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FRANCE

2012 ARTICLE IV CONSULTATION

December 2012

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 2012 Article IV consultation with France, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 29, 2012, 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 6, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its December 20, 2012 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Selected Issues Paper
Financial System Stability Assessment

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

December 6, 2012

KEY ISSUES:

The growth outlook is clouded by a stalling recovery in Europe and a competitiveness gap vis-à-vis partners. Assuming a rapid resolution of the euro area crisis, the authorities project growth to rebound to 0.8 percent in 2013, against 0.4 percent in the staff's scenario. The competitiveness shortfall is reflected in loss of export market share and low profit margins. Despite high unemployment and the open output gap, core inflation is declining only very slowly, owing to wage inertia.

The authorities are embarked on a path of rapid fiscal consolidation, reflecting euro area commitments and the need to solidify market confidence. They target a reduction of the deficit from 4½ percent of GDP in 2012 to 3 percent in 2013, with a view to reaching a balanced position by 2017. Based on a more conservative growth outlook, staff projects a deficit of 3½ percent of GDP in 2013. A more measured pace of fiscal consolidation would have been preferable on cyclical grounds, but market and euro area imperatives have reduced fiscal space. While planned adjustment over the medium-term is about evenly divided between revenue and expenditure measures, staff considers that the already high tax ratio (relative to partner countries) calls for rebalancing towards more expenditure containment.

Impediments in the functioning of the labor and product markets are at the core of the competitiveness gap that has built up over time. The planned reduction of labor costs (through a corporate income tax credit) will improve competitiveness, if supported by wage moderation. But the key to improved outcomes in terms of growth and employment lies in reforming the labor market so as to increase the capacity of enterprise to invest, adapt and create jobs. Discussions under way between social partners create a unique opportunity to achieve meaningful reforms in this area. Liberalization in the services sector would enhance the benefits of labor market reform, but may be difficult to pursue in tandem.

Financial stability concerns, which arose in connection with euro area tensions and dollar liquidity problems in 2011, have abated considerably. Since 2011, French banks moved swiftly to strengthen their solvency ratios and funding structures, largely through external deleveraging. However, banks remain heavily reliant on wholesale funding, which could be a source of vulnerability in the event of another severe liquidity or euro area confidence shock. A critical challenge for the French financial system, and its ability to provide long term financing to the domestic economy, comes from the need to adapt to international regulatory changes.

Approved By
Mahmood Pradhan and Martin Mühleisen

Discussions took place in Paris from October 15 to 29. The staff team comprised Messrs. Gardner (head), Hallaert, Cheng (all EUR), Geiregat (SPR), and Sy (MCM). France Executive Director Mr. Fayolle and Ms. Terracol (OED) participated in the discussions. Staff met with Ministers Moscovici (Finance and Economy), Sapin (Labor), Cahuzac (Budget), Bricq (Trade), Bank of France Governor Noyer, other senior officials, and financial sector, academic, parliament and trade union representatives.

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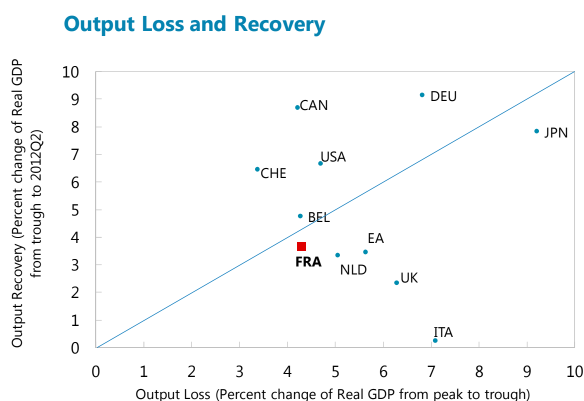
RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. The Economic and Financial Context

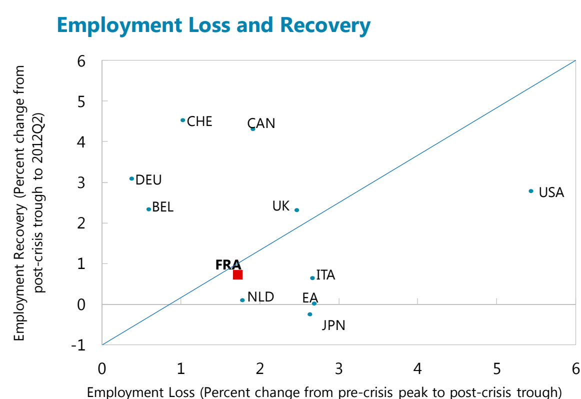
1. **While France weathered the 2008 financial and subsequent euro-area crises relatively well compared to other advanced countries, its recovery has been sluggish.** France suffered smaller output and employment losses than most advanced economies and euro area partners. However, output and employment remain below pre-crisis levels. Large automatic stabilizers and a relatively less open economy—than Germany, the UK and, obviously, the smaller European economies—may have shielded the economy from the full impact of the crises. France may also have been subject to lesser shocks or less exposed to asset price shocks (see Box 1)

Output Loss and Recovery



Sources: Haver Analytics; and staff calculations.

Employment Loss and Recovery



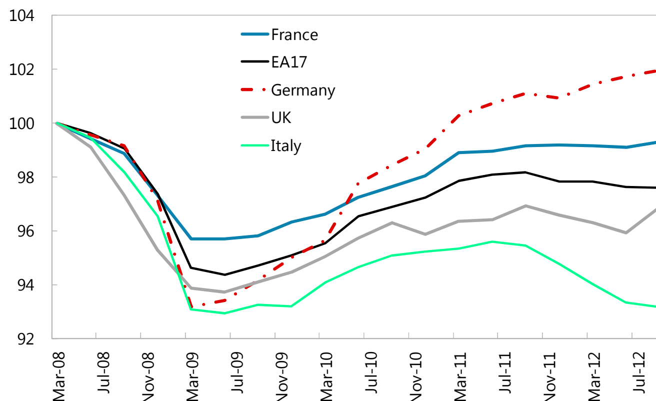
Sources: Haver Analytics; and staff calculations.

2. **France has become a less open economy over the last decade relative to partners, reflecting a steady loss of export market share relative to its European peers.** The loss of export competitiveness is reflected in a steady deterioration of the current account balance and a decline in the openness ratio of 9 percentage points from 2000 to 2010 relative to the euro area average, and of 24 percentage points relative to Germany.[1] While lower openness may have dampened the inward impact of the crisis through the trade channel, more significantly it limits the economy's ability to rebound in the short term and constrains potential growth in the medium term. The loss of competitiveness is also revealed by a steady narrowing of profit margins. Although some of the recent decline is likely to be cyclical, the share of capital income in national income has been trailing behind that of European partner countries.

[1] Openness ratio is defined as (exports + imports)/GDP.

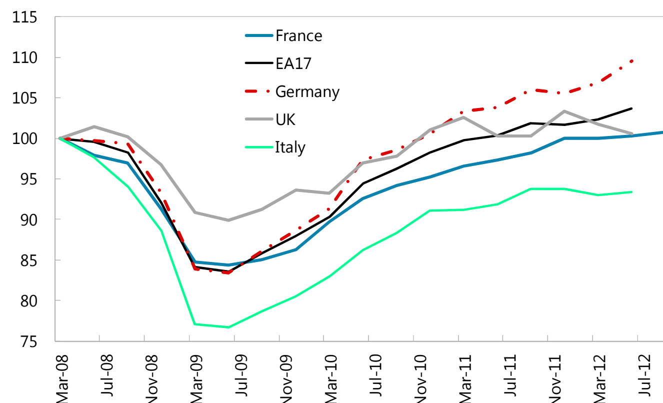
Figure 1. Evolution of Main Economic Indicators since 2008

Real GDP
(2008Q1=100)



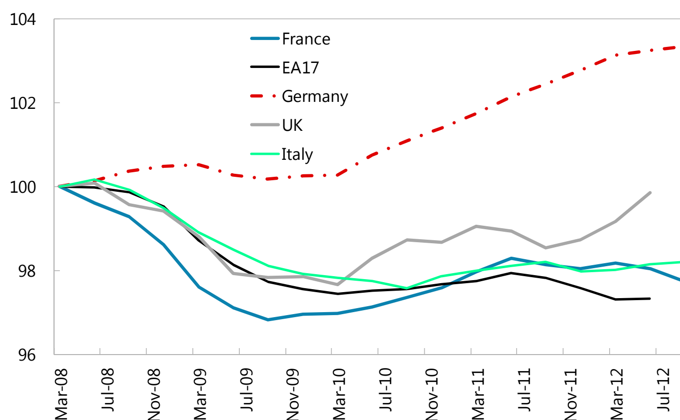
Sources: Haver; Staff calculations.

Real Exports
(2008Q1=100)



Sources: Haver; Staff calculations.

Employment
(2008Q1=100)



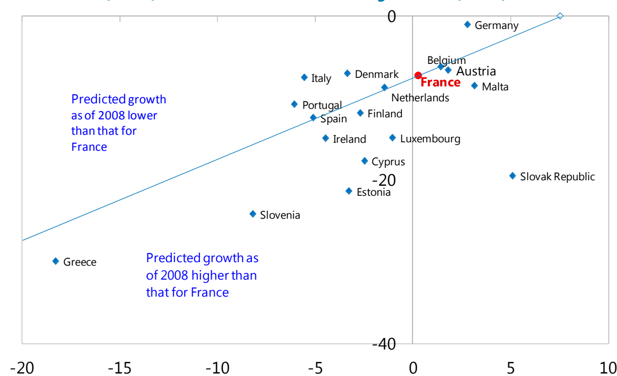
Sources: Haver; Staff calculations.

Box 1. France's Growth Performance through the Crises of 2008-12

France's growth performance since 2008—through both the global financial crisis and the subsequent euro area sovereign debt crisis—has been better than most of its European peers, with real GDP in 2012 projected to be slightly higher than it was in 2008. In order to put this observation into context, we ask the following two questions:

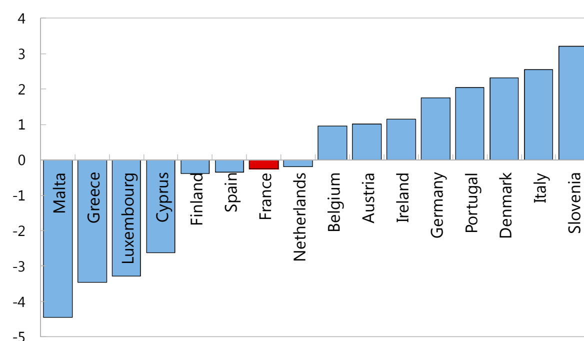
How much of the difference in growth outcomes was already anticipated in 2008? In the case of France, the 2008 Fall WEO vintage projected that real GDP in 2012 would be 7½ percent higher than in 2008. With cumulative growth of only ¼ percent over the period, the forecast error comes to 7¼ percent. By contrast, Germany was expected to grow by only around 3¾ percent over the period and, in the end, the forecast error was very small (approximately 1 percent). The line drawn through the chart on the right corresponds to a 2008 growth forecast of 7.5 percent (equal to that of France). Countries above the line had a lower growth forecast, while countries below it had a higher growth forecast.

Euro Area Countries: Cumulative Growth during 2008-2012, from the latest WEO (X-axis) vs Forecast Error from the vintage of 2008 (Y-axis)



Sources: WEO and staff calculations. The X-axis shows the projected culmulative growth rate for 2008-12 according to the 2012 October 2012. The Y-axis is the "forecast error" defined as the difference between the culumulative growth using the 2008 Fall WEO and that using the 2012 Fall WEO.

Unexplained Forecast Error



Sources: WEO. The unexplained forecast error is computed as the residuals by regressing the forecast error (defined above) on some economic shocks such as forecast errors (defined in a similar way) on fiscal consolidation and exports, as well as changes in house prices and bond yields.

To what extent can the forecast error be explained by observable shocks? To answer this question, we regress the forecast error on four economic and policy shocks: a fiscal shock (measured by the forecast errors of the structural deficit projection), an external shock (measured by the forecast error of exports), and two asset price shocks, i.e., changes in the real price of housing and in the sovereign yields.[2] The residuals from this regression should reflect idiosyncratic national factors[3]. France's very low regression residual suggests that France's forecast error can be largely explained by the observable shocks and its relative good performance reflects therefore smaller shocks (or lower exposure to asset price shocks) rather than French-specific positive characteristics. By contrast, Slovenia and Italy, for instance, appear to have benefited from idiosyncratic factors that reduced the impact of the shocks by over 2 percentage points of GDP. At the other extreme, growth in Malta, Greece and Luxembourg was 3–4 percent lower over the period than can be explained by the shocks they faced.

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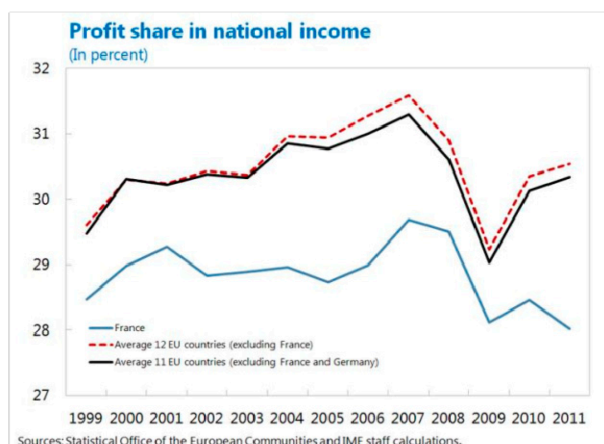
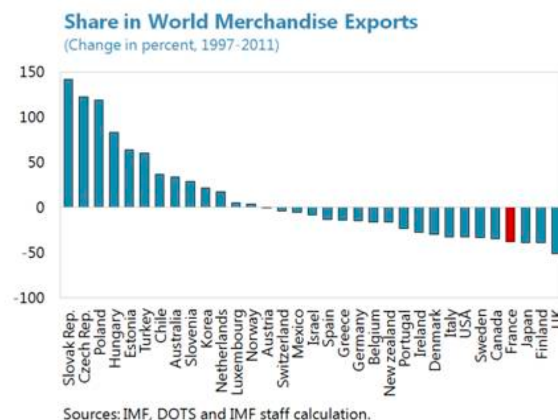
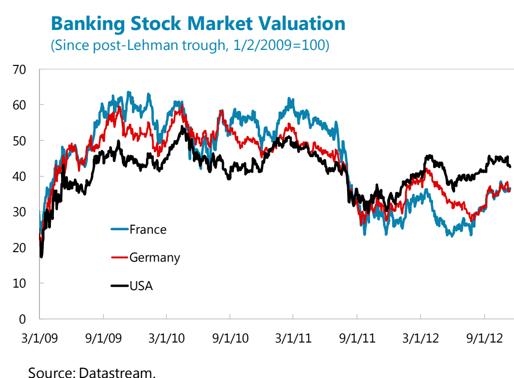
[2] Asset price shocks are measured as the difference in price (or yield) between now and 2008, on the assumption that changes in asset prices were unexpected.

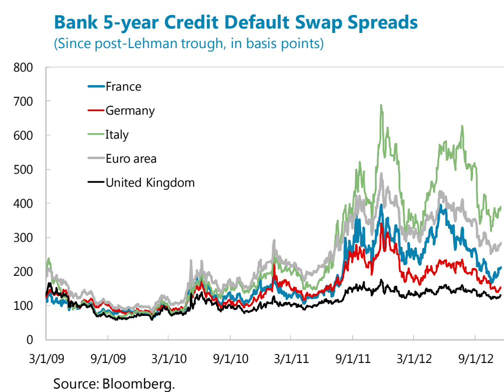
[3] With a sample of 18 countries (euro 17 plus Denmark) the regression shows a relatively good fit, with an adjusted R^2 of 86 percent.





3. **By contrast, financial integration with the rest of the world has increased over the last decade, as French banks moved to the top of the league in terms of size and global interconnectedness.**[4] Four of the 25 largest global banks (2011) are French. Mostly through increased wholesale funding, French banks became major players in investment banking, international credit and derivative markets. They also expanded their international operations through subsidiaries, mostly in Southern Europe. From 2000 to 2007, the balance sheet of the top four banks grew from 1.5 to 2.7 times GDP. French banks weathered the 2008 financial crisis relatively well, but their underlying business model may be less resilient in the current environment. They experienced sharper drops in market capitalization relative to peers since the euro crisis intensified in 2011, but also benefited from the abatement in market tension after July 2012.

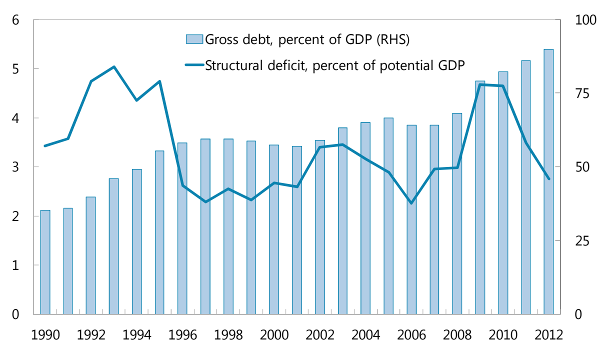




[4] See accompanying Selected Issues Paper, "The Business Model of French Banks".

4. **The euro area crisis highlighted the need to correct an underlying fiscal structural imbalance, but has not triggered, in the case of France, an adverse sovereign-banking risk spiral.** The combination of large structural fiscal deficits prior to the crisis and a strongly countercyclical fiscal stance in 2009 to 2010 eroded the room for maneuver on the fiscal front by the time the euro-crisis erupted. Sovereign spreads (vis-à-vis Germany) rose rapidly in the second half of 2011 as French banks also came under pressure. The authorities responded with a plan of steady fiscal consolidation and a deficit target of 4.5 percent of GDP for 2012. Sovereign-banking sector cross exposures increased, but not to a tipping point. French financial system holdings of domestic sovereign debt picked up the slack left by the decline of nonresident holdings starting in the second half of 2010. Meanwhile government guarantees to the financial sector increased to nearly 4 percent of GDP in 2011 and are expected to remain at 4 percent of GDP in 2013, about one third of which to Dexia.

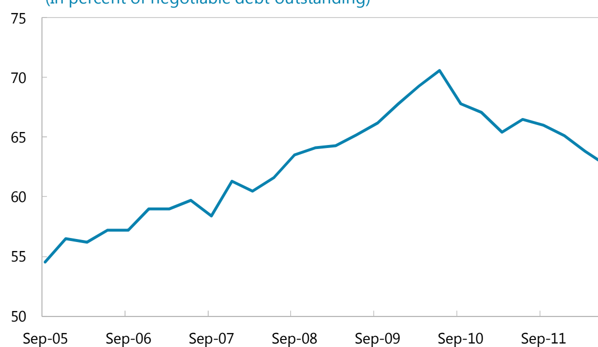
General Government Structural Deficit and Gross Debt



Source: IMF, WEO.

Non-resident holdings of French government negotiable debt securities

(In percent of negotiable debt outstanding)

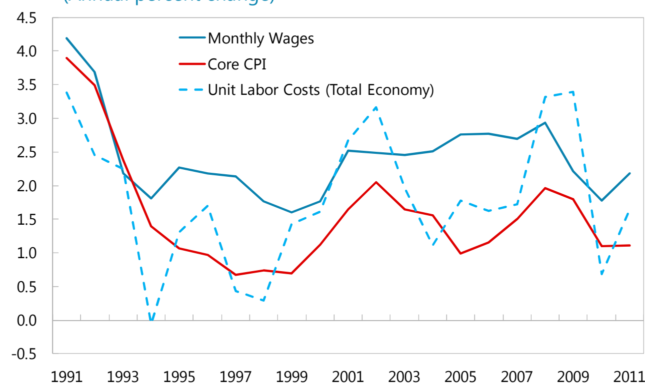


Source: French authorities.

5. **As elsewhere in Europe, the 2010–11 economic recovery gave way to stagnation in 2012.** Real GDP is projected to grow by 0.2 percent in 2012, with the unemployment rate rising to over 10 percent. Inflation is expected to remain at around 2 percent in 2012, reflecting not only the impact of higher commodity prices earlier in the year, but also the inertia of wage inflation.

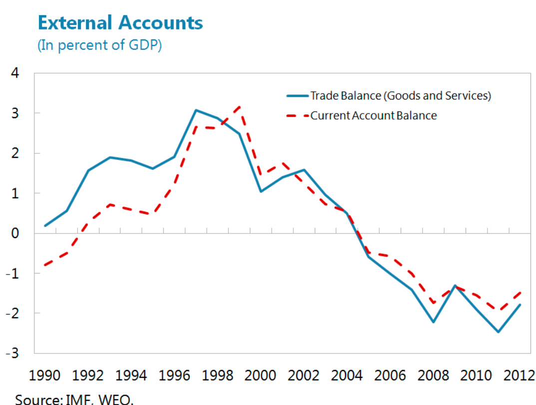
Core CPI and Wage Rates

(Annual percent change)



Sources: Haver's Analytics.

6. **The current account recorded a deficit of 1.9 percent of GDP in 2011, driven by a worsening balance in net exports of goods.** Exports continued to recover but imports were up by nearly 2 percentage points of GDP, largely on account of higher petroleum imports. The current account deficit in 2012 is projected to be smaller (1.5 percent of GDP), as a slowdown in import volume growth should more than offset a softening in real export growth. The surplus in the financial account in 2011 was marked by a retrenchment in net asset flows, in contrast to previous years. This evolution was notable in the banking sector, which also shed liabilities (and BIS data suggests that this has continued in the first half of 2012). France's net international investment position (IIP) dropped further in 2011. While the bulk of the negative net IIP is due to the government's net liabilities, small net positions in other sectors may mask large gross positions, as with the banking sector. The IMF's External Balance Assessment methodology points to relatively small deviations of the current account and the exchange rate from their estimated equilibrium levels (see Annex I).



7. **Upon taking office in mid 2012, the incoming government endorsed the 2012 and 2013 fiscal commitments of the previous government.** The slowing economy had opened up a gap relative to the previous government's budget deficit target, which had been based on an arguably overoptimistic growth assumption. At the same time, market tensions remained high. In response, the government took broad-based revenue measures equivalent to 0.6 percent of GDP (on an annual basis), in order to meet the 2012 fiscal deficit target. Achievement of the deficit target remains subject to uncertainties surrounding the financial performance of the social security accounts and local governments. As part of its electoral commitments, the incoming government also lowered the retirement age from 62 to 60 for certain categories of workers, financed through an increase in social security contributions by up to 0.5 percentage points by 2017.

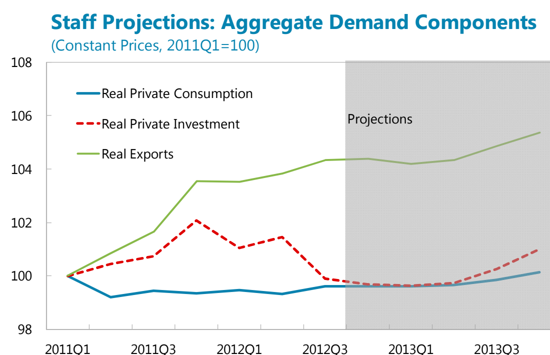
B. Outlook and Risks

8. **Banking on an early resolution of the euro area crisis, the authorities expected real GDP growth to bounce back to 0.8 percent in 2013.** This significant acceleration is predicated on an expected improvement of the euro area environment, which would revive exports and, in turn,

stimulate domestic investment and consumption. The authorities acknowledged that their projection is on the optimistic side, but still within a credible range of economic forecasts.

9. **Staff projects a more modest recovery, with growth of 0.4 percent in 2013.** The staff's projection takes into account continued weakness in high frequency indicators and the impact of continued fiscal consolidation in Europe generally. However, the difference relative to the authorities' scenario comes essentially from a much weaker contribution of the foreign balance to growth, which reflects the assumption that the resolution of the euro area crisis will take time. Tensions in the euro area are also expected to continue to weigh on confidence and thus on domestic demand through at least the first half of 2013. In the staff's scenario, the unemployment rate is projected to rise further, notwithstanding measures planned by the government to improve job prospects for new entrants and seniors. The main domestic downside risk to the projection is associated with a failure of private consumption and investment to rebound as expected in the second half of 2013.

Staff Projections: Aggregate Demand Components
(Constant Prices, 2011Q1=100)



Sources: Global Insight; Haver; and Staff projections.

France: Contributions to GDP
(in percent)

	IMF		Authorities
	2012	2013	2013
Real GDP growth	0.2	0.4	0.8
Total domestic demand	-0.4	0.5	0.6
Private consumption	0.0	0.2	0.2
Government consumption	0.3	0.3	0.3
Gross Fixed Investment	0.0	0.0	0.2
Stockbuilding	-0.7	0.1	0.0
Foreign balance	0.6	-0.1	0.2
Exports	0.7	0.2	1.3
Imports	0.1	0.3	-1.1

10. **Despite an open output gap, core inflation is projected to decline only very slowly in 2013.** In line with recent trends, nominal wage inflation in the private sector is expected to remain at around 2 percent in 2013 despite the increase in unemployment. Because of the high minimum wage and a compressed wage structure, the discretionary increase in the minimum wage decided by

the government in July 2012 (0.6 percentage points above the increase of the index) is likely to dampen the effect of labor market conditions on wage formation.[5]

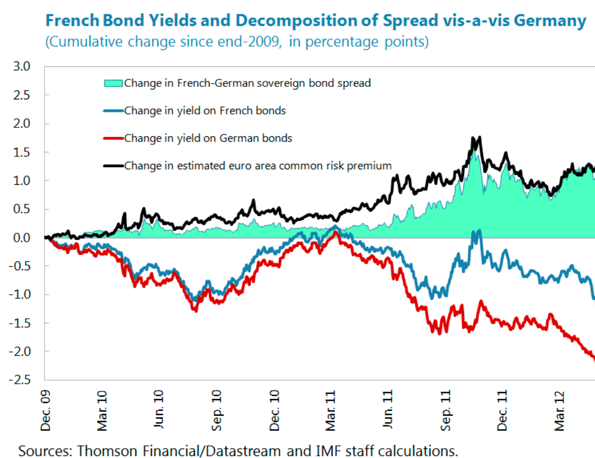
11. **The authorities also retain a more optimistic medium-term outlook, with average annual growth projected at 2 percent from 2014 to 2017, against 1.3 percent in the staff's scenario.** The authorities scenario is based on global growth returning to its pre-crisis level of over 5 percent, i.e., nearly a full percentage point higher than in the Fall 2012 WEO. In line with recent trends, the staff's scenario also assumes that real exports of goods and services will grow less than the export market, but that the gap will close over the medium term.

12. **Moody's recent sovereign downgrade by one notch (from Aaa to Aa1) appears to have been largely anticipated and did not trigger any noticeable market reaction.** Because banks' stand-alone ratings (without systemic support) are several notches below that of the sovereign, the rating action does not carry over to banks. Most banks remain, however, under negative watch by rating agencies. A downgrade would be potentially costly in terms of their wholesale funding and their derivative trading owing to higher margin and collateral requirements.

13. **Downside risks lie mostly in the re-emergence of significant euro area tensions** (see Risk Assessment Matrix)**.** Based on staff estimates, a decline of real GDP by half a standard deviation in the euro periphery relative to the baseline (equivalent to roughly 2 percentage points) would reduce growth in France by ½ a percentage point in 2013 and 1 percent in 2014.[6] The implication of renewed tensions in the euro area on French sovereign spreads is more ambiguous. The 2012 IMF Spillover Report shows that the behavior of bond spreads of euro area countries (including France) vis-à-vis Germany has been dominated by a common component, reflecting perceptions of euro area-wide risks. Based on this analysis, French yields would be adversely affected by renewed tensions. This effect could be dampened by the fact that France moved, in 2012, to a (relative) safe haven status, although this status could be reversed if, in parallel, renewed financial sector tensions were to set in motion an adverse sovereign-banking nexus.

[5] The minimum wage is indexed to the CPI plus half of the annual increase in the real hourly labor wage in industry. According to a study by the Banque de France, 20–30 percent of minimum wage increases find their way over the medium term in an increase in the average wage (Cette et al., Banque de France, Document de travail 366, February 2012).

[6] See accompanying Selected Issues Paper, "Growth and Fiscal Spillovers of France".



French Bond Yields and Decomposition of Spread vis-a-vis Germany
(Cumulative change since end-2009, in percentage points)

Sources: Thomson Financial/Datastream and IMF staff calculations.

14. **Financial vulnerabilities stem from the French banking sector's extensive cross-border financial linkages and exposure to wholesale funding.** French banks have reduced very significantly their exposures to euro area periphery countries, but exposures to Italy remain substantial, including through subsidiaries. A worsening situation in the periphery and its consequences through the area could affect Italy disproportionately and undermine French banks' ongoing recapitalization plans, and, in the extreme, threaten financial stability. While banks' funding structures have improved since 2011 (as discussed below), exposure to wholesale markets remains high, and margins for quick disposal of non-core assets have shrunk. As reported in the 2012 Spillover Report, European banks identified as having the capacity to create negative spillovers for all G-SIFIs (as well as all major European banks) include French banks. Spillovers from large systemic French banks could become active if they were forced into an accelerated retrenchment from corporate and investment banking, from retail banking in other countries, and from their holdings of sovereign paper of peripheral euro area countries.[7]

15. **Faster slowdown of growth in the core euro area and outside of the euro area is also a risk; as noted above, the expected gradual rebound of domestic demand could also be slower in coming.** While the staff's scenario accounts for the contractionary effect of fiscal policy, the size of the fiscal multipliers is itself uncertain, and private demand is also subject to other downside risks. Trade channels effects of weaker condition in the core euro area would be potentially significant. However, growth spillover analysis suggests that French output co-moves less with global output shocks than Italy, Belgium, Netherlands, and Germany, for instance. This may reflect France's large automatic stabilizers and less open economy.

[7] See accompanying Selected Issues Paper "Financial Spillovers".

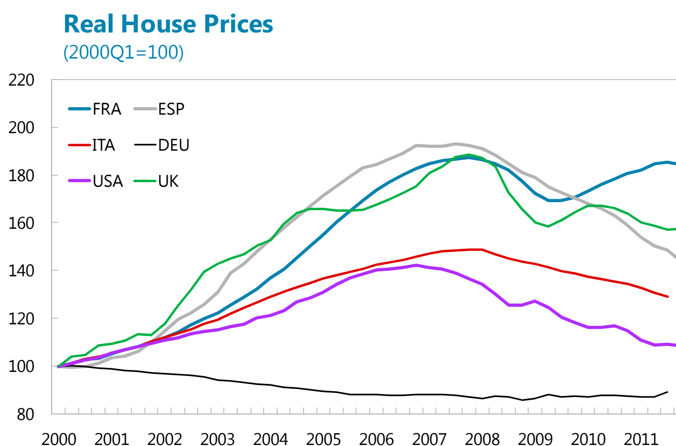
France: Risk Assessment Matrix[8]

Source of Risk	Relative Likelihood[9]	Impact if Realized
Strong intensification of the euro area crisis and related increase in financial market stress…	**Medium** Growth contagion from lower regional demand Increased financial segmentation due to uncertainty over euro area viability	**High** Strong adverse effects through the trade channel, notably from Spain and Italy. Higher interest rates owing to euro viability concerns. France's (relative) safe haven status possibly undermined by adverse sovereign-bank spillovers Fiscal policy response should be coordinated at the European level in order to support confidence, and calibrated based on the fiscal space of national authorities.
…leading to difficulties accessing wholesale market funding, with related liquidity pressures.	**Medium** Accelerated bank deleveraging aggravating crisis	**High** Stress for French SIFIs (from losses in euro area periphery and from exposure to wholesale market funding) with outward spillovers Appropriate liquidity support should be provided by the European Central Bank, and capital preservation measures on banks should be considered if necessary.
Failure to close competitiveness gap	**Medium** Difficulty in implementing structural reforms	**High** Absent an improvement in competitiveness, growth would falter, the external asset position would deteriorate, and fiscal adjustment would be more challenging.
Stagnation of world growth	**Medium** Slowing demand from emerging Asia and from the United States.	**Medium** Impact muted because of weaker trade links outside of the EU than European peers. Euro area-wide monetary policy would remain the first line of defense. France should continue to meet its medium-term fiscal targets.
Housing price correction	**Medium** Housing overvaluation estimated at 10–20 percent	**Low** Price adjustment expected to be gradual, with limited impact on banks owing to sound lending standards Macro-prudential measures could be introduced in the event of excessive risk taking in real estate.

[8] The Risk Assessment Matrix shows events that could materially alter the baseline path discussed in this report (which is the scenario most likely to materialize in the view of staff). The relative likelihood of risks reflects the staff's subjective assessment (at the time of discussions with the authorities) of the risks surrounding this baseline.

[9] In case the baseline does not materialize.

16. **Macroeconomic risks related to a correction in real estate prices appear to be relatively contained.**[10] The increase in housing prices (over 100 percent in real terms since the mid 1990s) has been supported by stronger fundaments (higher population growth, relatively low supply of housing, and low household indebtedness) than in other countries with rising real estate prices, but also by tax incentives that have fueled demand without addressing underlying supply constraints. There is a perception of price overvaluation, especially in Paris (by 10-20 percent at end-2011 according to staff estimates). However, there is no housing glut or household debt overhang that could trigger a sudden price adjustment. Moreover, stress tests suggest that banks are well placed to absorb the impact of a possible sizable price adjustment owing to tight underwriting criteria (emphasizing sustainability of the borrower's income, not collateral value) and the absence of nonrecourse loans. The impact of a possible price correction on private demand would also be contained reflecting weak evidence of wealth effects on consumption.



Sources: OECD and Staff calculations.

POLICY DISCUSSIONS

17. **Context:** the authorities face the four way challenge of a stalling recovery, the constraints on fiscal policy created by euro area fiscal rules and a rising debt ratio, a competitiveness gap related to structural rigidities, and the need to preserve financial stability in the face of continued uncertainty.

18. **Objectives:** the overarching economic objectives are to contribute to a common solution to the euro area crisis, and to create conditions for stronger growth, which would not only address social and employment needs, but would also ease the process of fiscal consolidation and allow the financial sector to pursue deleveraging in an orderly manner.

19. **Authorities' policy strategy:** the authorities noted that the first order of business for the President and his government had been to help support crisis resolution in the euro area, including by sticking to France's fiscal commitments consistent with the euro area stabilization strategy. With the risks of an imminent break up largely averted, policy priorities have shifted to the process of

[10] This analysis is based on the findings of the 2012 FSAP Update.

forging stronger financial and fiscal integration in the euro area and to domestic structural reforms to improve competitiveness and raise potential growth. The authorities noted that policies had taken on board previous Fund advice (see Annex II).

A. Calibrating Fiscal Adjustment

20. **The authorities considered that an ambitious fiscal target in 2013, consistent with their commitment vis-à-vis the EU, was the anchor of credibility and was needed to reinforce confidence in the euro area stabilization strategy.** To abide by the EU's Excessive Deficit Procedure (EDP), France is committed to bring its budget deficit down to 3 percent of GDP in 2013. To meet this objective, the 2013 budget contains measures equivalent to 1.2 percent of GDP. Combined with the measures already taken in July 2012, total structural adjustment in 2013 is estimated by staff at 1.3 percent of (potential) GDP, ¾ of it coming from revenue measures. About half of the structural adjustment targeted over the next five years (2012 to 2017) would thus take place in the first year. The authorities explained that such front-loaded adjustment is critical not only for bringing debt on a sustainable path and thus their policy credibility, but also for the credibility of the euro area crisis resolution strategy. They considered that any perceived lack of resolve on their part could lead to an unraveling of confidence and that the risks associated with such a scenario would vastly outweigh the impact of fiscal consolidation on demand. Market participants also highlighted the importance of meeting 2013 fiscal target, mostly as reassurance about the direction of policies. Reflecting the expectation of lower growth, staff projects that the 2013 budget will deliver a deficit of 3.5 percent of GDP.

21. **Staff took the view that the medium-term balanced budget target was appropriate, but that, if growth in 2013 were to fall short of the authorities' assumption, maintaining the 2013 deficit target unchanged at 3 percent of GDP would move fiscal policy into an overly pro-cyclical stance, notwithstanding the importance of coordination at the European level.** Even though the current policy stance is already pro-cyclical, staff acknowledged the constraints on policy choices noted by the authorities (see above). Staff estimates suggest that global fiscal consolidation plans could already be costing France 1.6 percentage points in foregone growth in 2013 to 2014—1.4 percentage points of which from domestic consolidation, the rest from consolidation in partner countries. Similarly, fiscal consolidation in France has potential outward effects on euro area partners—the most affected country would be Belgium, for which the resulting cumulative real GDP loss over the period 2012–14 would reach 0.4 percentage points. The authorities pointed out that fiscal multiplier effects associated with the 2013 budget are likely to be smaller than average because about 80 percent of the adjustment effort would fall on households in the top income centile with a low propensity to consume. Under the staff's scenario, which converges slightly more gradually toward a balanced budget position in the medium term, the debt

ratio would peak at 91 percent of GDP in 2014 and begin declining thereafter. The Debt Sustainability Analysis (Annex III) suggests that debt dynamics are resilient to most standard shocks, although not to a severe combined interest rate and growth shock.

22. **The authorities' originally planned for a 50/50 split between revenue and expenditure measures over the medium term (2012 to 2017), but have since decided to rebalance the planned adjustment slightly towards more expenditure containment** (in order to finance part of the planned reduction in labor costs—see below). Under the authorities' plans, expenditure growth would thus decline from an average of 1.8 percent per year (in real terms) in 2000 to 2012, to 0.5 percent in 2013 to 2017; and the tax burden would be reduced by 0.3 percentage points of GDP from its 2013 peak to 2017 (Box 2). Staff pointed out, however, that France had started out with an already higher tax burden than most of its peers in 2011, and that the measures taken in 2012 and planned for 2013 would only increase the distance from its peers, with the risk of accentuating distortions and disincentives.

23. **A more ambitious expenditure effort is also desirable to protect the medium-term deficit target against the risks that the authorities' relatively optimistic growth assumption for 2014 to 2017 will not be realized.** The authorities explained that expenditure containment over the medium term would rest on wage moderation and a stabilization of the number of civil servants at the central government level, stricter selection of investment projects, and tighter constraints on local government spending. An inter-ministerial committee (chaired by the PM), charged with identifying ways to rationalize government functions, should also help set spending priorities, and thus avoid inefficient across-the-board cuts. Staff remarked that the rapid growth in spending by local governments, in excess of the transfer of mandates, had already squeezed the room for maneuver of the central government, and that more adjustment should be expected of them. Also, the government's plans envision a gradual closure of the deficit of the social security accounts, based on regular revisions to pension policy and strict containment of health expenditures, but a more front-loaded effort to close the structural deficits of the social security funds would be desirable, if only to counter the risks associated with relatively optimistic assumptions about growth and employment. On the revenue front, the authorities indicated that they would review more critically the broad use of tax expenditures and social security exemptions.

Box 2. Medium-Term Fiscal Consolidation

The medium-term fiscal consolidation plan targets a balanced structural budget in 2016 and a steady reduction of the debt-to-GDP ratio starting in 2014. Over the period 2013 to 2017, the *Loi de programmation des finances publiques 2012 to 2017* (the medium-term budget law) projects that the adjustment burden would be roughly equally divided between revenue and spending measures, but revenue measures are frontloaded whereas expenditures measures are back-loaded. Following a 1 percentage point increase in 2012, the tax-to-GDP ratio would remain roughly stable while the containment of expenditures would gradually lower the expenditure-to-GDP ratio by 2.7 percentage points of GDP. The subsequent decision to offset the fiscal impact of the EUR 20 billion cut in labor cost—half by an increase in VAT rates and a new green tax and half by spending cuts—would reduce the expenditure-to-GDP and tax-to-GDP ratios by 0.2 points of GDP in 2015 and 0.4 points in 2016 and 2017 leaving the headline deficit trajectory unchanged.

Under staff's weaker growth projection, reaching a structural balanced budget by the end of the period requires more aggressive spending containment over the medium term. Real expenditure growth would need to be lower than projected by the authorities by almost 0.2 percent per year over 2015 to 2017. And compensating for the reduction in social security contributions would result in a near freeze of expenditures in real terms in 2015 to 2016 compared with a real growth of 0.3 percent in the authorities' scenario.

Medium-Term Fiscal Targets (2013 to 2017, in percent of GDP)[11]

	2013	2014	2015	2016	2017
			Authorities[12]		
Fiscal Balance	-3.0	-2.2	-1.3	-0.6	-0.3
Structural Balance[13]	-1.6	-1.1	-0.5	0.0	0.0
Real Spending Growth (in percent)[14]	0.9	0.7	0.3	0.3	0.8
Gross Debt	91.3	90.5	88.5	85.8	82.9
GDP Real Growth	0.8	2.0	2.0	2.0	2.0
			IMF Staff[12]		
Fiscal Balance	-3.5	-2.9	-2.1	-1.2	-0.1
Structural Balance[13]	-1.4	-1.1	-0.8	-0.5	0.0
Real Spending Growth (in percent)	0.8	0.7	0.1	0.1	0.5
Gross Debt	90.9	91.3	90.2	88.0	84.6
GDP Real Growth	0.4	1.0	1.5	1.7	1.9

Source: French authorities and IMF staff.

[11] Authorities projections and staff projections differ due to differences in projected growth rates, in potential growth, output gap, and unemployment over the period.

[12] Includes the fiscal impact of the measures to reduce labor cost.

[13] In percent of potential GDP.

[14] Staff estimates based on announced policies

Box 3. Transposition into French law of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

In October 2012, through an "organic law," France aligned its laws to the requirements of the European Treaty on Stability, Coordination, and Governance (Fiscal Compact). An organic law ranks, in hierarchy, between the Constitution and ordinary laws. As a result, all Budget Laws will have to be consistent with both the Constitution and the new organic law.

The organic law establishes:

- **The medium-term objective of a structural deficit capped at 0.5 percent of GDP.**[15] The organic law stipulates that the *Lois de Programmation des Finances Publiques* (LPFP, the multi-year fiscal laws established as part of the constitutional amendment of 2008) will define the medium-term structural deficit target and specify the yearly structural deficits to reach it. The LPFP will also have to present debt-to-GDP dynamics[16], and include a floor on new revenues and a ceiling on expenditures for the State and the Social Security system. As a result, in case a spending shock breaches the expenditure ceiling, expenditure cuts in other areas will have to compensate.

- **A new fiscal council, the "Haut Conseil des Finances Publiques" (HCPF), to ensure that the rules are met.** Under the new architecture, the HCFP, which is associated with (but not part of) the *Cour des Comptes* (Audit Court),[17] will provide an independent view on the appropriateness of the macroeconomic projections underpinning the LPFP, the draft budget law, and the draft Social Security Finance law[18], as well as their consistency with the medium-term trajectory toward the medium-term objective and with France's European commitments. The *Conseil Constitutionnel* (Constitutional Court) has indicated that it will consider the HCPF's views when deliberating on the credibility of the budget law, and thus its consistency with the Constitution.

- **A corrective mechanism.** If, taking into account the exceptional factors mentioned in the Treaty, the HCPF identifies that the fiscal outturn deviates from the medium-term trajectory, it will alert the government. The government will have to explain the reasons for the deviation and, if the deviation is substantial, it will have to implement corrective measures in the following year's Budget Law, at the latest.

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[15] If the public debt exceeds 60 percent of GDP, 1 percent otherwise. The structural deficit is the structural deficit of the general government.

[16] The LPFP, covering 2012 to 2017, already does so.

[17] The HCPF, chaired by the head of the Cour des Comptes, consists of 11 members: five (including the chair) from the Cour des Comptes, four nominated by Parliament, one by the *Conseil économique, social et environnemental* (a consultative assembly representing employers, labor unions, and NGOs), and, *ex officio,* the head of INSEE (the Statistical and Economic Studies Agency).

[18] The HCPF can, but is not required to, provide a view on the on the growth projections underpinning revised budget laws.

24. **Parliament approved in October 2012 an organic law transposing the requirements of the EU Fiscal Compact into French law** (Box 3). The organic law introduces a fiscal rule in the form of a medium-term structural deficit target and reinforces the link between annual budget laws and the medium-term target by requiring budgets to specify the trajectory toward the medium-term target, as well as corrective mechanisms in the event of deviations from it. It also sets up a fiscal council with three mandates: (i) to provide an independent opinion on the macro-economic assumptions underlying the state and social security budgets; (ii) to examine whether budgetary objectives are consistent with the medium-term fiscal targets of the multi-year fiscal law; and (iii) to identify deviations from established targets and monitor implementation of corrective actions. The fiscal council has the requisite independence from the executive branch, but its mandate is more limited than fiscal councils in the United Kingdom and the Netherlands, for instance, in that it will not produce an independent forecast. The authorities noted that reputational costs (for the government of deviating from the fiscal council's opinion on the government's growth forecast, and for the fiscal council members of endorsing projections that deviate from independent forecasts) would enforce greater discipline into the projections, without the costs (in terms of staffing and overall coherence) of separating the fiscal and macroeconomic projection functions. The staff asked about the possible conflict of interest between the monitoring and ex-ante evaluation roles of the fiscal council and the ex-post audit and advisory role of the Audit Court *(Cour des Comptes*) to which the fiscal council is associated. The authorities considered that such a risk was minimized by the broad and politically diverse composition of the fiscal council, which would not be dominated by Audit Court members.

B. Closing the Competitiveness Gap

25. **The competitiveness gap that has built up over time owes to a range of structural problems, with impediments in the functioning of labor and product markets at its core.** In July 2012, the government launched two initiatives to improve the functioning of the economy. First, it mandated social partners to negotiate a broad reform of the labor market by year-end to increase its flexibility while improving job security. Second, it commissioned a competitiveness report from Louis Gallois, a leading business executive, to identify the sources of competitiveness loss and related corrective actions. The Gallois report, released on November 5, highlights high labor costs (and low profitability) and non-cost factors, such as: the difficulty French SMEs have in accessing export markets; the inability of French manufacturers to move up the value added chain as compared, for instance, with German manufacturers; a weak integration between fundamental research and industrial R&D, despite France's noted preeminence in the hard sciences; an education system which still creates mismatches between demand and supply; and less stable relationships between large enterprises and their supply chain, again as compared to Germany.

Labor market functioning

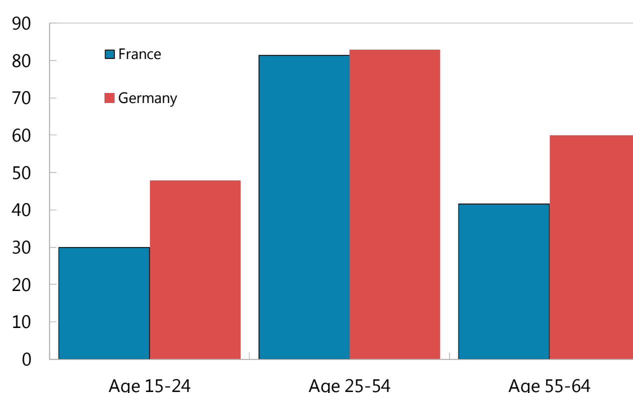
26. Discussions centered on the following priorities:

- **Creating more adaptable work and compensation arrangements at the enterprise level.** National regulations and collective sector agreements have limited the ability of enterprises to negotiate wage and/or work arrangements that take into account competitive or cyclical pressures. The authorities remarked that, by precluding negotiated arrangements, these rigidities have tended to accentuate conflictual labor relations with suboptimal outcomes in terms of job and capital preservation. These rigidities have also raised the (shadow) cost of labor over the cycle, and as such limited potential growth. The authorities have called on social partners to find ways for enterprises under pressure to negotiate more flexible work and pay arrangements with their employees, while giving employees and their representatives more say in the early stages of restructuring plans.

- **Lessening legal and judicial uncertainty of layoffs, and reducing the insider/outsider divide in the labor market.** The uncertainty that weighs on layoffs reflects both the broad work protection rights afforded by the labor code and the very lengthy and uncertain judicial process of challenging individual and collective layoffs. This uncertainty has raised the implicit cost of labor, created disincentives to hire, and promoted reliance on temporary work arrangements. The authorities acknowledged that this situation has, in turn, aggravated the dual labor market divide, where workers on temporary contracts (80 percent of new hiring) bear an uneven share of job uncertainty. Temporary work arrangements also undermine incentives to train and develop employees, and ultimately productivity growth. Staff analysis suggests that legal uncertainty over collective dismissals indeed acts as a critical hindrance to competitiveness[19]. To address these problems, the government has asked social partners to find ways to make open-ended contracts more attractive and to facilitate negotiated solutions that would discourage recourse to legal action in the case of collective dismissals.

- **Increasing labor market participation and employability.** The French labor market is characterized by low employment rates at both ends of the age range. The low level of employment of relatively skilled older workers may

Employment Rate by Age Group in 2011



Source: Haver.

[19] See accompanying Selected Issues Paper, "Structural Reforms and Export Performance".

reflect disincentives to work and to retain workers due to the combination of retirement and unemployment benefits. Employment rates among older workers have begun to increase in the wake of the 2010 pension reform (increase in the retirement age) and elimination of incentives for early retirement, but the government also introduced a new incentive scheme that targets the joint employment of a new worker (trainee) and retention of an older worker (trainer). However, the more persistent problem is with employment of youth and low-skilled workers. While the level of the minimum wage (discussed below) is an important constraining factor for unskilled workers, so are inadequate training opportunities and active labor market policies. Staff also pointed out that the high replacement rate and long duration of unemployment benefits undermined incentives to work after a spell of unemployment, and that benefits should be tightened, especially as labor market conditions improve. The authorities noted that efforts to improve training and active labor market policies are being stepped up following the merger of the job placement and unemployment benefits agencies into a single agency (*Pôle Emploi*).

27. **The authorities were optimistic that social partners would rise to the challenge of proposing meaningful reforms on all of the above issues.** Most parties acknowledged that the current situation is socially unsustainable and, according to some observers, the legitimacy of labor unions depends on their ability to be part of a cooperative solution. The government plans to support the outcome of the negotiations with legislative changes, but has also indicated that, in the absence of a suitable agreement, it would be willing to move ahead unilaterally.

Labor Costs

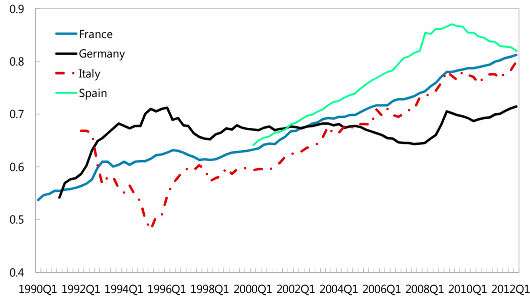
28. **There has been much debate on the role of labor costs in the competitiveness gap.** Although labor costs in the economy as a whole appear indeed to be higher than in Germany, the difference is not so evident in manufacturing, whereas it is much more pronounced in non-tradable services. Also, price competitiveness, as measured by the CPI-based real exchange rate, does not point to a serious misalignment. However, the share of capital income in national income, and relatedly profits as a share of value added, have been declining steadily in France in contrast to developments in partner countries. This suggests that French enterprises have been able to sustain price competitiveness by squeezing profit margins, which in turn has limited their capacity (and incentives) to invest. The open output gap would normally be expected to put downward pressure on real wages and restore profitability over time. However, this adjustment has been slowed by the combination of low inflation and stickiness of nominal wage inflation.

Figure 2. Economy-Wide Unit Labor Cost, Productivity, Labor Compensation, and Profits

(Seasonally and working day adjusted)

Total Economy

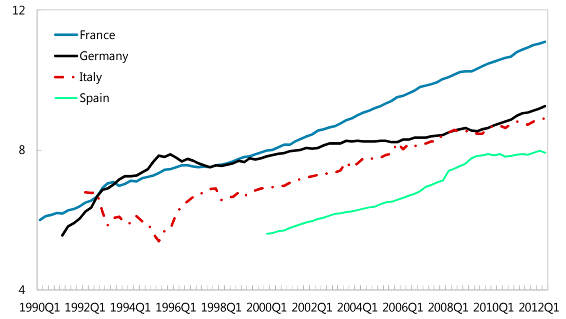
(Unit Labor Costs, euro per unit of value added produced at 2000 prices)



Source: Eurostat.

Total Economy

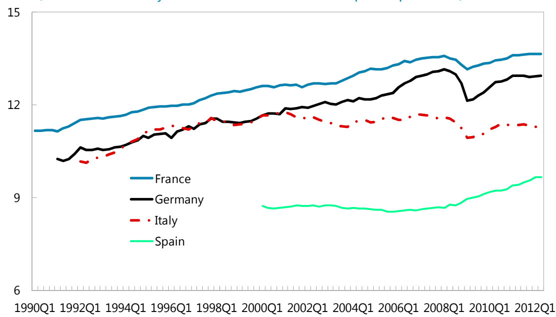
(Per-Labor Compensation, thousands of euro per labor)



Source: Eurostat.

Total Economy

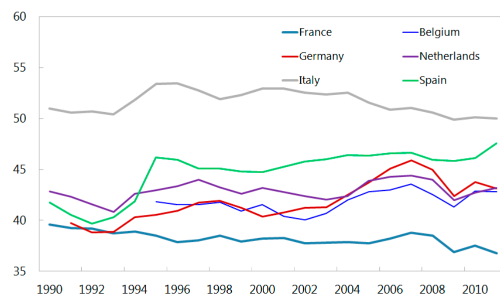
(Labor Productivity, thousands of euro at 2000 prices per labor)



Source: Eurostat.

Share of Profits In Gross Value Added

(Percent)



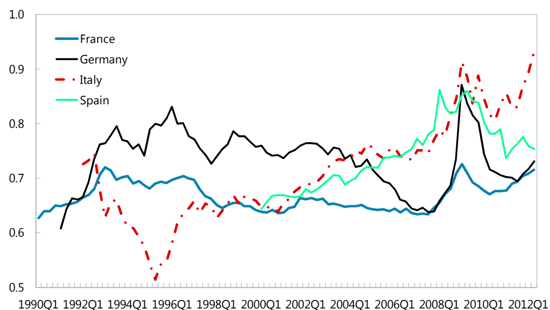
Source: Haver.

Figure 3. Unit Labor Costs, Productivity and Labor Compensation in Manufacturing and Non-Tradable Services[20]

(Seasonally and working day adjusted)

Manufacturing

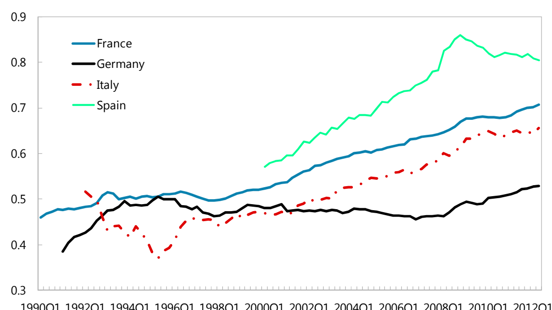
(Unit Labor Costs, euro per unit of value added produced at 2000 prices)



Source: Eurostat.

Non-Tradable Services

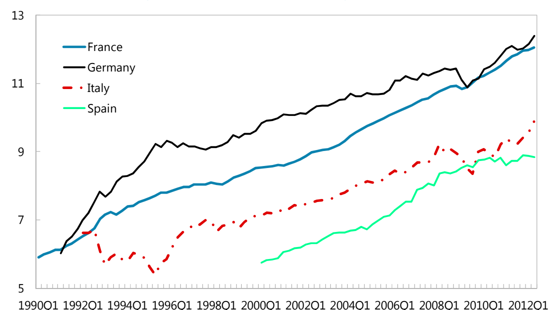
(Unit Labor Costs, euro per unit of value added produced at 2000 prices)



Source: Eurostat.

Manufacturing

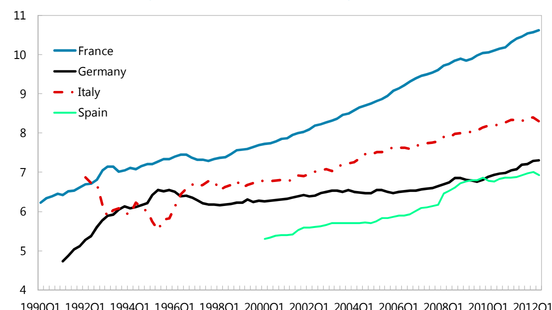
(Per-Labor Compensation, thousands of euro per labor)



Source: Eurostat.

Non-Tradable Services

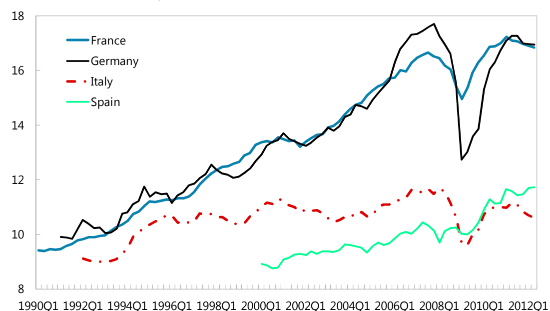
(Per-Labor Compensation, thousands of euro per labor)



Source: Eurostat.

Manufacturing

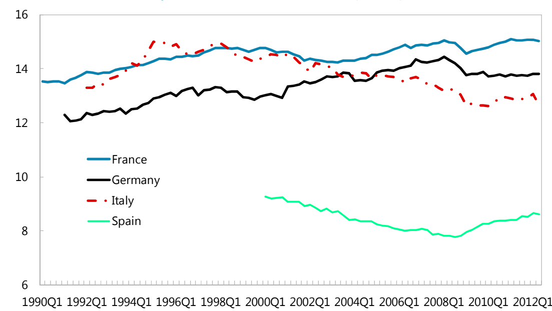
(Labor Productivity, thousands of euro at 2000 prices per labor)



Source: Eurostat.

Non-Tradable Services

(Labor Productivity, thousands of euro at 2000 prices per labor)



Source: Eurostat.

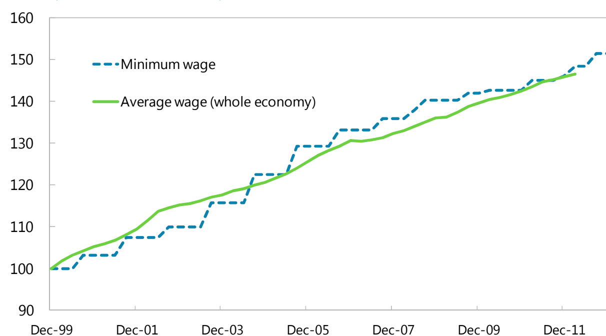
[20] Non-tradable services comprise wholesale and retail trade, real estate and professional services.

29. **To restore the profitability of enterprises, the Gallois report recommended a competiveness shock in the form of a reduction of employers' social security contributions of roughly 1.0 percent of GDP.** The report suggested that the reduction be financed through a mix of expenditure cuts and increases in income and indirect taxes. Staff took the position that: (i) rebalancing the distribution of national income in favor of capital through the tax system is likely to have only temporary effects if the measure is not accompanied by deeper structural reforms; and (ii) the effect risks being eroded even more quickly if it is financed by a shift in the tax burden rather than a cut in spending, because of the possible impact of higher taxes on wage demands.

30. **The government has taken on board the recommended reduction of social security contributions, but plans to phase it in over two years starting in 2014.** Rather than lowering social security contributions outright, the government will achieve the same objective through a corporate income tax credit. The authorities considered that they could not implement the measure in 2013, because of the adverse demand effects of higher (offsetting) taxes in the current context. The tax credit is to be financed by a mix of higher indirect taxes and cuts in spending starting in 2014. It is part of a broader package of measures which include a commitment to greater stability in the tax system for enterprises, and stronger apprenticeship programs.

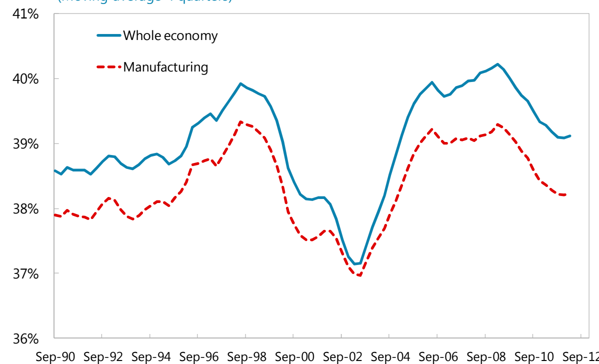
31. **The high level of the minimum wage is another impediment to growth and employment.** Because it applies uniformly across all sectors, the minimum wage is generally recognized as having contributed to the difficult integration of low-skilled and young workers in the labor force. The government's decision to boost the minimum wage in July by 0.6 percent above the normal indexation mechanism, although modest, reversed a policy of strict containment that had allowed minimum wage increases to drift below average wage growth since 2008. Staff recommended a policy of wage moderation when it comes to future changes to the minimum wage. Government programs have helped alleviate the impact of the high minimum wage through special employment schemes and reductions in social security contributions at the low end of the pay scale – the latter at a cost of 1 percent of GDP annually. The government has announced that it will continue to make use of subsidized employment schemes, notably with a target coverage of 100,000 unskilled youth in 2013. However, the effectiveness of subsidized employment schemes as a vehicle to durable entry into the labor force has been questioned.

Minimum Wage and Hourly Average Wage
(December 1999 =100)



Sources: Dares and IMF staff calculation.

Minimum Wage in Percent of Average Wage
(Moving average 4 quarters)



Sources: Dares and IMF staff calculation.

Services Market

32. **Services remain more regulated in France than in most other OECD countries, notably in professional services and transport.** This tends to lead to higher prices for households and enterprises, owing to lower productivity or higher rents. The impact on prices of the entry of a fourth mobile phone operator in 2012 illustrates the potential benefits of increased competition. Even though most services are not themselves exposed to international competition, they are an input for industries that do compete in international markets. For instance, about one fourth of all inputs consumed by industry comes from the services sector. Staff analysis suggests that that liberalizing network services and professional services would have a large positive impact on productivity, and by implication competitiveness.[21] By raising the purchasing power of households, deregulation of services would also support the labor market reforms discussed above.

33. **The authorities acknowledged the potential benefits of more competition in the services sector, but indicated that reforms had to be sequenced.** France has yet to make progress on the reforms of consumer services (retail, energy, telecommunication and real estate) announced as part of the "G20 action matrix." The authorities explained that, while priority had been given to labor market reforms, they would continue pursuing reforms on other fronts. Meanwhile, they have asked the OECD to conduct a study to identify the areas of reform with the greatest growth payoff.

C. Consolidating Financial Stability

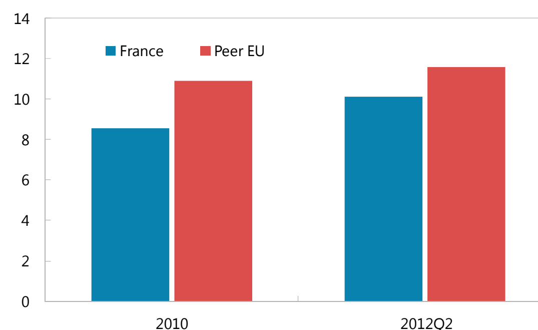
34. **Financial stability concerns, which arose in connection with euro area tensions and dollar liquidity problems in 2011, have abated considerably.** Whereas French banks' universal and diversified business model helped them weather the 2008 to 2009 financial crisis relatively well,

[21] See accompanying Selected Issues paper, "Gains from Services Sector Deregulation".

their exposure to periphery EU countries and their heavy reliance on wholesale funding caused significant drops in equity prices and raised concerns about financial stability in 2011. In response, French banks moved aggressively to strengthen their solvency ratios and funding structures through retained earnings and disposal of international non-core businesses. The key findings of the FSSA are discussed in Box 4.

35. **Reflecting the stability and profitability of the banks' domestic operations as well as the changed operational and regulatory environment, deleveraging focused on foreign operations.** It targeted mainly US dollar funded assets (such as trade and project financing), investment banking, and holdings of sovereign paper of higher-risk euro area countries. In contrast to banking sectors elsewhere, French banks were able preserve positive domestic credit growth (and low credit interest rates) through the whole crisis period (2008 to 2012). While lending standards may have been tightened given the slowdown of the economy, the overall softening of credit growth in 2012 is generally attributable to a shift in demand rather than supply. However, given ongoing balance sheet adjustments, domestic credit growth may be constrained in the event of an upswing in demand. Banks considered that the impact of their external deleveraging had been muted by the fact that other financial institutions were able to step in quickly into the areas vacated by them.

EU Bank Core Tier 1 Ratios



Sources: SNL Financial and Staff Estimates.

Box 4. Financial System Stability Assessment (FSSA) – Main Findings

The FSSA is based on the Financial Sector Assessment Program (FSAP) Update for France, which was undertaken in January and June 2012. The findings were further discussed with the authorities during the Article IV consultation mission in October 2012.

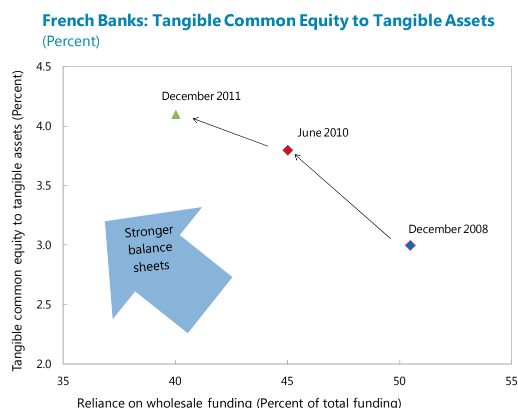
The key macro-relevant findings of the FSSA are as follows:

- France's financial system has shown resilience to severe market pressures but faces challenges. 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 regulatory and supervisory regime for banks, insurance and securities markets, and market infrastructures is of a very high standard. Areas for improvement include 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.

- 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 best international 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..

36. **Looking forward, banks have lowered overall risk exposures, but remain heavily reliant on wholesale funding; meanwhile they are well positioned to comply with internationally-set capital requirements ahead of schedule.** Exposure to high-yield euro area sovereigns has been reduced by 54 percent (nearly €30 billion) since 2010, and consolidated banking claims on the same group of countries were reduced by 17 percent over the same period. Non-sovereign exposures to high-yield euro area countries are mainly to the Italian non-financial private sector through French banks' subsidiaries. Liquidity buffers have been bolstered, including by making use of the ECB's Long Term Refinancing Operations (LTRO). The three largest banks report liquidity and funding buffers of over 100 percent of their funding needs. However, banks' ratios are based on less stringent assumptions than the proposed Basel III liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). At the same time, exposure to wholesale market funding remains high overall and could be a source of vulnerability in the event of another severe liquidity or euro area confidence shock. The FSAP stress tests suggest that, after one month of stress, several banks would require central bank support in reaction to an additional shock amounting to a 5 percent withdrawal of wholesale funding[22]. If faced with renewed pressures, French banks indicated that they have further margins to dispose of non-core assets before having to cut into their core lending activities. However such margins have shrunk, and quick deleveraging could be costly. Given the size of French banks, the realization of severe liquidity or capital shocks would require a policy response at the European level and, on that score, the authorities confirmed their desire to move swiftly on the three pillars of a European banking union (supervision, deposit insurance, and resolution).



37. **A critical challenge for the French financial system, and its ability to provide long term financing, comes from the need to adapt to international regulatory changes.** The main constraint on the banks' capacity to provide long-term loans could come from more stringent regulatory liquidity requirements. At the same time, insurance companies also face incentives to reduce investments in equity in response to new regulations and accounting standards. The conjunction of these two factors raises the question of how the financial system (dominated in France by these two types of institutions) will channel savings to meet the long-term financing (including equity) needs of enterprises. One avenue would be for banks to move more toward the originate-and-transfer model of credit, although it is not clear how quickly or easily market institutions can adapt to this. Another avenue is to increase the deposit base by removing tax incentives that deflects saving away from banks.

[22] Exposure to liquidity shocks is discussed in paragraph 25 of the accompanying FSSA.

38. **The review of the financial taxation of savings envisaged for next year would be the occasion to realign tax incentives toward long-term saving.** Presently, tax incentives benefit life insurance and short-term regulated savings products, which mostly accrue to public financial institutions. As a result, deposits accounted for only one third of total bank liabilities at end-2011, among the lowest in Europe. The government's decision to double the ceiling on regulated saving accounts, which are directed to the financing of social housing, will further divert deposits from the banking sector The effect is expected to be manageable, but staff noted that the constraints on the supply of social housing were not primarily a lack of financing and that if resources collected through regulated savings exceed the housing financing need they should be reallocated to banks. The authorities agreed that tax incentives should favor long-term saving regardless of the underlying financial instrument, and should not discriminate between financial intermediaries.

39. **In response to the Liikanen Group report, the authorities indicated that they would move ahead with their own banking reform to separate the retail from the "speculative" activities of banks.** The objective of the reform is to carve out only those activities that do not significantly contribute to the financing of the economy. In the authorities' view this means that only proprietary trading activities should be excluded, while market making activities which are considered critical to serving corporate clients should remain within the core business of banks.

STAFF APPRAISAL

40. **The growth outlook for France remains fragile owing to weak conditions in Europe generally, but it is also clouded by a loss of competitiveness relative to its trading partners.** As financial stability risks abate, and with the prospects of a gradual resolution of the euro area crisis, France's competitiveness gap will become the main challenge for macroeconomic stability, growth, and job creation. The loss of competitiveness predates the crisis, but risks becoming even more severe if the French economy does not adapt along with its major trading partners in Europe, notably Italy and Spain which, following Germany, are now engaged in significant reforms of their labor markets and services sectors.[23]

41. **The challenge for fiscal policy is to pursue consolidation at a pace that balances cyclical considerations with the need to preserve market confidence in French policies and in the euro area crisis resolution strategy.** The government's front-loaded adjustment strategy provides a strong signal of its resolve and enhances credibility which, over time, had suffered from the persistence of large structural deficits. However, it is also likely to dampen an already uncertain short-term growth outlook characterized by significant downside risks to demand. On purely cyclical grounds, a more measured pace of fiscal adjustment would be appropriate, but European and market imperatives have reduced fiscal space at this juncture. A pickup of growth in 2013 along the lines expected by the government should permit the measures deployed in the draft 2013 budget to achieve the government's fiscal target. By contrast, persistent weakness of economic activity in the euro area (and in France) should be the occasion to review the speed of fiscal consolidation at the European level, in order to provide more support to the recovery. Starting in 2014, the organic law transposing into French law the Fiscal Compact should also enhance the credibility and predictability of fiscal policy by linking policies to a structural deficit target.

42. **The quality of fiscal adjustment would be enhanced by rebalancing the fiscal effort toward expenditure containment beyond what is currently envisaged.** With rates of taxation already among the highest in Europe, the ratcheting up of the tax burden in 2012–13 places France at an additional competitive disadvantage relative to its peers. Stronger containment and rationalization of public spending is needed at all levels of the public sector. The initiatives taken by the government to improve the efficiency of public spending are welcome, but will need to be supported by stronger containment of local government spending, strict adherence to health spending limits, as well as timely adaptations of the retirement age to preserve the pension system's financial balance. The government's decision to review periodically the efficiency and the rationale

[23] Reforms are described in the 2012 Article IV Staff Reports for Italy and Spain, but the reforms have continued since then in the judicial and, bankruptcy areas (Italy), and product market liberalization (Spain).

of tax expenditures and social security contributions exemptions is also welcome, especially if it is used to achieve a more efficient tax system based on a broader base and lower rates. The main policy risk comes from the back-loading of expenditure adjustment, which could prove harder to realize than the upfront increase in taxes. This places more urgency on defining expenditure rationalization plans.

43. **The challenge for structural policies is to move the economy closer to the efficiency frontier while preserving the benefits of France's inclusive social model.** Rebalancing the distribution of national income toward entrepreneurial income should be part of the strategy, but cannot be durably achieved solely through the tax system. Wage moderation, notably in terms of the minimum wage, should also contribute. But the key to realizing more efficient and inclusive outcomes in terms of growth and employment lies in improving the functioning of the labor market by increasing the capacity of enterprises to invest and adapt, and strengthening employment incentives. Discussions under way between social partners create a unique opportunity to achieve the needed critical mass of reforms. The benefits of labor market reform would be further enhanced if combined with greater competition in the services sector, which would spur productivity and redistribute rents to households and sectors that are exposed to international competition.

44. **The French financial system has proven to be resilient and able to react quickly to vulnerabilities created by the crisis, although its globally systemic banks remain exposed to international and euro-area financial risks, notably through heavy reliance on the wholesale funding market.** Capital and liquidity buffers are much stronger today. Deleveraging was carried out by retrenching from investment banking and international trade financing, where other institutions could fill the gap relatively quickly, without squeezing access to credit. In the event of renewed financial market tensions, banks should still have margins to dispose of non-core assets, but at a cost and with likely outward spillovers.

45. **As banks and insurance companies, which are the backbone of the French financial system, adapt to international regulatory changes, the tax treatment of financial income should be realigned to support this process.** The overhaul of the financial taxation of savings envisaged by the government should be an important instrument to encourage long-term saving, regardless of the underlying financial instrument. Distortions created by regulated short term savings accounts should also be reduced over time.

46. It is recommended that the next Article IV consultation with France be held on the standard 12-month cycle.

Table 1. France: Selected Economic and Social Indicators, 2009–17

				Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real economy (change in percent)									
Real GDP	-3.1	1.7	1.7	0.2	0.4	1.0	1.5	1.7	1.9
Domestic demand	-2.6	1.6	1.7	-0.4	0.5	1.2	1.3	1.3	1.5
Nominal GDP (billions of euros)	1886	1937	1997	2042	2095	2161	2244	2334	2433
CPI (year average)	0.1	1.5	2.1	2.0	1.6	1.5	1.7	1.8	1.9
Unemployment rate (in percent)	9.5	9.7	9.6	10.3	10.6	10.7	10.5	10.1	9.7
Gross national savings (percent of GDP)	17.6	17.7	18.7	18.5	18.2	18.2	18.7	19.3	19.8
Gross domestic investment (percent of GDP)	18.9	19.3	20.6	20.0	19.7	19.8	19.9	20.0	20.1
Public finance (percent of GDP)									
Central government balance	-6.2	-6.3	-4.4	-3.7	-2.7	-2.1	-1.5	-1.0	-0.2
General government balance	-7.5	-7.1	-5.2	-4.5	-3.5	-2.9	-2.1	-1.2	-0.1
Structural balance (percent of potential GDP)	-4.7	-4.6	-3.5	-2.6	-1.4	-1.1	-0.8	-0.5	0.0
Primary balance	-5.1	-4.7	-2.6	-1.9	-1.0	-0.4	0.4	1.3	2.4
General government gross debt	79.0	82.3	86.0	89.5	90.9	91.3	90.2	88.0	84.6
Money and interest rates (in percent)									
Money market rate 1/	0.7	0.5	0.8	0.1	...	...	...	...	...
Government bond yield 1/	3.6	3.1	3.3	2.6	...	...	...	...	...
Balance of payments (in percent of GDP)									
Exports of goods	18.4	20.2	21.2	21.1	20.6	20.3	20.3	20.5	20.7
Volume growth (in percent)	-12.1	9.6	5.3	2.5	0.6	2.4	4.0	4.5	4.6
Imports of goods	20.7	23.0	24.9	24.2	23.6	23.3	23.0	22.8	22.7
Volume growth (in percent)	-9.6	8.9	4.9	0.2	0.9	2.9	2.9	3.0	3.5
Trade balance	-2.3	-2.7	-3.7	-3.1	-3.0	-3.0	-2.7	-2.3	-2.0
Current account	-1.3	-1.6	-1.9	-1.5	-1.5	-1.6	-1.2	-0.7	-0.3
FDI (net)	-3.2	-1.8	-1.8	-1.7	-1.6	-1.5	-1.4	-1.4	-1.3
Official reserves (US$ billion)	46.6	55.8	48.6	...	...	...	...	...	...
Fund position (as of January 31, 2012)									
Holdings of currency (percent of quota)	80.8	79.7	73.1	70.9	...	...	...	...	...
Holdings of SDRs (percent of allocation)	95.9	96.1	95.5	94.2	...	...	...	...	...
Quota (SDRs million)	10739	10739	10739	10739	...	...	...	...	...
Exchange rates									
Euro per U.S. dollar, period average	0.72	0.75	0.72	...	...	...	...	...	...
Nominal effective rate, ULC-styled (2000=100)	104.8	102.4	102.4	...	...	...	...	...	...
Real effective exchange rate, ULC-based (2000=100)	107.8	105.0	103.8	...	...	...	...	...	...
Potential output and output gap									
Potential output	1.0	0.8	0.5	0.5	0.6	0.6	0.7	0.8	0.8
Output gap	-4.6	-3.8	-2.7	-2.9	-3.1	-2.7	-1.9	-0.9	0.0
Social indicators									

Per capita GDP (2006): US$35,471; Life expectancy at birth (2009): 77.7 (male) and 84.4 (female);
Poverty rate (mid-2000s): 14.1 percent (60 percent line), 7.1 percent (50 percent line);
Income distribution (ratio of income received by top and bottom quintiles, 2004): 4.2.

Sources: French authorities; IMF staff estimates and projections.

1/ For 2012, average for January-April.

Table 2. France: Balance of Payments, 2008-17
(Percent of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
											Projections					
Balance on current account	1.2	0.7	0.5	-0.5	-0.6	-1.0	-1.7	-1.3	-1.6	-1.9	-1.5	-1.5	-1.6	-1.2	-0.7	-0.3
Balance on goods and services	1.7	1.1	0.5	-0.7	-1.0	-1.4	-2.2	-1.3	-1.9	-2.5	-1.8	-1.8	-1.9	-1.5	-1.0	-0.6
Balance of trade (f.o.b., c.i.f.)	0.3	0.1	-0.3	-1.3	-1.7	-2.2	-3.1	-2.3	-2.7	-3.7	-3.1	-3.0	-3.0	-2.7	-2.3	-2.0
Exports of goods and services	26.9	25.5	25.9	26.2	27.2	27.0	27.1	25.7	27.7	29.3	29.0	28.3	27.8	27.8	28.0	28.3
Exports of goods	21.0	20.1	20.4	20.6	21.5	21.2	21.2	18.4	20.2	21.2	21.1	20.6	20.3	20.3	20.5	20.7
Exports of services	5.9	5.5	5.5	5.6	5.7	5.8	5.8	7.3	7.5	8.1	7.9	7.6	7.5	7.5	7.6	7.6
Imports of goods and services	-25.2	-24.5	-25.4	-26.9	-28.2	-28.4	-29.3	-27.0	-29.6	-31.8	-30.7	-30.1	-29.7	-29.3	-29.0	-28.9
Imports of goods (f.o.b.)	-20.5	-19.9	-20.7	-21.9	-23.2	-23.4	-24.3	-20.7	-23.0	-24.9	-24.2	-23.6	-23.3	-23.0	-22.8	-22.7
Imports of services	-4.7	-4.6	-4.8	-5.0	-5.0	-5.0	-5.0	-6.3	-6.7	-6.9	-6.6	-6.5	-6.4	-6.3	-6.2	-6.2
Income, net	0.6	0.8	1.1	1.1	1.7	1.7	1.7	1.7	2.1	2.4	1.7	1.7	1.7	1.7	1.7	1.7
Current transfers, net	-1.0	-1.1	-1.1	-1.3	-1.2	-1.2	-1.3	-1.8	-1.7	-1.8	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Balance on capital account	0.0	-0.5	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	-1.1	0.6	-0.5	-0.1	1.4	1.6	0.9	1.2	1.4	2.9	1.5	1.5	1.6	1.2	0.7	0.3
Direct investment, net	-0.1	-0.6	-1.2	-1.9	-1.7	-2.6	-3.2	-3.2	-1.8	-1.8	-1.7	-1.6	-1.5	-1.4	-1.4	-1.3
Portfolio investment, net	-0.7	0.4	-3.2	-0.8	-6.0	-6.4	1.3	12.8	6.4	12.6	11.6	11.1	10.7	9.9	8.9	8.1
Other investment, net	-0.9	1.4	3.8	1.3	9.5	8.5	3.3	-7.8	-4.6	-8.9	-8.4	-8.0	-7.6	-7.2	-6.9	-6.5
Reserve assets	0.3	-0.1	-0.2	0.4	-0.5	0.0	0.4	0.2	-0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions, net	0.1	-1.3	0.2	1.8	-0.9	-0.7	0.8	0.1	0.1	-1.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: French authorities; IMF staff estimates and projections.

Table 3.a. France: General Government Statement of Operations, 2008-17
(Percent of GDP, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					Projections					
				(in percent of GDP)						
Revenue	49.9	49.1	49.5	50.8	51.7	52.7	52.7	52.5	52.3	52.4
Taxes	26.7	25.1	25.6	26.8	27.7	28.8	28.9	28.8	28.7	29.0
Social contributions	18.1	18.7	18.6	18.8	18.9	18.8	18.7	18.6	18.5	18.4
Grants	…	…	…	…	…	…	…	…	…	…
Other revenue	…	…	…	…	…	…	…	…	…	…
Expenditure	53.3	56.7	56.6	56.0	56.2	56.2	55.6	54.6	53.5	52.6
Expense	52.5	55.9	56.1	55.5	55.8	55.7	55.2	54.2	53.1	52.2
Compensation of employees	12.8	13.5	13.4	13.2	13.0	12.8	12.6	12.2	11.9	11.5
Use of goods and services	5.1	5.5	5.8	5.5	5.4	5.4	5.3	5.3	5.3	5.3
Consumption of fixed capital	2.6	2.8	2.7	2.6	2.6	2.5	2.5	2.4	2.3	2.2
Interest	2.9	2.4	2.4	2.6	2.6	2.5	2.5	2.5	2.5	2.5
Subsidies	1.4	1.7	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Grants	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.6	0.6	0.6
Social benefits	23.5	25.4	25.6	25.6	26.0	26.1	26.0	25.8	25.3	25.2
Other expense	3.4	3.8	3.8	3.7	4.0	4.3	4.2	3.8	3.6	3.3
Net acquisition of nonfinancial assets	0.8	0.8	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Acquisitions of nonfinancial assets	…	…	…	…	…	…	…	…	…	…
Disposals of nonfinancial assets	…	…	…	…	…	…	…	…	…	…
Consumption of fixed capital	-2.6	-2.8	-2.7	-2.6	-2.6	-2.5	-2.5	-2.4	-2.3	-2.2
Gross Operating Balance	0.1	-4.0	-3.9	-2.1	-1.5	-0.5	0.0	0.7	1.5	2.5
Net Operating Balance	-2.6	-6.7	-6.6	-4.7	-4.1	-3.0	-2.5	-1.7	-0.8	0.3
Net lending (+)/borrowing (–)	-3.3	-7.5	-7.1	-5.2	-4.5	-3.5	-2.9	-2.1	-1.2	-0.1
Net acquisition of financial assets	3.1	0.8	1.0	1.6	…	…	…	…	…	…
Monetary gold and SDRs	0.0	0.0	0.0	0.0	…	…	…	…	…	…
Currency and deposits	0.6	1.1	0.1	1.1	…	…	…	…	…	…
Debt securities	1.2	-1.1	0.8	-0.6	…	…	…	…	…	…
Loans	0.4	-0.2	0.2	0.3	…	…	…	…	…	…
Equity and investment fund shares	0.3	0.6	-0.5	-0.2	…	…	…	…	…	…
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	…	…	…	…	…	…
Financial derivatives and employee stock options	0.1	0.0	0.0	0.0	…	…	…	…	…	…
Other accounts receivable	0.5	0.3	0.4	0.9	…	…	…	…	…	…
Net incurrence of liabilities	6.4	8.3	8.1	6.8	…	…	…	…	…	…
SDRs	0.0	0.0	0.0	0.0	…	…	…	…	…	…
Currency and deposits	-0.1	0.1	0.9	0.6	…	…	…	…	…	…
Debt securities	5.7	7.9	5.5	5.6	…	…	…	…	…	…
Loans	0.6	0.4	1.0	-0.5	…	…	…	…	…	…
Equity and investment fund shares	0.0	0.0	0.0	0.0	…	…	…	…	…	…
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	…	…	…	…	…	…
Financial derivatives and employee stock options	0.0	0.0	0.0	0.0	…	…	…	…	…	…
Other accounts payable	0.3	-0.1	0.6	1.0	…	…	…	…	…	…
Memorandum items:										
Structural balance	-3.0	-4.9	-4.8	-3.6	-2.7	-1.4	-1.1	-0.8	-0.5	0.0
Structural balance (in percent of potential GDP)	-3.0	-4.7	-4.6	-3.5	-2.6	-1.4	-1.1	-0.8	-0.5	0.0
Structural primary balance 1/	-0.4	-3.0	-2.9	-1.4	-0.6	0.4	0.8	1.2	1.6	2.2
Central government net lending/borrowing	-3.3	-6.2	-6.3	-4.4	-3.7	-2.7	-2.1	-1.5	-1.0	-0.2
General government Maastricht balance	-3.3	-7.5	-7.1	-5.2	-4.5	-3.5	-2.9	-2.1	-1.2	-0.1
Gross debt (Maastricht definition)	68.2	79.2	82.3	86.0	89.5	90.9	91.3	90.2	88.0	84.6

Source: GFS yearbook, INSEE, French authorities, and IMF staff estimates and projections.
1/ Excludes cyclical effects.

Table 3.b. France: General Government Integrated Balance Sheet, 2002-10
(Percent of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
STOCK POSITIONS:									
Net worth	…	…	…	…	…	…	…	…	…
Nonfinancial assets	…	…	…	…	…	…	…	…	…
Net financial worth	-44.4	-46.6	-47.4	-45.4	-39.3	-35.7	-45.8	-52.3	-58.7
Financial assets	26.3	28.6	29.7	33.6	34.6	37.3	33.4	38.5	36.2
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	2.6	3.4	3.5	3.2	1.3	1.3	2.1	3.0	1.9
Debt securities	1.7	1.5	1.3	1.4	1.7	1.9	2.6	2.5	2.3
Loans	2.3	2.1	2.2	1.9	1.7	1.6	1.5	2.0	2.1
Equity and investment fund shares	12.1	13.5	15.4	19.3	22.1	24.2	18.8	21.9	20.9
Insurance, pensions, and standardized	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2
Other accounts receivable	7.6	8.1	7.2	7.7	7.8	8.1	8.2	9.0	8.8
Liabilities	70.7	75.2	77.1	78.9	73.9	73.0	79.2	90.8	94.9
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	1.5	1.0	0.9	0.9	1.2	1.2	1.4	1.3	1.2
Debt securities	52.7	56.3	59.5	61.3	56.2	54.5	60.8	70.9	74.4
Loans	9.3	10.0	9.8	9.9	9.7	10.0	9.8	11.0	11.5
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	7.3	7.9	6.9	6.8	7.0	7.3	7.3	7.7	7.8
Memorandum items:									
Debt (at market value)	70.7	75.2	77.1	78.9	73.9	73.0	79.2	90.8	94.9
Debt at face value	66.3	71.1	71.9	73.5	70.9	71.5	75.5	86.7	90.0
Maastricht debt	59.0	63.2	65.0	66.7	64.0	64.2	68.2	79.0	82.4
OTHER ECONOMIC FLOWS:									
Change in net worth from other flows	…	…	…	…	…	…	…	…	…
Nonfinancial assets	…	…	…	…	…	…	…	…	…
Net financial worth	-2.7	0.7	0.9	3.3	6.4	4.5	-7.6	2.2	-0.6
Financial assets	-1.5	0.5	2.0	3.7	4.3	3.4	-5.1	2.2	0.0
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Debt securities	0.0	0.1	-0.2	0.0	0.0	0.0	0.1	0.1	-0.1
Loans	0.0	-0.3	0.0	-0.1	0.0	0.0	0.0	0.1	0.0
Equity and investment fund shares	-1.5	0.7	2.1	3.9	4.3	3.3	-5.2	2.2	-0.1
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Other accounts receivable	0.0	0.0	0.0	0.0	0.0	0.1	0.0	-0.1	0.0
Liabilities	1.2	-0.2	1.1	0.5	-2.2	-1.1	2.5	0.0	0.6
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	1.3	-0.2	1.1	0.3	-2.1	-1.1	2.4	0.0	0.5
Loans	0.0	0.0	0.1	0.2	-0.1	-0.1	0.0	0.0	0.0
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.1

Source: GFS yearbook, French authorities, and IMF staff estimates and projections.

Table 4. France: Vulnerability Indicators, 2006–12
(In percent of GDP; unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	Est. 2012	Date 2012
External Indicators								
Exports (annual percentage change, in U.S. dollars)	24.9	17.9	-5.1	-2.9	-1.1	7.2	…	
Imports (annual percentage change, in U.S. dollars)	25.1	19.2	-3.2	-3.7	-0.8	5.8	…	
Terms of trade (annual percentage change)	-1.5	1.2	-0.7	2.8	-1.3	-2.1	…	
Current account balance	-0.6	-1.0	-1.7	-1.3	-1.6	-1.6	…	
Capital and financial account balance	1.4	1.7	1.0	1.2	1.4	9.5	…	
Of which								
Inward portfolio investment (debt securities, etc.)	8.4	4.5	6.4	16.7	5.0	-1.8	…	
Inward foreign direct investment	3.2	3.7	2.3	0.9	1.2	2.9	…	
Other investment (net)	9.5	8.5	3.3	-7.8	-4.6	-12.1	…	
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	42.7	45.7	33.6	46.6	55.8	48.6	49.2	Mar
Euros per U.S. dollar (period average)	0.8	0.7	0.7	0.7	0.8	0.8	0.8	Mar
Market Indicators								
Financial Markets								
Public sector debt 1/	64.1	64.2	68.2	79.2	82.3	86.0	…	
3-month T-bill yield (percentage points, eop)	3.5	3.8	1.9	0.4	0.5	0.1	0.1	Apr
3-month T-bill yield in real terms (percentage points, eop)	2.0	1.3	0.9	-0.6	-1.2	-2.2	-2.2	Mar
US 3 month T-bill	4.8	3.1	0.0	0.1	0.2	0.0	0.1	Apr
Spread with the US T-bill (percentage points, eop)	-1.4	0.7	1.9	0.3	0.3	0.1	0.0	Mar
5- to 8-year government bond (percentage points, eop)	3.8	4.4	3.5	3.5	3.3	3.2	3.0	Apr
10-year government bond (United States)	4.6	4.1	2.4	3.6	3.3	2.0	2.1	Apr
Spread with US bond (percentage points, eop)	-0.8	0.3	1.1	-0.1	0.1	1.2	1.0	Mar
Yield curve (10 year - 3 month, percentage points, eop)	0.3	0.5	1.6	3.1	2.8	3.0	2.9	Mar
Stock market index (period average)	273.1	306.1	232.0	178.6	200.3	192.1	181.0	Mar
Real estate prices (index, Q1-10=100, period average)	98.6	105.1	106.0	98.5	103.5	109.7	…	
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	11.0	13.4	6.2	-0.7	5.6	4.4	2.7	Mar
Bank credit to households	11.4	10.7	5.7	2.9	6.0	5.8	4.6	Mar
Housing Loans	15.1	12.8	7.5	3.7	8.2	6.2	6.0	Mar
Bank credit to nonfinancial enterprises	9.7	14.1	10.6	-2.1	1.4	4.7	3.6	Mar
Sectoral risk indicators								
Household sector								
Household savings ratio	14.9	15.4	15.5	16.4	15.9	16.1	…	
Household financial savings ratio	4.9	5.0	5.0	7.4	7.0	6.8	…	
Real estate household solvency ratio (index, 2001=100) 2/	97	97	101	102.0	99.4	100.4	98.4	Q1
Corporate sector								
Profitability of business sector (financial margin)	37.8	38.4	38.1	35.8	36.7	35.3	…	
Investment ratio	17.4	18.4	18.9	17.1	17.9	18.7	…	
Savings ratio	15.2	16.5	14.0	13.8	15.7	13.5	…	
Self-financing ratio	81.6	83.8	69.3	75.7	81.8	67.2	…	
Banking sector								
Share of housing loans in bank credit to the private sector	37.3	37.1	37.6	39.2	40.2	40.8	40.9	Mar
Share of nonperforming loans in total loans	3.0	2.7	2.8	4.0	3.8	3.7	…	
Ratio of nonperforming loans net of provisions to capital	6.8	6.6	10.3	19.3	17.2	21.9	…	
Liquid assets to total short-term liabilities	146.7	150.3	128.3	93.1	76.2	74.8	…	
Return on assets	0.6	0.4	0.1	0.3	0.6	0.6	…	
Return on equity	14.0	9.8	3.6	7.2	12.0	13.1	…	
Regulatory capital to risk-weighted assets	10.9	10.2	10.5	12.4	12.7	12.8	…	…

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.

Table 5. France: Daily Movements of Selected Financial Indicators

	Latest observation: 12/5/2012	Change since:			2010-2011		Since 2000	
		Last Closing	7 days ago	7/1/2011	Trough	Peak	Trough	Peak
				(Percent)				
CAC 40 Index	3590.5	0.3	2.5	-10.4	29.1	-13.6	49.4	-48.1
BNP Paribas Equity	43.4	0.6	3.0	-20.5	88.1	-27.2	108.8	-52.6
Crédit Agricole Equity	6.0	0.3	6.1	-44.0	109.9	-55.8	109.9	-81.5
Société Générale Equity	28.2	-1.1	4.3	-33.6	88.0	-46.0	88.0	-79.9
				(Basis points)				
3M Basis Swap Spread	-24.1	1.1	4.2	3.4	133.4	-16.4	185.9	-21.6
Euribor-OIS 3M Spread	12.4	-0.3	0.9	-9.2	2.0	-88.3	21.1	-194.6
Sovereign 10Y Yield Spread	65.2	1.3	-3.2	27.4	46.5	-124.9	66.6	-124.9
Sovereign 5Y CDS Spread	79.7	0.6	-4.6	0.3	50.0	-170.0	78.2	-170.0
BNP Paribas 5Y CDS Spread	143.7	-3.5	-18.8	30.7	93.6	-215.9	138.3	-215.9
Crédit Agricole 5Y CDS Spread	159.5	-0.9	-13.8	26.2	97.4	-244.3	153.7	-244.3
Société Générale 5Y CDS Spread	174.3	-2.8	-17.1	42.3	112.7	-265.9	168.4	-265.9

Sources: Bloomberg; and staff calculations.

Table 6. France: The Core Set of Financial Soundness Indicators, 2004-2011

Indicator	2004	2005	2006	2007	2008	2009	Estimate 2010	2011
Deposit-taking institutions 1/								
Regulatory capital to risk-weighted assets	11.5	11.3	10.9	10.2	10.5	12.4	12.5	12.2
Regulatory Tier I capital to risk-weighted assets	8.8	8.2	8.2	7.7	8.5	10.2	10.7	10.9
Nonperforming loans net of provisions to capital	9.8	8.6	6.8	6.6	8.2	10.8	10.0	9.2
Bank provisions to Nonperforming loans	n.a.	n.a.	170	158.3	131.0	109.5	112.0	115.3
Nonperforming loans to total gross loans	4.2	3.5	3.0	2.7	2.8	3.6	3.5	3.5
Sectoral distribution of loans to total loans, *of which*								
Deposit-takers	34.0	30.1	30.6	32.2	33.6	34.1	36.5	40.2
Nonfinancial corporation	18.7	18.8	18.6	18.1	18.3	17.5	20.5	19.2
Households (including individual firms)	24.9	26.5	26.6	24.8	24.1	24.5	30.5	28.7
Nonresidents (including financial sectors)	4.2	4.7	4.2	4.7	4.7	4.6	6.1	5.9
ROA (aggregated data on a parent-company basis) 2/	0.5	0.6	0.6	0.4	0.0	0.4	0.3	0.0
ROA (main groups on a consolidated basis) 3/	0.53	0.49	0.57	0.35	0.1	0.3	0.6	0.4
ROE (aggregated data on a parent-company basis) 2/	10.6	11.8	14.0	9.8	-1.0	8.2	7.9	1.2
ROE (main groups on a consolidated basis) 3/	12.7	13.5	17.22	13.34	3.8	6.4	11.8	8.2
Interest margin to gross income	33.2	32.4	28.2	25.3	40.4	34.9	49.4	51.5
Noninterest expenses to gross income	63.9	64.3	62.4	68.4	84.2	63.1	65.7	67.4
Liquid assets to total assets	21.3	20.5	19.9	18.9	18.3	18.3	23.0	24.1
Liquid assets to short-term liabilities	155.1	150.1	146.7	150.3	139.6	150.1	144.4	136.3
Net open position in foreign exchange to capital								
Net open positions in FX (in millions of euros) 4/	6,669	5275	5,283	7,058	n.a.	n.a.	n.a.	n.a.
Net open positions in equities to Tier I capital	4.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Banque de France, ACP

1/ These may be grouped in different peer groups based on control, business lines, or group structure.
2/ All credit institutions' aggregated data on a parent-company basis.
3/ Consolidated data for the seven main banking groups (2005, IFRS).
4/ Impact of the creation of the euro has to be taken into account.

Table 7. France: Encouraged Financial Soundness Indicators, 2004-11
(In percent, unless otherwise indicated)

Indicator	2004	2005	2006	2007	2008	2009	2010	Estimate 2011
Corporate sector								
Total debt to equity	73.0	71.0	59.2	55.1	87.5	78.4	77.7	87.8
Return on equity	5.4	5.2	4.4	4.0	5.6	4.5	4.5	4.7
Interest paid to financial firms 1/	8.7	8.8	9.7	11.5	13.7	9.9	8.8	10.1
Corporate net foreign exchange exposure to equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Number of enterprise bankruptcies (thousands)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Number of enterprise creations (thousands)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deposit-taking institutions								
Capital (net worth) to assets	5.1	4.4	4.5	4.1	4.2	4.5	4.6	5.5
International consolidated claims of French banks, *of which* (BIS data, as percent of total international claims)								
Advanced countries	84.2	83.7	85.1	84.0	84.2	83.3	79.8	79.3
Developing Europe	2.6	2.8	3.2	4.0	4.3	4.6	5.7	6.0
Latin America and Caribbean	1.0	1.1	0.9	1.0	1.1	1.2	1.4	1.4
Africa and Middle East	3.1	3.1	2.6	2.6	3.1	3.5	4.4	5.1
Asia and Pacific Area	2.6	2.6	2.5	2.9	2.6	2.9	4.0	3.6
Offshore Financial Centers	6.5	6.6	5.6	5.5	4.7	4.4	4.7	4.6
Gross asset position in financial derivatives to capital	372.5	543.7	337.0	235.0	633.2	362.7	286.2	388.8
Gross liability position in financial derivatives to capital	358.5	484.7	293.0	227.0	616.3	361.9	286.7	388.0
Large exposures to capital	4.6	3.6	1.4	4.7	3.1	4.1	6.3	2.4
Trading income to total income	20.0	23.9	26.0	16.8	-63.9	16.4	10.3	-13.2
Personnel expenses to noninterest expenses	56.5	58.3	54.0	53.3	51.6	61.1	44.9	42.1
Spread between reference lending and deposit rates	214	215	226	232	218	237	252	232
Spread between highest and lowest interbank rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.		
Customer deposits to total (noninterbank) loans	80.6	83.5	80.5	77.4	78.0	85.3	79.5	78.4
FX loans to total loans 2/	10.8	12.0	11.4	11.3	10.5	10.4	9.8	8.9
FX liabilities to total liabilities	15.1	17.8	18.6	18.1	16.8	15.3	16.4	15.4
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Market liquidity								
Average bid-ask spread in the securities market 3/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
Average daily turnover ratio in the securities market	n.a.	n.a.	7.0	7.7	5.4	3.4	4.3	n.a.
Other financial corporations								
Assets to total financial system assets	19.9	20.2	20.9	20.6	19.7	20.9	20.76	19.3886
Assets to GDP	159.9	180.8	207.8	223.1	207.4	227.5	231.9	220.932
Households								
Household debt to GDP	39.2	42.1	44.6	47.1	49.3	53.3	55.0	55.9
Household debt service and principal payments to income	12.36	12.85	14.49	12.10	11.68	12.26	13.17	12.6
Real estate markets								
Real estate prices	16.0	14.8	10.0	5.5	-3.8	-4.2	7.7	3.7
Residential real estate loans to total loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Commercial real estate loans to total loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Banque de France ; ACP ; BIS ; Ministère des Finances
1/ In percent of financial firms' gross operating surplus.
2/ Data cover interbank and customer lending to residents and nonresidents on a metropolitan basis.
3/ Or in other markets that are most relevant to bank liquidity, such as foreign exchange markets.
4/ Other indicators such as additional balance sheet data (e.g. maturity mismatches in foreign currency), data on the life insurance sector, or information on the corporate and household sector may be added where available and relevant.

Annex I. France: External Assessment

Background—External Developments

The current account recorded a deficit of 1.9 percent of GDP in 2011, driven by a worsening balance in net exports of goods. Exports continued to recover but imports were up by nearly two percentage points of GDP, especially on account of petroleum imports. The surplus in the financial account in 2011 was marked by a retrenchment in net asset flows, including in the banking sector (which also shed liabilities), in contrast to previous years. The balance of payments recorded a small deficit. France's net international investment position (IIP) dropped further. While the bulk of the negative net IIP is due to the government's net liabilities, small net positions in other sectors may mask large gross positions, as with the banking sector.

1. **Current account developments in 2011.** The current account in 2011 recorded a deficit of 1.9 percent of GDP, driven by a worsening balance in net exports of goods. Notwithstanding the continuation in the recovery of exports of goods since 2009, imports in 2011 jumped by nearly two percentage points of GDP, nearly half of it due to higher petroleum prices. The improvement in the balance on services continued in 2011, partly thanks to gains in the travel sector. The income balance remained in surplus thanks to net contributions from employee compensation and direct investment.

France: Current Account Balance, 2000–11 (in percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Current account	**1.5**	**1.8**	**1.2**	**0.7**	**0.5**	**-0.5**	**-0.6**	**-1.0**	**-1.7**	**-1.3**	**-1.6**	**-1.9**
Net exports of goods	-0.2	0.3	0.5	0.2	-0.2	-1.3	-1.7	-2.2	-3.1	-2.3	-2.7	-3.7
Exports of goods	22.4	22.0	21.0	20.1	20.4	20.6	21.5	21.2	21.2	18.4	20.2	21.2
Imports of goods	-22.6	-21.7	-20.5	-19.9	-20.7	-21.9	-23.2	-23.4	-24.3	-20.7	23.0	-24.9
Net exports of services	1.3	1.1	1.1	0.8	0.7	0.7	0.7	0.8	0.9	1.0	0.8	1.2
Income balance	1.5	1.5	0.6	0.8	1.1	1.1	1.7	1.7	1.7	1.7	2.1	2.4
Current transfers	-1.0	-1.1	-1.0	-1.1	-1.1	-1.3	-1.2	-1.2	-1.3	-1.8	-1.7	-1.8
Memorandum item:												
Nominal GDP (in US$ billions)	1,330	1,339	1,457	1,796	2,058	2,140	2,258	2,586	2,845	2,627	2,571	2,778

Source: French authorities and IMF staff estimates.

2. **Developments in the financial account**. The financial account ended 2011 with a surplus of 2.9 percent of GDP, including a small reduction in reserve assets (0.3 percent of GDP). In contrast with previous years, the surplus in 2011 was marked by a net retrenchment in net asset flows of some 1.6 percent of GDP (4.9 percent of GDP when direct investment is excluded), led by the banking sector and other non-public sector. Net external liability flows were still positive but these

have been declining and turned negative in the second half of 2011. The evolution of external liabilities was also dominated by the banking sector, where net external liabilities fell by 7.3 percent of GDP. Taken together, the retrenchment in external assets and liabilities accelerated in the second half of 2011, with net external asset claims abroad falling by US$257 billion and net external liabilities by US$196 billion (9.3 and 7.1 percentage points of 2011 GDP respectively).

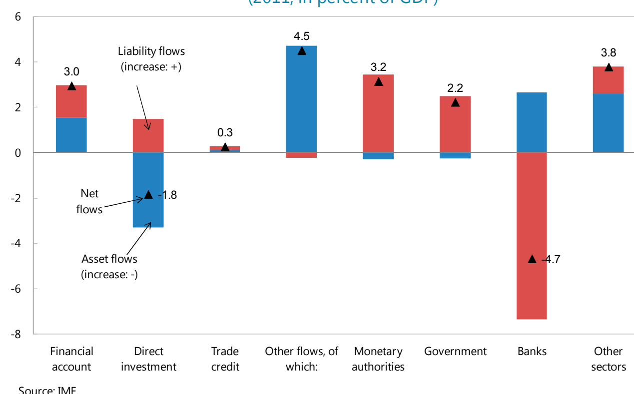
France: Capital and Financial Account, 2000–11 (in percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital and financial account	**-2.1**	**-2.1**	**-1.1**	**0.2**	**-0.4**	**0.0**	**1.3**	**1.7**	**0.9**	**1.3**	**1.4**	**3.0**
Capital account	**0.1**	**0.0**	**0.0**	**-0.5**	**0.1**	**0.0**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**-2.2**	**-2.1**	**-1.1**	**0.6**	**-0.5**	**-0.1**	**1.4**	**1.6**	**0.9**	**1.2**	**1.4**	**2.9**
Direct investment	-9.9	-2.7	-0.1	-0.6	-1.2	-1.9	-1.7	-2.6	-3.3	-3.2	-1.8	-1.8
Portfolio investment	2.6	1.6	-0.7	0.4	-3.2	-0.8	-6.0	-6.4	1.3	12.8	6.4	12.6
Financial derivatives	0.4	0.2	0.4	-0.4	0.3	0.3	0.2	2.3	-0.6	-0.9	1.8	0.7
Other investment	4.5	-1.5	-0.9	1.4	3.8	1.3	9.5	8.5	3.3	-7.8	-4.6	-8.9
Reserve assets	0.2	0.4	0.3	-0.1	-0.2	0.4	-0.5	0.0	0.4	0.2	-0.3	0.3
Errors and omissions	0.6	0.3	0.1	-1.3	0.2	1.8	-0.9	-0.7	0.8	0.1	0.1	-1.0

Source: French authorities and IMF staff estimates.

3. **International Investment Position (IIP)**. France's net IIP turned negative in 2007 and dropped to -15.4 percent of GDP by the end of 2011.[1] The IIP is being supported mainly by a net positive position in direct investment (of about 15 percent of GDP) and reserve assets (about 6 percent of GDP), but these are more than offset by the combined negative net position of the other components (portfolio investments, other investments, and financial derivatives). The bulk of France's net negative position is due to the government's net liabilities which have been accumulating gradually over 2010 to 2011. Again, small net positions may mask large gross positions. This is the case for the banking sector, which at the end of 2011 had a net position of -0.4 percent of GDP but gross assets and liabilities of 80.8 percent of GDP and 80.4 percent of GDP, respectively (excluding any outstanding direct investment).

France. Balance of Payments: Asset and Liability Flows
(2011, in percent of GDP)

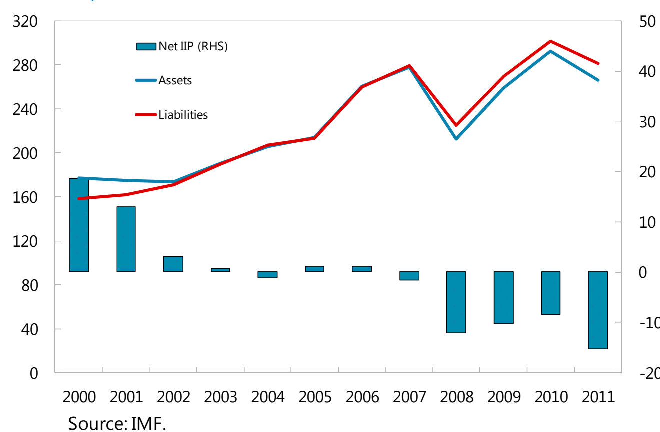


[1] As a result of differences between end-of-period and average exchange rates, ratios calculated using variables expressed in U.S. dollars may differ somewhat from ratios calculated for the same variables expressed in euros.

Incidentally, the net IIP of banks improved by 6.3 percentage points of GDP compared to 2010, as a result of a reduction in assets by 11.8 percentage points of GDP and in liabilities by 18.1 percentage points.

France: International Investment Position

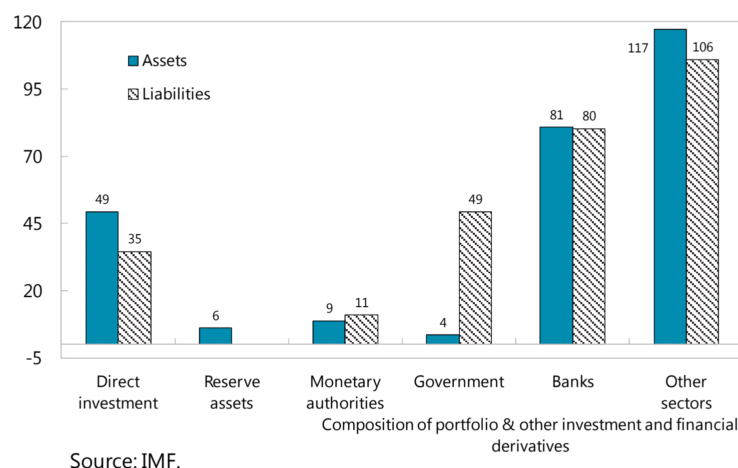
(In percent of GDP)



Source: IMF.

France: Composition of International Investment Position

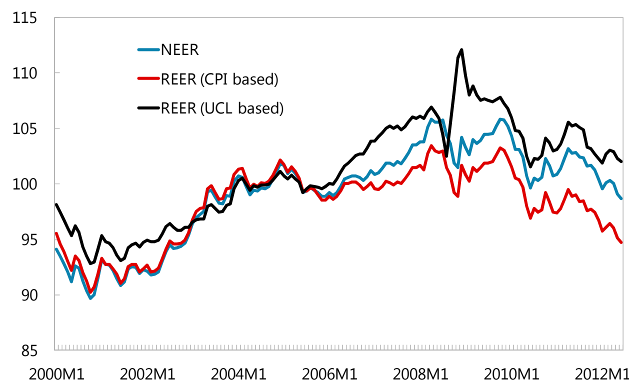
(2011, in percent of GDP)



Source: IMF.

4. **Developments in the real exchange rate**. France's real effective exchange rate (on CPI basis) depreciated by about 2.8 percent from end-2010 through June 2012, compared with a depreciation of 3.9 percent for the entire Euro Area. Measured over the same period, the real exchange rate in terms of unit cost of labor (UCL) depreciated by 0.9 percent, compared with a depreciation of 2.3 percent for the Euro Area as a whole.

France: Nominal (NEER) and Real Effective (REER) Exchange Rates
(Jan. 2000–Jun. 2012 , Index: average 2005 = 100) 1/



Source: IMF, Information Notification System.
1/ An increase (decrease) is an appreciation (depreciation). CPI is the consumer price index and ULC the unit cost of labor.

External Assessment

The EBA methodology suggests small gaps relative to the current account and real exchange rate "norms" (in the order of 1 percent of GDP and 3 percent, respectively), especially when viewed from a medium-term perspective. Nevertheless, the gradual deteriorations in the current account balance and international investment position over the last decade point to a competitiveness problem. Structural reforms to reduce rigidities in the labor and product markets, promote innovation, and create favorable business conditions could help restore competitiveness and improve the current account balance.

5. **This section assesses the level of the current account and real exchange rate**. The external assessment uses the External Balance Assessment (EBA) methodology which is being developed by the IMF; the EBA is the successor to the CGER methodology and was first introduced in the 2012 Pilot External Sector Report. Like its predecessor, the EBA methodology consists of three complementary approaches: the current account method, the real exchange rate method, and the external sustainability method (see Box below). The EBA results discussed in this section are based on an update using (WEO) data for Fall 2012.

External Balance Assessment (EBA) methodology

The EBA consists of three complementary methods: the regression-based **current account** and **real exchange rate methods**, and the model-free **external sustainability method**.

The current account and real exchange rate approaches use the same conceptual model, one being quantity based and the other one price based, so the discussion focuses on the current account method. The starting point is a regression model that explains the current account ("ca", in percent of GDP) in terms of non-policy variables ("X"), policy variables ("P"), and a residual ("ε"). The non-policy variables capture determinants such as demographics, growth, and cyclical influences. The regression model has four policy variables: fiscal policy (the cyclically-adjusted fiscal balance), social protection (proxied by public health spending as a percentage of GDP), the presence of capital controls, and foreign exchange intervention (change in reserves). Many variables are expressed in terms of deviations from world averages for multilateral consistency, and some allow for interaction terms.

The current account is decomposed into a current account "norm", which uses the estimated current account from the regression model but with the policy variables set at recommended levels (denoted P*), and the current account "gap". This gap is the sum of the contribution from policy variables deviating from their recommended levels and the regression residual. Formally:

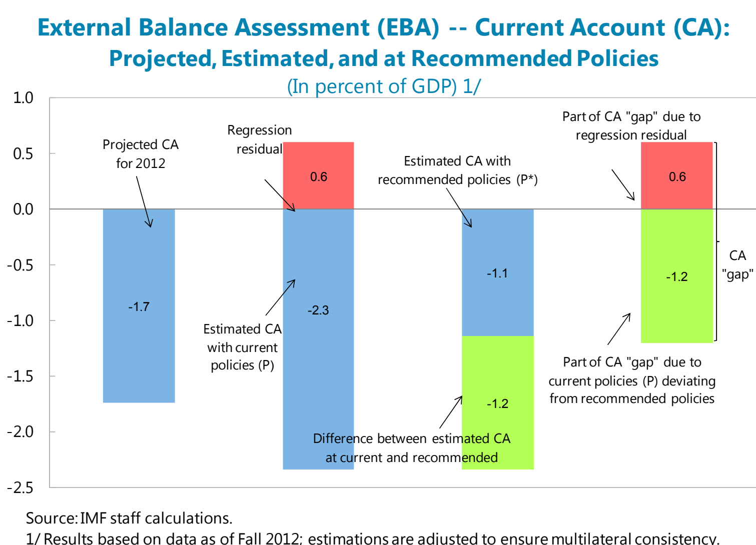
$$ca = \underbrace{\alpha + X.\beta + P.\gamma}_{\text{Estimated current account}} + \varepsilon = \underbrace{\alpha + X.\beta + P^{*}.\gamma}_{\text{Current account "norm"}} + \underbrace{(P - P^{*}).\gamma + \varepsilon}_{\text{Current account "gap"}}$$

The recommended policy level for the cyclically-adjusted fiscal balance is obtained from country desk teams; for social protection it is taken from a regression benchmark; for capital controls, it is obtained by taking the smaller of either the country's value or the average level of the capital controls measure, and for the change in reserves, it is either the observed change in 2012, if the overall reserves level was deemed adequate, or zero, if reserves were in excess of a range deemed adequate.

The external sustainability method calculates a current account gap as the difference between the medium-term current account and the current account which stabilizes net foreign assets (NFA) to GDP ("nfa") at a benchmark level. The medium-term current account is the WEO level projected 2017, the growth rate ("g") is the medium-term nominal growth rate, and for most countries the benchmark NFA/GDP is set at the 2010 level, with the latter taken from the *External Wealth of Nations* database. The NFA-stabilizing current account is then given by $ca^{*} = \left(\frac{g}{1+g}\right).nfa_{2010}$.

6. **Current account method**. The current account approach suggests a *current account gap* equal to -0.6 percent of GDP in 2012. This is the result of the difference between a *current account norm* (when policy variables are at recommended values) of -1.1 percent of GDP and the realized current balance of -1.7 percent of GDP. The current account gap results from two parts: policy gaps (that is, actual policies deviating from recommended policies) contributed -1.2 percentage points of GDP, while the regression residual (that is, the part not explained by the regression model) contributed 0.6 percentage points of GDP. The policy gap is mostly explained by actual spending on social protection being significantly higher than the benchmark "recommended" estimate.

External Balance Assessment (EBA) -- Current Account (CA): Projected, Estimated, and at Recommended Policies
(In percent of GDP) 1/



Source: IMF staff calculations.
1/ Results based on data as of Fall 2012; estimations are adjusted to ensure multilateral consistency.

7. **Real exchange rate method**. The real exchange rate method suggests a real exchange rate gap of -3 percent in 2012, that is: a real appreciation of 3 percent would close the gap with the estimated real exchange rate, evaluated at recommended policies. This is the net result of a regression residual contributing -6 percent and policy gaps contributing +4 percent.

France: External balance assessment (EBA): Exchange rate approach (2012)

Real exchange rate gap	**-3%**
Contribution from policy gaps	4%
Regression residual	-6%

Source: IMF staff calculations.

8. **External sustainability (ES) method**. The ES method suggests a positive current account gap of 0.1 percent of GDP. The benchmark current account that would stabilize net foreign assets

(in percent of GDP) at the end–2010 level is -0.5 percent of GDP. This benchmark is compared with the medium-term projection for the current account (adjusted to ensure closed output gaps and a constant real effective exchange rate) of -0.3 percent of GDP.

France: External balance assessment (EBA): External sustainability approach

(In percent of GDP)

Realized 2011 CA/GDP (A)	Unadjusted 2017 CA/GDP (B)	Adjusted 2017 CA/GDP (C)	NFA/GDP 2010 (benchmark) (D)	CA/GDP stabilizing NFA at benchmark (F)	CA/GDP gap (C)-(F)
-2.2%	-0.4%	-0.3%	-17.9%	-0.5%	0.1%

Source: IMF staff calculations.

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Annex II. France: Main Recommendations of the 2011 Article IV Consultation and Authorities' Response

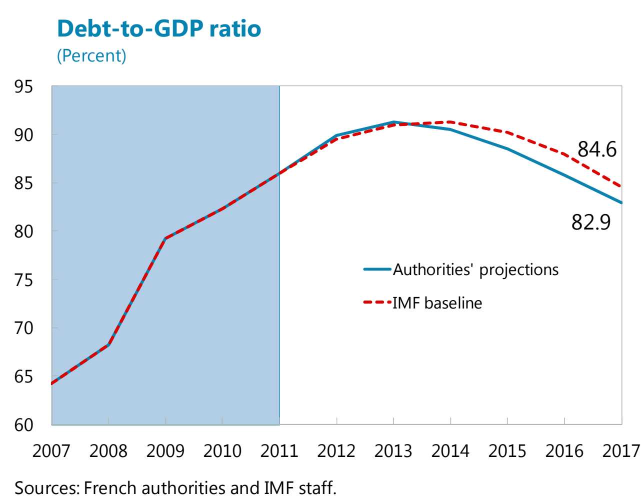
Fund Recommendations	Policy Actions
Fiscal Policy	
Prepare contingency measures in case growth outcomes fall short of expectations	Each downward revision of projected economic growth was accompanied by new fiscal measures in order to meet the fiscal targets.
Enact a fiscal rule	A fiscal rule was introduced in the fall 2012 as part of the transposition into French law of the European Fiscal Compact.
Cap the autonomous spending of local governments and social security	To contain local government spending, financial transfers from the state to the local governments are frozen in 2012 and 2013 and will be cut in 2014 and 2015. Policy measures reduced the growth rate of social security spending (from 3.6 percent in 2010 to 3.2 percent in 2011 and to a projected 2.8 percent in 2012).
Deepen the reforms of the pension and health care systems	The implementation of the 2010 pension reform was accelerated by one year in November 2011. However, in July 2012, the increase of the retirement age from 60 to 62 was eliminated for some workers and the cost was covered by an increase in social contributions of up to 0.5 percent by 2017.
Financial Sector Policy	
Swiftly raise banks capital levels, with the aim of meeting Basel III requirements by 2013/14.	French banks are well positioned to comply ahead of schedule with internationally-set capital requirements. Some banks already meet the Basel III capital ratios.
Structural Reforms	
Keep real wage increase in line with productivity improvements	Wage moderation continues to be applied for civil servants. However, in 2012, the government decided to increase the minimum wage by more than required by the indexation formula.
Increase labor force participation	The pension reforms and the elimination of incentive for early retirement have increased the participation of seniors in the labor market.
Foster competition in the services sector	The adoption of a law to increase competition in consumer services committed as part of the G20 has been postponed. A fourth mobile operator entered the market in January 2012. 4G licenses were allocated in December 2011 and increased competition.
Modernize the tax and benefit system	The various fiscal packages adopted in 2011 and 2012 rely on tax increases (some of them temporary) but do not modernize or reform the tax system.

Annex III. Debt Sustainability Analysis

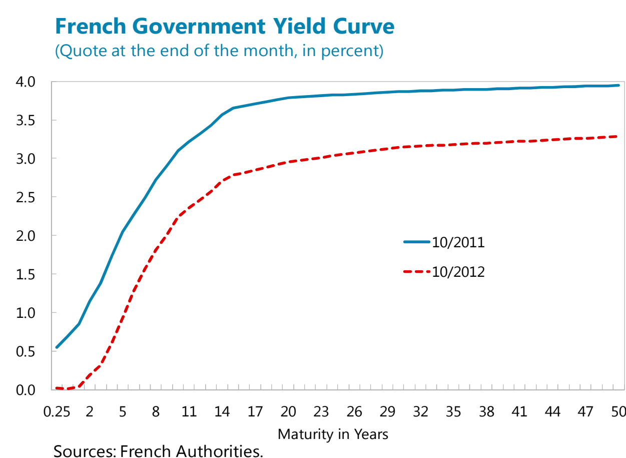
Due to the combined effect of low growth and large fiscal deficits, the debt-to-GDP ratio increased from about 64 percent on the eve of the crisis to about 90 percent in 2012.Reducing of the debt ratio over the medium term has become a key objective of the authorities' policy. Under staff projections, which integrate the authorities' announced fiscal measures, the debt-to-GDP ratio would peak in 2014 and decline thereafter. The path of the debt ratio is particularly vulnerable to growth and interest rate shocks.

Background

- **Debt ratio.** The combined effect of low growth over several years and the persistence of high fiscal deficits (due to the impact of large automatic stabilizers and of the fiscal stimulus) have increased the debt-to-GDP ratio by 25.7 percentage points in five years to almost 90 percent in 2012. Part of the increase is also due to the financial support to other Euro area countries[1], which is projected at 2.5 percent of the GDP in 2012.[2] Under the authorities' scenario, the debt ratio would start declining as early as 2014. Under staff projections, the ratio would start declining only in 2015.



Sources: French authorities and IMF staff.



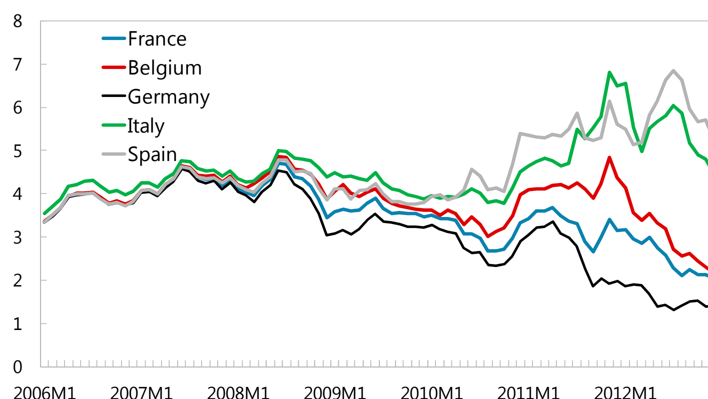
Sources: French Authorities.

- **Sovereign yields.** Currently, yields on French debt are at historically low levels. The benchmark yield (10 years) has declined from just under 5 percent in July 2008 to 2¼ percent in mid–October 2012. Spreads over the German Bund, which had increased to almost 200 basis points in November 2011, have since declined to about 60 basis points. Since July 2012, France's short term debt has been auctioned at negative interest rates.

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

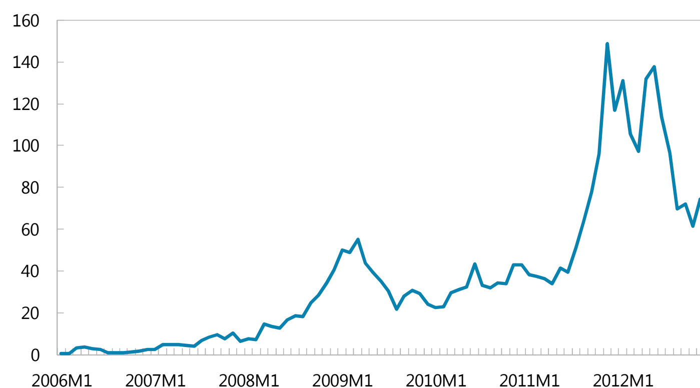
[2] 2.8 percent lower in 2017 under the authorities' framework.

10 Year Sovereign Yields
(In Percent)



Source: Thomson Financial/Datastream.

French 10 Year Sovereign Spread with German Bund
(In Basis Points)



Source: Thomson Financial/Datastream.

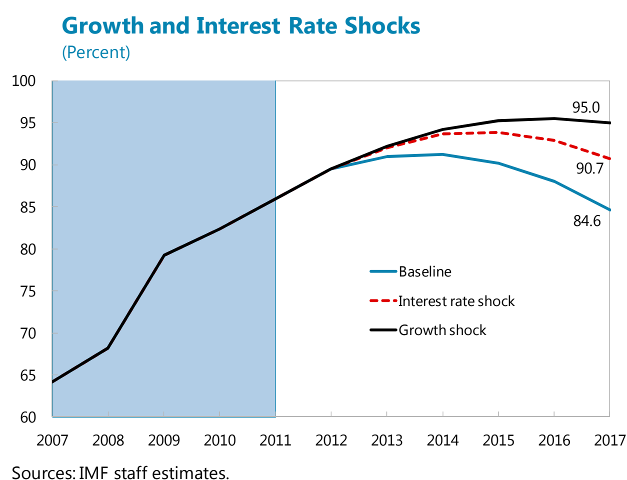
- **Debt service.** Owing to the sharp decline in interest rates, the rising debt has had a limited impact on the debt service. Interest payments account for 2.6 percent of GDP, the same level as in 2006 when the debt-to-GDP ratio was 25.8 percentage point lower.

Scenario analysis

- **Baseline** (See Table 1)**.** Staff projects that the debt-to-GDP ratio will peak at 91.3 percent in 2014 and then decline to about 84½ percent in 2017. Interest payments would remain at their low level of 2.5 percent of GDP because: (i) fiscal consolidation leads to a primary surplus starting in 2015; and (ii) given the maturity structure of the debt (average maturity of just over 7 years as of end September 2012), the projected increase of market interest rates starting in 2014 passes through slowly to implicit interest rate and the budget. A 100 basis point shock to all (short and long) interest rates is estimated to increase debt payment by only 0.1 percent of GDP.

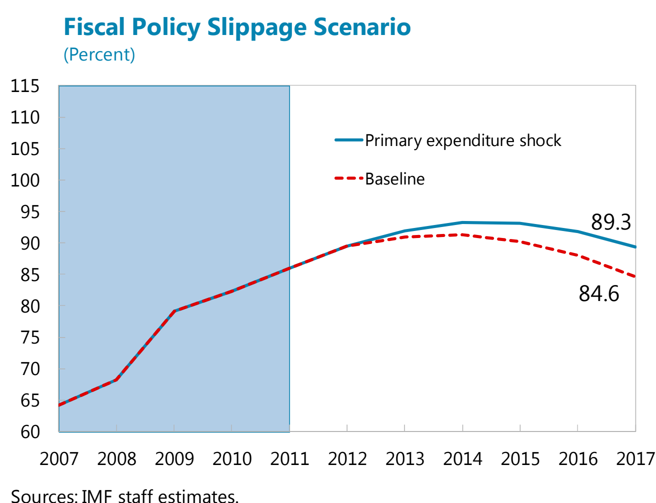
Four scenarios are used to evaluate the sustainability of debt and the vulnerability of shocks.

- **Slow recovery scenario.** Under this scenario, real GDP is assumed to contract in 2013 by 0.5 percent and to increase only gradually thereafter to 1 percent in 2017. As a result, the debt-to-GDP would increase to 95 percent in 2017, despite the implementation of the fiscal measures assumed in the baseline. The lower growth scenario could result from the combination of several factors including a failure to implement domestic structural reforms, an external demand shortfall, additional bank deleveraging affecting domestic credit growth, and possibly a larger impact of the fiscal consolidation on economic growth.



Sources: IMF staff estimates.

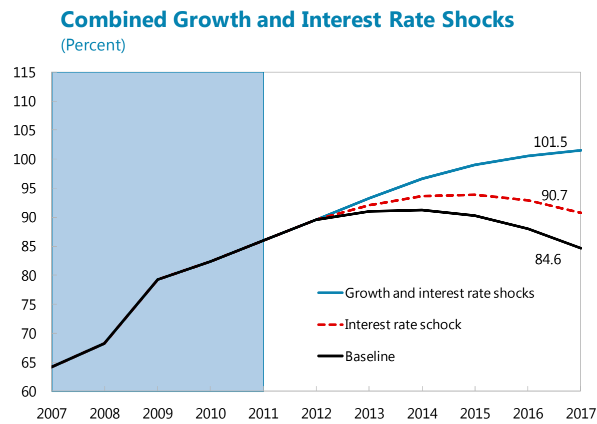
- **High interest rate scenario.** An interest rate shock could be triggered by renewed tensions in the euro area. The shock is assumed to be of a similar magnitude as the one experienced by Italy during 2009 to 2011 (across different maturities): interest rates on new short-term debt are 1.8 percentage points higher than in the baseline during the whole period starting in 2013 and interest rates on medium- and long-term debt are higher than in the baseline scenario by 2.9 percentage points in 2013 to 2014, 2.1 points in 2015, 1.9 points in 2016 and 1.5 points in 2017. No spending cut is assumed to offset the fiscal impact of higher interest rates. Under this scenario, reflecting the slow pass through of interest rates on the budget, the debt ratio would peak in 2015 (2014 in the baseline) at 93.8, and would decline afterwards, but would still be above 90 percent in 2017.



Sources: IMF staff estimates.

- **Fiscal policy slippage scenario.** In this scenario, difficulties in containing spending as planned are assumed to raise primary expenditure by about 1 percent of GDP above the level projected in the baseline starting in 2013. Assuming everything else constant, the debt to GDP ratio rises to 91.8 percent in 2016 before declining and coming back in 2017 close to its 2012 level.

- **Combined growth and interest rate.** This scenario, which combines the interest rate and growth shocks described above, could potentially arise in the event of renewed stress in the euro area crisis combined with insufficient structural reforms. Under this scenario, the debt-to-GDP ratio rises above 100 percent as early as 2016 and is still increasing by 2017.



Sources: IMF staff estimates.

Table 1. France: Public Sector Debt Sustainability, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	64.2	68.2	79.2	82.3	86.0	**89.5**	**90.9**	**91.3**	**90.2**	**88.0**	**84.6**	**-1.0**
o/w foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in public sector debt	0.1	4.0	10.8	3.3	3.6	3.6	1.4	0.3	-1.0	-2.2	-3.4	
Identified debt-creating flows (4+7+12)	-0.3	1.8	9.3	5.0	2.8	2.6	1.2	0.1	-1.2	-2.3	-3.5	
Primary deficit	0.0	0.4	5.1	4.7	2.6	1.9	1.0	0.4	-0.4	-1.3	-2.4	
Revenue and grants	49.9	49.9	49.1	49.5	50.8	51.7	52.7	52.7	52.5	52.3	52.4	
Primary (noninterest) expenditure	49.9	50.4	54.2	54.2	53.4	53.6	53.7	53.2	52.1	50.9	50.0	
Automatic debt dynamics 2/	-0.3	1.4	4.1	0.3	0.2	0.7	0.2	-0.3	-0.8	-1.0	-1.1	
Contribution from interest rate/growth differential 3/	-0.3	1.4	4.1	0.3	0.2	0.7	0.2	-0.3	-0.8	-1.0	-1.1	
Of which contribution from real interest rate	1.1	1.3	1.9	1.6	1.5	0.9	0.5	0.5	0.5	0.5	0.5	
Of which contribution from real GDP growth	-1.4	0.1	2.2	-1.3	-1.4	-0.2	-0.3	-0.9	-1.3	-1.5	-1.6	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	0.4	2.2	1.6	-1.7	0.8	1.0	0.2	0.2	0.2	0.1	0.1	
Public sector debt-to-revenue ratio 1/	128.8	136.6	160.9	166.4	169.2	173.1	172.5	173.1	172.0	168.4	161.3	
Gross financing need 6/	9.9	12.5	20.7	22.7	19.3	15.2	16.7	16.2	15.1	13.4	11.3	
in billions of U.S. dollars	256.6	354.2	544.7	581.9	537.2	392.6	434.8	432.7	416.8	383.7	334.6	
Scenario with key variables at their historical averages 7/						**89.5**	**92.4**	**95.2**	**98.2**	**101.0**	**103.8**	**1.3**
Scenario with no policy change (constant primary balance) in 2012-2017						**89.5**	**91.8**	**93.6**	**94.8**	**95.7**	**96.5**	**-1.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.3	-0.1	-3.1	1.7	1.7	0.2	0.4	1.0	1.5	1.7	1.9	
Average nominal interest rate on public debt (in percent) 8/	4.4	4.7	3.5	3.1	3.3	3.1	2.8	2.8	2.8	2.9	3.0	
Average real interest rate (nominal rate minus change in GDP deflator, in p	1.8	2.1	2.8	2.1	2.0	1.1	0.6	0.6	0.6	0.7	0.6	
Nominal appreciation (increase in US dollar value of local currency, in perc	10.3	-6.6	7.2	-9.5	-0.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	2.6	2.5	0.7	1.0	1.3	2.0	2.2	2.2	2.2	2.3	2.4	
Growth of real primary spending (deflated by GDP deflator, in percent)	1.3	0.8	4.5	1.3	0.3	0.7	0.6	0.0	-0.6	-0.5	0.0	
Primary deficit	0.0	0.4	5.1	4.7	2.6	1.9	1.0	0.4	-0.4	-1.3	-2.4	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
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.

INTERNATIONAL MONETARY FUND

FRANCE

December 6, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By The European Department

CONTENTS

I. FUND RELATIONS 2

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ANNEX I. FRANCE: FUND RELATIONS

(As of October 31, 2012)

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

II. **General Resources Account:**

	SDR Million	Percent of Quota
Quota	10,738.50	100.00
Fund Holding of Currency (Exchange Rate)	7,197.16	67.02
Reserve Tranche Position	3,541.39	32.98
Lending to the Fund		
New Arrangements to Borrow	2,207.39	

III. **SDR Department:**

	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	9,469.87	93.44

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements:** None

VI. **Projected Payments to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal					
Charges/Interest	0.14	0.72	0.72	0.72	0.72
Total	0.14	0.72	0.72	0.72	0.72

VII. **Implementation of HIPC Initiative:** Not applicable

VIII. **Safeguards Assessments:** Not applicable

IX. **Exchange Rate Arrangements:**

- France's currency is the euro, which floats freely and independently against other currencies.
- France maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions imposed solely for the preservation of international security. These restrictions involving certain individuals and

entities and which target specified countries have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). In accordance with the relevant EU regulations and UNSC resolutions, certain restrictions are maintained on the making of payments and transfers for current or military international transactions with respect to Belarus, the Democratic Republic of Congo, the former Government of Côte d'Ivoire, the Islamic Republic of Iran, the former government of Iraq, the Democratic People's Republic of Korea, Guinea (republic of), Guinea Bissao, the former Government of Liberia, the former Government of Libya, Myanmar, the former Government of Tunisia, Transnistria (the independentist region of Moldova), Eritrea, the former Government of Egypt, Somalia, Sudan and South Sudan, Syria, certain individuals associated with the government of the former Federal Republic of Yugoslavia, certain individuals associated with the murder of former Lebanese Prime Minister Rafiq Hariri, and Zimbabwe.

- Measures have been taken to freeze accounts of listed persons and entities linked to terrorists pursuant to the relevant EU regulations (n°881/2002, n°2580/2001 and n°753/2011) and UN Security Council resolutions (resolutions 1267 and 1373 and subsequent resolutions).

X. **Article IV Consultation:**

The last Article IV consultation was concluded on July 25, 2011. The associated Executive Board assessment is available at http://www.imf.org/external/np/sec/pn/2011/pn1199.htm and the staff report at http://www.imf.org/external/pubs/ft/scr/2011/cr11211.pdf France is on the standard 12-month consultation cycle.

XI. **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 noticed 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.

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

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

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

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

***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 04/344, 11/03/04
FSAP Assessment and Reports on ROSCs	IMF Country Report No. 04/345, 11/03/04
FSAP Assessment	IMF Country Report No. 05/185, 06/08/05
Publication of FSAP—Detailed Assessment of Observance of Standards and Codes	IMF Country Report No. 05/186, 06/08/05

Summary: The 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.

Notwithstanding the strengths of the French financial sector, a number of issues emerged from the FSAP, including (i) concentration in banking may have reached a point where further consolidation could intensify concerns over the scope for collusion and long-term stability where many banks could be considered "too big to fail;" (ii) banks' large and growing portfolios of fixed-rate residential housing loans could represent a longer-term risk in the event of large increases in funding costs and/or a significant fall in real estate prices; (iii) some administered savings schemes and other policy measures give rise to costs and impede financial market innovation. These schemes are not well targeted to achieve intended social goals and are not well aligned with current priorities, such as strengthening the pension system; (iv) the banking system's rapid accumulation of capital strengthens banks' resilience.

This accumulation is harder to control for mutual banks, given their legal restrictions on remuneration of their members. And, for all banks, it could encourage expansion through expensive takeovers and risky new ventures; (v) the supervisory system of the financial sector is composed of specialized segments. Coordination mechanisms need to be further adapted. Additional steps

should be considered in the future as cross-sectoral financial groups become more prevalent; (vi) the consolidation of the French stock and futures markets with others in Europe has increased the importance of effective cooperation across national jurisdictions. Moreover, the authorities face the challenge of adjusting to and effectively implementing the significant regulatory overhaul that took place in late 2003; and (vii) the infrastructure for the clearing and settlement of payments and securities is generally sound and modern. However, there is some room for improvement in the clearing and settlement of retail payments and securities, where the multilateral netting systems lack fully adequate safeguards to ensure timely settlement in case of default.

ANNEX II. FRANCE: STATISTICAL ISSUES

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. The transmission of data in electronic form from INSEE (*Institut national de la statistique et des études économiques*) and the profusion of data from various institutions (*Banque de France*, INSEE, ministry of finance, ministry of labor and solidarity) have helped to build an infrastructure, in which all data can be easily accessed through the Economic Data Sharing System. A data ROSC mission conducted an assessment of the statistical system in March 2003, and the report was published in October 2003. A factual update to the main report was published in November 2004.

France's monetary and banking statistics methodology conforms with the European Central Bank framework, which provides comparable details as the Standardized Report Forms developed by STA. 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. France follows the European System of Integrated Economic Accounts 1995 (ESA95). Data for GDP and its expenditure components are available from 1978 onwards. Both annual and quarterly accounts provide reliable information, although estimates from the two accounts differ slightly before the quarterly accounts are revised to be aligned to the annual ones. In 2005, national accounts estimates were rebased to 2000 prices.

Government finance statistics have been strengthened recently. Both central and general government data are presented in a more comprehensive fashion than previously and the data for 2006 and 2007 also reflect the various impacts of recent budgetary reform. Although the source data is 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 ESA95. INSEE's website has recently been enhanced; in particular, it includes expenditure tables and government revenues by subsector (central government, miscellaneous central government agencies, local governments, and social security administration).

Balance-of-payments statistics should be interpreted with caution, given large errors and omissions. Greater coherence between the external current account and the rest of the world account in the national accounts is needed. In this regard, work with promising early results has been undertaken on the transportation account.

ANNEX III. FRANCE: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of November 30, 2012)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	10/12	11/12	Monthly	Monthly	Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/12	11/12	Monthly	Monthly	Monthly
International Investment Position	2011	Q1:2012	Annual	Annual	Annual
Reserve/Base Money	10/12	11/12	Monthly	Monthly	Monthly
Broad Money	10/12	11/12	Monthly	Monthly	Monthly
Central Bank Balance Sheet	10/12	11/12	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	10/12	11/12	Monthly	Monthly	Monthly
Interest Rates[2]	10/12	11/12	Monthly	Monthly	Monthly
Consumer Price Index	10/12	11/12	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q4:2011	05/12	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	09/12	11/12	Monthly	Monthly	Monthly
Stock of Central Government Debt	10/12	11/12	Monthly	Monthly	Monthly
Stock of Central Government-Guaranteed Debt	Q3:2012	10/12	Quarterly	Quarterly	Quarterly
External Current Account Balance	Q3:2012	11/12	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q3:2012	11/12	Quarterly	Quarterly	Quarterly
GDP/GNP	Q3:2012	11/12	Quarterly	Quarterly	Quarterly
Gross External Debt	Q4:2011	05/12	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
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IMF Executive Board Concludes 2012 Article IV Consultation with France

On December 20, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with France.[1]

Background

The growth outlook for France remains fragile reflecting weak conditions in Europe. While market tensions have recently eased, the path towards a resolution of the euro area crisis remains uncertain and fiscal consolidation throughout Europe will continue to depress demand. In this environment, growth is expected to slow markedly from 1.7 percent in 2011 to 0.2 percent in 2012, and to recover only very gradually to 0.4 percent in 2013. With job creation remaining subdued, unemployment is expected to rise further.

The recovery of the French economy is also hampered by a loss of competitiveness which is reflected in a steady loss of export market share and low profit margins relative to European partners, which in turn affects the ability of enterprises to invest and innovate. The competitiveness gap owes largely to impediments in the functioning of labor and product markets

[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. 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.

(especially services) accumulated over time. To begin to address these problems, the government has announced a reduction of employers' social security contributions (to reduce labor costs), and has indicated that it would seek to make the labor market more adaptable based on the result of ongoing negotiations between the social partners.

The sizable fiscal consolidation which started in 2010 is continuing. The overall budget deficit is projected to come down from 7.5 percent of GDP in 2009 to 4.5 percent in 2012. The 2013 budget targets a further reduction of the deficit to 3 percent of GDP, with a view to reaching a balanced budget position over the medium term. Adjustment is heavily frontloaded and about equally divided (over the medium term) between revenue and expenditure measures. Based on the IMF's more conservative growth outlook, the 2013 budget would result in a deficit of 3.5 percent of GDP.

Financial stability concerns, which arose in connection with euro area tensions and dollar liquidity problems in 2011, have abated considerably. French banks have moved aggressively to improve their solvency ratios and funding structures; and they are well positioned to comply ahead of schedule with internationally-set capital requirements. However, banks remain heavily reliant on wholesale funding, which could become a vulnerability in the event of renewed market stress.

Executive Board Assessment

Executive Directors welcomed the resilience of the French economy in withstanding relatively well the euro area crisis and enjoying a safe haven status. They noted, however, that economic growth remains sluggish and the near-term outlook is subject to downside risks. The main challenge going forward would be to further strengthen the recovery, while addressing the competitiveness gap vis-à-vis trading partners and safeguarding financial stability. In this context, Directors underscored the need to properly calibrate fiscal policy and remove structural rigidities that constrain competitiveness and growth.

Directors commended the authorities for their commitment to fiscal discipline in line with the euro-area stabilization strategy, and for the transposition of the EU Fiscal Compact into French law. They noted that the adoption of the fiscal responsibility law and creation of the Fiscal Council would strengthen credibility by anchoring fiscal policy to a balanced position over the medium term. Many Directors stressed that adherence to the EU's fiscal target in 2013 would be crucial to preserve credibility and market confidence, and advised that contingency measures be prepared should downside risks materialize. Other Directors encouraged the authorities to refrain from additional fiscal tightening in the event of slower-than-expected growth in 2013. Directors called for a rebalancing of fiscal adjustment over the medium term toward additional expenditure containment in a growth-friendly manner, stressing the adverse supply side effects of the high tax ratio.

Directors underscored the need to address the competitiveness gap through deep labor and product market reforms. They welcomed the authorities' recent decision to lower social security contributions, and recommended wage moderation as a supporting measure. They also welcomed the ongoing negotiations among social partners to improve the functioning of the labor market, and encouraged the authorities to move forward with the ambitious labor market reform. Directors also observed that greater competition in the services sector would help lower production costs and enhance the benefits of the labor market reform. They called on the authorities to open the services sector to more competition, while acknowledging the need for careful sequencing of the various reforms.

Directors noted the Financial System Stability Assessment's findings that the French financial system has been resilient to shocks and that financial stability risks have receded. They commended the authorities' strong regulatory and supervisory regime, and welcomed moves to boost financial oversight further, including at the European level. Directors welcomed the rapid improvements in bank capitalization and funding structures in the aftermath of the crisis. Nevertheless, they observed that banks remain exposed to the risk of financial stress owing to their still-significant reliance on wholesale funding and exposure to periphery euro-area countries. To stimulate deposit mobilization by banks, Directors encouraged further tax reform to create a level playing field and remove disincentives against bank deposits.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2012 Article IV Consultation with France is also available.

France: Selected Economic and Social Indicators, 2009–13

				Projections	
	2009	2010	2011	2012	2013
Real economy (change in percent)					
Real GDP	-3.1	1.7	1.7	0.2	0.4
Domestic demand	-2.6	1.6	1.7	-0.4	0.5
Nominal GDP (billions of euros)	1886	1937	1997	2042	2095
CPI (year average)	0.1	1.5	2.1	2.0	1.6
Unemployment rate (in percent)	9.5	9.7	9.6	10.3	10.6
Gross national savings (percent of GDP)	17.6	17.7	18.7	18.5	18.2
Gross domestic investment (percent of GDP)	18.9	19.3	20.6	20.0	19.7
Public finance (percent of GDP)					
Central government balance	-6.2	-6.3	-4.4	-3.7	-2.7
General government balance	-7.5	-7.1	-5.2	-4.5	-3.5
Structural balance (percent of potential GDP)	-4.7	-4.6	-3.5	-2.6	-1.4
Primary balance	-5.4	-4.8	-2.7	-2.0	-1.2
General government gross debt	79.0	82.3	86.0	89.5	90.9
Money and interest rates (in percent)					
Money market rate 1/	0.7	0.5	0.8	0.1	...
Government bond yield 1/	3.6	3.1	3.3	2.6	...
Balance of payments (in percent of GDP)					
Exports of goods	18.4	20.2	21.2	21.1	20.6
Volume growth (in percent)	-12.1	9.6	5.3	2.5	0.6
Imports of goods	20.7	23.0	24.9	24.2	23.6
Volume growth (in percent)	-9.6	8.9	4.9	0.2	0.9
Trade balance	-2.3	-2.7	-3.7	-3.1	-3.0
Current account	-1.3	-1.6	-1.9	-1.5	-1.5
FDI (net)	-3.2	-1.8	-1.8	-1.7	-1.6
Official reserves (US$ billion)	46.6	55.8	48.6	...	...
Exchange rates					
Euro per U.S. dollar, period average					
Nominal effective rate, ULC-styled (2000=100)	104.8	102.4	102.4	...	...
Real effective exchange rate, ULC-based (2000=100)	107.8	105.0	103.8	...	...

Social indicators

Per capita GDP (2006): US$35,471; Life expectancy at birth (2009): 77.7 (male) and 84.4 (female);

Poverty rate (mid-2000s): 14.1 percent (60 percent line), 7.1 percent (50 percent line);

Income distribution (ratio of income received by top and bottom quintiles, 2004): 4.2.

Sources: French authorities; IMF staff estimates and projections.

1/ For 2012, average for January-April.