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France: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for France

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with France, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 16, 2009, with the officials of France on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 13, 2009. 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.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 29, 2009 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for France.

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

Selected Issues Paper

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

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FRANCE

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with France

Approved by M. Belka and D. Marston

July 13, 2009

This report is based on discussions held in Paris during June 4-16, 2009. The concluding statement of the mission is available at http://www.imf.org/external/np/ms/2009/061609.htm

***Staff team*:** Ms. Gulde-Wolf (head), Mr. De Vrijer, Ms. Yontcheva, Ms. Xiao, Mr. Monfort (all EUR), and Ms. Yakadina (FAD).

***Country interlocutors*:** Mrs. Lagarde, the Minister of Economy, Industry, and Employment; Mr. Woerth, the Minister of the Budget, the Civil Service, and the Reform of the State; Mr. Noyer, the Governor of the *Banque de France*; Mr. Wauquiez, the Deputy Minister for Employment; the deputy secretary general of the Presidency; the director general of the treasury; the deputy chief of staff of the Minister for Social Affairs; the chief of staff of the Minister in charge of the implementation of the recovery plan; the directors of the budget, taxation, labor and social affairs, and their staffs; the deputy chief of staff in the cabinet of the prime minister; members of the finance commissions of the National Assembly and the Senate; INSEE; the Banking Commission; the Financial Market Authority (AMF); the French Financing Corporation (SFEF); the bank recapitalization agency (SPPE); the French Banking Federation (FBF); the French Association of Financial Management (AFG); the Competition Authority; the Pensions Advisory Council (COR); the French Economic Observatory (OFCE); and representatives of labor unions, employer organizations, and the financial sector. Mr. Fayolle (Executive Director) or Mr. Claveranne (Alternate Executive Director) attended the meetings.

***Fund relations*:** The previous Article IV consultation took place on February 15, 2008; a staff visit took place in July 2008. France accepted the obligations under Article VIII and maintains an exchange system free of restrictions, except for certain exchange measures imposed for security reasons in accordance with the relevant EU regulations and UN Security Council resolutions.

***Data*:** France subscribes to the Fund's Special Data Dissemination Standard, and comprehensive economic data are available on a timely basis.

Contents Page

I. Executive Summary and Staff Appraisal

1. **The global financial crisis and the contraction of world trade have pulled the French economy into a severe recession and put its financial sector under strain.** Structural features combined with early policy action have helped soften the downturn, which is somewhat less pronounced than in the euro area as a whole. Nonetheless, unemployment has risen steeply since mid-2008, while consumer price inflation has come down rapidly. With the fiscal stance easing in 2008, the budget deficit exceeded the Maastricht ceiling. French banks faced the need to write down toxic assets, and government recapitalization and liquidity measures were required to support the sector. While significant, financial sector losses remained below those in peer countries.

2. **The expected gradual recovery of the global economy and long-standing supply rigidities are likely to slow the pace of the recovery.** The near-term outlook is challenging with real GDP projected to drop by 3 percent in 2009, followed by a gradual recovery next year. The unemployment rate is likely to surpass 10 percent in 2010. Although inflation is expected to remain below zero in the coming months, deflation is unlikely to set in given entrenched nominal wage and price rigidities. The risks to the outlook are mostly tilted to the downside in view of the sensitivity of the French economy to a worse-than-foreseen contraction in the European Union and underlying tail risks, in particular in the financial sector. Over the medium term, potential output growth is projected to slow, and the output gap is expected to narrow only gradually.

3. **The key policy challenge is to align actions to counter the crisis with indispensable longer-term reforms** to strengthen financial stability, safeguard fiscal sustainability, and deepen the reform of labor and product markets to boost France's competitiveness and economic growth.

4. **Further actions are required to fully uncover and, if needed, address underlying vulnerabilities in the banking sector.** Banks' net earnings have dropped sharply and their leverage remains relatively high. The unfolding economic downturn and ensuing rise in defaults might exert further stress on the financial system. As French banks are exposed to mature markets, they are vulnerable to potential spillovers from systemic countries. In addition, one bank has a sizable exposure to Central and Eastern Europe. Undertaking rigorous, EU-wide coordinated stress tests to determine banks' capital and liquidity needs, and appropriate disclosure of the results are important. On the basis of such stress tests, the authorities should assess if there are needs for follow-up actions to further recapitalize banks, and for measures to ensure the soundness of their balance sheets.

5. **France has played an active role in promoting international regulatory and supervisory reforms.** In light of the integrated financial markets in Europe and their close links to the rest of the world, such reforms need to be coordinated at the European and

international levels. France's strong support can help to bring the European regulatory reform to a successful next stage. In addition, it is important to strengthen international cooperation on financial sector exit strategies, particularly on deposit guarantees and bank-asset guarantees, to avoid creating destabilizing financial flows.

6. **The fiscal response to cushion the downturn has been appropriate**. In addition to the full operation of sizable automatic stabilizers, fiscal stimulus measures in 2009-10 amount to above 1½ percent of GDP, and are estimated to raise real GDP by about 1 percent cumulatively. The measures are mostly front-loaded and relatively well diversified, with an emphasis on temporary investment expenditures and various tax breaks. An additional temporary effort for 2010 might be needed in the event that the economic downturn is deeper and more protracted than currently anticipated. Since fiscal space in France is limited, there would only be room for a modest additional effort, while it is important to ensure that all discretionary stimulus measures are indeed temporary.

7. **France's main fiscal challenge is to avoid an unsustainable public debt dynamics.** The impact of the recession will lead to uncomfortably high fiscal deficits and a further debt build-up in 2009 and beyond. Moreover, rising government expenditures related to the aging of the population will put pressure on the public finances. Staff welcomes the multi-year budget framework law adopted in January 2009 as a good opportunity to credibly strengthen fiscal consolidation. However, this approach needs to be reinforced by adopting more realistic growth assumptions, clearly articulating specific measures to contain spending at all levels of government, and streamlining tax expenditures and social contribution exemptions. The consolidation progress achieved by the central government should be complemented by strengthening fiscal responsibility of local governments. Continued efforts are also required to preserve the sustainability of the social security system.

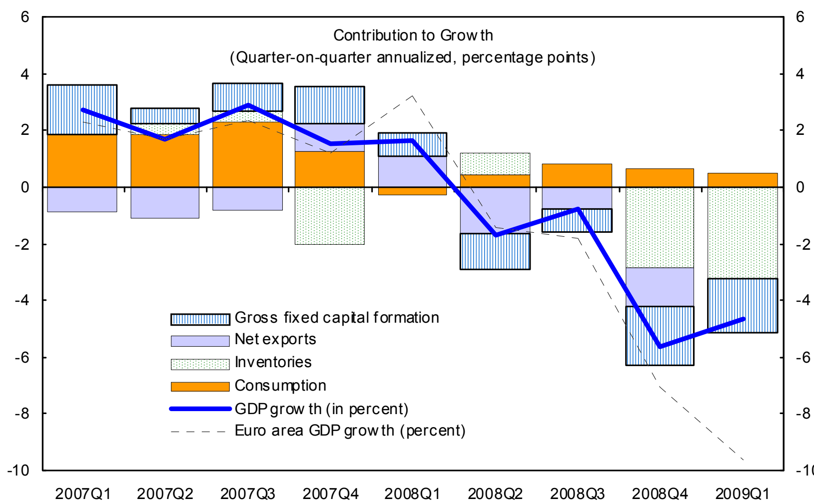
8. **Decisively pursuing structural reforms is essential for boosting competitiveness and growth, safeguarding fiscal sustainability, and raising welfare.** Important measures have been taken since the launch of the Government's 2007 economic program but much remains to be done to reduce long-standing structural rigidities. In view of the high returns, further action should focus on job creation, and on improving market efficiency and productivity. International experience has shown that strengthening labor market activation and training policies can be successful even in difficult economic times. Continued minimum wage moderation will support job creation for young and low-skilled workers, and improve labor-cost competitiveness. Raising the legal retirement age would help promote senior employment. The recent establishment of a single Competition Authority should help to further strengthen competition policies. The EU Services Directive also provides an opportunity for deregulating professional services.

9. **It is proposed that the next Article IV consultation be held on the regular 12-month cycle.**

II. Context: Into the Storm

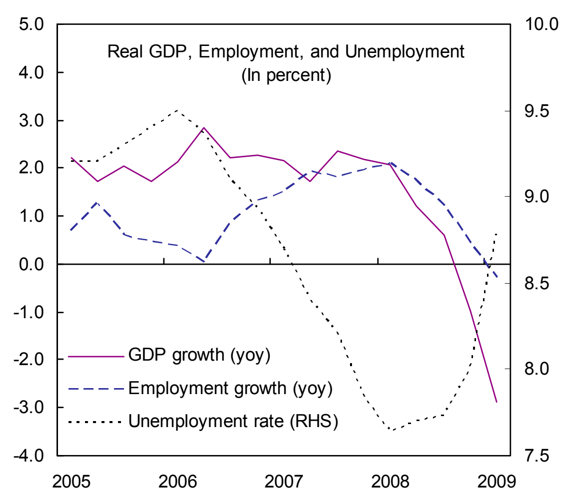
A. A Severe Recession Hit France in 2008

10. **The global crisis is exacting a heavy toll on the French economy.** Oil and food price shocks, the worsening of the financial crisis, and the global economic downturn already buffeted the economy in 2008, when real GDP growth slowed to a sluggish 0.4 percent. As world trade collapsed in the last part of the year, exports and business investment sharply contracted. A strong inventory correction contributed to a cumulative drop in real GDP by 2.7 percent over the last quarter of 2008 and the first quarter of 2009. Because of France's lower trade openness and its large social safety net, the downturn was somewhat less pronounced than in the euro area as a whole, in which real GDP decreased by 4.2 percent over the same period. A sharp adjustment of corporate investment and residential construction is expected to further weaken domestic demand, in spite of an expansionary fiscal stance. Private consumption is relatively more resilient but will most likely also be affected, with a lag, by rising unemployment and the continued weak household confidence. For 2009 as a whole, the authorities and staff expect real GDP to contract by 3 percent, with a tepid recovery starting only in 2010.



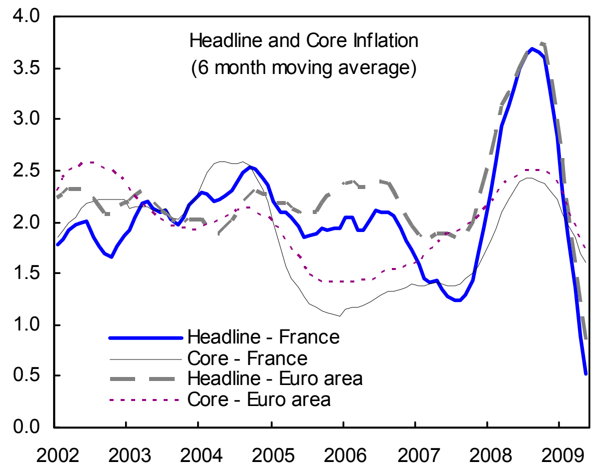
Sources: Eurostat and IMF staff estimates.

11. **Unemployment is on the rise again.** The unemployment rate reached a low of 7.5 percent in February 2008, about ¾ percentage point below the previous cyclical trough in June 2001. Since then, the rise of the unemployment rate has been steeper than in previous recessions, increasing to 9.3 percent as of May 2009. The likely further deterioration in the labor market and the uncertainty about income prospects are weighing on consumer confidence and spending.



Sources: IFS and Eurostat.

12. **The 2008 inflationary shock was potent but short-lived, and inflation is expected to continue falling in the coming months.** The surge in energy and other commodity prices in early 2008 caused a sharp spike in headline inflation to above 3½ percent by mid-year, similar to price developments in the euro area. After the summer, commodity prices came down rapidly and annual headline inflation fell below zero in May 2009. Core inflation has remained broadly stable at around 1½ percent, in line with the euro area average. Consumer prices will continue to decline on an annual basis during the remainder of the year as a result of base effects from the decline of commodity prices. However, entrenched nominal wage and price rigidities would prevent deflation from setting in. While a sizable output gap will subdue price increases, inflation is expected to rebound somewhat to about 1 percent in 2010.



Source: Haver Analytics and IMF staff estimates.

13. **Monetary conditions have eased and lending rates have come down, but market financing costs remain elevated.** The monetary conditions index (MCI) has come down sharply since mid-2008, reflecting ECB easing, including through unconventional measures. Although the ECB has aggressively supported bank liquidity following the worsening of the financial crisis in the latter part of 2008, money market activity has fallen sharply and credit has decelerated further. As of end-June, bank lending rates had declined from their heights at end-2008 by more than 100 basis points to around 4 percent for medium- and long-term loans and by about 200 basis points to around 3 percent for short-term loans. Corporate spreads have also narrowed but remain at a still high level of 255 basis points.

14. **The fiscal stance eased in 2008 and the fiscal deficit exceeded the Maastricht ceiling.** The general government deficit increased from 2.7 percent of GDP in 2007 to 3.4 percent in 2008, triggering a reopening of the European Commission excessive deficit procedure (EDP).[1] While primary expenditures were kept in check,[2] revenues were affected by the worsening economic situation and by tax cuts granted under the law on work,

[1] A previous EDP for France was closed in January 2007. EDPs with several other EU countries have also recently been opened.

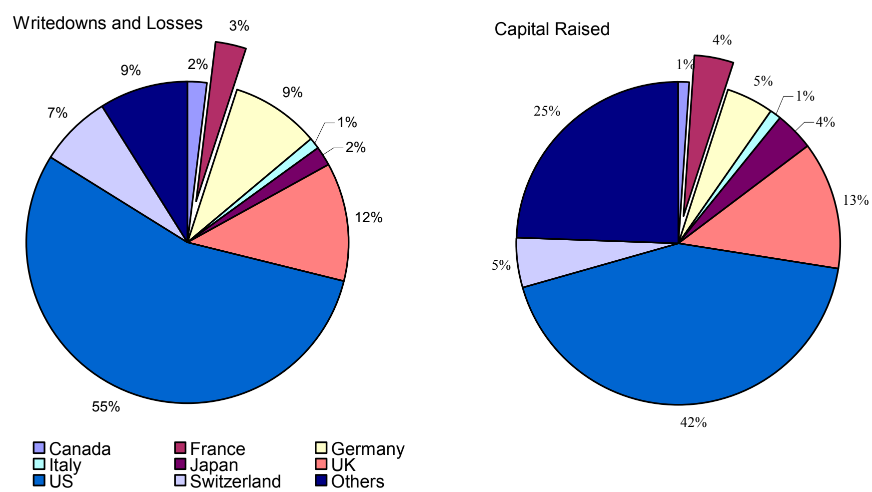
[2] The lower real growth rate of primary expenditures of 0.3 percent in 2008, compared to the average over the last decade of 2.2 percent, is partly the result of the pick-up in inflation but also reflects tighter control of health expenditures and lower spending growth of local governments.

employment, and purchasing power (*Loi de Travail, Emploi et Pouvoir d'Achat*, TEPA).[3] Although the TEPA law provides incentives to work more, it also entails sizable annual budgetary costs (0.3-0.5 percent of GDP in 2008).

B. The Financial Sector is Weathering the Crisis Comparatively Well

15. **French banks have been affected by the global financial crisis but have proved relatively resilient thus far.**[4] French banks have written down a large proportion of assets relative to their initial value. Total losses and write-downs of French banks since the onset of the crisis account for about 3 percent of losses and write-downs around the globe, considerably less than those of banks in the U.S., the U.K., Germany, and Switzerland, and less than the share of French banks in the global banking system.[5] The relatively less negative impact of the crisis on French banks thus far could reflect in part their relatively conservative lending practices and the consistent supervisory coverage of all lending institutions by the *Commission bancaire*. The crisis has resulted in a sharp drop in earnings and a significant rise in costs but most French banks continued to register net profits in 2008. While valuations of French financial stocks have declined steeply since end-2006, the deterioration was nevertheless somewhat less than in the U.S. and other countries in Western Europe. Reflecting rising global credit risk, CDS spreads of French banks have also increased considerably, but again on average somewhat less than for other European banks.

Geographical Distribution of Writedowns and Losses and of Capital Raised



[3] The TEPA law was adopted in August 2007 with a scheduled implementation period of five years. It includes the elimination of taxes and social security contributions on overtime work up to a ceiling; the deductibility of mortgage interest payments; the quasi-elimination of the inheritance tax; and the reduction of an overall tax ceiling to 50 percent of income.

[4] See also the chapter in the forthcoming Selected Issues Paper on "French Banks amid the Global Financial Crisis."

[5] French banks account for about 10 percent of world banking assets.

16. **The authorities responded to the deepening of the crisis in 2008 by taking a number of measures to recapitalize banks and support credit** (Box 1). These measures have helped to stabilize the financial system and thus far no French bank has ended up under majority state ownership. Total new capital raised by French banks, including in financial markets, accounts for about 4 percent of aggregate bank capital raised around the globe since mid-2007, similar to their share in global bank losses and write-downs. Annual credit growth slowed sharply from 13 percent in 2007 to less than 2 percent in April 2009. The credit squeeze is far from over and its effects on the real economy are still unfolding.

Box 1. Measures Taken by the Government to Support the Banking Sector

The French authorities have taken the following measures to support the banking system:

- In the aftermath of Lehman Brothers' bankruptcy, placed the French subsidiary of Lehman Brothers under state administration.
- Participated, with the governments of Belgium and Luxembourg, in the €6.4 billion recapitalization of Dexia group and agreed to guarantee debts issued by Dexia for a period of one year, extendable if necessary. The government contributed €1 billion and the *Caisse des Dépots et Consignations* injected €2 billion. The government has also issued guarantees on Dexia's obligations (to a maximum €55 billion).
- Set up the *Société de Financement de l'Économie Française* (SFEF), a bank refinancing agency with the purpose of boosting bank lending to households, SMEs, and local governments. The SFEF will be able to issue until end-December 2009 up to €265 billion (about 14 percent of GDP) of government-guaranteed obligations with maturities not exceeding five years. French banks that meet all prudential regulations will be able to borrow from the SFEF against collateral.
- Established the *Société de Prise de Participations de l'État* (SPPE) for bank recapitalization purposes. The SPPE is a fund of €40 billion (about 2 percent of GDP) that will finance itself on the market with its debt being guaranteed by the government. The six largest French banks have already obtained the first tranche of €10.5 billion in the form of Tier 1 qualifying subordinated loans. A second recapitalization tranche has been announced in the same aggregate amount.
- Supported the merger between *Groupe Caisse d'Épargne* (GCE) and *Groupe Banque Populaire* (GBP) with a total capital injection by the SPPE of €5 billion, of which €3 billion will be taken by the new merged entity.

Banks receiving state support must commit to increase credit to households, SMEs, and local authorities at a rate of at least 3-4 percent per year. The banks are also obliged to keep the government regularly informed on their progress in lending and must agree to follow certain compensation rules. In particular, the government has recently issued a decree banning stock options and limiting bonuses for bank managers; the decree is not retroactive and will run through 2010 but could be extended.

C. Macro-Financial Linkages Could Prolong the Crisis

17. **The deceleration of credit to the economy thus far was mostly related to waning demand but financial sector problems could slow the recovery.** Overall, the relative size of the financial sector has been stable since 2000 and its contribution to growth is smaller than in some other large economies. The links between the financial sector and the real economy, including wealth effects, are estimated to be weaker in France than in the U.S. or the U.K. Lending surveys indicate that the deceleration of credit to the private sector was more related to slowing demand than to the tightening in lending standards. However, the economic downturn may lead to an increase in counterparty risks for the financial sector and adverse feedback loops. The household saving rate has remained broadly unchanged over the last ten years, despite the doubling of house prices and significant fluctuations in equity prices. At the same time, household confidence is sensitive to developments in equity markets, and the deterioration of the financial environment could induce households to increase their precautionary savings.

18. **House prices saw a correction in 2008 and remain under pressure**. With an average annual growth rate of about 10 percent, above the euro area average, nominal house prices more than doubled over the last decade and were estimated to have been overvalued by some 20 percent compared to fundamentals in 2007.[6] House prices have declined so far by about 7 percent from their peak in the beginning of 2008. The resulting decline in construction activities has contributed to the economic contraction, although less than the drop in manufacturing output.

19. **Negative wealth effects of the house price correction are mitigated by the relatively low level of household indebtedness and the relatively difficult access to house financing.** Housing-related debt amounted to 35 percent of GDP and 53 percent of gross disposable income in 2007, both below the euro area average. French households have the most difficult access to mortgage financing among peer countries, and home mortgages are granted largely on the basis of the repayment capacity of the borrower rather than the (potential) value of the house.[7] The lack of financial instruments that promote consumer credit when households' wealth increases would also prevent a sharp deterioration of consumption when housing prices decline.[8]

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[6] See IMF, World Economic Outlook, The Changing Housing Cycle and the Implications for Monetary Policy, April 2008.

[7] The IMF World Economic Outlook of April 2008 contains a study that constructs a mortgage market index that lies between 0 and 1, with higher values indicating easier household access to mortgage credit. The French index has the lowest value of 0.23, while the index for Germany is 0.28, for the U.K. 0.58, and for the U.S. 0.98.

[8] In France, there is no mortgage equity withdrawal and no fee-free prepayment. The typical loan-to-value ratio is 75 percent and the average term is 15 years. Covered bond issuance accounts for only 1.6 percent of residential loans outstanding and mortgage-backed securities issuance amounts to 1 percent of residential loans outstanding.

III. OUTLOOK AND RISKS: IMPLICATIONS OF THE GLOBAL DOWNTURN

A. Outlook is Challenging

20. **Economic activity in France is expected to contract less than in major partner countries, but long-standing supply rigidities could hamper the recovery.** Unlike the U.K. and the U.S. economies, the French economy is not weighted down by unsustainable levels of household debt. French growth has been less export driven than in Germany and its production structure is relatively less specialized; as a result, the impact of the slump in foreign demand has been less pronounced (Box 2). Also, labor markets in France are relatively rigid, automatic stabilizers are important, and social protection is among the highest in the euro area. While these characteristics shield France somewhat from the current downturn, they are also likely to slow the pace of the recovery.

Box 2. Comparison of Business Cycle Fluctuations in France and Germany

The current downturn is deeper than in previous recessions. The recessions related to the oil crisis of 1974-75, the breaking of the inflation spiral in the early 1980s, and the EMS crisis in 1992-93 lasted on average three to four quarters and real GDP contracted by a maximum of 2.1 percent.

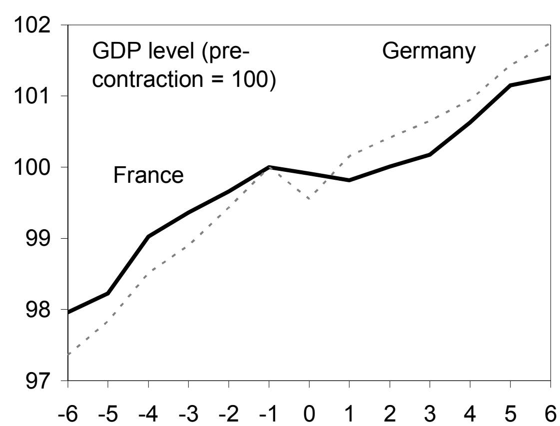
France has tended to experience less output volatility than Germany, with shallower recessions and more sluggish recoveries. Over the past 40 years, France has experienced about two-thirds less episodes of quarterly GDP contraction than Germany and two-thirds less episodes of consecutive quarterly contractions (a standard definition of a recession). During these episodes, the output contraction was generally smaller, but the subsequent recovery was also less strong.

Business cycle volatility and determinants

	France	Germany
Business cycle (1970-2008)		
Growth volatility (Std. dev. annual)	1.5	1.7
(Std. dev. quarter)	0.5	0.8
Episodes of negative quarterly growth	14	36
During which: average output decline	-1.4	-1.6
Trade and industrial specialization		
Industrial value added (% of GDP, 2007)	21.5	29.4
Exports G&S (% of GDP, 2000-08)	27.2	39.9
World demand (import growth of trade partners, 2009-10)	-11.9	-9.2
Automatic stabilizers		
Government revenues (% of GDP, 2008)	49.7	43.7
Social expenditures (% of GDP, 2007)	22.2	20.4

Sources: OECD; IFS; and IMF staff estimates.

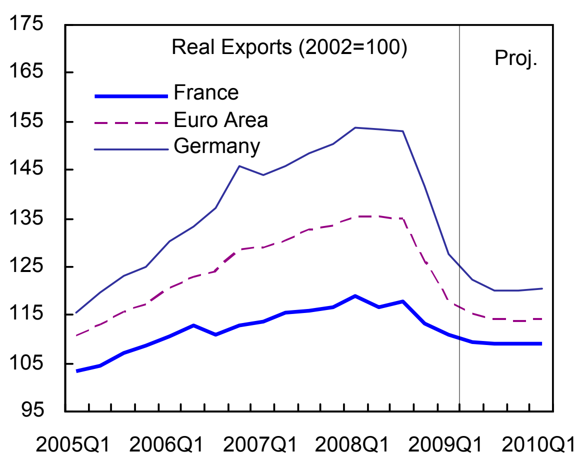
France and Germany: episodes of growth contraction

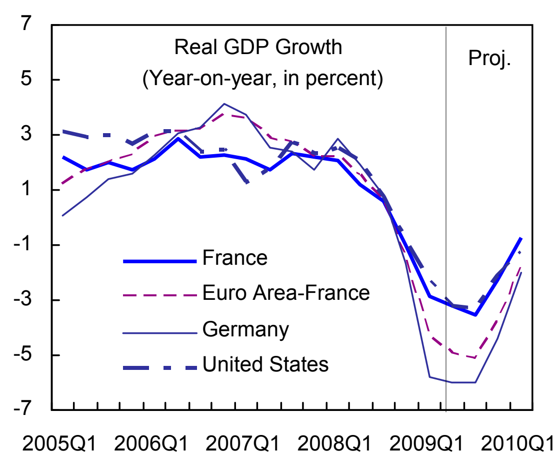


Episodes of quarterly GDP contractions over 1970-2007; index scaled by GDP the quarter preceding the contraction.

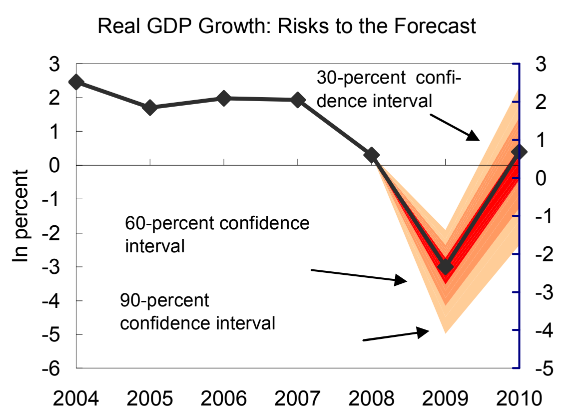
France is partly buffered by a smaller industrial and export-oriented sector. During the last decade, French exports to new EU members expanded relatively slowly and were somewhat hampered by their concentration on consumer goods which made them vulnerable to competitive pressures form emerging markets. Moreover, faster wage growth in France combined with the euro appreciation in recent years aggravated underlying competitiveness problems. While the smaller export sector implied that France benefited less from rising global demand, it also suffers less from its decline.

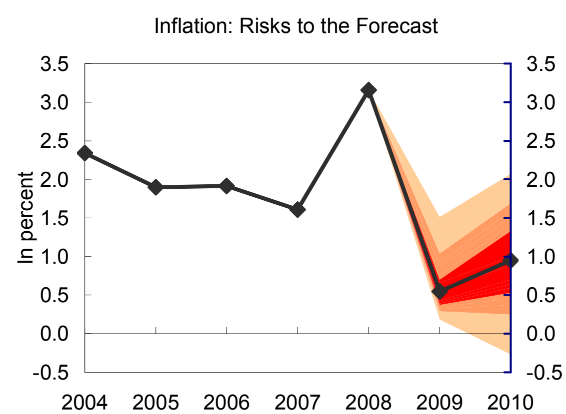
21. **The recovery is expected to be gradual, with GDP growth projected at ½ percent in 2010 and at about 2 percent on average over 2011-14**. Staff projects the fall in exports to slow in the period ahead, in view of the expected bottoming out of the recession in partner countries. Nevertheless, growth is expected to suffer from some further decline in net exports in 2010, while investment will only gradually recover. The positive dynamics provided by a resumption of private consumption and the gradual re-building of inventories will be modest. Net exports are expected to be supportive from 2011 onwards, while the gradual increases in investment and consumption should bring GDP growth above its potential rate. Nonetheless, staff expects an output gap to remain by 2014.





22. **Risks to the outlook are tilted mostly to the downside, linked to spillovers from France's high commercial and financial integration in the world economy.** Two-thirds of France's exports are destined to the European Union, and its trade performance would be

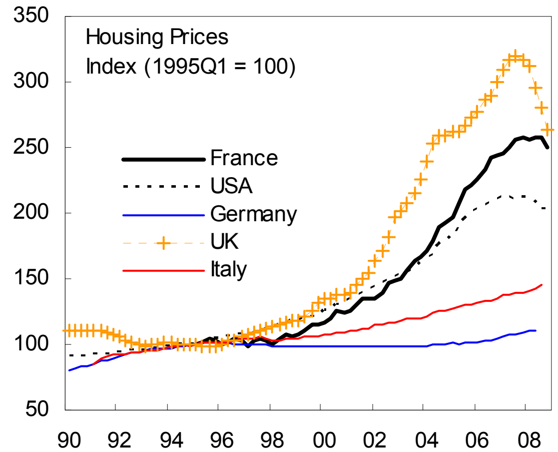




The chart includes the following risks to the baseline projections of growth (-3.0 percent in 2009 and 0.4 percent in 2010):
- persistent tightening of financing conditions;
- drop in foreign demand;
- earlier recovery of business confidence
- progress in reform agenda;

They are weighted by the staff's subjective probability assessment of their occurrence.
The risks to the inflation forecast (0.3 percent in 2009, 1.1 percent in 2010) are similar.

seriously affected by a further contraction in the region. While the French economy is less exposed to countries initially more affected by the global crisis, such as the U.S. and the U.K., the spillovers from the steep downturn in Germany have been significant. A worsening of the financial crisis would hurt banks' balance sheets and could further depress credit growth. The jump in unemployment this year and next could further shake confidence and weaken private consumption, which has been the bedrock of aggregate demand thus far. There is also a risk that a sharp housing price correction could dampen construction activity and, to a limited extent, household consumption. With sharply falling house sales, declining loan applications and waning consumer demand, the house price correction is expected to continue in 2009 and the first part of 2010. On the upside, the international fiscal stimulus and a recovery of global activity could speed up the restoration of confidence. Recent business indicators show some encouraging signs of stabilization, albeit at very depressed levels. Developments in France are estimated to have a limited impact on other regions outside the euro area.



Source: Global Insight.

B. Impact on Potential Growth

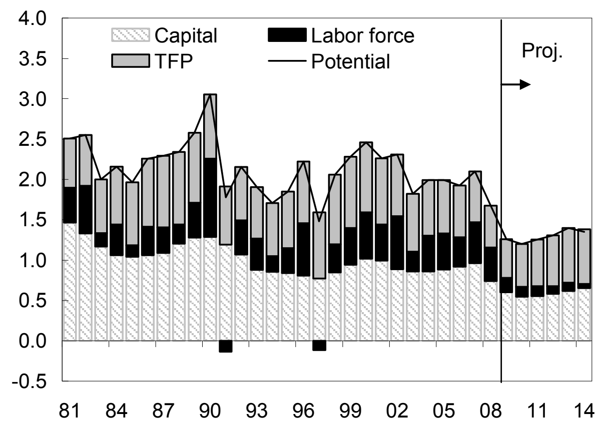
23. **Staff expects potential growth to slow by 1 percentage point to about 1 percent in 2009-14, due to the combined impact of demographic changes and the current crisis** (Box 3). Official projections foresee a decline in labor force growth by more than ½ percent in the next five years compared to the last decade, even under more favorable macroeconomic conditions than the current ones. In addition, the sharp contraction of investment and its expected gradual recovery are projected to reduce the growth rate of the capital stock by ¾ percent. Total factor productivity (TFP) growth is also projected to be lower in the short-run as the downturn will temporarily reduce allocative efficiency. Once the adjustment following the crisis has been completed, potential growth is projected to rebound to close to 1½ percent. The authorities have also revised their potential growth projections downward but to a lesser extent. They argued that the recovery would be supported by a stronger pick-up in business investment, while the structural transformations induced by the crisis could support TFP growth, as for example experienced by the Nordic countries in the 1990s.

Box 3: Impact of the Crisis on Potential Output

Potential growth is expected to slow due to the combined impact of the current crisis and demographic changes. To account for the impact of factor inputs, a simple Cobb-Douglas production function has been used, calibrated with a capital-output ratio set at 0.4, broadly in line with the share of capital income in GDP. In this set-up, annual potential growth is expected to decline from 2 percent in 2000-08 to 1 percent in 2009-14.

- The growth contribution of the labor force is projected to decline by 0.4 percent, in line with the 2006 INSEE labor force projections. The impact on effective labor is only marginally compensated by the end of the trend decline in working hours.
- The growth contribution of the capital stock is projected to decline by 0.3 percent, reflecting the broad standstill of investment in 2008 followed by the expected sharp contraction in 2009, and a gradual recovery thereafter.
- TFP growth is projected to suffer from the crisis but converge back to its long-term average rate of ½ percent. To account for the adjustment cost of the crisis (reduced allocative efficiency and loss of labor skills arising from prolonged unemployment), the projections incorporate a discount of ½ percent in 2008-09, which gradually disappears by 2014.

France. Contribution to potential growth, 1981-2014



Source: IMF staff estimates.

The long-term impact of the current crisis on potential output could be more severe than assumed under the baseline scenario:

- The INSEE labor force projections assumed that higher fertility, larger immigration, and higher labor force participation rates (in part due to pension reform), should delay the decline of the labor force to 2015. However, this projection was based on relatively favorable economic conditions. Although the higher unemployment could force workers into the labor force to obtain complementary income, the discouraged worker effect seems to dominate in France.[1] In addition, the mounting unemployment could also discourage inflows of migrant workers.
- By forcing a restructuring of the economic landscape, the crisis may render obsolete a substantial fraction of the existing capital stock.

[1] A. Jacquot (1997), *Les flexions des taux d'activité sont-elles seulement conjoncturelles?* Économie et Prévision, No. 127.

IV. Policy Challenges: Responding to the Financial Crisis, Safeguarding Fiscal Sustainability, and Increasing Growth

24. **In a difficult environment, France needs to address sometimes conflicting short and medium term policy challenges.** Short term policies have to respond the crisis, with an emphasis on financial sector stabilization and an appropriately supportive fiscal stance. Yet long-standing concerns—fiscal sustainability and more flexible structures to support growth—are also weighing into the policy mix.

A. Policies to Preserve Financial Stability

25. **The authorities have taken important policy actions to support the financial sector and showed concern about maintaining credit to the economy.** Capital injections through the SPPE have enhanced the banks' capital adequacy; the upfront fiscal costs amount thus far to 0.7 percent of GDP. The ability of the SFEF to attract a wide range of investors from various market segments and to place debt at very tight spreads has helped banks to expand their lending capacity at low funding costs. Thus far, the SFEF has issued €62 billion of government-guaranteed debt. Also, the creation of an independent *médiateur de crédit* is helpful to ensure fair lending practices. However, the numerical credit targets attached to the government support of banks are prone to creating distortions. The authorities pointed out that the credit targets reflect their concern about maintaining credit growth in the economy and would be implemented judiciously, taking into account the declining demand for credit. Government support of the merger between GCE and GBP with capital injections and the setting of conditions for further government intervention were positive steps in moving towards resolving problems in a subsidiary of these two banks (*Natixis*). The implementation of some measures under the *Paris-Place Financière* initiative and the generalized distribution of the *Livret A* are welcome steps to increase competition and efficiency in the financial sector.

26. **Although capital adequacy ratios have improved, the banks' leverage is still relatively high.** Government capital injections and the banks' own capital-raising efforts have helped to compensate the decline in retained earnings and raised the average Tier 1 ratio from 7.7 in 2007 to 8.3 in 2008, in line with the average in peer countries. Leverage, measured as the ratio of total assets to total capital, stabilized at 24. While banks have improved their shock-absorption capacity, some amount of deleveraging may still be needed.

27. **The overall risk from exposure to emerging markets appears manageable.** The banks' exposure to offshore financial centers and emerging markets is limited and geographically diversified. Exposure to emerging markets represents 4 percent of total bank assets (14 percent of GDP), similar to that of German banks and higher only than the relatively low level of U.S. banks. The exposure is geographically diversified, with CEE representing about 37 percent of the total exposure to emerging markets. Exposure to the

Czech Republic, Poland, and Russia accounts for half of the banks' total exposure to CEE. Among the three major French banks exposed to CEE only one bank has a sizable involvement.

Foreign Claims of Banks on Individual Countries, December 2008
(In percent of bank assets)

	France	Austria	Germany	Sweden	Switzerland	U.K.	U.S.
All countries	33.4	33.0	38.2	53.1	63.5	34.8	5.7
Mature market (MM) countries	28.6	13.9	32.4	42.9	55.0	25.1	3.7
Offshore centers	1.3	0.7	2.0	1.1	4.0	4.2	0.4
Emerging market (EM) countries	3.5	18.4	3.8	9.0	4.5	5.5	1.6
Of which:							
Africa and Middle East	1.0	0.4	0.5	0.2	0.6	1.6	0.1
Asia and Pacific	0.8	0.3	1.0	0.3	1.5	2.6	0.7
Central and Eastern Europe	1.3	17.7	1.9	7.9	1.4	0.3	0.2
Latin America/Caribbean	0.3	0.1	0.3	0.1	0.9	0.8	0.5

Sources: BIS, Haver Analytics, IFS, WEO, and IMF staff estimates.

28. **The mature market bias of French banks suggests that spillovers from aggravated financial sector stress in these countries would have a material impact on their risk profile.** French banks' exposure to foreign markets is not excessive and tilts towards mature markets. Foreign claims represent 33½ percent of bank assets and 125 percent of GDP, a moderate level compared with banks in peer countries. Exposure to mature markets represents 85 percent of total foreign claims in 2008 (both interbank and corporate lending), with exposure to Germany, Italy, the U.S., and the U.K. accounting for half of the total exposure to mature markets. As a result, France is vulnerable to a further deterioration of the financial systems in these countries.

29. **Pressures on bank earnings and profitability are mounting and the financial turmoil will likely continue to exert an adverse impact on financial performance for some time.** Earnings risks come not only from decelerating lending, but also from the trading book due to high market volatility and valuation uncertainty. With the turn of the economic and credit cycle, as well as the ensuing rise in defaults, asset quality has deteriorated. The share of impaired loans in the total loan portfolio increased slightly to 2.8 percent in 2008. Increased risk aversion is reducing investors' appetite for complex corporate and investment banking (CIB) products and services, which would materially compress CIB revenues and depress profitability. The unfolding feedback loops between the financial sector and the real economy may lead to an increase in counterparty risk. Remaining toxic assets as well as other risky assets held on the banks' books, including leveraged buy-out (LBOs) and collateralized loan obligations (CLOs), may incur additional losses and write-downs.[9]

[9] At end-2008, remaining toxic assets of major French banks stood at about €18 billion and total exposure to LBOs and CLOs amounted to €37 billion, together estimated at less than one percent of total bank assets.

30. **Additional measures, some of which are already in train, may be necessary to strengthen financial stability.** Specifically, staff makes the following recommendations:

- Carry out rigorous, preferably EU-wide coordinated stress tests, focusing on the quantity and quality of capital needed, followed up with appropriate disclosure;
- On the basis of such stress tests, if needed, follow-up action should be taken to further recapitalize banks and ensure sound balance sheets;
- Continue to prompt banks to improve the quality of their capital by reducing the proportion of hybrid capital and increase the proportion of core capital given investors' focus on capital quality;
- Support confidence in the financial system through continued adequate supervision and full transparency about the financial standing of key institutions; and
- Continue to prompt banks to implement fully measures to strengthen internal controls and operational risk management, and restructure CIB activities.

31. **Going forward, the French authorities agreed that maintaining adequate capital and continued supervisory vigilance are needed.** They were confident about the resilience of the French banking sector and the adequacy of the banks' capital level. They also noted the improvement in corporate governance of mutual banks. Acknowledging the ongoing deterioration in bank profitability and increase in counterparty risk, they agreed, however, that additional write-downs may be needed and further losses from certain risky assets and banking activities are a concern. Financial supervisors assured staff of their continued vigilance and determination to timely take any action needed to ensure financial sector soundness. They considered that the leverage ratio should be interpreted with caution in view of possible differences in accounting practices. The stress tests conducted by the supervisory authority based on end-2008 data showed the banks' continued resilience under different scenarios.[10] The authorities also agreed with staff on the importance of carrying out further EU-wide stress tests but emphasized the need for an agreed approach among all participating member countries to disclosure of the results.

32. **International coordination and cooperation are essential and France has been active in supporting European regulatory reform.** The French authorities have proposed a series of steps, including: (i) strengthening supervision of EU-wide financial groups; (ii) harmonizing regulatory frameworks; (iii) undertaking joint supervision of cross-border banks and insurance companies; (iv) enhancing transparency and surveillance of non-regulated markets, credit rating agencies, and compensation; and (v) strengthening internal controls and

[10] The authorities confidentially shared with staff the aggregated results of these stress tests.

governance. France is instrumental in promoting hedge fund regulations and could play an important role in supporting the recommendations of the de Larosière group.[11] The authorities expressed their continued strong support for international harmonization of regulations and supervisory practices and their preference for a simple and clearly defined capital adequacy measure. They also agreed with staff on the importance of strengthening international cooperation on financial sector exit strategies, particularly on the maximum coverage of deposit insurance and bank-asset guarantees across the European Union, to avoid destabilizing financial flows.[12]

B. Providing Economic Stimulus While Safeguarding Fiscal Sustainability

33. **The initial 2009 budget aimed at containing the fiscal deficit at 2.7 percent of GDP, followed by a gradual consolidation to achieve fiscal balance by 2012.** The budget also included a set of revenue and expenditure measures aimed at boosting economic activity. On the revenue side, cash-flow support through monthly rather than quarterly VAT reimbursements and tax credits on R&D outlays aimed at relaxing liquidity constraints for enterprises, especially SMEs. Combined with the third-year implementation of the TEPA law, total tax relief in the initial budget represented 0.4 percent of GDP. On the expenditure side, the introduction in July 2009 of a new earned-income supplement (*Revenu de solidarité active,* RSA) that smoothes the effect of benefits thresholds to increase incentives for the low-skilled to seek employment would increase social benefits by about 0.1 percent of GDP.[13]

34. **As the economic outlook deteriorated, the authorities adopted additional stimulus measures and let the automatic stabilizers operate fully.** The discretionary fiscal stimulus amounts to above 1½ percent of GDP in 2009-10, and the automatic stabilizers are estimated to amount to some 3 percent of GDP per year. The size of the discretionary fiscal stimulus is suitable in light of the sizable automatic stabilizers, and is in line with the EU European Economic Recovery Plan.[14] The fiscal stimulus plan is well-diversified and the measures are timely and relatively well-targeted (Box 4). Good public financial management helps to keep the execution of the stimulus package on track. Although the counter-cyclical fiscal stance is cushioning the downturn, it would, together with the drop in tax revenues, increase the

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[11] See http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf. The group proposes to set up: (i) a European Systemic Risk Council (ESRC) linked to the ECB to bridge macro- and micro-prudential oversight; and (ii) a European System of Financial Supervisors (ESFS) to oversee the work of national supervisors.

[12] The French deposit insurance limit has been kept unchanged at €70,000.

[13] The total cost of the RSA is estimated at 0.5 percent of GDP, but its net cost (after accounting for savings from consolidating previous low-income supplements) is only 0.1 percent of GDP, which is financed by an additional social charge on investment income. In the December 2008 stimulus package, a one-off allowance (€200) was disbursed in April to people likely to be RSA eligible.

[14] Commission of the European Communities, November 2008.

Box 4: Discretionary Fiscal Stimulus and its Impact

Discretionary fiscal stimulus measures to date amount to 1.2 percent of GDP in 2009 and 0.5 percent in 2010. The 2009 budget already contained some relief measures to households and businesses, including the TEPA law and the implementation of the RSA. Subsequently, the government announced a €26 billion (1.4 percent of GDP) fiscal stimulus plan (*Plan de relance*) for 2009-10, followed by a package of household tax breaks and social benefits (0.1 percent of GDP); reduction of the VAT rate for restaurants to 5.5 percent (0.1 percent of GDP); loans to the car industry (0.3 percent of GDP); and the phasing-out of the *taxe professionnelle* (0.6 percent of GDP). The last two measures are not included in the headline fiscal stimulus, because loans are registered below the line and the reduction of the local business tax is expected to be offset by other tax increases.

France. Fiscal stimulus, 2009-10

	In percent of GDP	
	2009	2010
Measures in 2009 budget		
Cash flow measures	0.3	<0.1
TEPA law	0.1	0.1
Other	<0.1	0.1
New measures		
Public investment	0.3	0.2
Social safety net	0.1	<0.1
Other expenditures	0.2	<0.1
Personal income tax	0.1	0.0
Corporate income tax 1/	0.0	<0.1
VAT	0.1	0.1
Total general government	1.2	0.5
Memorandum		
Investment of public enterprises	0.2	0.1
Credit support to the auto. sector	0.3	0.0

Sources: French authorities and IMF staff estimates.
1/ Excluding the phasing out of the *taxe professionnelle*.

The stimulus measures are relatively well diversified, front-loaded, and with an emphasis on temporary investment expenditures and tax breaks:

- Immediate support has been provided to the corporate sector through a series of cash-flow measures (tax credits on R&D outlays, accelerated reimbursement of VAT credits, and accelerated depreciation of investment).
- Public investment will be boosted by direct infrastructure investment at the central government level, the provision of matching revenues to local authorities, and infrastructure projects to be implemented by public enterprises.
- Households will benefit from a temporary reduction of the personal income tax in 2009, public expenditures on social housing, additional unemployment benefits, and the extension of the social safety net through the RSA.

The stimulus is estimated to raise real GDP by about 1 percent cumulatively in 2009-10. Estimates of fiscal multipliers vary widely but studies generally concur on finding a higher multiplier for direct expenditures than for tax relief. In the case of France, staff estimates that the tax multipliers are in the range of 0.2-0.4 and expenditure multipliers in the range of 0.9-1.1.[1] Assuming a full compensation of the local business tax in 2010, the discretionary fiscal stimulus is expected to result in a net real GDP impact of 0.7 percent in 2009 and of 0.2 percent in 2010.

[1] See the chapters on fiscal policy in the forthcoming Selected Issues Paper.

overall fiscal deficit to almost 7½ percent of GDP in 2009. Taking account of the upfront fiscal cost of the financial sector measures, the public debt is projected to increase to 77.5 percent of GDP in 2009 from 67.5 percent in 2008.[15]

35. **In the event that the economic downturn will be deeper and more protracted than currently anticipated, some additional fiscal stimulus might be needed in 2010 but fiscal space is limited** (Box 5). Given the uncertainty around the baseline forecast, a possible worsening of the economic outlook cannot be dismissed. Taking into account the trade-off between the costs of additional debt and the potential benefits of further stimulus, staff estimates that France could afford only a modest additional fiscal effort. The authorities indicated that any additional stimulus would focus on measures which have the largest fiscal multipliers, e.g., public investment and targeted transfers. They also noted that a continued accommodative monetary policy stance of the ECB would support the effectiveness of the fiscal stimulus.

36. **In view of the strong need for medium-term fiscal consolidation, fiscal stimulus measures should include sunset clauses or be automatically reversible.** In particular, this would be desirable for the recently implemented VAT reduction for restaurants that introduces an additional distortion in the tax system without generating broader economic benefits. The elimination of the part of the local business tax (*taxe professionnelle)* that hurts business investment is an important step toward streamlining the tax system. The authorities have indicated that its implementation will be guided by the principle of revenue neutrality, while seeking not to add to the already high tax burden on enterprises.

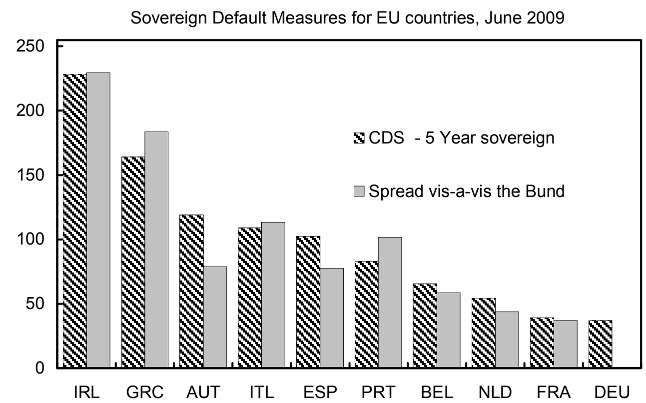
37. **Over the medium term, the main fiscal challenge remains to consolidate the public finances as unchanged policies would lead to an unsustainable debt dynamics.** The multi-year fiscal framework law adopted in January 2009 envisages reducing the structural balance to close to zero by 2012. This fiscal consolidation is based on the government's commitment to moderate real expenditure growth to about 1 percent but underlying growth assumptions seem overly optimistic.[16] The government's recent spending proposals (excluding stimulus measures) for the 2010 budget are in line with the expenditure targets contained in the fiscal framework law. In addition, the President has announced a new national loan to finance strategic priorities. While the size and content of this plan are still under discussion, significant new spending would not be consistent with fiscal consolidation. Under current policies and taking account of the economic downturn, staff projects France's structural fiscal deficits over the medium-term to remain broadly flat at almost 4½ percent of

[15] The debt numbers do not include guarantees on non-general government debt.

[16] The growth rate of real expenditures of the central government would be limited to zero percent, of the local government to 1¼ percent, and of the social security administration to 1¾ percent. Real GDP growth was assumed to be 0.2-0.5 percent in 2009, 2 percent in 2010, and 2½ percent in 2011-12.

Box 5. How Much Fiscal Space has France for an Additional Fiscal Stimulus in 2010?

The benefits of additional fiscal stimulus must be balanced against the costs. In the current context of financial crisis and severe downturn, a fiscal stimulus can help prevent a drastic further deterioration in activity. However, fiscal priorities such as keeping the debt under control or promoting policy credibility may outweigh the benefits of fiscal easing. Among the factors determining fiscal space are financing and sustainability constraints, institutional limits, and credibility issues.



Source: Bloomberg and Datastream.

- **Financing constraints**. Measures of sovereign default risks have risen since early 2008, showing an increased perception of sovereign risk. However, compared to its EU partners, France enjoys a relatively favorable position and ranks well compared to its peers.

- **Sustainability constraints and institutional factors.** According to the SGP criteria, all key fiscal indicators such as the current and prospective debt levels, the fiscal deficit, and the difference between the interest rate on public debt and the GDP growth rate indicate that France has no additional fiscal space.

- **Credibility factors.** Historically, French fiscal policy has shown a deficit bias, responding asymmetrically to shocks by loosening during downturns but only modestly consolidating during expansions. Stimulus measures enacted during downturns have often become permanent, placing upward pressure on the public debt. The multi-year fiscal framework law is an important step forward to raise credibility.

GDP. Given the expected persistence of a negative output gap, the overall deficit will remain largely above the 3 percent Maastricht threshold and the public debt ratio would surpass 90 percent by 2012. Looking ahead, rising debt service obligations will aggravate the fiscal costs related to population aging. Therefore, decisive implementation of a clear consolidation strategy at all levels of government needs to be anchored in the 2010 budget and pursued in the new multi-year fiscal framework to be prepared next year. Historical experience indicates that successful fiscal consolidations were often launched in the midst of economic downturns or the early stages of recovery.

38. **Starting in 2010, strictly containing real expenditure growth is required to initiate a reduction in the public debt ratio and bring the deficit below the ceiling of 3 percent of GDP.** While preparing for contingency stimulus measures, the government should at the same time adopt credible medium-term consolidation plans to anchor

expectations. The table below illustrates the fiscal outcome under two different assumptions on the real growth rate of structural primary expenditures (i.e. excluding discretionary fiscal stimulus and unemployment benefits). The baseline scenario, based on current policies, acknowledges the efforts made since 2008 to contain spending growth, notably the maintenance of non-replacement of every second retiring civil servant in the central government, but also assumes a somewhat larger inertia of expenditures than assumed in the multi-year fiscal framework law. It assumes a real growth rate of primary structural expenditures of 1.4 percent, above the average potential growth rate, which would not enable to stabilize the debt ratio nor reduce the deficit under the Maastricht ceiling. The second scenario illustrates the effects of decisive consolidation efforts. It assumes that the real growth rate of structural primary expenditures will be limited to 0.4 percent from 2010 onwards. This would ensure a steady reduction in the structural deficit. Given the persistence of a negative output gap, the overall deficit would remain above 3 percent of GDP through 2013. After peaking in 2013, the public debt-to-GDP ratio would start to decline.

France: Selected Fiscal Indicators, 2008-14
(in percent of GDP)

	2008	2009	2010	2011	2012	2013	2014
Baseline scenario							
Fiscal balance	-3.4	-7.4	-7.5	-7.1	-6.6	-5.9	-5.2
Structural balance	-3.3	-4.0	-4.0	-4.2	-4.5	-4.5	-4.6
Cyclical balance	-0.1	-3.4	-3.5	-2.9	-2.1	-1.3	-0.7
Primary fiscal impulse 1/	0.0	-1.2	0.4	0.2	-0.1	0.0	0.1
Debt	67.5	77.5	83.9	88.3	91.7	94.1	95.6
Consolidation scenario 2/							
Fiscal balance	-3.4	-7.4	-7.0	-6.1	-5.1	-3.9	-2.7
Structural balance	-3.3	-4.0	-3.5	-3.2	-3.0	-2.5	-2.0
Cyclical balance	-0.1	-3.4	-3.5	-2.9	-2.1	-1.3	-0.7
Primary fiscal impulse 1/	0.0	-1.2	0.9	0.6	0.4	0.5	0.5
Debt	67.5	77.5	83.4	86.8	88.8	89.2	88.3

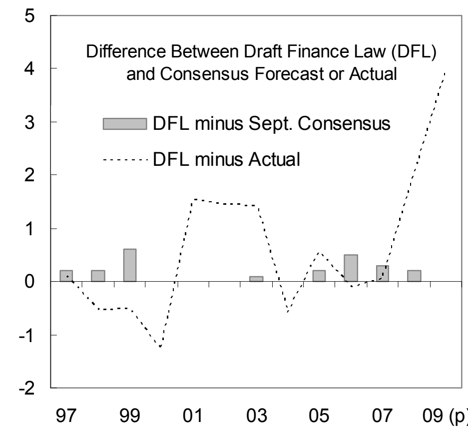
Source: IMF staff estimates.

1/ Primary fiscal impulse: increment of the primay structural balance (not reported).
2/ Assume a growth of real primary expenditures (excl. unemployment and fiscal stimulus) of 0.4 instead of 1.4 percent from 2010 onwards.

39. **Fiscal consolidation would benefit from institutional reforms in the budget process:**

- **The credibility of the budget needs to be strengthened.** Since 2001, the balanced budget goal has been announced but continuously postponed. In spite of repeated commitments, the deficit has never dipped under 2 percent of GDP, which has undermined the government's credibility. The multi-year budgeting approach could provide the framework to restore credibility to the process but should be reinforced by clearly articulating specific measures to achieve the announced fiscal targets. The authorities could also benefit from adopting contingency spending reduction plans. Increased ownership of the consolidation goals at all levels of government could help achieve the necessary expenditure restraint.

- **Basing budget projections on more realistic macroeconomic assumptions would help ensure that the objectives are achieved.** Overly sanguine growth assumptions are bound to lead to disappointing revenue collection and too high spending growth. The government's assumption of real GDP growth of 2½ percent in 2011-12 appears too optimistic in light of the current growth outlook.



40. **The general review of public policies (*Révision Générale des Politiques Publiques*, RGPP) was launched in 2008 and the government's commitment to pursue the ensuing reforms is to be commended.** However, the budgetary savings identified so far (½ percent of GDP) are insufficient to bring the public finances on a sustainable path and the measures identified in the RGPP to improve spending quality at the central government level need to be complemented by similar reviews for other levels of government.

41. **The consolidation progress already achieved by the central government is encouraging**. The objective of zero growth of real expenditures by the central government would need to be maintained even when rising debt service would force offsets in other expenditures. The authorities indicated that they intend to continue to focus on reducing public sector employment (non-replacement of every second retiring civil servant).

42. **Caution should be given not to erode the benefits of improved spending discipline through further recourse to already very large tax expenditures and social contribution exemptions** (*niches fiscales et sociales*). In this respect, completion of the general review of the tax system (RGPO) would help streamline tax expenditures.[17] Some countries (e.g., Canada) have succeeded in reducing tax expenditures, which tend to be nontransparent and distortive. A key element is to incorporate the ongoing annual reviews in the government budget; these reviews should assess these policies on their relevance, effectiveness, and cost-efficiency. A thorough tax review would also help to streamline the tax code, broaden the tax base, and move to more unified VAT rates, in order to increase tax productivity and reduce incentives to shift activities to the informal sector. An increased use of environmental taxation would match recent initiatives proposed by several European countries.

[17] Revenue losses are estimated at about €70 billion per year (some 3½ percent of GDP).

43. **Greater fiscal responsibility at the local government level is vital to healthy public finances**. Increased devolution of responsibilities to local governments has so far failed to deliver more fiscal discipline through a clearer connection between the cost and the benefits of public services. The civil service reduction implemented at the central level was broadly balanced by hiring at the local government level. The spending drift by overlapping regional and local government structures would need to be reassessed. In this respect, the arrival of large cohorts of local civil servants at retirement age after 2010 provides an opportunity for savings by extending the policy of non-replacement of every second retiring civil servant to local governments. The authorities indicated their intention to take action based on the recommendations of the Balladur Committee which focus on improving local government effectiveness.

44. **With an aging population, continued efforts are necessary to ensure the sustainability of the social security system**. The reform of special pension regimes in 2007 and the gradual increase of the contribution period needed for entitlement to a full pension will slightly reduce the significant projected financing gaps in the period ahead. Reforming the structure of the pension system could limit its fiscal cost for new entrants in the labor market. However, the legal pension age of 60 years remains considerably below that in other euro area countries. The authorities have initiated welcome first steps toward discussing the pension age with social partners, and this discussion should be intensified as part of the planned social dialogue "*Rendez-vous 2010*." With respect to health costs, expenditure control has helped to reduce spending slippages, but further action is needed. It is also important to adequately take account of rising long-term health expenditures resulting from technical progress in health services and to start preparing an appropriate policy response.

45. **The success of fiscal consolidation will be helped by progress in implementing the structural reform agenda.** Although France is not expected to grow out of its public debt, measures to raise labor force participation and productivity would significantly contribute to ensuring long-term fiscal sustainability.

C. Competitiveness and Structural Reforms Critical for Higher Growth

46. **The French economy needs to boost its potential output.** It is therefore crucial to pursue steadily the reform agenda started in 2007, as structural rigidities would also negatively affect the expected pace of the recovery. Significant structural reforms have been initiated but lack of competitiveness remains the main issue behind the current account deficit and structural rigidities still hamper labor and product markets.

47. **Despite a modest improvement since end-2007, a competitiveness gap, in particular with Germany, remains**. The current account balance has improved in late 2008, after an almost continued deterioration since 2002, although foreign market shares have continued to slide. Since 2002, the REER has appreciated by 10 percent (both based on consumer prices and on unit labor costs), reflecting in part the 40 percent appreciation of the

euro/U.S. dollar exchange rate over the same period. However, the REER, based on consumer prices, is only 1 percent higher than its average level over the past 30 years. Assessments based on the CGER methodologies point on average to a small overvaluation in 2008, which was partly corrected by end-March 2009. Overall, the evolution of the REER cannot fully explain France's disappointing export performance. While higher wage increases in France than in the euro area as a whole were compensated by somewhat higher productivity growth, the rise in unit labor costs vis-à-vis Germany has resulted in a loss of competitiveness. Supply rigidities in responding to changing global demand have also hampered export performance. Wage moderation and structural reforms are needed to close the competitiveness gap.

Estimates Applying the CGER Methodology 1/

	France		Euro area	Germany	Italy
	Current estimate (Apr. '09)	Previous Article IV (Dec. 07)			
Current account norm (macro balance)	-6	1	5	0	18
Equilibrium exchange rate (EREER)	4	1	17	6	9
NFA stabilizing (External sustainability)	9	9	0	-13	16
Average	2	4	7	-2	14

1/ Positive number indicates that REER is above equilibrium.

48. **Increasing the employment rate would boost potential output, smooth distributional inequalities, and help restore fiscal sustainability**. France has one of the lowest employment rates among OECD countries—especially among seniors, low-skilled, and young workers. Lifting the French employment rate (65.2 percent of the labor force) gradually to the average level in the euro area (67.3 percent) would boost the potential growth rate by up to ½ percent over the medium term and reduce unemployment-related government expenditures by up to 1 percent of GDP. The labor market modernization law (*Loi de Modernisation du Marché de Travail*, MMT) adopted in June 2008, following negotiations with the social partners, has somewhat eased labor contract regulations and lifted some restrictions of the 35-hour work week but the tax and social contribution exemptions of overtime work weigh heavily on the public purse. Vigorously pursuing labor reforms should include:

- Fully equipping the unified job placement agency (*Pôle emploi*) to effectively boost support to unemployed workers and strictly enforce job-search requirements. International experience points to the need to focus on job training, placement services, and cooperation with private agencies, in order to strengthen activation policies.

- Helping low-skilled workers enter the job market. The recently introduced RSA is a step in the right direction to remove inactivity traps keeping potential low-skilled workers out of the labor force. In addition, moderation of the relatively high minimum wage (SMIC) needs to be pursued in order to help low-skilled workers find a job and reinforce the trend decline in the share of workers paid at the SMIC.[18] The creation of the independent expert commission for SMIC review is a welcome step in this regard. Beyond labor costs, low-skilled workers are also penalized by the lack of competition in several service sectors that prevents innovation and job creation.

- Promoting "senior labor." France has implemented several reforms, notably the gradual withdrawal of the waiver on job-search requirements for older unemployed workers and the gradual increase in the contribution period needed for obtaining a full pension. In addition, the government and the social partners should find an understanding on the need to raise the legal retirement age to facilitate entry for older workers. Effective vocational training and activation policies are also required to help senior workers rejoin the labor market.

49. **Further product market reforms are essential for energizing economic growth, creating jobs, and increasing consumer welfare.** The inflation dynamics initiated by the boom in energy and commodity prices in early 2008 have highlighted some concerns about price-setting in food and retail markets. Promoting competition would be a durable way to raise purchasing power, while supporting productivity growth and enhancing competitiveness.

50. **Retail trade has been partially liberalized but important steps remain to be taken.** Staff welcomes the recent establishment of a single and reinforced Competition Authority, which should help implement stronger competition policies and increase the visibility of resulting benefits. The economic modernization law (*Loi de Modernisation de l'Economie*, LME) has eased some restrictions on new retail establishments but discounters continue to face administrative limitations to entry into the French market. Deregulating opening hours and sales periods of stores would promote a more competitive environment leading to lower prices for consumers. Also, the benefits to the consumer of ending price regulations on key products, for example over-the-counter drugs, would be enhanced if followed by market liberalization.

51. **The EU Services Directive provides an opportunity for further liberalization that should be fully seized.** The OECD has identified that in France entry barriers and restrictions on professional services go beyond what is needed for consumer protection. Introducing greater competition in health-related services and professional services to businesses and individuals (notaries, accountants) would be a welcome structural reform.

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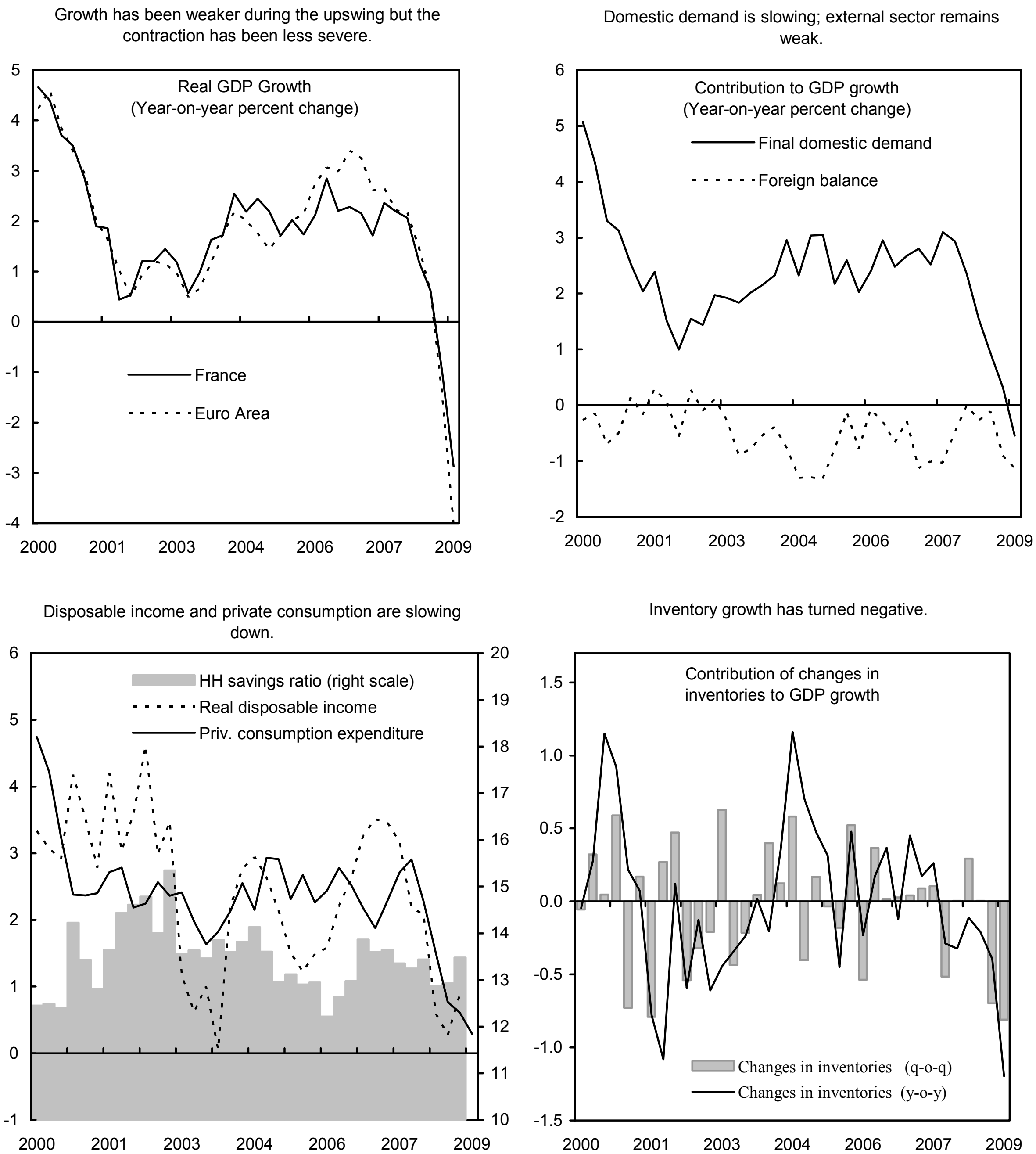
[18] The share of workers paid at the minimum wage in France (15 percent) is about double the average in OECD countries, SMIC moderation will be required for some time to reestablish a motivating wage scale.

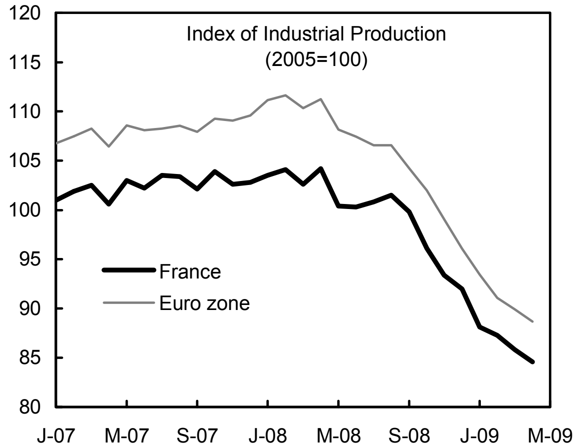
Figure 1. France: Economic Developments
(Percent change)



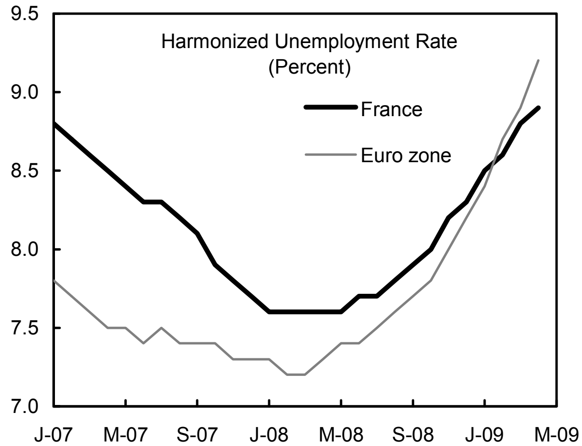
Sources: Global Insight/DataInsight, and IMF, World Economic Outlook.

Figure 2. France: Into the Recession

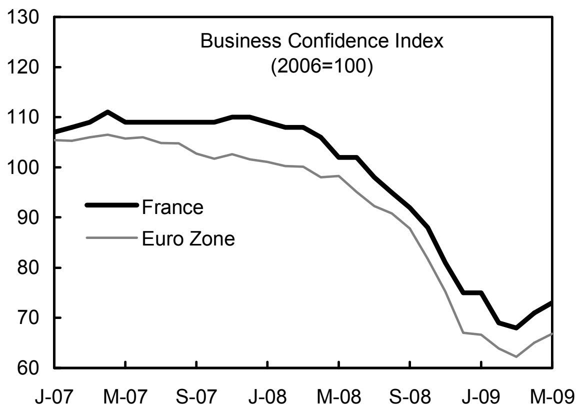
Industrial production peaked in early 2008, slided in the first part of the year, then collapsed after September.



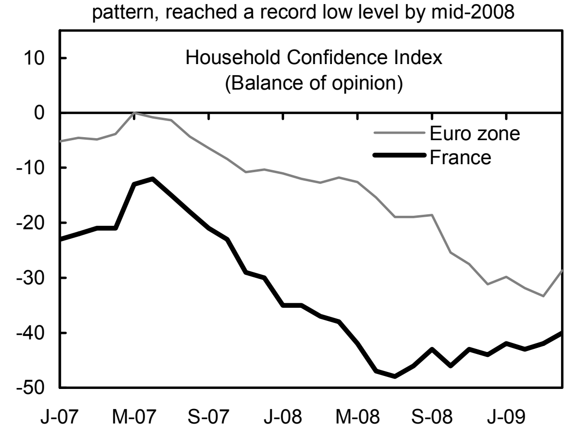
The increase in unemployment, from mid-2008, was steeper than the historical average but marginally less so than in the euro area.



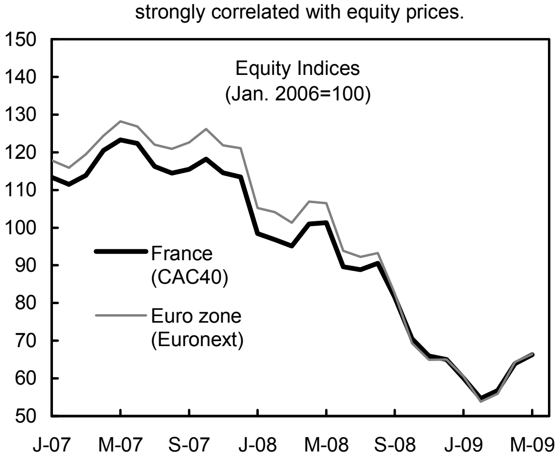
Business sentiment started to falter in mid-2007 but later than in the euro area...



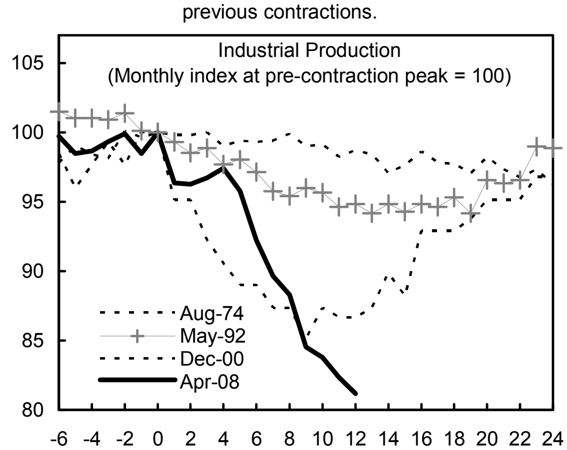
… while household confidence, following broadly the same pattern, reached a record low level by mid-2008



Both household and corporate confidence indicators are strongly correlated with equity prices.

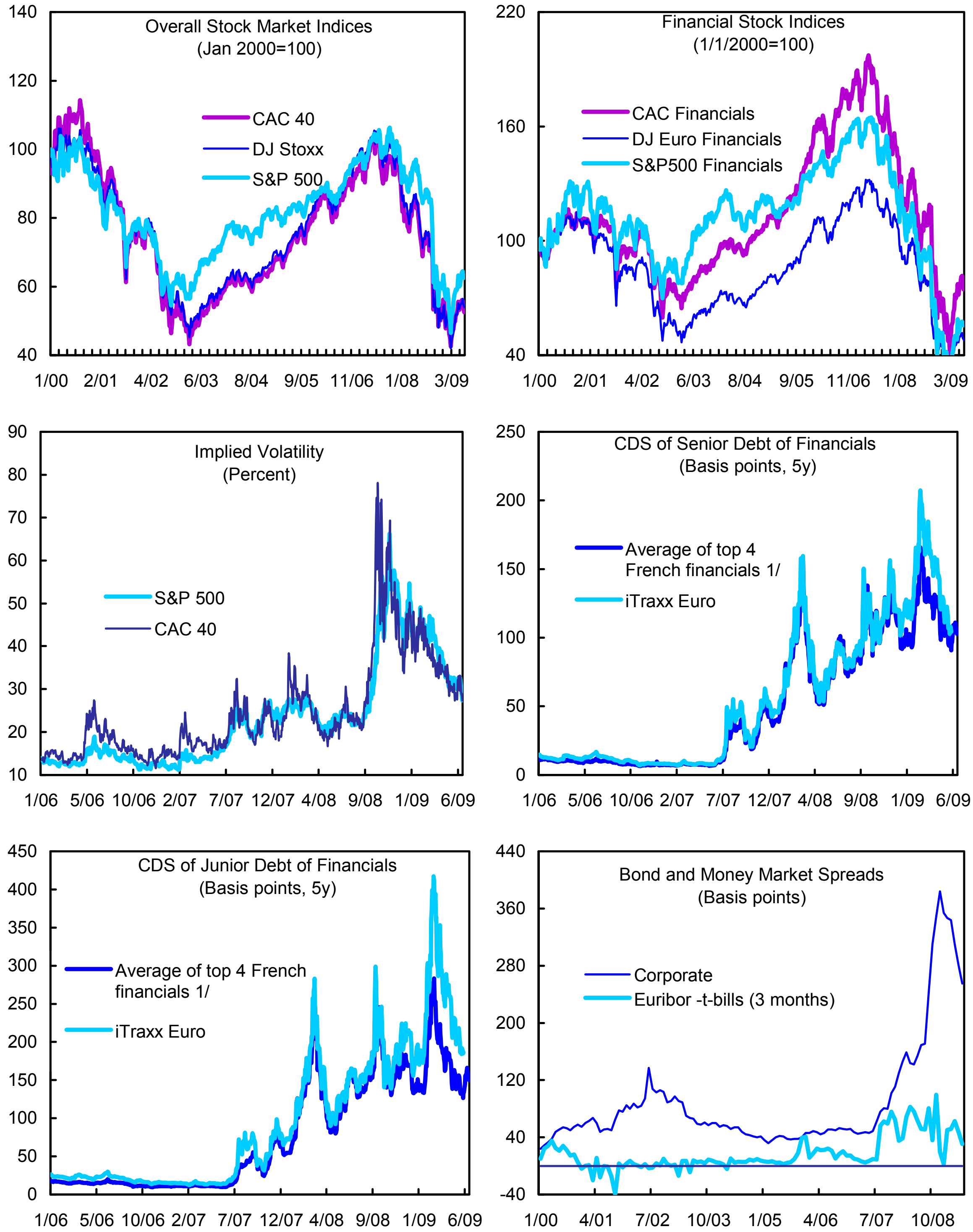


The industrial contraction is steeper and larger than in previous contractions.



Sources: Global Insight/DataInsight, and IMF staff estimates.

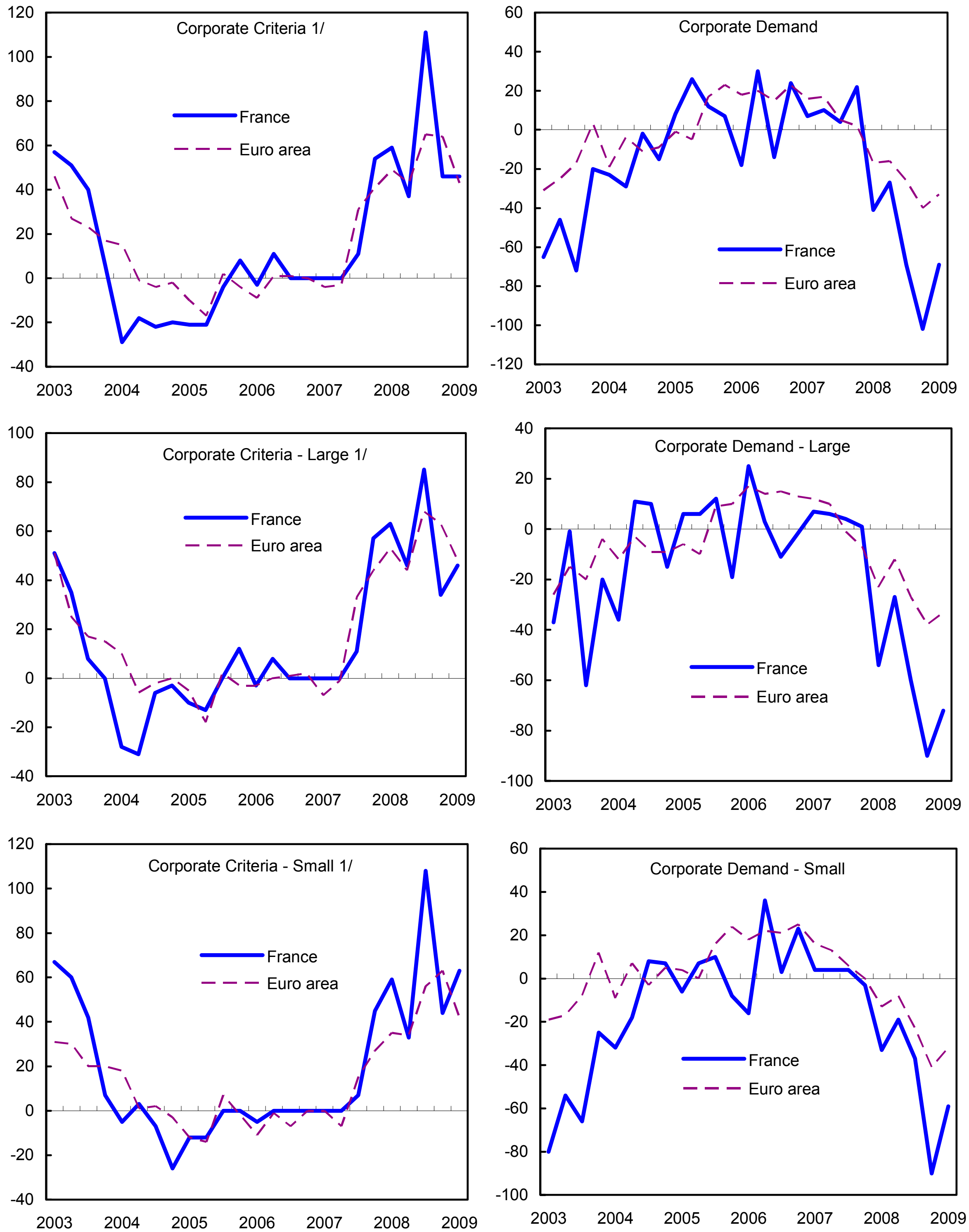
Figure 3. France: Financial Market Developments



Sources: Thomson Financial/Datastream, Bloomberg.

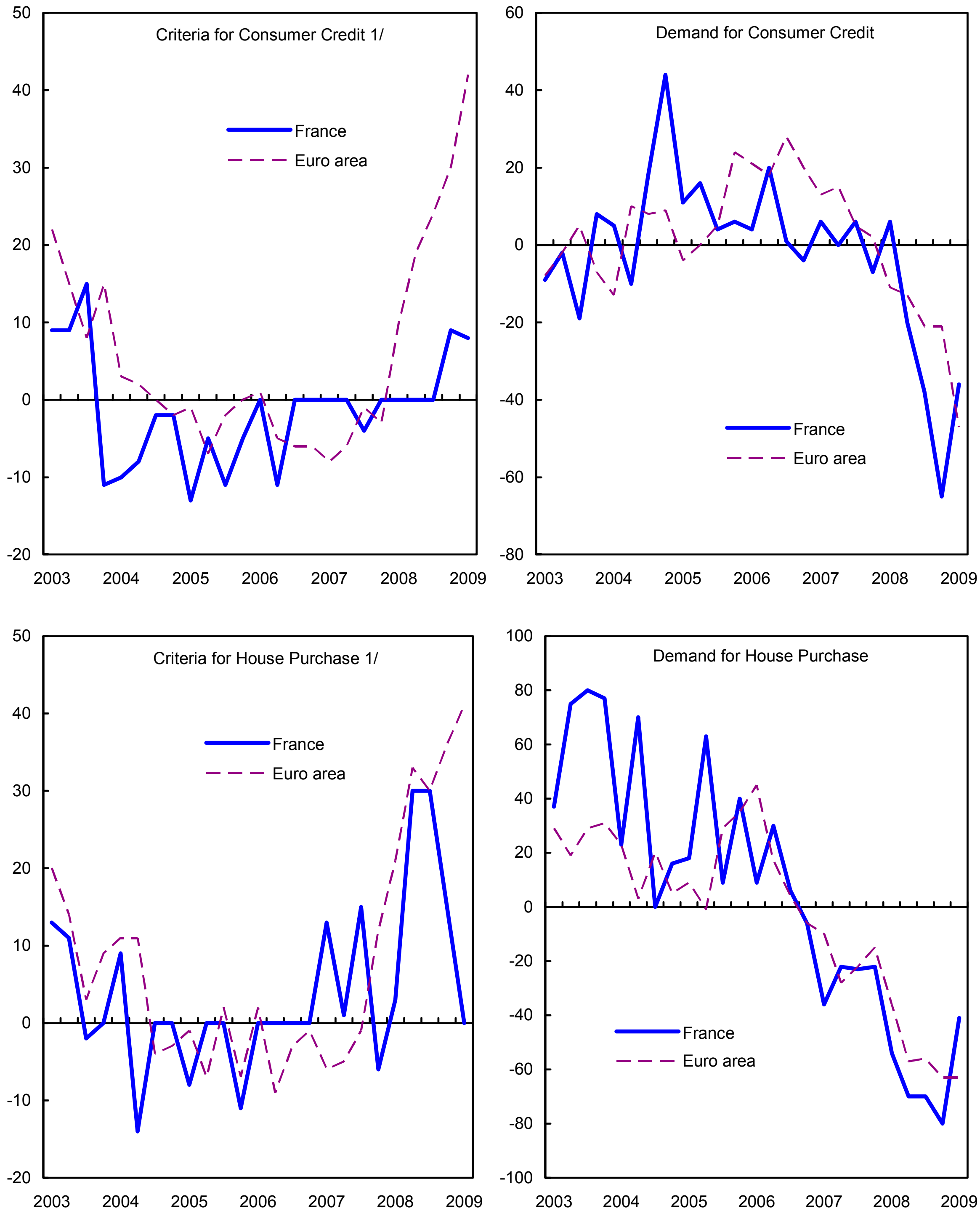
1/ AXA, BNP Paribas, Credit Agricole, and Societe Generale.

Figure 4. France: Corporate Lending Standards and Demand



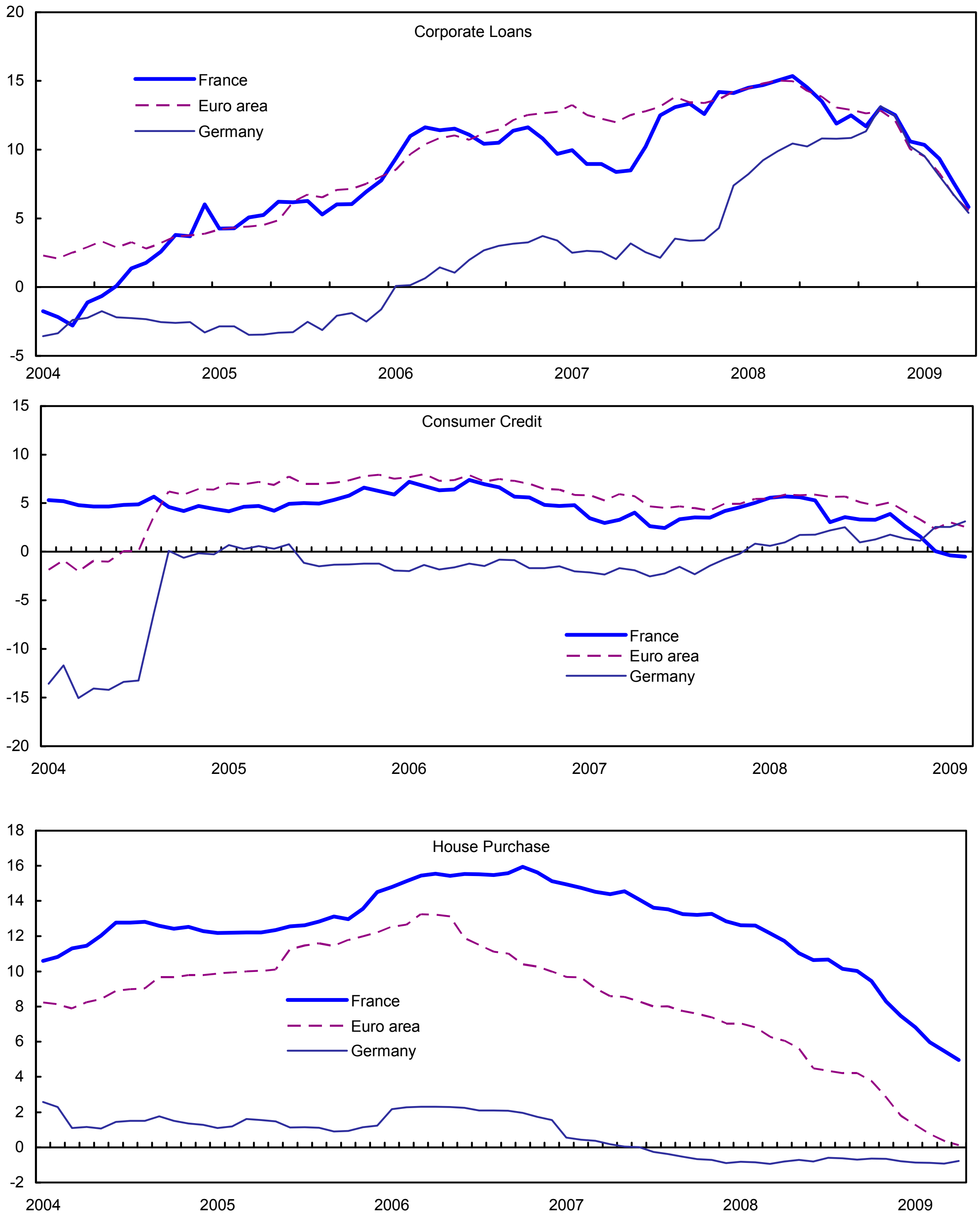
Sources: Global Insight/Datainsight; ECB and Bank of France.
1/ Criteria above (below) zero indicates tightening (loosening) of lending standards compared to previous 3 months.

Figure 5. France: Consumer Lending Standards and Demand



Sources: Global Insight/Datainsight; ECB and Bank of France.
1/ Criteria above (below) zero indicates tightening (loosening) of lending standards compared to previous 3 months.

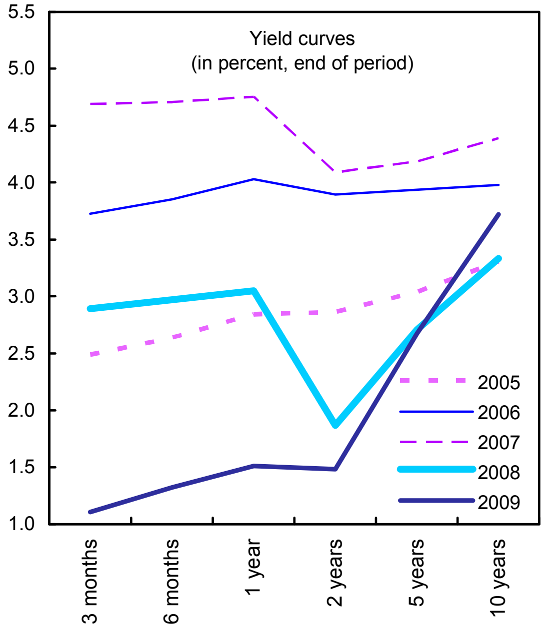
Figure 6. France: Loan Developments
(Annual growth rates)



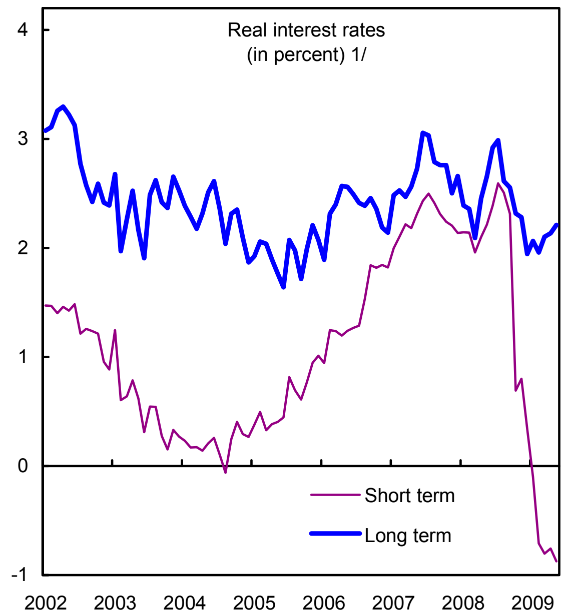
Source: ECB.

Figure 7. France: Monetary Conditions

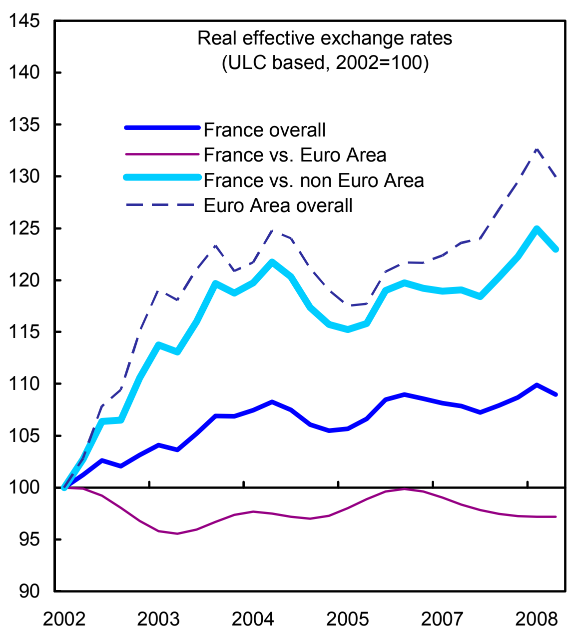
Interest rates have declined along the yield curve...



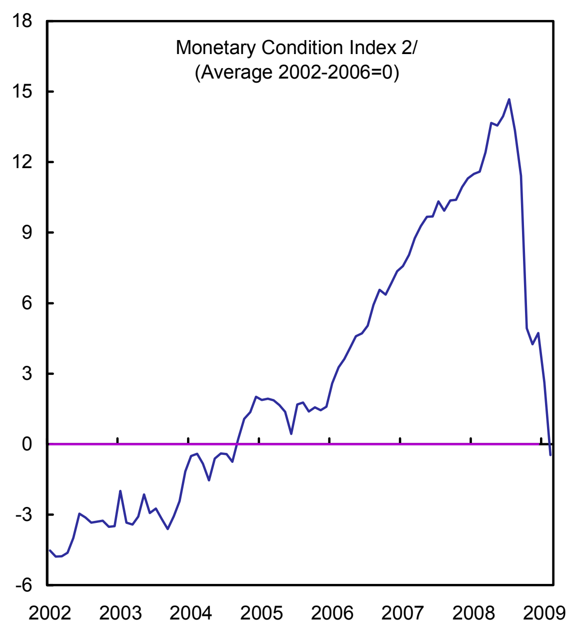
...especially for short term rates.



The REER deteriorated against the world as a whole but improved against the euro area.



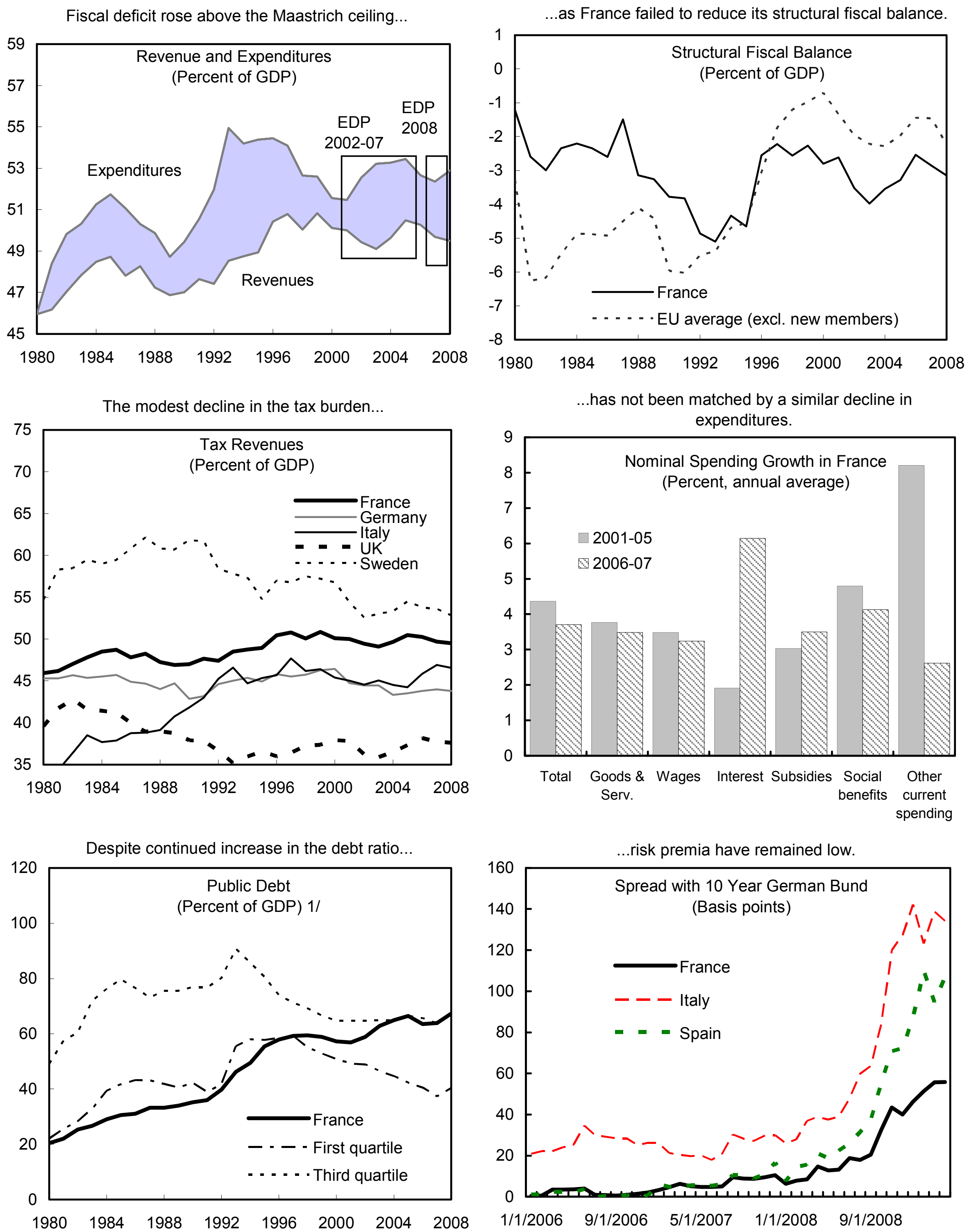
Overall monetary conditions have eased significantly.



Sources: Datastream/Thomson Financial; European Commission; and IMF, IFS and WEO.

1/ Short term rate is 3 month Euribor and long term rate is 10 year French government bond.
2/ The monetary conditions index is a weighted average of the real effective exchange rate and the short-term real interest rate, with weights, 1 and 2.5, respectively. A higher index implies tighter conditions (using underlying CPI).

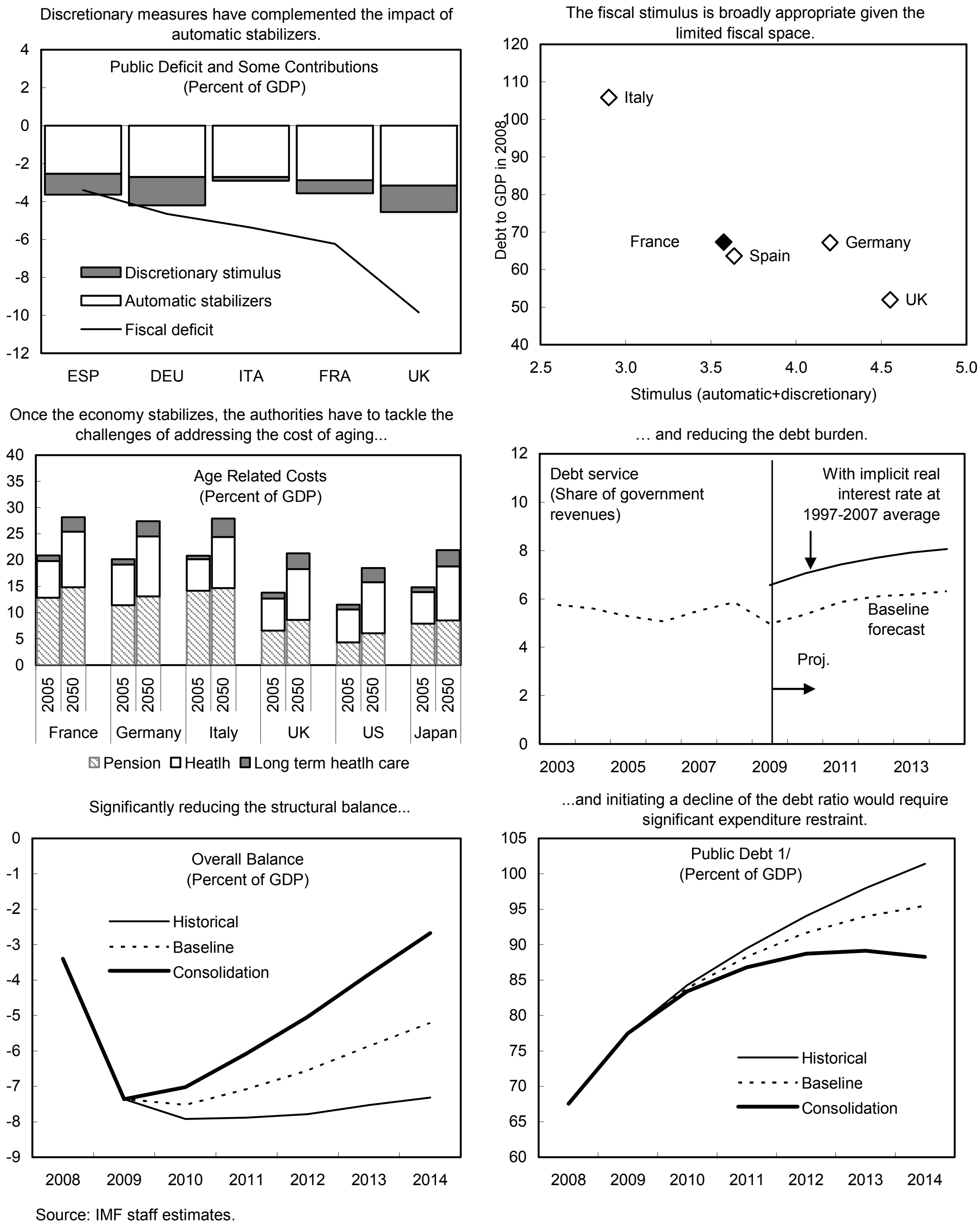
Figure 8. France: Fiscal Developments



Sources: Eurostat; Datastream; Haver; and IFS.

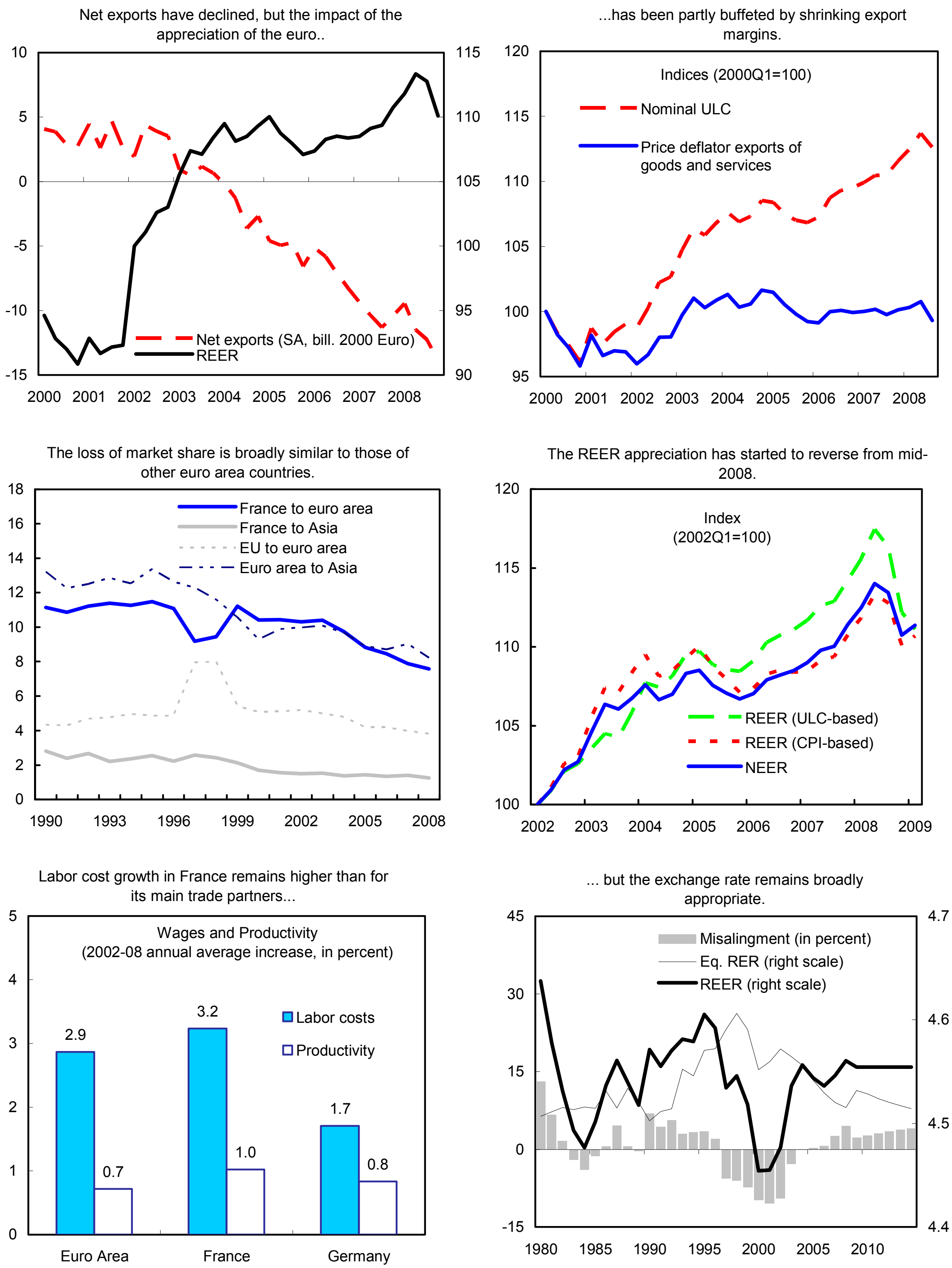
1/ Sample of twelve EU countries for which full historical data is available classified by level of debt to GDP in a given year.

Figure 9. France: Fiscal Challenges



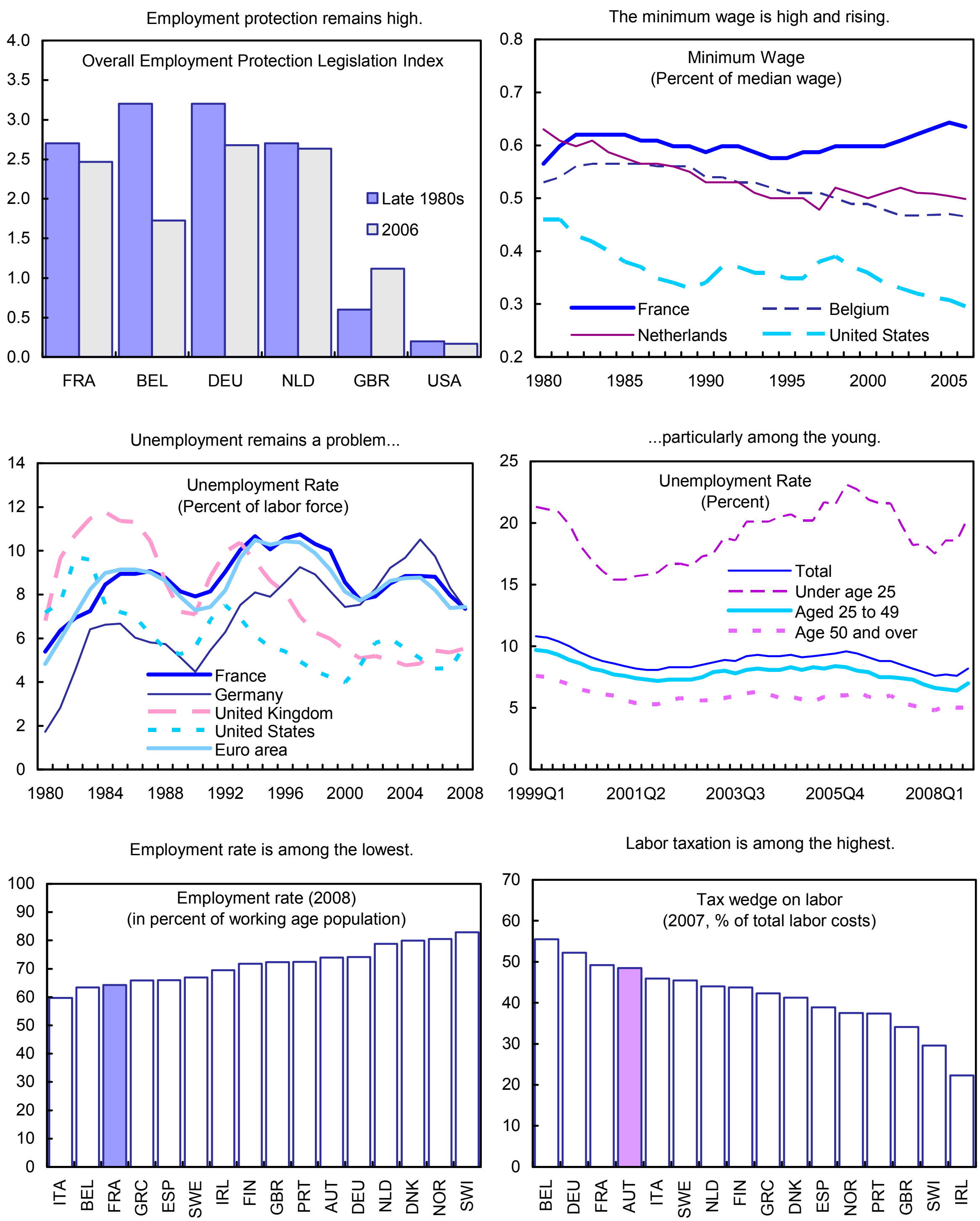
Source: IMF staff estimates.
1/ Under different assumption of the growth of real expenditures for 2010-14: (i) "historical", average growth at 2.2 percent, as in 1997-2007; (ii) "baseline" staff scenario with growth at 1.4 percent; and (iii) "consolidation", with growth at 0.4 percent.

Figure 10. France: Competitiveness and External Performance



Sources: INSEE; IFS; Eurostat; European Commission; Haver; and IMF staff estimates.

Figure 11. France: Labor Market Indicators



Sources: OECD; Datastream; and IMF staff calculations.

Table 1. France: Selected Economic and Social Indicators, 2007-14

			Projections					
	2007	2008	2009	2010	2011	2012	2013	2014
Real economy (change in percent)								
Real GDP	2.3	0.4	-3.0	0.4	1.7	1.9	2.2	2.3
Domestic demand	3.2	0.6	-2.0	0.5	1.7	1.7	1.8	1.8
CPI (year average)	1.6	3.2	0.3	1.1	1.4	1.8	1.8	1.8
Unemployment rate (in percent)	8.3	7.8	9.5	10.2	10.0	9.6	8.9	8.1
Gross national savings (percent of GDP)	21.2	19.9	18.8	18.2	18.2	19.5	18.8	19.3
Gross domestic investment (percent of GDP)	22.2	22.2	20.4	20.3	20.4	20.4	20.6	20.7
Public finance (percent of GDP)								
Central government balance	-2.1	-2.8	-5.7	-6.0	-5.7	-5.3	-4.8	-4.3
General government balance	-2.7	-3.4	-7.4	-7.5	-7.1	-6.6	-5.9	-5.2
Structural balance (percent of potential GDP)	-3.0	-3.3	-3.9	-3.9	-4.1	-4.4	-4.5	-4.5
Primary balance	0.0	-0.6	-5.0	-4.8	-4.0	-3.3	-2.5	-1.7
General government gross debt 1/	63.9	67.5	77.5	83.9	88.3	91.7	94.1	95.6
Money and interest rates (in percent)								
Money market rate 2/	4.0	3.8	1.1	...	...	...	...	...
Government bond yield 2/	4.3	4.2	3.6	...	...	...	...	...
Balance of payments (in percent of GDP)								
Exports of goods	21.1	21.1	15.4	15.4	15.9	16.3	16.8	17.3
Volume growth (in percent)	2.5	-0.5	-14.5	-0.9	3.8	4.3	4.8	5.4
Imports of goods	23.2	24.1	17.8	18.4	19.0	19.4	19.6	19.9
Volume growth (in percent)	5.4	0.6	-10.6	-0.4	3.3	3.3	3.3	3.6
Trade balance	-2.1	-3.0	-2.4	-3.0	-3.1	-3.0	-2.8	-2.6
Current account	-1.0	-2.3	-1.6	-2.1	-2.2	-2.1	-1.8	-1.4
FDI (net)	-2.5	-3.6	-2.5	-1.0	-1.0	-0.9	-0.9	-0.8
Official reserves (US$ billion) 2/	45.7	33.6	24.7	...	...	...	...	...
Fund position (as of December 31, 2008)								
Holdings of currency (percent of quota)		86.3						
Holdings of SDRs (percent of allocation)		58.1						
Quota (SDRs million)		10,739						
Exchange rates								
Euro per U.S. dollar 2/	0.73	0.68	0.75	...	...	...	...	...
Nominal effective rate (2000=100) 2/	102.4	104.9	103.6	...	...	...	...	...
Real effective exchange rate (2000=100) 2/	103.6	106.0	102.1	...	...	...	...	...
Potential output and output gap								
Potential output	2.1	1.3	0.9	0.8	0.9	1.0	1.3	1.3
Output gap	0.9	-0.1	-3.9	-4.3	-3.6	-2.7	-1.9	-1.0

Social indicators

Per capita GDP (2006): US$35,471; **Life expectancy at birth** (2006): 77.2 (male) and 84.1 (female);

Poverty rate (2005): 12.1 percent (60 percent line), 6.3 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/ The debt figure does not include guarantees on non-general government debt.
2/ For 2009, average for January-April.

Table 2. France: Balance of Payments, 2007-2014
(Percent of GDP)

			Projections					
	2007	2008	2009	2010	2011	2012	2013	2014
Balance on current account	-1.0	-2.3	-1.6	-2.1	-2.2	-2.1	-1.8	-1.4
Balance on goods and services	-1.3	-2.3	-1.7	-2.2	-2.3	-2.1	-1.8	-1.5
Balance of trade (f.o.b., c.i.f.)	-2.1	-3.0	-2.4	-3.0	-3.1	-3.0	-2.8	-2.6
Exports of goods and services	26.8	26.8	20.0	20.0	20.6	21.2	21.8	22.5
Exports of goods	21.1	21.1	15.4	15.4	15.9	16.3	16.8	17.3
Exports of services	5.8	5.7	4.6	4.6	4.7	4.9	5.0	5.2
Imports of goods and services	-28.2	-29.1	-21.7	-22.3	-22.9	-23.3	-23.7	-24.0
Imports of goods (f.o.b.)	-23.2	-24.1	-17.8	-18.4	-19.0	-19.4	-19.6	-19.9
Imports of services	-5.0	-5.0	-4.0	-3.8	-3.9	-4.0	-4.0	-4.1
Income, net	1.5	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Current transfers, net	-1.2	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Balance on capital account	0.1	0.0	0.1	-0.1	0.0	0.0	0.0	0.0
Balance on financial account	2.0	4.0	1.5	2.2	2.2	2.1	1.8	1.5
Direct investment, net	-2.5	-3.6	-2.5	-1.0	-1.0	-0.9	-0.9	-0.8
Portfolio investment, net	-6.4	4.6	2.4	1.9	2.0	1.9	1.7	1.3
Other investment, net	8.5	3.0	1.2	1.1	1.1	1.0	1.0	0.9
Reserve assets	0.0	0.4	0.4	0.1	0.1	0.0	0.0	0.0
Errors and omissions, net	-1.1	-1.8	0.0	0.0	0.0	0.0	0.0	0.0

Sources: French authorities; IMF staff estimates and projections.

Table 3. France: High-Frequency Financial Indicators

		Change since:				
	June 30, 2009	30 days	Jan.1, 2009	Sep.1, 2008	Jan.1, 2008	Jan.1, 2007
Financial institution equity prices 1/						
BNP Paribas	46.3	-5.1	52.9	-25.2	-37.7	-44.0
Credit Agricole	8.9	-14.1	11.0	-37.9	-58.3	-69.3
Societe Generale	38.9	-5.2	8.0	-41.1	-58.0	-67.7
Credit default swap spreads 2/						
BNP Paribas	73.6	-1.1	2.3	10.0	45.9	67.7
Credit Agricole	110.8	3.8	27.9	16.0	69.8	104.5
Societe Generale	102.6	-1.3	-6.8	13.4	72.9	96.5
Stock indices 3/						
CAC 40	3140.4	-4.2	-2.4	-29.8	-44.1	-43.3
Euro stoxx 50	2401.7	-2.0	-1.9	-28.6	-45.4	-41.7
Interbank interest rates 4/						
Overnight	0.4	-54.2	-83.8	-91.1	-90.3	-89.7
3-month	1.1	-13.4	-62.0	-77.8	-76.5	-70.5
Government interest rates 4/						
3-month	0.6	-17.0	-65.2	-86.7	-84.8	-83.2
10-year	3.7	-5.8	9.0	-14.1	-15.8	-6.6
Money market risk spread 5/	52.2	57.5	123.5	64.1	89.4	29.2

Sources: Bloomberg; Datastream.

1/ Euros; change in percentage points.
2/ Basis points, 5-year CDS.
3/ Index; change in percentage points.
4/ Percent; change in percentage points.
5/ Basis points; 3-month interbank rate minus 3-month Treasury Bill.

Table 4. France: Vulnerability Indicators, 2003-09

(In percent of GDP; unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	Estimate 2009	Date 2009
External Indicators								
Exports (annual percentage change, in U.S. dollars)	19.7	18.7	8.0	12.5	7.1	1.8	-31.9	Q1
Imports (annual percentage change, in U.S. dollars)	21.6	19.6	12.0	12.2	8.4	4.4	-29.6	Q1
Terms of trade (annual percentage change)	-0.2	-0.7	-1.0	-0.7	0.6	-1.2	…	…
Current account balance	0.8	0.6	-0.4	-0.5	-1.0	-2.3	-1.1	Q1
Capital and financial account balance		-0.4	-1.1	-0.8	1.3	2.9	…	…
Of which								
Inward portfolio investment (debt securities, etc.)	11.1	8.0	10.5	10.1	1.5	6.2	…	…
Inward foreign direct investment	2.4	1.5	3.0	2.8	6.1	4.4	…	…
Other investment (net)	1.4	3.8	1.2	1.1	10.7	2.8	…	…
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	30.2	35.3	27.8	42.7	45.7	33.6	28.6	May
Euros per U.S. dollar (period average)	0.8	0.7	0.8	0.8	0.8	0.8	0.7	May
Market Indicators								
Financial Markets								
Public sector debt 1/	62.9	64.9	66.3	63.6	63.9	67.5	71.1	Q1
3-month T-bill yield (percentage points, eop)	2.1	2.0	2.3	3.5	3.8	1.9	0.7	May
3-month T-bill yield in real terms (percentage points, eop)	-0.3	-0.3	0.6	1.8	1.0	0.7	-0.7	May
US 3 month T-bill	0.9	2.2	3.9	4.8	3.1	0.0	0.2	May
Spread with the US T-bill (percentage points, eop)	1.2	-0.2	-1.6	-1.4	0.7	1.9	0.5	May
5- to 8-year government bond (percentage points, eop)	4.3	3.6	3.4	3.8	4.4	3.5	3.8	May
10-year government bond (United States)	4.3	4.2	4.5	4.6	4.1	2.4	3.3	May
Spread with US bond (percentage points, eop)	0.1	-0.6	-1.1	-0.8	0.3	1.1	0.5	May
Yield curve (10 year - 3 month, percentage points, eop)	2.3	1.6	1.1	0.3	0.5	1.6	3.1	May
Stock market index (period average)	166.5	196.9	228.0	273.1	306.1	232.0	173.1	May
Real estate prices (index, 2000=100, period average)	135.6	156.5	172.9	185.1	192.1	187.3	182.2	Q1
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	5.2	8.3	8.9	6.9	13.5	5.9	1.8	Apr
Bank credit to households	7.8	9.6	11.7	11.0	11.0	6.9	5.6	Apr
Housing Loans	9.9	13.6	15.0	15.0	12.8	5.9	7.6	Apr
Bank credit to nonfinancial enterprises	-1.1	6.0	7.2	6.0	13.7	9.4	5.9	Apr
Sectoral risk indicators								
Household sector								
Household savings ratio	15.8	15.8	14.9	15.1	15.6	15.3	...	…
Household financial savings ratio	6.6	6.2	5.0	4.7	4.7	4.5	...	…
Real estate household solvency ratio (index, 2000=100) 2/	96	90	91	92	94	95	…	…
Corporate sector								
Profitability of business sector (financial margin)	37.9	37.6	37.4	37.7	38.2	38.0	...	…
Investment ratio	17.0	17.3	17.8	18.3	19.3	19.8	...	…
Savings ratio	15.9	14.7	13.8	13.8	14.5	13.1	...	…
Self-financing ratio	87.4	79.1	72.2	70.2	69.8	61.6	...	…
Banking sector								
Share of housing loans in bank credit to the private sector	32.8	34.7	36.6	36.4	36.6	34.9	38.8	Apr
Share of nonperforming loans in total loans	4.8	4.2	3.5	3.0	2.7	2.8	…	…
Ratio of nonperforming loans net of provisions to capital	11.6	9.8	8.6	6.8	6.6	7.0	…	…
Liquid assets to total short-term liabilities	153.7	155.1	150.1	146.7	150.3	150.5	…	…
Return on assets	0.4	0.5	0.6	0.6	0.4	0.0	…	…
Return on equity	8.5	10.6	11.8	14.0	9.8	-1.0	…	…
Regulatory capital to risk-weighted assets	11.9	11.5	11.3	10.9	10.2	…	…	…

Sources: French authorities; FNAIM; 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: General Government Accounts, 2007-2014

(In percent of GDP, unless otherwise indicated)

	2007	2008	Projections 2009	2010	2011	2012	2013	2014
General government								
Revenue	49.7	49.4	47.9	48.4	48.6	48.9	49.1	49.3
Tax revenue	43.0	42.9	41.5	41.9	42.1	42.4	42.6	42.6
Of which								
VAT	7.2	7.0	...	...	...	...	...	...
Income tax	2.6	2.6	...	...	...	...	...	...
Corporate tax	2.7	2.5	...	...	...	...	...	...
TIPP	1.3	1.2	...	...	...	...	...	...
Nontax revenue	6.6	6.5	6.4	6.5	6.5	6.6	6.6	6.6
Expenditures	52.4	52.8	55.3	55.9	55.7	55.5	55.0	54.5
Primary expenditures	49.7	50.0	52.9	53.1	52.5	52.2	51.6	51.0
Of which								
Salaries	13.1	...	...	...	...	...	...	...
Pensions	13.0	...	...	...	...	...	...	...
Health expenditure	7.1	...	...	...	...	...	...	...
Other social transfers	5.4	...	...	...	...	...	...	...
Debt service	2.7	2.8	2.4	2.8	3.1	3.3	3.4	3.5
Balance 1/	-2.7	-3.4	-7.4	-7.5	-7.1	-6.6	-5.9	-5.2
Primary balance	0.0	-0.6	-5.0	-4.8	-4.0	-3.3	-2.5	-1.7
Structural balance 2/	-3.0	-3.3	-3.9	-3.9	-4.1	-4.4	-4.5	-4.5
Central government balance 1/	-2.1	-2.8	-5.7	-6.0	-5.7	-5.3	-4.8	-4.3
Social security balance 1/	-0.1	0.0	...	...	...	...	...	...
Local government balance 1/	-0.4	-0.3	...	...	...	...	...	...
ODAC balance 1/	-0.2	-0.2	...	...	...	...	...	...
Gross debt 3/	63.9	67.5	77.5	83.9	88.3	91.7	94.1	95.6
Interest payments	2.7	2.8	2.4	2.8	3.1	3.3	3.4	3.5
Memorandum items:								
Nominal GDP (in billion of Euros)	1,892	1,945	1,905	1,934	1,997	2,071	2,154	2,243
Structural nominal GDP (in billion of Euros)	1,879	1,951	1,986	2,024	2,074	2,133	2,201	2,270
Real GDP growth (in percent)	2.3	0.3	-3.0	0.4	1.7	1.9	2.2	2.3
Real expenditure growth (in percent)	2.5	0.5	2.2	1.5	1.5	1.6	1.3	1.3
of which : primary	2.3	0.3	3.3	0.8	0.8	1.2	1.1	1.1
of which : structural primary 4/	2.6	0.5	1.5	1.4	1.4	1.4	1.4	1.4

Sources: French authorities; IMF staff estimates and projections.

1/ Maastricht definition.
2/ In percent of potential GDP.
3/ The debt figure does not include guarantees on non-general government debt.
4/ Excludes fiscal stimulus package and unemployment benefits.

Table 6. France: The Core Set of Financial Soundness Indicators, 2002-08

Indicator	2002	2003	2004	2005	2006	2007	2008
Deposit-taking institutions 1/							
Regulatory capital to risk-weighted assets	11.5	11.9	11.5	11.3	10.9	10.2	...
Regulatory Tier I capital to risk-weighted assets	9.2	9.0	8.8	8.2	8.2	7.7	8.3
Nonperforming loans net of provisions to capital	12.6	11.6	9.8	8.6	6.8	6.6	7.0
Bank provisions to Nonperforming loans	...	...	...	...	170	158.3	131.0
Nonperforming loans to total gross loans	5.0	4.8	4.2	3.5	3.0	2.7	2.8
Sectoral distribution of loans to total loans, *of which*							
Deposit-takers	33.6	34.2	34.0	30.1	30.6	32.2	33.6
Nonfinancial corporations	19.8	18.9	18.7	18.8	18.6	18.1	18.3
Households (including individual firms)	22.6	24.5	24.9	26.5	26.6	24.8	24.1
Nonresidents (including financial sectors)	4.4	4.3	4.2	4.7	4.2	4.7	4.7
ROA (aggregated data on a parent-company basis) 2/	0.5	0.44	0.5	0.6	0.6	0.4	0.0
ROA (main groups on a consolidated basis) 3/	0.43	0.39	0.53	0.49	0.57	0.35	0.1
ROE (aggregated data on a parent-company basis) 2/	9.1	8.50	10.6	11.8	14.0	9.8	-1.0
ROE (main groups on a consolidated basis) 3/	9.6	10.0	12.7	13.5	17.22	13.34	3.8
Interest margin to gross income	37.5	35.5	33.2	32.4	28.2	25.3	40.4
Noninterest expenses to gross income	65.5	64.4	63.9	64.3	62.4	68.4	84.2
Liquid assets to total assets	20.7	21.6	21.3	20.5	19.9	18.9	25.5
Liquid assets to short-term liabilities	157.0	153.7	155.1	150.1	146.7	150.3	150.5
Net open position in foreign exchange to capital							
Net open positions in FX (in millions of euros) 4/	3,134	4,772	6,669	5275	5,283	7,058	...
Net open positions in equities to Tier I capital	4.9	3.5	4.8	...	...	...	...

Sources: French authorities.

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, 2002-08

(In percent, unless otherwise indicated)

Indicator	2002	2003	2004	2005	2006	2007	2008
Corporate sector							
Total debt to equity	84.1	72.6	68.7	65.4	57.4	56.1	89.0
Return on equity	9.9	9.3	8.4	8.4	8.1	7.6	...
Interest paid to financial firms 1/	29.6	27.3	25.6	25.7	27.3	31.4	33.8
Number of enterprise bankruptcies (thousands)	44.9	47.2	48.4	49.3	47.7	51.1	55.9
Number of enterprise creations (thousands)	214.9	239.0	269.0	271.2	285.5	325.7	331.7
Deposit-taking institutions							
Capital (net worth) to assets	5.2	5.4	5.1	4.4	4.5	4.1	4.2
International consolidated claims of French banks, *of which*							
(BIS data, as percent of total international claims)							
Advanced countries	83.9	85.3	84.2	83.7	85.1	83.8	83.3
Developing Europe	2.3	2.8	2.6	2.9	3.3	4.1	4.2
Latin America and Caribbean	1.8	1.4	1.0	1.1	0.9	1.0	1.1
Africa and Middle East	3.6	3.3	3.1	3.1	2.6	2.6	3.0
Asia and Pacific Area	2.8	2.7	2.6	2.6	2.5	2.9	2.8
Offshore Financial Centers	5.6	4.5	6.5	6.6	5.6	5.5	5.5
Gross asset position in financial derivatives to capital	378.9	306.8	372.5	543.7	337.0	235.0	...
Gross liability position in financial derivatives to capital	343.5	282.7	358.5	484.7	293.0	227.0	...
Large exposures to capital	5.2	0.9	4.6	3.6	1.4	4.7	...
Trading income to total income	2.4	16.8	20.0	23.9	26.0	16.8	...
Personnel expenses to noninterest expenses	55.2	56.0	56.5	58.3	54.0	53.3	51.6
Customer deposits to total (noninterbank) loans	81.5	82.8	80.6	83.5	80.5	77.4	78.0
FX loans to total loans 2/	12.6	11.2	10.8	12.0	11.4	11.3	10.5
FX liabilities to total liabilities	15.1	14.2	15.1	17.8	18.6	18.1	16.8
Market liquidity							
Average daily turnover ratio in the securities market	20.0	18.0	18.0	10.5	7.0	7.7	6.1
Other financial corporations							
Assets to total financial system assets	35.2	36.6	37.8	37.6	38.1	36.2	32.7
Assets to GDP	142.3	151.3	167.6	184.3	204.1	209.7	184.9
Households							
Household debt to GDP	36.4	37.8	40.0	43.0	45.5	48.0	50.7
Household debt service and principal payments to income	...	10.1	11.2	10.2	12.5	10.7	10.0
Real estate markets							
Real estate prices	10.1	12.4	16.0	14.8	9.9	5.7	-2.9
Residential real estate loans to total loans	65.7	67.1	69.1	71.2	73.4	74.7	74.8

Sources: French authorities.

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

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

Table 8. Financial System Structure, 2002-08

	2002	2003	2004	2005	2006	2007	2008
Number			(Number of institutions)				
Banks							
Commercial Banks	345	333	326	316	313	312	310
Private	341	329	323	312	309	308	307
Domestic	142	138	139	131	131	130	136
Foreign	199	191	184	181	178	178	171
State-owned 1/	4	4	3	4	4	4	3
Credit unions and mutuals	136	129	127	125	121	111	105
Other credit institutions							
Finance companies	494	464	427	411	388	319	300
of which mortgage institutions	4	4	4	4	4	4	5
Specialized financial institutions	16	15	11	8	7	7	6
Municipal credit institutions	21	21	21	21	20	19	18
Securities firms	136	131	124	119	116	105	101
Insurance companies 3/	456	444	423	415	407	589	589
Life and retirement	126	125	119	119	115	164	164
Non-life	295	286	274	267	263	378	378
Reinsurance	35	33	30	29	29	47	47
Concentration							
Commercial Banks 2/	11	10	10	10	9	9	9
Securities companies 2/	3	4	3	2	2	2	2
Assets				(Billions of euro)			
Banks							
Commercial Banks	2,360	2,440	2,862	3,719	4,284	5,107	5,469
Private	2,278	2,365	2,850	3,600	4,159	4,973	5,344
Domestic	1,866	1,982	2,429	3,005	3,559	4,221	4,510
Foreign	412	383	422	595	600	752	834
State-owned 1/	82	75	11	120	125	135	125
Credit unions and mutuals	881	935	1,053	1,128	1,259	963	1,101
Other credit institutions							
Finance companies	508	536	433	405	477	345	374
of which mortgage institutions	76	92	107	126	149	186	199
Specialized financial institutions	43	47	40	21	20	20	21
Municipal credit institutions	2	2	2	2	1	1	1
Securities firms	65	219	215	271	354	542	486
Insurance companies (assets) 3/							
Life and retirement	832	907	985	1,103	1,232	1,312	1,243
Non-life	143	152	160	171	180	177	167
Reinsurance	31	31	22	31	42	44	34
Deposits							
Banks							
Private commercial	516	527	574	677	758	785	977
State-owned	4	8	0	92	92	92	91
Foreign-owned subsidiaries	53	48	45	57	59	86	83
Branches of foreign banks	19	21	20	26	25	31	27

Sources: French authorities.

1/ Includes development banks. Nonbank development finance corporations should be included separately under “Other credit institutions.”
2/ Number of institutions with 75 percent of total assets.

INTERNATIONAL MONETARY FUND

FRANCE

Staff Report for the 2009 Article IV Consultation—Informational Annexes

Prepared by the European Department

July 13, 2009

Contents | Page

ANNEX I. FRANCE: FUND RELATIONS
(As of May 31, 2009)

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 holdings of currency	8,580.49	79.9
Reserve position in Fund	2,158.12	20.1

III. **SDR Department:**

	SDR Million	Percent of Allocation
Net cumulative allocation	1,079.87	100.00
Holdings	628.57	58.21

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				
	2009	2010	2011	2012	2013
Principal					
Charges/interest	1.03	2.16	2.16	2.16	2.16
Total	1.03	2.16	2.16	2.16	2.16

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.

- In accordance with EU regulations and the relevant UN Security Council resolutions, certain restrictions are maintained on the making of payments and transfers for current international transactions with respect to the former government of Iraq, the former government of Liberia, Myanmar, certain individuals associated with the previous government of the former Republic of Yugoslavia, and Zimbabwe. Financing of, and financial assistance related to, military activities in the Democratic Republic of the Congo (from October 1, 2003), Somalia (effective January 27, 2003), and Sudan (from January 26, 2004) are prohibited. Restrictions also apply on transfers with respect to the Taliban and individuals and organizations associated with terrorism. The restriction with respect to the Socialist People's Libyan Arab Jamahiriya has been notified to the Fund under Decision No. 144-(52/51).

- Measures have been taken to freeze accounts of listed persons and entities linked to terrorists pursuant to the relevant EU regulations and UN Security Council resolutions.

X. **Article IV Consultation:**

The last Article IV consultation was concluded on February 15, 2008. The associated Executive Board assessment is available at www.imf.org/external/np/sec/pn/2008/pn0823.htm and the staff report at www.imf.org/external/pubs/ft/scr/2008/cr0875.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 II. France: Table of Common Indicators Required for Surveillance

(As of June 30, 2009)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	05/09	06/09	Monthly	Monthly	Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	05/09	06/09	Monthly	Monthly	Monthly
Reserve/Base Money	05/09	06/09	Weekly	Weekly	Weekly
Broad Money	05/09	06/09	Monthly	Monthly	Monthly
Central Bank Balance Sheet	05/09	06/09	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	05/09	06/09	Monthly	Monthly	Monthly
Interest Rates[2]	05/09	06/09	Monthly	Monthly	Monthly
Consumer Price Index	05/09	06/09	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Q1:2009	06/09	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	05/09	06/09	Monthly	Monthly	Monthly
Stock of Central Government Debt	05/09	06/09	Monthly	Monthly	Monthly
Stock of Central Government-Guaranteed Debt	Q1:2009	06/09	Quarterly	Quarterly	Quarterly
External Current Account Balance	Q1:2009	06/09	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q1:2009	06/09	Quarterly	Quarterly	Quarterly
GDP/GNP	Q1:2009	06/09	Quarterly	Quarterly	Quarterly
Gross External Debt	05/09	06/09	Monthly	Monthly	Monthly

[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
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 09/96
FOR IMMEDIATE RELEASE
July 31, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2009 Article IV Consultation with France

On July 29, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with France.[1]

Background

The global financial crisis and the contraction of world trade have pulled the French economy into a severe recession and put its financial sector under strain. Structural features combined with early policy action have helped soften the downturn, which is somewhat less pronounced than in the euro area as a whole. Nonetheless, unemployment has risen steeply since mid-2008, while consumer price inflation has come down rapidly. With the fiscal stance easing in 2008, the budget deficit exceeded the Maastricht ceiling. French banks faced the need to write down toxic assets, and government recapitalization and liquidity measures were required to support the sector. While significant, financial sector losses remained below those in peer countries.

The authorities responded to the deepening of the crisis in 2008 by adopting fiscal and financial sector measures. In response to the crisis automatic stabilizers were allowed to operate fully, with further support provided by a discretionary fiscal stimulus package (above 1½ percent of GDP for 2009-10). The fiscal measures are mostly front-loaded and relatively well diversified, with an emphasis on temporary investment expenditures and various tax breaks. The authorities also undertook a number of measures to recapitalize banks and support liquidity.

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

Those measures have helped to stabilize the financial system and thus far no French bank has come under majority state ownership. France has been playing an active role in promoting international regulatory and supervisory reforms in support of increased cross border cooperation in financial stability.

Important structural reform measures have been taken, or are under review. Progress includes the establishment of a single Competition Authority with enlarged powers, the creation of a unified job placement agency, and the partial liberalization of retail markets. Further action in the areas of pension reform, job creation, and on improving market efficiency and productivity are under debate.

The near-term outlook is challenging with real GDP projected to drop by 3 percent in 2009, followed by a gradual recovery in 2010. The risks to the outlook are mostly tilted to the downside in view of the sensitivity of the French economy to a worse-than-foreseen contraction in the European Union and underlying tail risks, in particular in the financial sector. The steep increase in unemployment could further shake confidence and weaken private consumption. A worsening of the financial crisis would hurt banks' balance sheets and could further depress credit growth. At the same time, lower trade openness and higher social protection are expected to continue to shelter the French economy relative to its peers.

Executive Board Assessment

Executive Directors noted that the French economy has not been immune from the global crisis. The country is in deep recession, unemployment is rising, and the financial sector is under strain. Nevertheless, France has been somewhat less affected than the euro area as a whole due to its relatively low trade openness and large social safety net. The authorities' early policy response, together with the economy's structural features, has helped soften the downturn and stabilize the financial system. Directors commended the size and composition of the fiscal stimulus measures—with full play of France's sizable automatic stabilizers.

Directors noted that the near-term economic outlook remains challenging, with GDP growth expected to contract by 3 percent in 2009 and to recover only gradually in 2010. Risks are tilted to the downside, and the crisis could also dampen potential output growth, calling for continued progress with the structural reform agenda. Directors recognized, however, that near- and medium-term economic projections are subject to unusual uncertainty at the present juncture.

Directors saw the main challenge to fiscal policy as the provision of short-term stimulus without derailing medium-term fiscal consolidation objectives. A number of Directors considered that some modest additional fiscal action might be needed if downside risks materialize, but should be focused on temporary and investment-based measures given France's limited fiscal space. A number of other Directors, however, saw no scope for additional fiscal support, in light of the sizable stimulus already in train and the pressing consolidation needs.

Directors stressed that safeguarding medium-term fiscal sustainability and avoiding unsustainable debt dynamics is a key priority for the coming years, and they welcomed the authorities' determination in this regard. Important steps already taken in this direction are the adoption of a multi-year budgeting framework, zero-growth expenditure at the central government level, and the ongoing reduction in public sector employment. Directors encouraged the authorities to build on these measures by embarking on a resolute medium term consolidation effort. The strategy should be underpinned by realistic growth assumptions, the articulation of specific expenditure savings at all levels of government, and the streamlining of tax expenditures. Directors looked forward to institutional steps aimed at ensuring that efforts by the central government are accompanied by enhanced fiscal responsibility at the local level. With an aging population, continued efforts are necessary to ensure the sustainability of the social security system.

Directors observed that high supervision standards and cautious lending practices have helped French banks weather the financial crisis relatively well. They considered that the government's intervention in the banking sector has been well-handled, while suggesting that further intervention should not be ruled out. It will be important to continue to closely monitor banking sector risks, in view of potential spillovers from mature markets. Directors underlined that further, preferably EU-wide coordinated, stress tests would help assess the need for any follow-up actions to address capital and liquidity needs. Directors commended the authorities' leadership in bringing forward international regulatory reforms, particularly on strengthening supervision of EU-wide financial groups, and supported their call for coordination on exit strategies from financial sector support.

Directors called for sustained further progress on France's reform agenda. They welcomed the authorities' determination to tackle long-standing structural weaknesses alongside near-term crisis-related efforts, with a special focus on labor and product market reforms. To boost competitiveness and growth, safeguard fiscal sustainability, and raise welfare, Directors recommended efforts to foster job creation—especially for young, low-skilled, and senior workers. This would include continuing moderation in the setting of the minimum wage, activation policies such as job training, and raising the legal retirement age to promote senior employment. Directors welcomed the recent establishment of a single Competition Authority and recommended to draw on the EU services directive for deregulating certain professional services.

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 2009 Article IV Consultation with France is also available.

France: Selected Economic and Social Indicators, 2007-14

				Projections				
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Real economy (change in percent)								
Real GDP	2.3	0.4	-3.0	0.4	1.7	1.9	2.2	2.3
Domestic demand	3.2	0.6	-2.0	0.5	1.7	1.7	1.8	1.8
CPI (year average)	1.6	3.2	0.3	1.1	1.4	1.8	1.8	1.8
Unemployment rate (in percent)	8.3	7.8	9.5	10.2	10.0	9.6	8.9	8.1
Gross national savings (percent of GDP)	21.2	19.9	18.8	18.2	18.2	19.5	18.8	19.3
Gross domestic investment (percent of GDP)	22.2	22.2	20.4	20.3	20.4	20.4	20.6	20.7
Public finance (percent of GDP)								
Central government balance	-2.1	-2.8	-5.7	-6.0	-5.7	-5.3	-4.8	-4.3
General government balance	-2.7	-3.4	-7.4	-7.5	-7.1	-6.6	-5.9	-5.2
Structural balance (percent of potential GDP)	-3.0	-3.3	-3.9	-3.9	-4.1	-4.4	-4.5	-4.5
Primary balance	0.0	-0.6	-5.0	-4.8	-4.0	-3.3	-2.5	-1.7
General government gross debt 1/	63.9	67.5	77.5	83.9	88.3	91.7	94.1	95.6
Money and interest rates (in percent)								
Money market rate 2/	4.0	3.8	1.1	…	…	…	…	…
Government bond yield 2/	4.3	4.2	3.6	…	…	…	…	…
Balance of payments (in percent of GDP)								
Exports of goods	21.1	21.1	15.4	15.4	15.9	16.3	16.8	17.3
Volume growth (in percent)	2.5	-0.5	-14.5	-0.9	3.8	4.3	4.8	5.4
Imports of goods	23.2	24.1	17.8	18.4	19.0	19.4	19.6	19.9
Volume growth (in percent)	5.4	0.6	-10.6	-0.4	3.3	3.3	3.3	3.6
Trade balance	-2.1	-3.0	-2.4	-3.0	-3.1	-3.0	-2.8	-2.6
Current account	-1.0	-2.3	-1.6	-2.1	-2.2	-2.1	-1.8	-1.4
FDI (net)	-2.5	-3.6	-2.5	-1.0	-1.0	-0.9	-0.9	-0.8
Official reserves (US$ billion) 2/	45.7	33.6	24.7	...	...	...	...	...
Fund position (as of December 31, 2008)								
Holdings of currency (percent of quota)		86.3						
Holdings of SDRs (percent of allocation)		58.1						
Quota (SDRs million)		10,739						
Exchange rates								
Euro per U.S. dollar 2/	0.73	0.68	0.75	...	...	...	...	...
Nominal effective rate (2000=100) 2/	102.4	104.9	103.6	...	...	...	...	...
Real effective exchange rate (2000=100) 2/	103.6	106.0	102.1	...	...	...	...	...
Potential output and output gap								
Potential output	2.1	1.3	0.9	0.8	0.9	1.0	1.3	1.3
Output gap	0.9	-0.1	-3.9	-4.3	-3.6	-2.7	-1.9	-1.0

Social indicators

Per capita GDP (2006): US$35,471; **Life expectancy at birth** (2006): 77.2 (male) and 84.1 (female);
Poverty rate (2005): 12.1 percent (60 percent line), 6.3 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/ The debt figure does not include guarantees on non-general government debt.
2/ For 2009, average for January-April.

Statement by Ambroise Fayolle, Executive Director for France
July 29, 2009

We wish to thank staff for a thought-provoking report that conveys a broadly fair picture of the current situation of the French economy and the challenges it faces.

The discussions with the team were very much appreciated by the French authorities, in addition to providing useful input for their own assessments at this critical juncture. The French authorities set great store in the surveillance exercise and have full confidence in the Fund's expertise as illustrated by the fact that they shared in confidence with staff the aggregated results of the stress tests of the French banks. They fully agree with the need to align actions to counter the crisis with indispensable longer-term reforms. It is in that spirit that they have handled the situation so far.

Resilience to the crisis: appropriate policies and structural features

The French economy has not been immune from the extraordinary global crisis: 2009 is a year of recession and unemployment has risen. My authorities' forecasts are broadly in line with staff, even if they tend to see risks as being more balanced around their similar baseline scenario. While acknowledging that the current situation calls for great caution when forecasting, the recent satisfactory data that have just been released for the second quarter could lead to an upward revision for the second half of 2009.

Three features have helped smooth the impact of the crisis rather well compared to some other advanced countries, as acknowledged by staff:

- appropriate ad hoc policies : (i) the fiscal stimulus (1 ½ percent of GDP according to staff, a little more according to my authorities who acknowledge that staff had to abide by a Fund-wide methodology) which was diversified, effectively front-loaded, and with an emphasis on temporary investment expenditures and tax breaks ; **and (ii) the measures to support the banking sector :** creation of an independent *médiateur du crédit* (i.e. Ombudsman) between banks and borrowers ; setting of indicative credit targets for banks ; creation of a bank refinancing agency (SFEF) to help bank lending to households, SMEs, and local governments; creation of a bank recapitalization agency (SPPE), available on a voluntary basis ; support of two banks (Dexia group, in close and efficient cooperation with the governments of Belgium and Luxembourg ; Groupe Caisse d'Epargne and Groupe Banque populaire, which are about to merge, with a partial capital injection from the SPPE) ;

- sizeable automatic stabilizers, that amount to 3 percent of GDP, and constitute a key element of government support to the economy;

- structural features pertaining notably to its growth model (where private consumption plays a significant role), the high level of social welfare – including unemployment benefits, an ambitious and comprehensive long standing regulation framework of financial institutions and, last but not least, sound household and banks' behavior. In that regard, my authorities agree that the lending practices of the banks and the consistent supervisory coverage of all lending institutions (para. 15) played a significant role.

Financial sector: a relevant business model and sound supervision

We are grateful for the Selected Issues, which provide useful input to the debate, in particular the section on "French banks amid the global financial crisis".

French banks have proved to be relatively resilient. The financial crisis has taken its toll on bank profits and market financing costs remain elevated in relative terms, but two key features of the French banks can be put forward to explain why they have weathered the crisis comparatively well.

First, most French banks have a universal banking business model. Their activities are well diversified and retail banking accounts for an important share of their profits. Consequently, they also rely on a large deposit base for their funding. In addition, their lending practices are rather conservative, in particular in the mortgage sector where lending standards are based on households' ability to service their debt according to their revenues rather than on the value of their purchases.

Second, banks have been protected by a sound supervision model. As recalled by staff, the stress tests conducted by the *Commission bancaire* showed the banks' continued resilience under different adverse scenarios. This said, the global financial and economic environment is still highly uncertain and my authorities will continue to remain vigilant and closely monitor the situation of the sector.

The crisis must also be seen as an opportunity to rebuild a sounder international financial system less likely to give birth to turmoil of this magnitude. Looking forward, my authorities are determined to keep on top of the domestic, European and international agenda the timely implementation of the ambitious decisions agreed by the G-20 Leaders regarding the reform of financial regulation.

Fiscal: an unprecedented effort to keep expenditures under control

My authorities entirely agree with staff on the need to keep a sound public debt strategy. They are very attached to preserving the credibility of the budget[1]. As a consequence, they have stuck to the objective of zero growth of real expenditures of the central government.

[1] In that regard, the second bullet point of para. 39, page 22, should be nuanced : between 1997 and 2007, differences between draft finance law and consensus, forecast or actual, were not biased in a systematic way ; and it is fair to recognize that 2008 and 2009 are two exceptional years.

An unprecedented effort to reduce public sector employment is under way (non-replacement of every second retiring civil servant in the central government) that has been reaffirmed during the crisis. A strong emphasis is put on controlling health costs and local authorities' expenditures.

My authorities take good note of staff's recommendations on institutional reforms in the budget process. They discussed extensively with staff the issue of increased ownership of the consolidation goals at all levels of government. They share the goal but have to comply with the constitutional and political environment. They have committed to consider how to adopt and implement many important, although highly sensitive, measures put forward in a recent report drafted by a bipartisan group, chaired by former Prime Minister Balladur, notably the adoption of an annual target for local expenditure growth. A draft law is currently under preparation by the government and could be presented to parliament in the very near future.

More broadly, **the general review of public policies (RGPP), launched in 2008 at the government level, has been extended** to other levels of government, as recommended by staff, starting with state-owned firms.

As for tax expenditures and social contribution exemptions, the multi-year fiscal framework law enacted in January 2009 has adopted the principle of strict neutrality (i.e. any adoption of such an exemption must be fully compensated by a cut in expenditure). My authorities thank staff for the useful discussion during the mission, as reflected in para. 42. This issue is at the top of the agenda of my authorities. As for the environmental taxation, former Prime Minister Rocard has been asked to chair a bipartisan mission to explore the modalities of the adoption of a carbon tax. A decision should be reached soon by the government in the context of the upcoming 2010 budget.

Structural reforms: building on the momentum

Staff's assessment of the negative impact of the crisis on the potential growth in the short run seems pessimistic, with a trend much lower than that of the OECD, among others, not to mention the French government. Given the significant implications such a figure can have on structural balance assessment, **we look forward to a more general discussion on potential growth in systemic countries as promised by management.** Among other nuances to staff's calculations:

- since 2003, several measures taken by the authorities have put a halt to the decreasing trend of time work ;

- staff considers for granted that the crises only have a negative impact on total factor productivity (TFP), whereas this effect is in fact ambiguous and is therefore considered with caution by other institutions and economists ;

- some assumptions are inaccurate. For instance, it is stated in box 3 that the INSEE labor force projection "was based on relatively favorable economic conditions with a gradual reduction of unemployment", when in fact these projections were based on a constant labor force participation.

That said, my authorities are totally convinced of the need for structural reforms in the short and longer run and are determined to stick to their reform agenda, as acknowledged by staff in its two previous article IV consultations. This agenda aims at promoting competition, raising the employment rate, and increasing the flexibility of the labor market.

My authorities' determination for reforms has not decreased with the crisis. A lot has been accomplished since the last article IV consultation. Let me underscore a few achieved as well as ongoing reforms, most of which having been mentioned in the report : **(i) competition :** the unique and reinforced authority (an IMF recommendation) is in place since March ; the legal and institutional framework of retail trade has been considerably liberalized ; the distribution of *Livret A* (savings account) has been generalized ; **(ii) working hour flexibility and the rise of labor force participation :** a much more liberalized contract relationship, easement of the 35-hour week legislation, broadening of the authorization of work on Sunday, unification of the job placement agency, no government boost to the minimum wage for the third year in a row, introduction of a new earned income supplement, the *revenu de solidarité active* (RSA) that smoothes the effect of benefit thresholds to increase low-skilled employment ; **(iii) promoting "senior labor"** : possibility to combine pension and salary, increase in pension for those who retire later…

More broadly, my authorities are determined to tackle the challenges of an aging population. Beyond the 2007 reform of special pension regimes and the gradual increase of the contribution period, in 2010 the authorities will hold a public and nation-wide debate on the legal retirement age.

International support

France remains committed to provide financial support dedicated to mitigating the impact of the crisis on countries hit hard. As for the IMF, France assumes its full responsibilities as a shareholder: it has entered into a bilateral loan agreement of $15 billion with the Fund and has provided $1 billion to the PRGF-ESF trust fund.