments declined steadily from close to 3 percent of GDP to 1.5 percent of GDP over the same period. Before the pandemic, the debt level was projected to remain broadly stable at close to 100 percent of GDP throughout the forecast horizon.

2. Baseline assumptions. The baseline fiscal scenario is based on the initial 2020 budget law, the four subsequent amending laws, and the Recovery Plan included in the 2021 budget. No offsetting measures or consolidation effort is assumed in the baseline. After contracting by 9.2 percent in 2020, the economy is projected to recover over 2021– 25. Growth is projected at 5.4 percent in 2021, 3.7 percent in 2022, and remain above potential by 2025 when the output gap is expected to be broadly closed. The level of nominal output would still be about 4 percent below the level projected before the onset of the pandemic.

3. Baseline projections.

- **Fiscal deficit.** Staff projects the primary fiscal deficit to deteriorate to 9.8 percent of GDP, from 1.6 percent in 2019 (or 0.7 percent of GDP when the effect of the CICE conversion is excluded), as a result of the policies implemented in response to the crisis, the role of automatic stabilizers and the contraction in output. The primary deficit is projected to decline to 6 percent of GDP in 2021—on the back of the sharp rebound in activity together with a partial withdrawal of the emergency package—and continue declining to reach 3.4 percent of GDP in 2025—compared to a projection of around 1¾ percent of GDP before the pandemic and a debt-stabilizing level of 2.2 percent of GDP. The effective interest rate is expected to remain contained at around 1 percent over 2021-25 on the back of exceptionally accommodative monetary policy.

- **Debt and gross financing needs.** The debt level is projected to increase by 18 percent of GDP in 2020 to about 116 percent of GDP—with 9 percentage points accounted by interest-growth dynamics. Debt is projected to increase further to about 122 percent of GDP over the medium term as the primary deficit contribution over 2021–25 (21 percent of GDP) would be only partly offset by favorable interest-growth dynamics (-17 percent of GDP). Under the baseline, the gross financing needs of the government would peak at around 28 percent of GDP in 2022 before declining to 26 percent of GDP in 2025.

4. Mitigating factors. While risks from elevated debt and high gross financing needs under the baseline scenario are deemed to be high, the ECB's accommodative monetary stance, that is expected to keep France's financing costs low for a long period, and financing from the EU Recovery Fund, are important mitigating factors.

5. Realism of Projections. The median forecast error for real GDP growth during 2011–19 was -0.3 percent, suggesting an upward bias in staff projections during that period. This is associated with a median forecast error of -0.2 percent for the primary balance and a -0.3 percent median forecast bias for inflation. Cross-country experience suggests that the projected adjustment and level of the cyclically-adjusted primary balance (CAPB) are below the thresholds that would cast doubt on the feasibility of the adjustment, based on high-debt country experience. More specifically, at 2.5 percent of GDP, the largest projected adjustment over any three years during the projection is below the threshold of 3 percent of GDP. The near-term adjustment in the CAPB, while large compared with historical and cross-country experience, reflects mostly the sizeable but temporary fiscal measures adopted in response to the pandemic, which are largely assumed to expire by 2021. In addition, the maximum average level of the cyclically-adjusted primary deficit for any consecutive 3-year period during the projection horizon reaches -3 percent of GDP, well below the threshold of 3.5 percent of GDP.

6. Shocks and Stress Tests. The increase in contingent liabilities related to fiscal measures in response to the COVID-19 pandemic has increased the overall risks to the path of public debt with respect to the 2019 DSA.[1] In addition, France's debt dynamics would worsen significantly more than under the baseline in a scenario in which the economy is hit by a combination of a negative shock to growth and a negative shock to public finances, which is the most pertinent scenario for France at the current juncture, with debt reaching 131 percent of GDP in 2025 (compared to 122 percent under the baseline). A scenario in which contingent liabilities materialize would also lead to sizable deterioration in debt dynamics, with debt reaching close to 128 percent of GDP by 2025.

- **Growth shocks.** Under this scenario, real output growth rates in 2020–21 are assumed to be lower than in the baseline by one standard deviation (0.7 percentage points). 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. Public debt would increase to about 125 percent of GDP by 2025 under this scenario. Gross financing needs would peak at about 30 percent of GDP in 2022 before declining to 27 percent of GDP in 2025.

[1] The authorities approved an envelope of about of public guarantees of about 14.9 percent of GDP in response to the crisis, largely for bank loans (Annex V). By end-October 2020, about 5.4 percent of GDP in loan guarantees had been claimed.

- **Primary balance shock.** This scenario examines the implications of a dual shock of lower revenues and rise in interest rate, leading to a deterioration of -2.1 percent of GDP in the primary balance in 2021. Public debt would follow a similar path than under the growth shock scenario, reaching about 125 percent of GDP in 2025.

- **Interest rate shock.** This scenario assumes an increase of 348 basis points in the cost of debt throughout the projection period.[2] 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.[3] But the debt ratio by 2025 would be comparable to the previous scenarios, reaching about 125½ percent of GDP. Gross financing needs would peak in 2023 at 29½ percent of GDP.

- **Real exchange rate shock.** This scenario assumes a 13 percent devaluation of the real exchange rate in 2020 and examines the impact on debt through the inflation channel. Debt and gross financing needs would be very similar than under the baseline scenario.

- **Combined macro-fiscal shock.** This scenario combines shocks to real growth, the interest rate, the exchange rate, and the primary balance. Under this scenario, debt would reach close to 124 percent of GDP in 2022 and 131 percent by 2025. Gross financing needs would peak at more than 30 percent of GDP in 2023.

- **Contingent liability shock.** This scenario assumes 1 percent of GDP in bank recapitalization needs and 3 percent of GDP in COVID guarantees being called (representing approximately 60 percent of currently claimed guarantees). The total magnitude of the contingent liability shock is therefore equal to about 4 percent of GDP. Real GDP growth in 2021-22 is also assumed to be 0.7 percent lower than in the baseline. Under this scenario, debt increases faster than under the combined macro-fiscal shock, reaching 124½ percent of GDP by 2022 but then the subsequent trajectory is somewhat lower, with debt at 128 percent of GDP by 2025.

- **Heat map.** Risks from the debt level and gross financing needs are deemed high, given that France is above the pre-COVID thresholds of 85 and 20 percent of GDP under the baseline and all stress scenarios, respectively. The share of public debt held by non-residents is high with non-residents holding 54 percent of French debt, a level substantially lower than the peak of 71 percent reached early 2010. The high share of public and private (mainly banks) debt held by non-residents results also in high external financing requirements. Risks also stem from the sharp increase in contingent liabilities from bank loan guarantees granted, as part of the emergency measures, and possible bank recapitalization needs should banks face difficulties.

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

[3] As of end-2019, the average maturity of debt was 8 years.

B. External Debt Sustainability Analysis

The external DSA provides a framework to examine a country's external debt sustainability that complements the External Sector Assessment (Annex I). Under the baseline scenario, external debt is projected to increase from 210 percent of GDP in 2019 to 234 percent of GDP in 2021 and then decline gradually thereafter to a level close to the pre-COVID ratio, helped mainly by favorable growth interest rate differentials. France has a high level of external debt, but some mitigating factors include the current low cost of debt, the high amount of foreign assets, the limited share of debt in foreign currency, and a positive non-interest current account.

7. Background. External debt increased by 24 percent point of GDP in 2020 following the large contraction in GDP from COVID-19 and associated financing needs. Globally active banks account for about half of the external debt (104 percent of GDP), while the government accounts for another quarter (54 percent of GDP). Intercompany loans account for about 10 percent of GDP in external debt. France also holds a substantial stock of foreign assets (around 290 percent of GDP in 2018).

8. Assessment. France's external debt, while high, is sustainable over the medium term. Under the baseline scenario, external debt is projected to decline from 234 percent of GDP in 2020 to 215 percent of GDP in 2025 but remain close to pre-COVID levels. This gradual decline is helped by the projected non-interest current account surpluses of close to 1.0 percent of GDP in the medium term, and favorable growth interest rate differentials. Some mitigating factors include the current low cost of debt, the high amount of foreign assets, the limited share of debt in foreign currency, and a positive non-interest current account. The path of external debt is robust to standard stress test scenarios. Under the historical scenario, in which macroeconomic variables are set equal to their current negative growth averages, the external debt would not decline over the medium term. Under this scenario, external debt would steadily increase from 233 percent of GDP in 2020 to about 277 percent of GDP in 2025. External debt is more vulnerable to a real depreciation and to some extent the growth shock, while the effect of an interest shock as well as a non-interest current account shock would be small. Under the real depreciation scenario, with a one-time depreciation of 30 percent in 2021, external debt would peak at 258 percent of GDP and reach 252 percent of GDP by 2025.

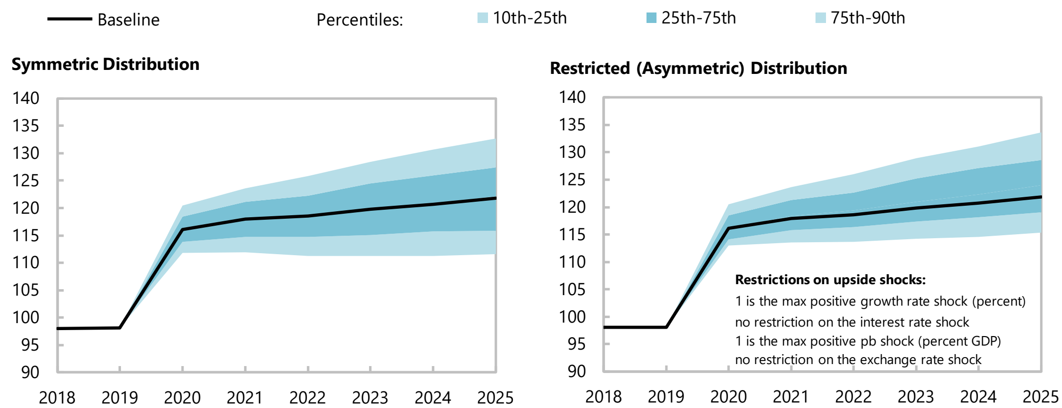
Figure VI.1. France Public DSA Risk Assessment

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

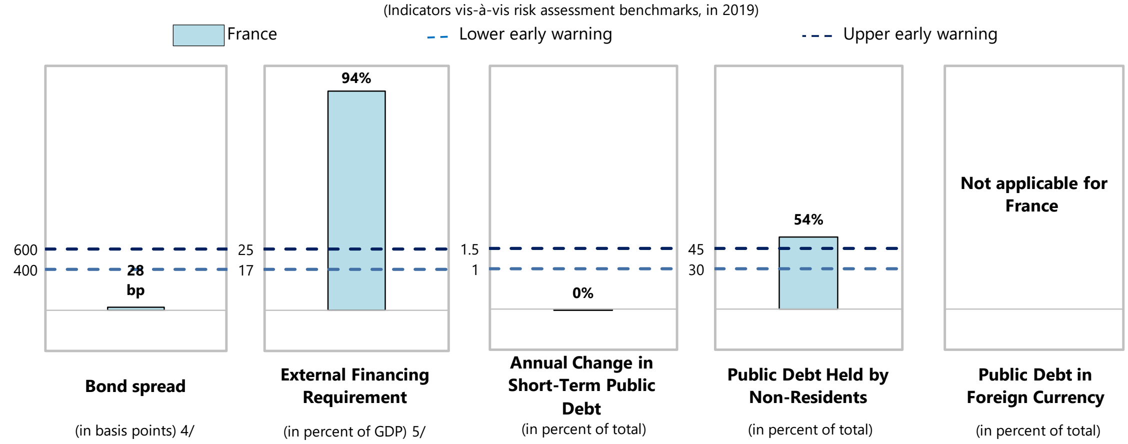
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)



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:

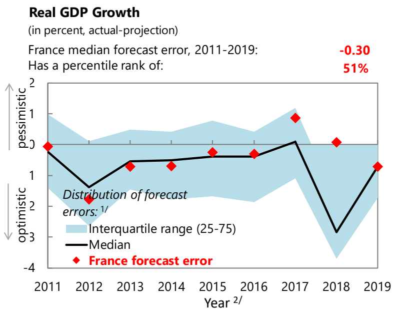
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

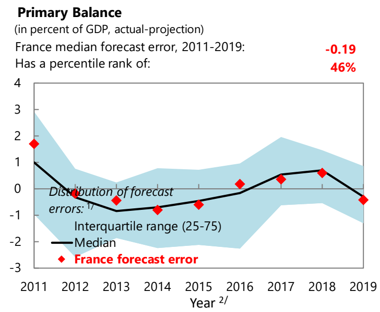
4/ Long-term bond spread over German bonds, an average over the last 3 months, 05-Sep-20 through 04-Dec-20.

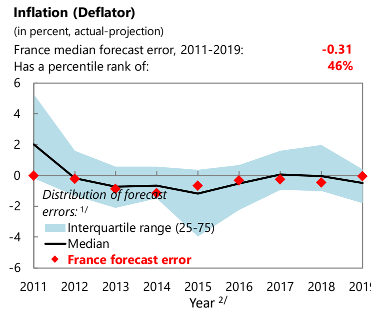
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure VI.2. France Public DSA—Realism of Baseline Assumptions

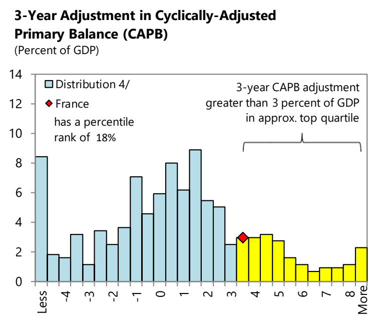
Forecast Track Record, versus surveillance countries

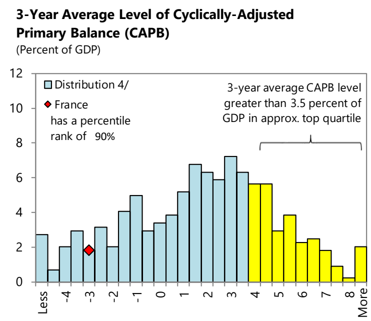




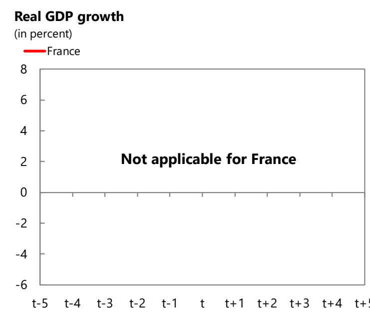


Assessing the Realism of Projected Fiscal Adjustment





Boom-Bust Analysis 3/



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

(in percent of GDP unless otherwise indicated)

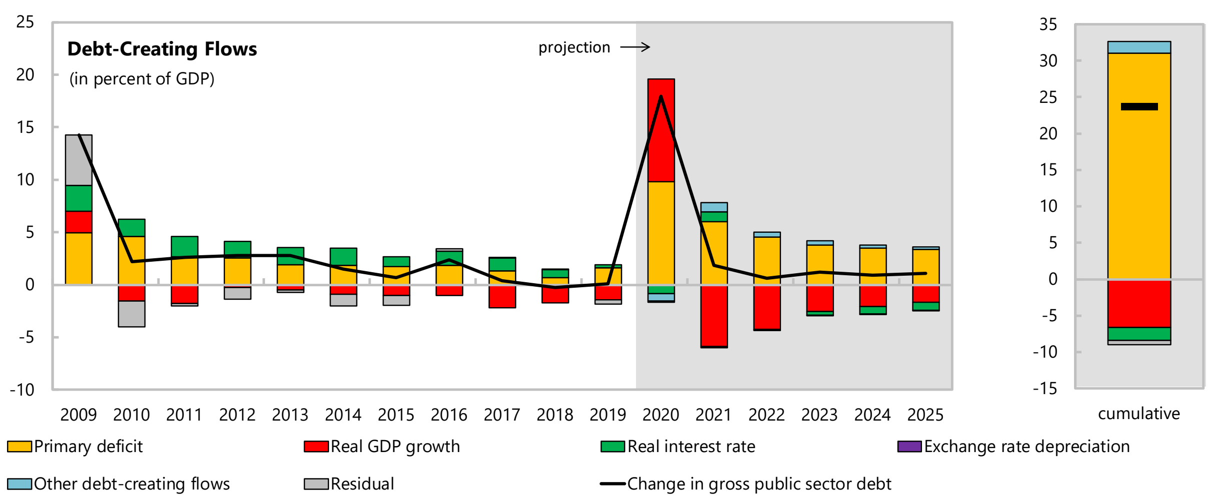
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	91.9	98.1	98.1	116.1	117.9	118.6	119.8	120.7	121.8
Public gross financing needs	21.1	16.2	15.9	26.5	27.0	28.2	28.1	26.3	26.2
Real GDP growth (in percent)	0.8	1.8	1.5	-9.2	5.4	3.7	2.2	1.8	1.4
Inflation (GDP deflator, in percent)	0.8	1.0	1.2	2.3	0.3	1.0	1.2	1.5	1.6
Nominal GDP growth (in percent)	1.6	2.8	2.8	-7.2	5.7	4.8	3.4	3.3	3.1
Effective interest rate (in percent) [4/]	2.7	1.8	1.5	1.2	1.2	0.9	0.9	0.9	1.0

As of December 04, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		27
5Y CDS (bp)		17
Ratings	Foreign	Local
Moody's	Aa1	Aa1
S&Ps	AA	AA
Fitch	AA+	AA+

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	3.3	-0.3	0.1	18.0	1.8	0.6	1.2	0.9	1.1	23.7	
Identified debt-creating flows	3.4	-0.3	0.5	18.1	1.9	0.7	1.3	1.0	1.2	24.2	
Primary deficit	2.6	0.7	1.6	9.8	6.0	4.5	3.8	3.5	3.4	31.0	-2.2
Primary (noninterest) revenue and grants	52.0	53.3	52.5	52.5	52.6	52.1	51.5	51.4	51.3	311.5	
Primary (noninterest) expenditure	54.6	54.0	54.1	62.4	58.7	56.7	55.3	54.9	54.7	342.5	
Automatic debt dynamics [5/]	0.8	-0.9	-1.2	8.9	-5.0	-4.3	-2.9	-2.8	-2.4	-8.4	
Interest rate/growth differential [6/]	0.8	-0.9	-1.2	8.9	-5.0	-4.3	-2.9	-2.8	-2.4	-8.4	
Of which: real interest rate	1.6	0.8	0.3	-0.9	0.9	-0.1	-0.3	-0.7	-0.7	-1.8	
Of which: real GDP growth	-0.8	-1.7	-1.4	9.8	-5.9	-4.2	-2.6	-2.1	-1.7	-6.7	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	-0.7	0.9	0.5	0.4	0.3	0.2	1.6	
Direct equity support to strategic firms	0.0	0.0	0.0	0.4	0.5	0.0	0.0	0.0	0.0	0.9	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other stock/flow adjustments	0.0	0.0	0.0	-1.1	0.4	0.5	0.4	0.3	0.2	0.7	
Residual, including asset changes [8/]	-0.1	0.0	-0.4	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	



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 $ae(1+r)$.

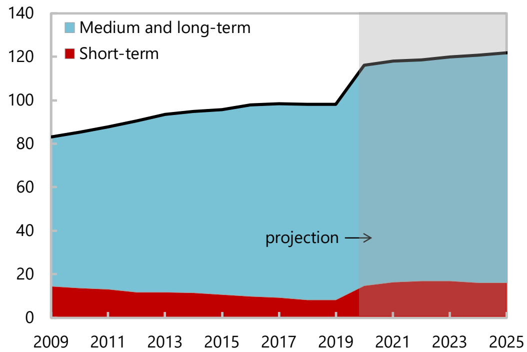
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

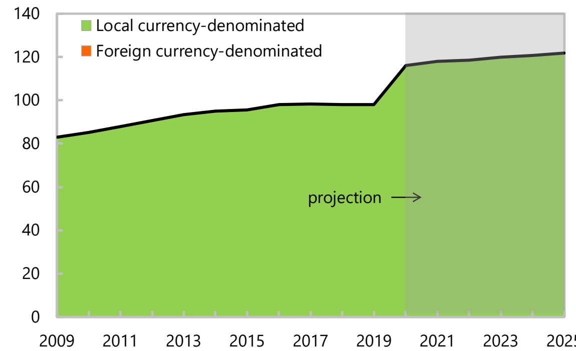
Figure VI.4. France Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



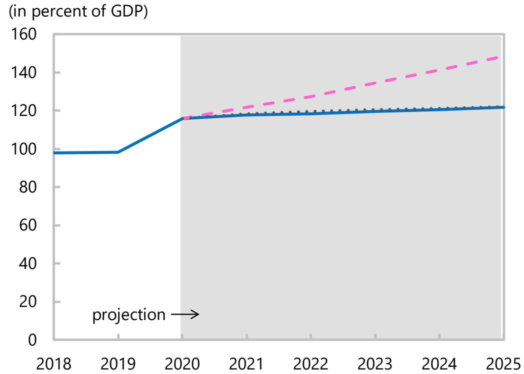
By Currency
(in percent of GDP)



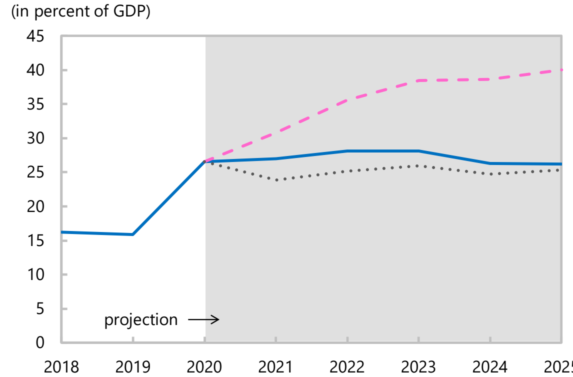
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

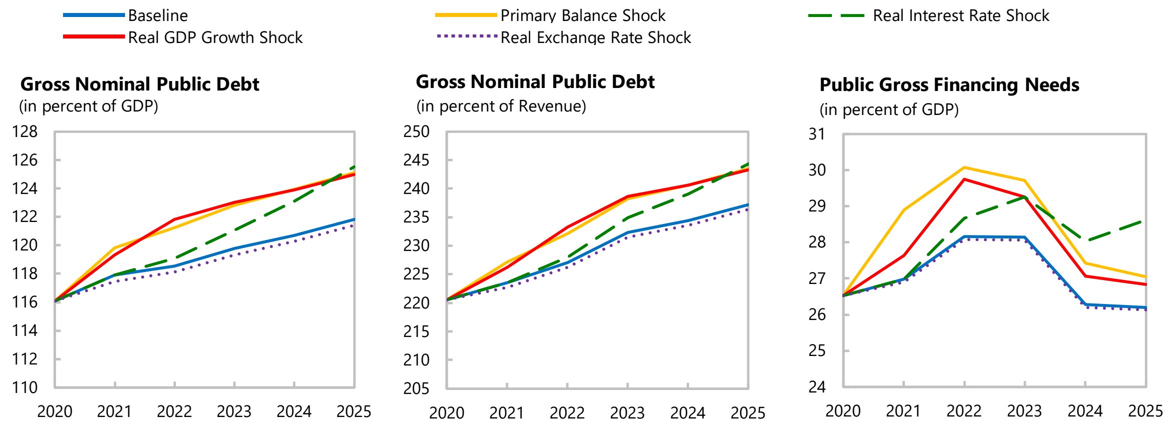
Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.2	5.4	3.7	2.2	1.8	1.4
Inflation	2.3	0.3	1.0	1.2	1.5	1.6
Primary Balance	-9.8	-6.0	-4.5	-3.8	-3.5	-3.4
Effective interest rate	1.2	1.2	0.9	0.9	0.9	1.0
Constant Primary Balance Scenario						
Real GDP growth	-9.2	5.4	3.7	2.2	1.8	1.4
Inflation	2.3	0.3	1.0	1.2	1.5	1.6
Primary Balance	-9.8	-9.8	-9.8	-9.8	-9.8	-9.8
Effective interest rate	1.2	1.2	0.9	0.9	0.9	1.0

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.2	1.4	1.4	1.4	1.4	1.4
Inflation	2.3	0.3	1.0	1.2	1.5	1.6
Primary Balance	-9.8	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	1.2	1.2	1.2	1.4	1.5	1.7

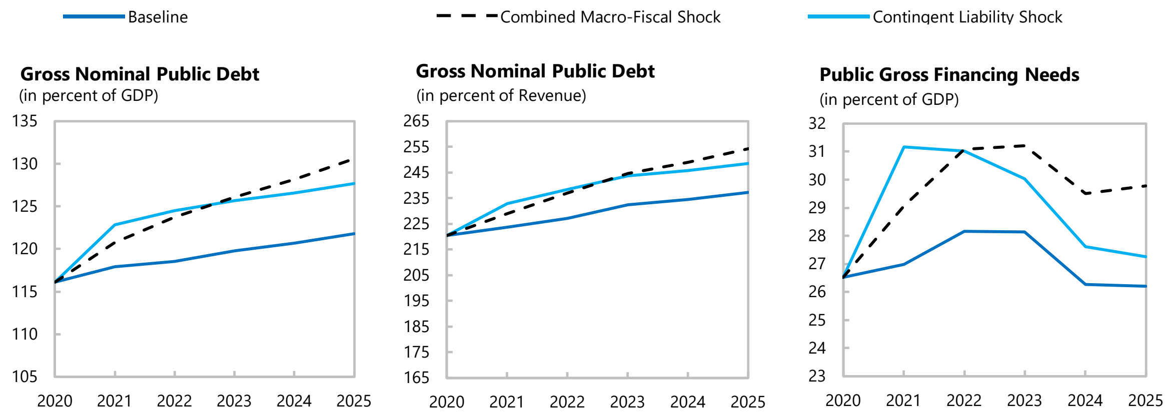
Source: IMF staff.

Figure VI.5. France Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.2	5.4	3.7	2.2	1.8	1.4
Inflation	2.3	0.3	1.0	1.2	1.5	1.6
Primary balance	-9.8	-7.9	-5.3	-4.2	-3.6	-3.4
Effective interest rate	1.2	1.2	1.0	1.0	1.0	1.1
Real Interest Rate Shock						
Real GDP growth	-9.2	5.4	3.7	2.2	1.8	1.4
Inflation	2.3	0.3	1.0	1.2	1.5	1.6
Primary balance	-9.8	-6.0	-4.5	-3.8	-3.5	-3.4
Effective interest rate	1.2	1.2	1.4	1.6	1.9	2.2
Combined Shock						
Real GDP growth	-9.2	4.7	3.1	2.2	1.8	1.4
Inflation	2.3	0.1	0.8	1.2	1.5	1.6
Primary balance	-9.8	-7.9	-5.5	-4.2	-3.6	-3.4
Effective interest rate	1.2	1.2	1.4	1.6	1.9	2.2

Real GDP Growth Shock	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.2	4.7	3.1	2.2	1.8	1.4
Inflation	2.3	0.1	0.8	1.2	1.5	1.6
Primary balance	-9.8	-6.5	-5.5	-3.8	-3.5	-3.4
Effective interest rate	1.2	1.2	1.0	1.0	1.0	1.1
Real Exchange Rate Shock						
Real GDP growth	-9.2	5.4	3.7	2.2	1.8	1.4
Inflation	2.3	0.7	1.0	1.2	1.5	1.6
Primary balance	-9.8	-6.0	-4.5	-3.8	-3.5	-3.4
Effective interest rate	1.2	1.2	0.9	0.9	0.9	1.0
Contingent Liability Shock						
Real GDP growth	-9.2	4.7	3.1	2.2	1.8	1.4
Inflation	2.3	0.1	0.8	1.2	1.5	1.6
Primary balance	-9.8	-10.0	-4.5	-3.8	-3.5	-3.4
Effective interest rate	1.2	1.2	1.1	1.0	1.0	1.1

Source: IMF staff.

Table VI.1. France External Debt Sustainability Framework, 2015–25

(in percent of GDP unless otherwise indicated)

	Actual							Projections					
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025
1 **Baseline: External debt**	204.5	205.8	207.1	204.6	210.4			**233.5**	**224.5**	**220.0**	**218.3**	**216.3**	**214.9**
2 Change in external debt	13.6	1.3	1.3	-2.5	5.8			23.1	-9.0	-4.5	-1.7	-2.0	-1.4
3 Identified external debt-creating flows (4+8+9)	6.5	-3.8	-7.8	-10.0	-2.0			23.0	-10.2	-7.2	-4.3	-4.1	-3.3
4 Current account deficit, excluding interest payments	-3.4	-2.5	-1.9	-1.9	-2.5			-0.6	-0.8	-0.5	-0.5	-0.9	-1.0
5 Deficit in balance of goods and services	0.4	0.5	0.9	1.0	1.0			1.8	1.6	1.6	1.4	1.1	0.9
6 Exports	31.9	31.6	32.1	33.0	32.8			28.1	27.3	27.4	27.9	28.7	29.3
7 Imports	32.3	32.1	33.1	34.0	33.9			29.9	28.9	29.0	29.4	29.8	30.2
8 Net non-debt creating capital inflows (negative)	0.1	-1.1	-1.8	-2.5	-0.3			0.3	-0.4	-0.6	-0.8	-1.2	-1.2
9 Automatic debt dynamics 1/	9.8	-0.1	-4.1	-5.6	0.7			23.3	-8.9	-6.1	-3.0	-2.0	-1.1
10 Contribution from nominal interest rate	3.7	3.0	2.7	2.5	3.1			2.7	2.4	1.8	1.7	1.8	1.9
11 Contribution from real GDP growth	-2.5	-2.2	-4.5	-3.5	-3.2			20.6	-11.3	-8.0	-4.7	-3.8	-3.0
12 Contribution from price and exchange rate changes 2/	8.5	-0.9	-2.3	-4.6	0.8			...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3) 3/	7.1	5.1	9.1	7.5	7.8			0.1	1.1	2.7	2.6	2.1	2.0
External debt-to-exports ratio (in percent)	641.2	652.0	644.6	620.2	641.2			832.1	823.3	802.4	781.2	753.9	732.5
Gross external financing need (in billions of US dollars) 4/	1900.9	2061.7	2132.9	2257.6	2378.9			2703.2	2829.2	2996.7	3093.7	3174.2	3257.3
in percent of GDP	77.9	83.4	82.2	80.9	87.6	10-Year	10-Year	105.5	99.4	99.7	99.1	98.2	97.6
Scenario with key variables at their historical averages 5/								**232.9**	**247.2**	**254.8**	**262.2**	**269.5**	**276.9**
						Historical	Standard						
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation						
Real GDP growth (in percent)	1.1	1.1	2.3	1.8	1.5	1.4	0.7	-9.2	5.4	3.7	2.2	1.8	1.4
GDP deflator in US dollars (change in percent)	-15.5	0.2	2.6	5.6	-4.1	-1.1	6.6	4.0	5.4	1.8	1.6	1.7	1.7
Nominal external interest rate (in percent)	1.7	1.5	1.4	1.3	1.5	1.6	0.2	1.2	1.1	0.9	0.8	0.8	0.9
Growth of exports (US dollar terms, in percent)	-10.4	0.3	6.8	10.4	-3.1	3.1	7.6	-19.3	7.9	6.2	5.9	6.3	5.5
Growth of imports (US dollar terms, in percent)	-11.6	0.8	8.1	10.5	-3.0	3.1	8.4	-16.7	7.3	6.2	5.2	4.9	4.7
Current account balance, excluding interest payments	3.4	2.5	1.9	1.9	2.5	2.6	0.5	0.6	0.8	0.5	0.5	0.9	1.0
Net non-debt creating capital inflows	-0.1	1.1	1.8	2.5	0.3	0.9	1.3	-0.3	0.4	0.6	0.8	1.2	1.2

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP

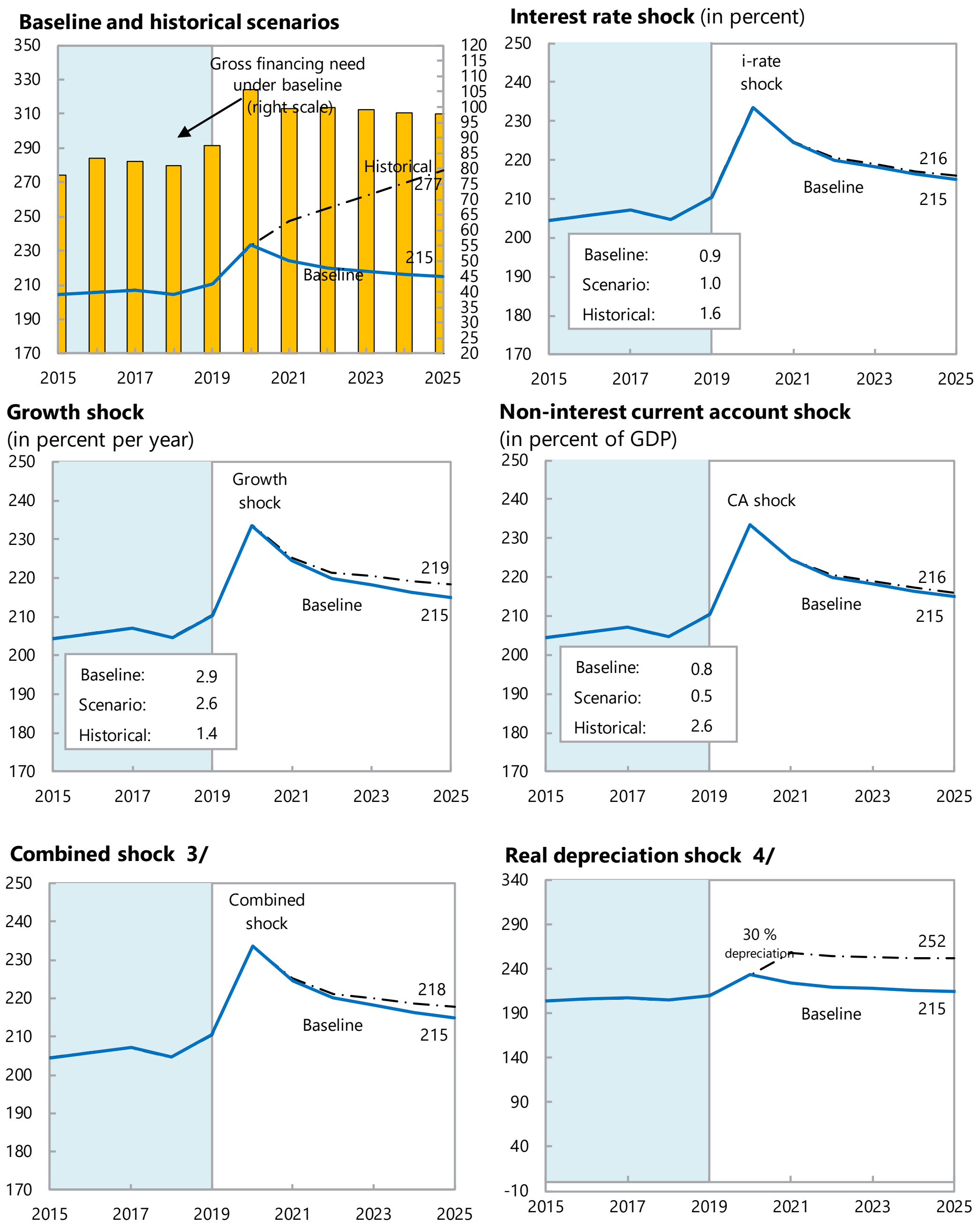
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

Figure VI.6. France External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)

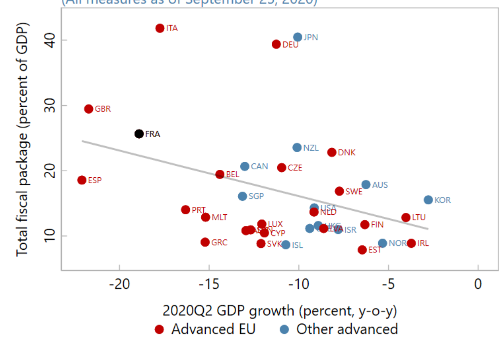


Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2021.

Annex VII. France's COVID-19 Fiscal Package[1]

1. In response to one of the largest economic contractions among peers, the French authorities announced and legislated a large fiscal package. France was one of the advanced economies that suffered the most as a result of the pandemic and the strict containment measures to control its first wave, contracting by 18.9 percent year on year by 2020:Q2 (only behind Spain and the United Kingdom). In response, the authorities introduced a large emergency fiscal package of 21.7 percent of GDP. The emergency support was complemented with a recovery fiscal package (*Plan de Relance*) legislated in the 2021 budget law, with additional measures of about 3.9 percent of GDP for 2021 and beyond, bringing the total package to about 25.6 percent of GDP. While France's fiscal package is one of the largest among advanced economies, a cross-country comparison suggests that the fiscal response to the crisis was in line with peers once the magnitude of initial output losses is considered. There is, however, significant variation across countries—with much larger responses in Germany and Japan, for instance, despite lower initial output losses.

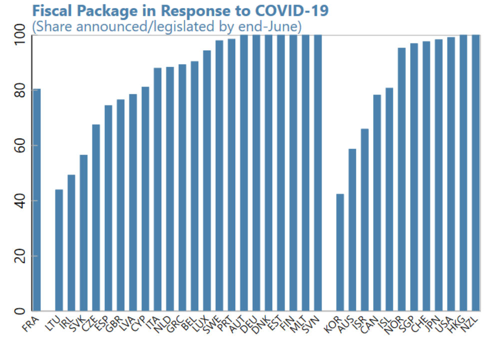
Size of Fiscal Package Against Output Contraction
(All measures as of September 25, 2020)



Sources: Fiscal Monitor database of Covid-19 measures (as of Nov. 6); and IMF staff calculations.

2. The emergency fiscal response along 2020 was timely and flexible. The first COVID-19 case in France was reported on January 24 and, as the epidemic spread quickly in subsequent weeks, the authorities introduced a national lockdown on March 17. This was followed by a rapid fiscal response, with about 80 percent of the total package announced over March–November already legislated or announced by end-June. The first budget amendment, legislated on March 23, introduced measures of up to 15.5 percent of GDP. A second amendment law was passed on April 25, and a third one was voted on July 30, bringing the fiscal package to 21 percent of GDP. As the second wave of the pandemic hit France in the fall and a partial lockdown was introduced on October 30, a fourth amendment to the 2020 budget included close to 1 percent of GDP in additional measures, bringing the total emergency package to close to 22 percent of GDP.

Fiscal Package in Response to COVID-19
(Share announced/legislated by end-June)

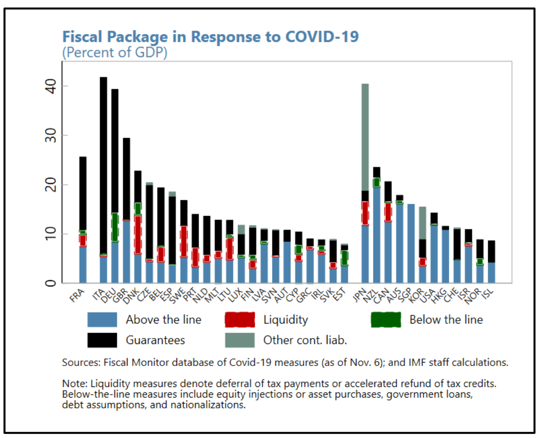


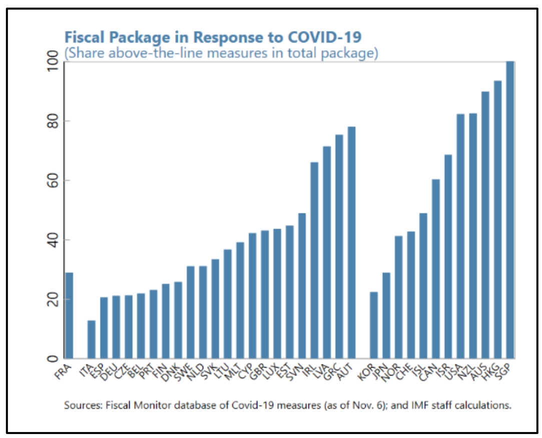
Sources: Fiscal Monitor database of Covid-19 measures; and IMF staff calculations

Note: Share of fiscal package announced/legislated as of November 6.

[1] Prepared by Bertrand Gruss (EUR).

3. The response was centered on liquidity and contingent instruments, with limited initial impact on the deficit, but the composition of the fiscal package was adjusted as the crisis unfolded. The bulk of France's initial fiscal package comprised a program of public guarantees for bank loans (*Prêt garanti par l'État*, or PGE, accounting for 13.3 percent of GDP)[2] and other liquidity measures for firms, such as postponement of social security contribution payments and advanced reimbursement of tax credit (1.5 percent of GDP initially). Initial above-the-line measures affecting the deficit represented only 0.5 percent of GDP (mostly funding for the short-time work scheme, or STW). Given the extent of uncertainty at the time, this strategy reassured firms that sizable support was available if needed while containing the impact on public finances if the effects of the crisis were temporary. As the crisis evolved, the composition of the fiscal package shifted towards a larger use of above-the-line measures, which were expanded to about 3.8 percent of GDP for 2020 (expansion of STW, exoneration of social contributions, grants to SMEs and self-employed, and support to the health sector) and about 3½ percent of GDP for 2021–22 (recovery plan), complemented with direct assistance to firms, mostly large and strategic, through below-the-line measures (equity, quasi-equity, or debt securities). Nonetheless, above-the-line measures still account for only 30 percent of the fiscal package. France's relatively low reliance on discretionary above-the-line measures during the crisis is in line with EU peers, but it is smaller than the average for other advanced economies.[3]





4. The fiscal response was effective in preserving households' labor income at the height of the crisis. At the onset of the crisis, and similarly to many EU peers, France decided to preserve household income largely by protecting jobs. The application process for France's STW was simplified, the eligibility criteria were expanded, and the reimbursement of wages that firms can claim significantly increased (Box 2 and Annex VIII). As a result, employment contracted by only 1.8 percent (y-o-y) in 2020:Q2, compared to an output contraction of almost 19 percent, and households' disposable income declined by only 2 percent. Among EU countries, a similar outcome

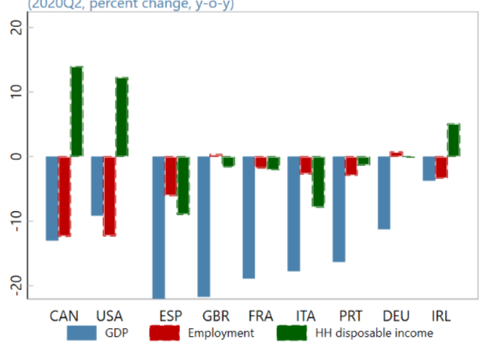
[2] By early November, only about 40 percent of the PGE envelope had been used.

[3] While the lower reliance on discretionary above-the-line measures in France partly reflects the role of its regular safety net and other automatic stabilizers, the difference in 2020 expenditure between the initial budget law and the fourth amendment is less than 0.5 percent of GDP once discretionary measures are excluded.

was observed in Germany, Portugal, and the U.K., where comparable STW schemes were in place or adopted. Italy and Spain registered larger losses in disposable income, reflecting worse employment outcomes but also less generous STW schemes. Other advanced economies, such as Canada and the United States, followed a very different strategy to preserve households' income, relying on direct transfers rather than job protection schemes.

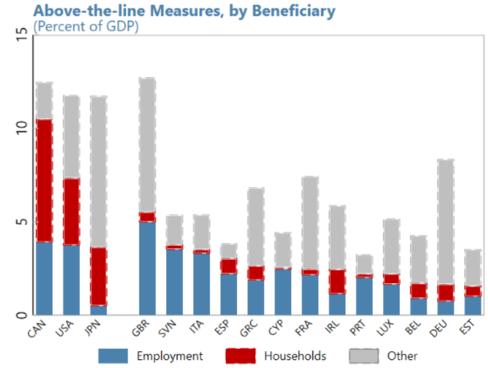
5. Fiscal support aimed at preserving households' income also appears to have been efficient. A cross-country comparison of the envelope targeted at employment support also suggests that France's approach to preserve household income was also efficient. Its envelope for above-the-line measures directed at households and to employment support programs was smaller than that of some peers (e.g. Italy) that registered a worse outcome in terms of employment and households' disposable income. This may reflect the flexibility of the French STW during the crisis. Firms were allowed to register their workers in the scheme on a precautionary basis and then adjust as needed, only claiming the number of reduced hours effectively used.[4]

Output, Employment, and Households' Disposable Income
(2020Q2, percent change, y-o-y)



Sources: Fiscal Monitor database of Covid-19 measures (as of Nov. 6); and IMF staff calculations.

Above-the-line Measures, by Beneficiary
(Percent of GDP)



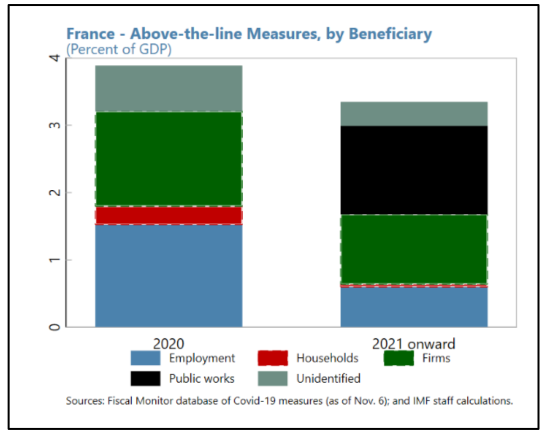
Sources: Fiscal Monitor database of Covid-19 measures (as of Nov. 6); and IMF staff calculations.

6. The recovery plan (*Plan de Relance*) shifted the focus of fiscal support toward boosting growth and supporting the long-term transformation of the economy. About 60 percent of the above-the-line measures approved for 2020 were directed at supporting household income (especially labor income) while grants for SMEs accounted for 20 percent of the envelope (2/3 of measures directed at firms). The package announced for 2021 and beyond reflects a refocus towards the recovery of the economy.[5] A significant fraction of the additional spending (1.6 percent of GDP) is directed to public investment in green technology and the health sector. The

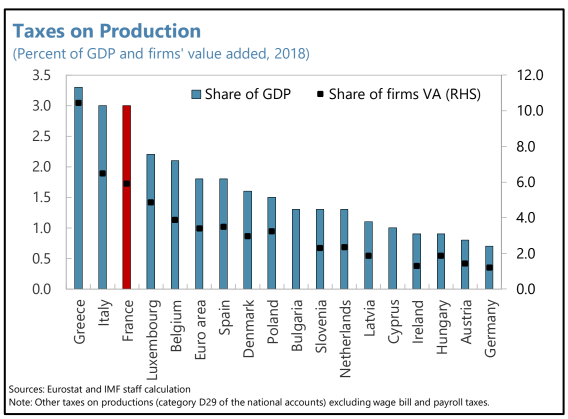
[4] About 12 million workers, or ½ of total employees, were registered in the scheme, on average, over March-June, but actual claims over that period reached only 6.6 million workers, or 3 million in full-time equivalent terms.

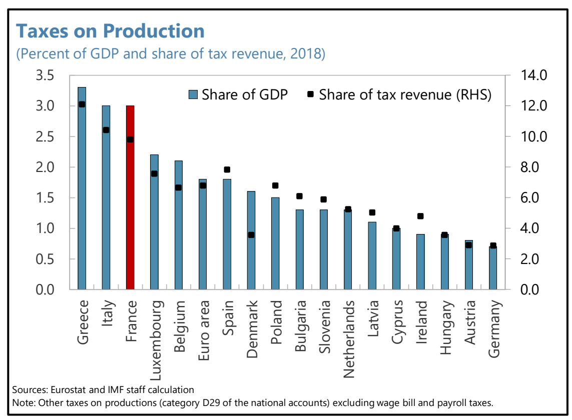
[5] The authorities *Plan de Relance* has been announced as a fiscal package for 2021-22. However, a fraction of its spending component (about 18 percent) is expected to be implemented after 2022. Moreover, while the package reported here reflects the effect of tax cuts in 2021-22, as communicated by the authorities, the measure is permanent, leading to a revenue loss of about 0.4 percent of GDP per year.

spending envelope for employment support was reduced from 1.5 percent of GDP in 2020 (exclusively on funding the STW scheme) to 0.6 percent of GDP for 2021–22, with half of this aimed at job creation (hiring subsides for the youth) and training; the rest represents ongoing STW funding. Fiscal support for firms shifted from mostly grants and exoneration of social security contributions in 2020 to subsidies (aimed at green investment and digitalization) and permanent cuts in business taxes (about 0.4 percent of GDP per year).



7. The announced tax cut is focused on production taxes, which are highly distortive and affect France's competitiveness. Compared to EU peers, France relies excessively on production taxes, accounting for 3 percent of GDP (10 percent of total tax revenue), a level only comparable to Greece and Italy.[6] Production taxes affect relative input prices, inducing substitution toward a less efficient input mix at the firm level; increase the breakeven point of firms, affecting their probability of survival; and can act as a tax on exports and subsidy to the use of imported inputs.[7] Moreover, distortions at the firm level can get amplified through different stages of production, affecting aggregate productivity more than proportionally.





8. The tax reform should be complemented with offsetting measures to ensure budget neutrality over the medium term. The tax cuts are estimated to lead to a permanent drop in revenue of about 0.4 percent of GDP. While there is merit in reducing distortive taxes, tackling the effects of the pandemic does not warrant the introduction of permanently expansionary measures.

[6] Production taxes are taxes that firms face as a result of engaging in production, independently of the quantity or value of the goods and services produced or sold; may be payable on the use of land, fixed assets or labor employed, or on certain activities or transactions.

[7] See Martin and Trannoy (2019) for an overview of production taxes in France and evidence on their detrimental effect for the competitiveness of French firms.

Some options to offset these tax cuts include further streamlining of tax expenditures and subsidies[8] (especially those that incentivize the use of fossil fuels) and the gradual increase in carbon prices (see *Selected Issues Paper* on climate mitigation policies). While these measures could be legislated immediately, their activation should be delayed until the recovery is firm.

9. The tax reform misses the opportunity to simplify an overly complex system. The reform will reduce the tax rate of the CVAE (*cotisation sur la valeur ajoutée des entreprises*), and two taxes on the use of real-estate property—the CFE (*cotisation foncière des entreprises*) and the TFPB (*taxe foncière sur les propriétés bâties*), reducing the tax burden for firms by about €10 billion per year.[9] However, the reform misses the opportunity to simplify an overly complex tax system while targeting the same amount. One option would be to complete the elimination of the C3S tax, which raised close to €4 billion in 2019, and adjust the cut of the other taxes accordingly. The C3S was already reduced twice, in 2015 and 2016, and was scheduled to disappear in 2017. The literature suggests that the C3S is particularly distortive, while evidence on the distortions from taxes on the use of real-estate property is less compelling.[10] Moreover, analysis of the effect of previous reductions in the C3S suggest that its elimination would be associated with a 1 percent increase in affected firms' exports and would significantly improves the survival changes of firms during recessions (Urvoy 2019).

Production Taxes

Miscellaneous taxes on production (billion euros) /1	**2019**
Contributions on the value added of the corporations (CVAE)	14.2
Corporate tax on real-estate properties and non-developped land (TFPB)	15.5
Property contributions of the corporations (CFE)	6.8
Solidarity social contributions of the corporations (C3S)	3.8
Other	31.9
Total	**72.2**

Sources: INSEE; and IMF staff estimates.
1/ Other taxes on productions (category D29 of the national accounts) excluding wage bill and payroll taxes.

[8] France spends about 30 percent more than peers on subsidies tax expenditures (IMF Country Report No. 19/245). The 2020 budget included €90 billion, or 4 percent of GDP, in tax expenditures.

[9] A cap on the CET (*contribution économique territoriale*), that comprises both the CVAE and the CFE, was adjusted from 3 percent to 2 percent of value added to avoid offsetting the effect of the lower CVAE.

[10] Martin and Trannoy (2019) argue that the cascading effect of the C3S throughout production stages imply a much large effect on equilibrium prices compared to its tax rate, and a sizable effect on aggregate productivity by encouraging inefficient vertical integration (equivalent to 10-to-20 percent of the tax revenue collected. In turn, Urvoy (2019) finds no significant evidence that the rate of the CFE has an effect on the use of real estate (e.g. on rental expenses). And there is only weak evidence that local taxes, including the CFE, affected location decision in France (Rathelot and Sillard 2008).

Annex VIII. Short-Time Work Scheme in Selected Countries

	FRANCE				GERMANY		SPAIN		ITALY		UK
	Pre-Covid	Covid			Pre-Covid	Covid	Pre-Covid	Covid	Pre-Covid	Covid	Covid
Name of program	*Activité partielle*	*Activité partielle*	*Activité partielle--droit commun*	*Activité partielle--longue durée*	*Kurzarbeit*		*ERTE*		*Cassa Integrazione Guadagni (CIGO and CIGS programs)*		*Job Retention Scheme*
Period		Mar-Dec 2020	From Jan 2021	From Jul 2020				Mar 2020-Jan 2021			March-December 2020
Replacement rate for worker	70% of gross (84% net), with floor at min wage		60% of gross (71% net), with floor at 90% of min wage	70% of gross (84% net), with floor at 90% of min wage	60% net (67% with children)	Increase to 70% (77%) from 4th month; 80% (87%) from 7th month (if 50%+ cut in hours)	70% of gross wage, 50% after 180 days		80 percent of gross foregone earnings	80 percent of gross foregone earnings	80% of gross salary of furloughed hours (partial hours allowed since July)
Cap on worker compensation	No	No	No	€4,606 (net)	No		€ 1,412		€1,199 gross if monthly salary higher than €2,159 (€998 otherwise)		No
Replacement rate for firms (share of cost covered by State)	Fixed amount per hour (about 90% of min wage)	100% before June and 85% since June; 100% for selected sectors until Jan 2021	60%; 100% for selected sectors until Jan 2021	85%	100% but employers pay 80% of SSC (about 27% of compensation at avg. salary)	100%	100%		100% but employers required to pay additional SSC	Additional SSC waived for 27 weeks; no previous contribution required	100% (Mar-Aug); 87.5% (Sept); 75% (Oct)
Cap on firm compensation	N/A	€30.3/hour or €4,608 at monthly basis (84% of net wage at 4½ times the minimum wage)			No		N/A		N/A		£2,500 (Mar-Aug); £2,187 (Sept); £1,875 (Oct)
Max duration	6 months	12 months	6 months	24 months (within 36 months)	6 months	Exceptional until end 2021	120-720 days (depending on contribution period)	No expiration during special ERTE measures	13 continuous weeks	42 weeks (to use up to Jan 2021)	8 months
Sectors / firms eligible	All	All	All	All	All	All	Firms with at least 10 employees.		Medium and large size firms, mostly in manuf. and construction	All businesses (max of 36 weeks)	All
Work contracts eligible		No condition on type of contract, part or full time, seniority			Permanent or fixed-term contracts and paying SSC	Expanded to temporary workers			N/A	All employees eligible (except newly hired executives)	Any contract but must have been on payroll on 3/19/2020
Other conditions and additional support	NA	State covers 100% training cost	State covers 70% training cost. SSC waived.	Collective agreement needed; reduction in hours cannot exceed 40% of regular hours. State covers 80% training cost	Min 1/3 of workforce subject to reduced hours of 10% or more; draw down working time account balances and exhaust leave balances before applying	Min 10% of workforce subject to reduced hours of 10% or more; requirement to draw down balances waived. Employer SSC waived until June 30, only 50% SSC until end 2021	Min 10% of firms' workforce is subject to reduced hours	Eligibility conditions eased as Covid-19 considered force majeure. No requirement for prior min. contrib. or reduction of accumulated entitlement.	Case-by-case authorization; consultation with unions required; agreement required only for some programs	Simplified access. Eased eligibility depends on turnover loss and need agreement with union (if 5+ employees). Prohibition of dismissal in some programs	There are rules on what the employee can do while on furlough. SSC waived over Mar-Jul. Job Retention Bonus of £1,000/employee brought back from furlough and kept continuously employed during Nov 2020-Jan 2021 and paid on average £520 per month.

Annex IX. Financing Support to Strengthen Equity and Incentivize Investment in Selected Countries

Type of Instrument	Country Experience	Considerations around selectivity, pricing and (time-bound) duration
1. Hybrid financing options	• Ireland offers a funding package to eligible businesses (upon submitting a business recovery plan) which is a hybrid of repayable advances and equity instruments (cumulative redeemable preference shares). • The United States' assistance for SMEs includes a grant element to the provision of guaranteed loans whereby a portion of the loan can be forgiven in an amount equal to eight weeks of the borrowers' key expenses, including payroll, mortgage interest, rent, and utilities.	These programs have flexible and affordable pricing that can ensure sufficient take-up. However, under some schemes, selection could be too broad, and the government could find it difficult to exit equity stakes and/or losses may be large.
2. Conversion of loans into equity or quasi-equity	• UK's Future Fund scheme issues convertible loans which automatically convert to equity at a minimum conversion discount of 20 percent to the price of the next qualifying funding round, which is the discount rate. To qualify, the amount of equity capital raised must be at least the size of the convertible loan. • The Federal Reserve added more "equity-like" features to the main street lending program when it lengthened maturities and pushed back amortization in changes announced on June 8 (Federal Reserve 2020c).	Private sector participation, through for example matched up funding can ensure efficient selection, but the government could find it difficult to exit equity stakes. Parametric relief on loans could entail higher fiscal risk and increase the duration of exposure.
3. Tax credit for incurred losses	• The United States CARES Act eased the extent and ability to carry back and carry forward net operating losses. • China increased the tax loss carry-forward period (from five to eight years) for severely affected companies. • Austria introduced rules to allow a carryback (expected) of tax losses for 2020 as a response to address the economic implications of the coronavirus (COVID-19) pandemic. • Czech Republic allows taxpayers to deduct tax losses as a carryback for two years or carried forward for five future tax years.	These tax offsets provide receivables against pandemic losses providing liquidity support to firms, and in some instances, solvency support. Depending on the design, this could however be mistargeted to firms with no recovery prospects and extended longer in duration.
4. Capital and investment subsidy and/or support	• German's KfW syndicated loans offer investment and operating cost financing and assume up to 80 percent of the risk through sub-participation, or as a syndicate partner. • Italy's SME support scheme comprise a tax credit for private investors (up to 20 percent of the invested amount) and tax credit for companies with capital increase. • Spain's Investment guarantee facility supports the granting of new financing to self-employed workers and companies primarily to undertake new investments. • Australia's Backing Business Investment (BBI) program allows businesses with turnover of less than AUD $500 million to deduct 50 percent of the cost of a business's investment in a new asset.	Investment and capital tax subsidies could be fiscally costly given the uncertain economic environment and possibly low returns to investment.

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 17, 2020

Prepared By | European Department

CONTENTS

FUND RELATIONS

(As of December 2, 2020)

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)	15,942.44	79.10
Reserve Tranche Position	4,212.68	20.90
Lending to the Fund		
New Arrangements to Borrow	442.64	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	8,109.45	80.02

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				
	2019	**2020**	**2021**	**2022**	**2023**
Principal					
Charges/Interest	0.44	2.16	2.16	2.16	2.16
Total	**0.44**	**2.16**	**2.16**	**2.16**	**2.16**

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 is an Article VII member and 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, which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultation:

The last Article IV consultation was concluded on July 22, 2019. The associated Executive Board assessment is available at https://www.imf.org/en/News/Articles/2019/07/24/pr-19295-france-imf-executive-board-concludes-2019-article-iv-consultation and the staff report at https://www.imf.org/en/Publications/CR/Issues/2019/07/24/France-2019-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-48523. 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*
France–Financial System Stability Assessment **(FSSA)**	IMF Country Report No. 19/241, 07/24/19
France: Financial Sector Assessment Program—Technical Notes	
Anti-Money Laundering and Combating the Financing of Terrorism Regime in France	*IMF Country Report No. 19/326, Oct 2019*
Balance Sheet Risks and Financial Stability	*IMF Country Report No. 19/324, Oct 2019*
Issues in Insurance Supervision and Regulation	*IMF Country Report No. 19/323, Oct 2019*
Key Attributes of Effective Resolution Regimes for Insurance Companies	*IMF Country Report No. 19/328, Oct 2019*
Macroprudential Policy Framework and Tools	*IMF Country Report No. 19/327, Oct 2019*
Nonfinancial Corporations and Households Vulnerabilities	*IMF Country Report No. 19/321, Oct 2019*

Risk Analysis of Banking and Insurance Sector	*IMF Country Report No. 19/322, Oct 2019*
Select Topics in Financial Supervision and Oversight	*IMF Country Report No. 19/325, Oct 2019*

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.

The FSAP Update undertaken in July 2019 confirmed that the financial system is more resilient than it was in 2012. French banks' capital positions and asset quality have improved. Banking business is better placed to handle cross-border contagion, including from exposures to high-yield EA economies. Insurers' solvency ratios have been stable and have been bolstered by the effective implementation of Solvency II. Household savings and balance sheets are relatively sound and house prices presently appear broadly aligned with fundamentals. The French financial conglomerate (FC) and bancassurance models thus far have worked well. Important institutional and policy changes have also taken place since the 2012 FSAP. At the national level, the authorities have strengthened the macroprudential framework by establishing the High Council for Financial Stability (HCSF), enhanced monitoring of financial stability risks, introduced macroprudential measures, and taken various financial reform measures. At the European level, significant changes include the Banking Union (BU), Capital Requirements Regulation/Capital Requirements Directive (CRR/CRD), Solvency II, and efforts towards a Capital Markets Union (CMU).

The 2019 report however found that there are several challenges. Banking and insurance business lines, and the corporate sector, carry important financial vulnerabilities that need close attention Private nonfinancial sector and public debt has continued to rise, with some concentration of vulnerable corporate debt. Risks from a tail of highly indebted corporates appear manageable, though stress tests show that some banks' large exposures to highly indebted corporates may increase notably under stress. Bank face profitability pressures due to the interest rate environment, lower revenue from market-related business, and stronger market competition. The reliance of banks on wholesale funding is better managed but is still sizable, and, could pose further risks to profitability and solvency. Insurers are broadly resilient against market shocks, but vulnerabilities stem from the concentrated exposures, mostly to their parent banks. Nonbanks—insurers and investment funds—are playing a larger role given the growing cross-border and non-EU exposures. The French financial conglomerate model, while so-far working well, is complex to manage and exposed to contagion and unexpected reputational risks. Finally, the incomplete BU and the slow progress towards CMU are creating uncertainty and constraining faster shifts in business models.

The 2019 report recommended augmenting policy tools to contain vulnerabilities and continue to act pre-emptively if systemic risks intensify. To mitigate intensification of corporate—and potentially household—vulnerabilities, the FSAP proposed: (i) active engagement with the ECB on the possible use of bank-specific (Pillar II) measures; (ii) considering fiscal measures to incentivize corporates to finance through equity rather than debt; and (iii) a sectoral systemic risk buffer. Additional liquidity buffers in all major currencies including in U.S. dollars, and intensified monitoring of insurers' exposures to parent banks, are desirable. A high priority should be placed on enhancing oversight of financial conglomerates, including through augmented conglomerate-level reporting and stress testing, and improving the resolution framework for insurers by including the bail-in tool. Stronger and formal coordination between the French Prudential Supervision and Resolution Authority (ACPR), French Financial Markets Authority (AMF), and the European Central Bank (ECB), alongside adequate skilled supervisory resources are also essential.

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.

Table 1. France: Table of Common Indicators Required for Surveillance
(As of December 2020)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	11/20	11/20	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/20	11/20	Monthly	Monthly	Monthly
International Investment Position	Q2:2020	Q4:2020	Quarterly	Quarterly	Quarterly
Reserve/Base Money	10/20	11/20	Monthly	Monthly	Monthly
Broad Money	10/20	11/20	Monthly	Monthly	Monthly
Central Bank Balance Sheet	10/20	11/20	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	10/20	11/20	Monthly	Monthly	Monthly
Interest Rates[2]	11/20	11/20	Daily	Daily	Daily
Consumer Price Index	11/20	11/20	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2019	11/20	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	09/2020	11/20	Monthly	Monthly	Monthly
Stock of Central Government Debt	10/20	11/20	Monthly	Monthly	Monthly
External Current Account Balance	09/20	11/20	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	09/19	11/20	Monthly	Monthly	Monthly
GDP/GNP	Q3:2020	Q4:2020	Quarterly	Quarterly	Quarterly
Gross External Debt	Q2:2020	Q4:2020	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).

INTERNATIONAL MONETARY FUND

FRANCE

January 8, 2020

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By	European Department

This statement reports on developments and provides information that has become available since the staff report was issued to the Executive Board. The thrust of the staff appraisal remains unchanged.

1. **The French government launched its COVID vaccination campaign at the end of 2020, while maintaining containment measures amidst a still rising infection load.** The second lockdown was eased in mid-December and replaced by a night curfew. However daily new infections continued to be above the government's target of 5,000. In response, the opening of bars, restaurants, theaters, cinemas and concert venues has been postponed and existing night curfews have been tightened in several departments. Along with other EU countries, France began vaccinating on December 28, 2020. However, by January 7, 2021, only about 44,500[1] people had been vaccinated compared with the government target of 1 million vaccinations by end-January.

2. **The authorities passed the 2021 budget, including additional support for households and firms amid ongoing containment measures.** Compared to the initial draft, the final bill adopted by the National Assembly introduced additional support (about 0.7 percent of GDP) to offset the economic impact of containment measures, largely through the expansion of pre-existing emergency programs (e.g. solidarity fund and short-time work scheme). The additional measures for 2021 will be partly financed by unused appropriations from 2020 (about 0.4 percent of GDP). The final bill also extended the scope of the quasi-equity guarantees program (while maintaining its overall envelope) by including subordinated bonds in the list of investment instruments that can benefit from state guarantees.

3. **While virus-related risks remain high, the economic outlook improved slightly amidst better than expected high frequency indicators and additional**

[1] Source: CovidTracker and Ministère de la Santé.

fiscal support in France and its trading partners. High frequency data for November and December 2020 suggest that activity is likely to decline less than expected in 2020Q4. Furthermore, additional fiscal support in France and its trading partners is expected to underpin a slightly faster return of activity in the near-term. While agreement on a post-Brexit framework between the EU and the UK on December 24, 2020 reduced downside risks, the possibility of increased COVID infections from the new more virulent UK strain and slow rollout of vaccines might increase them in the short run.

4. The prudential authority – Haut Conseil de stabilité financière (HCSF) – announced amendments to its macroprudential measures concerning the housing sector and banks expanded loan repayment moratoria. The amended HCSF recommendations aim to ease mortgage lending standards, in particular for first time buyers. Specifically, the benchmark ceiling for the debt service to income ratio (DSTI) will be raised from 33 percent to 35 percent. In addition, amortization deferrals of up to 2 years will be allowed. The share of new loans that can diverge from best practices in terms of maturity or DSTI will be increased from 15 percent to 20 percent and will be more targeted on first-time buyers. The recommendations will also be adjusted to clarify that they do not prevent loan buybacks and renegotiations as long as they reduce the DSTI ratio or the maturity of the loans. The HCSF intends to make these recommendations legally binding in summer 2021. The latest data (*Evaluation des risques du système financier français*, forthcoming) indicate that banks expanded loan moratoria from around €20 billion in May to €262.7 billion at end-September, taking advantage of the flexibility in the accounting and prudential treatment of claims restructured under debt moratoria.

5. The regulation tightening the screening of non-EU investments will be extended through 2021. The threshold above which investors from outside the European Union buying stakes in listed French companies must seek approval was lowered from 25 percent to 10 percent during the crisis (end-April 2020). This regulation was due to expire at the end of 2020 but has now been extended until the end of 2021.

Table 1. France: Selected Economic Indicators, 2019-22

		Projections		
	2019	2020	2021	2022
Output (%)				
Real GDP growth	1.5	-9.0	5.5	4.1
Nominal GDP (billions of euros)	2,426	2,257	2,389	2,510
Employment (%)				
Unemployment rate	8.5	8.7	10.4	9.8
Prices (year average, %)				
Inflation	1.3	0.5	0.7	1.0
General government finance (% GDP)				
General government balance	-3.0	-10.6	-7.7	-5.1
Primary balance	-1.6	-9.3	-6.5	-4.2
General government gross debt	98.1	115.3	117.6	117.5
Balance of payments (% GDP)				
Current account	-0.7	-2.1	-1.6	-1.5

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

Statement by Mr. Buissé and Mr. Rozan on France

January 13, 2021

The French authorities would like to underline their appreciation for the work conducted by staff for this Article IV consultation, made under particularly difficult circumstances. They strongly valued this engagement and exchange on the diagnosis, risks and policy priorities. This highlights the importance of the resumption of Article IV consultations in this recovery phase. The article IV report and the two selected issues papers represent a particularly valuable contribution to the policy debate in France, and more generally in advanced economies.

France has been hit by the crisis after several years of strong reform implementation that were bearing fruits, with a notable improvement of economic fundamentals. The crisis was met with decisive and comprehensive policy actions to contain the spread of the virus, protect livelihoods and limit economic scarring. The tools implemented to support firms and households were designed in consultations with all stakeholders, and their efficiency is being monitored on an ongoing basis. This fiscal response was articulated at the European level, with an unprecedented coordination and the negotiation of new tools, to ensure maximum effectiveness and solidarity, and strongly complemented by the ECB's accommodative monetary policy.

As the crisis evolves, France's response, in particular through the *Plan de Relance* (Recovery Plan), will continue to be at the same time swift, flexible and ambitious, to support the short to medium term recovery, and to align it with France's long term economic transformation needs, continuing the strong reform drive at the heart of the Government's action, while adapting its implementation to the current context. The priority remains to (i) protect the most vulnerable, and the Government will continue to rebuild the social protection system for a fairer society; (ii) deepen and accelerate the effort towards climate transition; (iii) make the French economy even more competitive, resilient, and innovative and develop skills ; (iv) and modernize public administration and public services, conscious of the need to contain public spending in the medium term and to enhance its efficiency.

<u>The crisis has impacted the French economy at a time when growth was robust, and unemployment was down to a ten-year low</u>. Indeed, over the past three years, France has embarked on an ambitious reform path, which has made France a more competitive and attractive place for investors.

(i) The labor market was made more dynamic, thanks to a simpler labor code, a renovated vocational training system, and the implementation of a massive investment plan in skills. Results are already showing, and the new tools are being taken up at a rapid pace, with increased and improved collective negotiation at the firm level, and a rising number of apprenticeships. The macroeconomic effects of these structural reforms combined with measures aimed at reducing labor costs were already visible before the crisis, with very dynamic job creations, unemployment falling to around 8.1% at end 2019, and improvements in job quality through a greater use of long term contracts and full-time employment. Growth in France reached 1.5 % in 2019, above the 1.3 % average of the Euro Area;

(ii) The social model, already strongly redistributive, has been renovated to ensure stronger equality of opportunity. Reforms have been undertaken to tackle the lack of social mobility. Schemes targeted to support people furthest from the labor market have been reinforced and rationalized to increase their effectiveness. Measures in the field of public education have been taken to ensure more equal opportunities, including expanding daycare capacity to accommodate 30 000 additional children until 2022, lowering the mandatory school age to 3-years-old, and halving class sizes in sensitive areas. Finally, some statutory minimum social benefits ("*minimas sociaux*") have been significantly increased (minimum old-age pension, adult disability allowance) and dental and optic health benefits have been enhanced;

(iii) Continuous efforts have been made to contain labor costs and support the cost-competitiveness of the French economy, by permanently reducing social contributions on labor (€20 billion of employee contributions cut offset by an increase in the generalized social contribution (CSG) with a broader base, conversion of the CICE tax credit into a permanent reduction in employer social security contributions). The business environment was simplified through the Action Plan on the Growth and Transformation of firms (*PACTE*) and the ESSOC Law has further simplified the regulatory environment for firms. Thanks to these measures, competitiveness is improving: since 2012, unit labor costs in France have risen more slowly than in the euro area. French market shares have stabilized over the period. Competitiveness has consequently greatly improved, as shown by the results of the international rankings;

(iv) Support has been deployed to stimulate corporate investment, in particular in innovation, to support productivity. Capital and capital income taxation have been reformed so as not to deter productive investment. Corporate taxation has been adapted, with a gradual path of reduction of the corporate income tax rate until 2022, reducing both firm-level tax burden, and the debt bias. Innovation has also been supported through several financing mechanisms (in particular, an important investment plan has been launched in 2017 with €13 billion earmarked for innovation, and the Fund for innovation and industry has strengthened its support to breakthrough innovation by €250 million annually). Amortization rules for productive investment in the digital sector and robotization by SMEs have been adapted. All of these measures have supported a very dynamic corporate investment in the recent pre-crisis period. The deindustrialization process appears to have halted, with 30 000 additional industry jobs since mid-2017.

<u>The pandemic has triggered an unprecedented economic crisis, with a massive impact on output. A rebound is expected for 2021 thanks to support measures.</u>

The Budget bill relies on a -11 % recession in 2020. This prudent assumption was made in October, in view of the restrictions to be implemented at the end of the month to curb the pandemic, but the latest data suggest the cost of the second lockdown has been smaller than expected. The shock is highly differentiated across sectors. Although activity has only slightly decreased in the agricultural sector, as well as in IT and financial sectors, it has drastically fallen in sectors that were directly affected by the containment measures, for instance hotels and restaurants. The automobile and aerospace industries and transport services also experienced significant drops in their activity. Domestic demand has plummeted because of the drop of household consumption and corporate investment, although investment is estimated to have decreased less than in the EA. Production was strongly impacted by the disorganization of supply chains and the containment measures. The crisis has taken a particular toll on external trade, due to the exposure of French exports to aeronautics and tourism.

The *Plan de Relance*, announced in September, supported by the EU's Recovery and Resilience Facility, as well as the massive action of the ECB, will contribute to the rebound of the activity in 2021, though uncertainty is high. Thanks to the support measures taken by the Government, household incomes as well as the productive capacity have been largely preserved in 2020. The Government expects a rebound in activity for 2021, at 6 %, thanks to the progressive lifting of sanitary restrictions, and the implementation of the *Plan de relance*. The level of uncertainty is however particularly high. The evolution of the health situation will be crucial, both on the downside (worsening pandemic) and the upside (treatment and vaccine). Trade tensions could also become more acute, even if the Brexit deal has reduced the immediate level of risks. Financial markets should be monitored. There is also high uncertainty about household consumption: given the large savings accumulated in 2020, and the push provided by the *Plan de relance*, the recovery of consumption could be more dynamic than expected.

A massive public reaction has proven effective to face the short-term shock linked with the pandemic, amounting to around €500 billion.

To preserve jobs, skills and household income, the Government has taken unprecedented strong measures. It put in place a series of massive emergency measures to protect companies and workers, notably through the Solidarity fund, state-guaranteed loans and a short-time unemployment scheme. As noted by staff in the report, the take-up of these schemes has been high. It is estimated that about 2/3 of the 2020 shock to national income has been absorbed by the public sector, through both automatic stabilizers and emergency measures.

The short-time work scheme (*dispositif d'activité partielle*) has been strongly reinforced and has been very effective in helping companies cope. At its peak in April, over 8 million workers were benefitting from this scheme. While the generosity of this scheme was fully warranted during the containment phase, the scheme has been recalibrated and tightened for the recovery phase (in June 2020 and starting from February 2021) to balance the financial support to the most affected sectors with the need to provide an incentive to resume activity in sectors that do not directly suffer from the containment measures. The take-up diminished quite in line with the rebound in activity observed in Q3. The current state of the scheme appears appropriate, and the government will continue to assess its efficiency going forward, along the evolving situation.

Strong additional measures have been taken to support the purchasing power of workers and specific attention has been paid to the most vulnerable. Unemployment benefits were extended and adapted during the lockdown. The implementation of some parts the unemployment insurance reform has been delayed. Automatic renewal of rights to certain social benefits have been decided. Exceptional financial assistance has been dedicated to the most fragile.

Companies have received unprecedented support. A €300 billion guaranteed loan scheme has been put in place, with a take-up of around €130 billion at end 2020. The deferral of social contribution and tax payments, and an accelerated refund of tax credits also provided significant liquidity to firms. Beyond liquidity support, direct financial support has been provided to SMEs, independent workers and micro-companies, given their fragility, to help cover fixed expenses during periods of stopped or reduced activity. A Solidarity Fund, credited with €20 billion for 2020, has been created to that effect.

After the end of the first lockdown, sectoral support plans have been adopted to help specific sectors particularly affected by the crisis. A first set of measures has extended emergency measures to take into account the specific situation of sectors affected by prolonged social distancing, for instance tourism, hotels, restaurants, culture, publishing, retail stores. In addition, a second set of measures has provided equity support and support to structural transformation to sectors facing solvency issues in a difficult economic environment, in particular the automotive, aerospace, tourism sectors, and technological startups.

To support both the short-term recovery and the medium-term transformation of the French economy, a recovery plan, the "Plan France Relance", was unveiled in September and started being implemented

at the end of 2020. The €100 billion Recovery Plan will be partly funded by €40 billion of direct subsidies from the European Union, following the historic European agreement in July. It is designed to sustain the growth potential of the French economy, support employment creation, social and territorial cohesion, and speed up the greening of the economy. It will support French companies and industries' competitiveness and invest in technologies to maintain France among the most competitive and innovative countries. **By supporting both supply and demand, it supports job creation and aims to help restore the pre-crisis level of economic activity in 2022**. It has been designed and calibrated to have a lasting impact on growth.

- **Along its first pillar, a strong emphasis has been placed on the green transition, to reach France's climate objectives**. €30 billion are dedicated to this effect. The recovery plan will include investments for energy-retrofitting, for sustainable mobility, for decarbonation of the industry and for the development of green technologies (hydrogen, biofuels, recycling).

  More generally, policies developed throughout the crisis have made sure the pursuit of climate objectives is not postponed but accelerated. As noted in the latest Fiscal monitor, France is leading the way in terms of greening its COVID-19 fiscal package. Green budgeting is being implemented, and the budget voted for 2021 has been fully climate-tagged and analyzed expenditure by expenditure through an environment and climate lens. This is a landmark achievement to be able to closely follow and monitor the impact of the recovery plan on climate and the environment. Going forward, the Government will continue to implement policies compatible with reaching climate commitments at the domestic and at the European level. The Selected Issues paper on climate policies was a very useful contribution to take stock of the already robust climate mitigation policies in France, as well as highlighting useful policy debates to be held at the domestic or EU level. More specifically on carbon pricing, European coordination is necessary for an effective climate action. The European Commission is exploring, as part of the European Green Deal, a reform of the EU's Emission Trading System, and to possibly extend its perimeter. Due attention will have to be paid to the social acceptability of this going forward.

- **The second pillar will provide €34 billion to reinforce the competitiveness and resilience of the French economy**. Measures will include cut in distortive production taxes (€10 billion per year on a permanent basis, the first two years being part of the France Relance Plan for a total amount of €20 billion), measures to reinforce corporate balance sheets and investments in innovation, in the digitalization of SMEs and in the resilience of the French industry, especially to secure critical supplies.

  One key objective is to strengthen corporate balance sheet, to secure a strong and long-lasting recovery. Going beyond broad-based liquidity support, the Government is putting in place a publicly supported scheme of participatory loans and subordinated bonds to SMEs and mid-size companies, allowing for quasi-equity financing up to €20 billion (consistent with estimates of the equity gap due to the crisis). This scheme will provide medium to long-term financing to firms with a viable business model but which need equity or quasi-equity to continue investing and growing due to their current indebtedness. The public support will consist of a portfolio guarantee granted to investments funds which invest in quasi-equity instruments, in order to address the current market failure regarding access to quasi-equity. This mechanism has been discussed with all stakeholders to ensure its adequate take-up, both on the side of beneficiaries, financial sectors and investors. The massive participation of the private sector was necessary to quickly scale up this equity support. The design of this instrument was carefully assessed to ensure market-led selectivity, adequate pricing, and time-bound support. The Government will closely monitor the implementation of the mechanism to ensure the success of this strategy.

More generally, while we agree with staff that it will be important to shift support from providing broad-based emergency support to targeted support for the most dynamic parts of the economy, the general design of the public support to the granting of participatory loans and subordinated bonds, which is time-bound and relies on a market-based mechanism to determine the conditions of the support, is appropriate. Close monitoring will of course be necessary to ensure the intended effects are reached.

In addition, a significant and permanent cut in production taxes will be implemented, amounting to €20 billion over the next two years. France is characterized by the large number and high level of production taxes, which weigh on the competitiveness of French companies, and particularly the industry. **Three production taxes are concerned (CVAE, TFPB, CFE): this combination of measures better targets the competitiveness of industrial companies, and SMEs in particular, than a cut in C3S would have done**. CVAE has been shown to weigh heavily on companies that need to regularly renew their productive equipment, and therefore creates distortions at the detriment of capital-intensive sectors. The reform of real estate property taxes (TFPB and CFE) will directly benefit industrial companies since it corrects the calculation of the tax base which penalized them considerably compared to other types of business premises.

- **The third pillar will provide €36 billion for skills, social and territorial cohesion**. The significant means devoted to scaling up employment support measures and investment in skills and competences will help safeguard jobs, improve the employability of the most vulnerable, especially the youth, and strengthen productivity. Among the key measures, €1.6 billion is dedicated to training young people in strategic and dynamic sectors, €1 billion to lifelong training, €1.1 billion to subsidizing new hires under the age of 26 and €7.6 billion are dedicated to preserve employment through a long duration short time work scheme (along with support to training).

  The long duration short time work scheme has been designed to be targeted and provide the right incentives, without impeding factor reallocation. Its use is conditioned on signing a collective agreement, and it has been designed to target companies that should return, over the medium to longer term, to a level of activity similar to that of the pre-crisis-level. Moreover, only up to 40 % of usual working hours (50 % in exceptional cases) can be covered by the scheme, in order to avoid skills obsolescence.

  More generally we will welcome further exchanges with staff on their ideas on how to ensure an efficient reallocation of labor in the recovery phase.

Specific attention is paid to the timely implementation of the recovery plan, as well as its efficiency. In order to be timely, the recovery plan should be implemented as quickly as possible to secure the recovery. A comprehensive monitoring and evaluation framework has been set out by law. The budgetary design of the plan enables the Government to shift the allocation of credits whenever the implementation of an action is deemed unsatisfactory. There has been a heavy involvement of relevant stakeholders, both at national and local levels, in the preparation of the plan, and the governance has been designed to ensure swift and flexible implementation.

The crisis response measures required a substantial mobilization of fiscal tools and a deepening of the deficit. While 2019 was marked by a reduction of the deficit to 2,1% of GDP (not counting the temporary effect of the replacement of the tax credit for employment and competitiveness (CICE) by a permanent cut in social security contribution), in 2020, the public deficit is estimated to reach -11,3 %, while debt is estimated to reach 119,8 %, given the drop in activity and the sizable and fully justified public intervention to offset the effects of the crisis.

The normalization of the situation of the public finances, helped by the rebound in activity and the implementation of structural reform, will be done progressively, so as to preserve the recovery. The deficit will be reduced to 8,5% in 2021, and public debt should stabilize around 122,4%. The COVID related debt will be ring-fenced, and public resources will be dedicated to its amortization, with a credible trajectory and calendar. **More generally, while the consolidation of public finances should not be engaged too promptly to preserve the recovery, the Government is fully committed to maintaining the sustainability of public finances in the medium term,** based on the growth recovery, improved spending efficiency, and strict control of the evolution of expenditure volumes. It will be able to rely on a high level committee, chaired by Jean Arthuis, former Finance minister and former chair of the Senate finance committee, which is expected to deliver its recommendations at the end February 2021 in order to help redefine a fiscal trajectory and improve the governance of public finances.

<u>We generally share staff's assessment of the financial sector. In the current context, vigilance on the build-up of risks in the financial sector is critical, given the impact of the crisis on corporate balance sheets</u>. The banking sector appears to be adequately capitalized, and it entered the crisis with comfortable capital buffers and low NPL ratios. However, we do not fully share the results of the Solvency Stress Test undertaken by staff, as it does not take into account the prudential filters on expected loss provisions recommended by the Basel Committee and implemented into EU law in June. Finally, the banking and insurance sector profitability in the low-interest environment requires monitoring, and supervisory authorities will remain vigilant regarding the possible build-up of risks in the commercial real-estate sector.

<u>More generally, the crisis has emphasized the need for continued reforms, following the strong reform drive of the first three years of the mandate.</u>

The reform agenda will continue to be implemented, while adapting it to the changing circumstances, along the following four directions:

- **First, efforts to rebuild the welfare state for a fairer society will continue**: the **health system** will receive additional funding to enhance its long term resilience ("*Ségur de la Santé*" agenda), while work is being undertaken to limit the growth of spending related to outpatient care. The **reform of unemployment benefits** will be implemented. The objectives remain unchanged (support job creation, fight precarity by incentivizing work and limit excessive use of short-term contract). Some measures are already in place, but the implementation modalities of the rest of this important reform are currently being adapted to ensure they fit the current economic and social context. In addition, the discussions with social partners on the **pension reform** will resume, with the goal of moving towards a single universal retirement regime. Reforms aimed at **fighting inequalities** will continue, with the implementation of the Plan Pauvreté to protect the most vulnerable, and new initiatives will be implemented in 2021 to fight inequalities of opportunities;
- **Second, beyond the climate agenda highlighted in the *Plan de relance*, and the green budgeting exercise that started this year**, the Government is preparing a **new Law on climate and the environment**, that will implement part of the proposals made by the Citizens' Convention for Climate. The objective is to build a credible trajectory, compatible with reaching climate neutrality by 2050;
- **Third, scaled-up support will be provided for innovation and the development of a knowledge-based society**, in particular through a Multiannual Program Law on Research, which will invest

€25 billion in public research over the next ten years, and through the fourth *Programme d'investissement d'avenir,* which will target support to advanced technology;

- **Fourth, the authorities will continue the modernization of public services**: the housing policy reform started in 2017 will be deepened; the law on the acceleration and simplification of public action ("ASAP" Law) is being rolled out to enhance the relationship between citizens and the administration, and make administrative structures and procedures more efficient.