

France: 2011 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

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 2011 Article IV consultation with France, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 14, 2011, 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 8, 2011. 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 staff statement of July 25, 2011 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 25, 2011 discussion of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

FRANCE

Staff Report for the 2011 Article IV Consultation

Prepared by the Staff Representatives for the 2011 Consultation with France

Approved by Ajai Chopra and Tamim Bayoumi

July 8, 2011

Executive Summary

Context: Supportive policies and reforms contributed to a gradual recovery from the crisis, but the unsettled external environment continues to pose risks, especially related to possible spillovers from the euro area crisis. Moreover, current growth prospects allow only for a gradual reduction in the high unemployment. Progress is being made in fiscal consolidation but more efforts might be needed to reach the 2012–13 targets. The financial sector is gaining strength while risks linked to rapid house price increases and direct exposures to euro area crisis countries seem at this stage contained.

Challenges: The main challenges for French policy makers are to strengthen the recovery and reduce unemployment while safeguarding financial sector stability. Achieving these objectives would require measures to bring down the public debt in a sustainable manner; regulatory reform to improve the resilience of the financial sector and vigilance on housing market developments; and structural policies to enhance competitiveness and boost inclusive growth.

Policy Recommendations: Preparing specific contingency measures is important to ensure reaching the 2012–13 fiscal targets in case growth is less strong than foreseen by the authorities while adopting a fiscal rule would enhance credibility of the consolidation strategy. Improving resilience of the financial sector requires implementation of Basel III regulatory reforms and reduction of the contribution to systemic risks from global systemically important financial institutions. Structural reforms to strengthen incentives for work, increasing economic efficiency, and innovation are needed to enhance competitiveness and boost inclusive growth.

Authorities' response: There was general agreement on the policy measures to be taken. The authorities were determined to achieve their fiscal consolidation objectives and have introduced a draft law to establish a fiscal rule. They were also committed to making the financial sector more resilient, but noted that international discussions were still ongoing and cautioned about a possible negative impact of some regulatory reform proposals. Building on the progress made in recent years, they intended to continue structural reforms but noted that some of these were politically challenging.

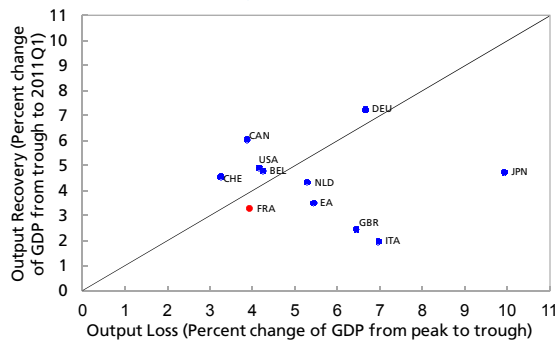
Mission team: Ms. Gulde-Wolf (head), Mr. De Vrijer, Mr. Cheng, Ms. Poirson Ward, Mr. Hallaert (all EUR), and Mr. Sy (MCM).

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I. GRADUAL RECOVERY AMID GLOBAL UNCERTAINTY AND STRUCTURAL CHALLENGES

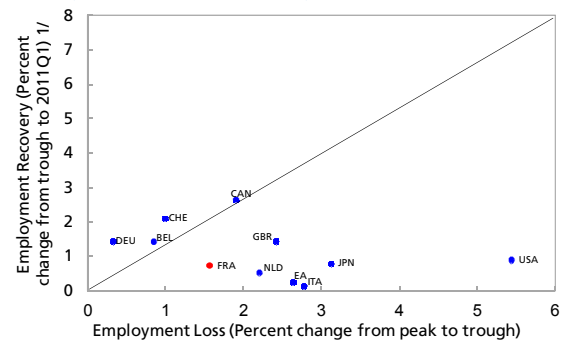
1. **Supportive policy measures and reforms contributed to a gradual recovery from the crisis.** In terms of both output and employment losses during the crisis, France has fared better than most advanced economies and the euro area as a whole. However, real GDP growth of 1½ percent in 2010 was below that in other core euro area countries and the rebound in employment was weaker. Notwithstanding the strong growth in 2011:Q1, both output and employment still remain below their pre-crisis levels.

Output Loss and Recovery



Sources: Haver Analytics; and staff calculations.

Employment Loss and Recovery



Sources: Haver Analytics; and staff calculations.
1/ FRA, CHE, ITA and EA until 2010Q4.

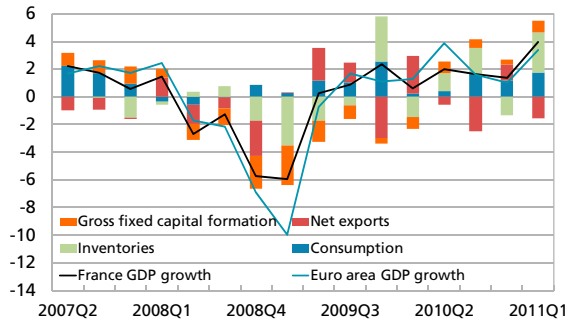
2. **The recovery in 2010 and early 2011 was largely driven by robust consumption and stock-building.** Consumption was spurred by purchases and orders of automobiles just before and delivery after the expiry of the car scrapping scheme at end-2010. Fixed investment has begun to pick up from 2010:Q2 as construction spending recovered and purchases of new houses increased. Activity in early 2011 also benefited from a catch-up effect from the strikes and cold weather at end-2010. The contribution of net exports to growth was positive but small in 2010 and a drag on growth in 2011:Q1, reflecting sluggish export growth as a result of declining foreign market shares together with dynamic import demand.

Figure 1. France: Economic Growth, 2007–10

The recovery is underway.

Contribution to Growth

(Percent, annualized quarter-on-quarter)

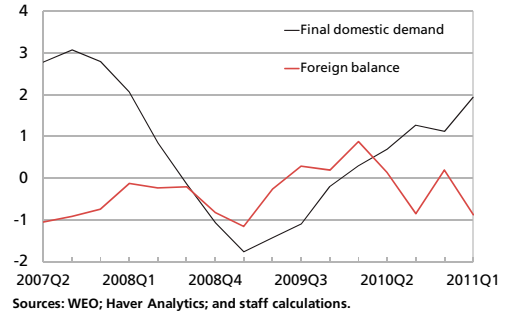


Sources: WEO; Haver Analytics; and staff calculations.

Domestic demand is the engine of growth,...

Contributions to GDP Growth

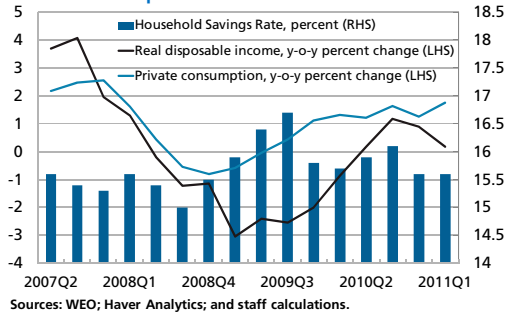
(Year-on-year percent change)



Sources: WEO; Haver Analytics; and staff calculations.

...with consumption growth and a recovery in disposable income.

Household Savings Rate, Real Disposable Income and Private Consumption

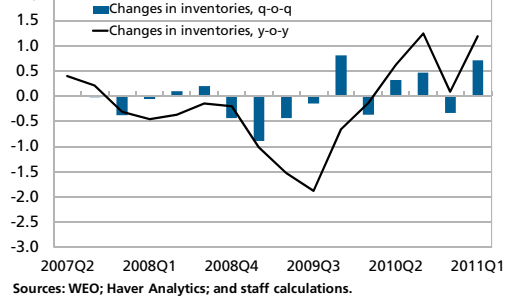


Sources: WEO; Haver Analytics; and staff calculations.

Inventory destocking has weighed on output in recent months.

Contribution of Changes in Inventories to GDP Growth

(Percent)

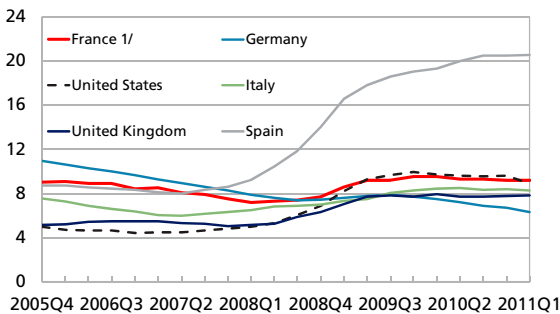


Sources: WEO; Haver Analytics; and staff calculations.

3. **The unemployment rate has started to decline but remains high.** Compared to output, employment has recovered much less from the downturn. After reaching a trough of around 7¼ percent in the first quarter of 2008, the unemployment rate climbed to above 9½ percent by 2009:Q3, and thereafter declined gradually to around 9 percent by early 2011. Staff estimates that the increase in the unemployment rate since 2008:Q2 has resulted in some further increase in its structural component, thereby holding back potential growth going forward.

Unemployment Rates

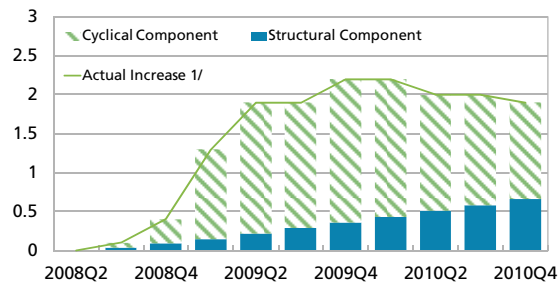
(Percent)



Source: Haver Analytics.
1/ Metropolitan France, excluding overseas departments.

Unemployment Rate Increase Since 2008Q2

(Percentage points)



Sources: Haver Analytics; and staff calculations.
Note: Structural/cyclical components are calculated based on the methodology developed by Benes et al. (IMF working paper No. 10/285).
1/ Metropolitan France, excluding overseas departments.

4. **The external environment has remained unsettled.** Specifically,
- *Euro area financial risks*—France has thus far not been affected much by the turbulence in European sovereign debt markets, but concerns over euro area sovereign debt persist. Indeed, sovereign bond spreads (vis-à-vis Germany) and sovereign CDS spreads remain somewhat higher than in the first part of 2010, likely reflecting increased market awareness of high public debt in the euro area and of French banks' exposure to some euro area crisis countries (Box 1).
 - *Commodity price hikes*—Strong demand for commodities by emerging market countries coupled with the events in the Middle East and North Africa region and the disaster in Japan have prompted a world oil and food price hike that pushed up annual headline inflation in France to 2 percent in March 2011 (Box 2). Although core inflation remained subdued—in light of the still sizable output gap and high unemployment—higher headline inflation could undermine consumer confidence and erode purchasing power.
5. **At the same time, France faces a number of well-known structural challenges.** The policy response to these would impact on the speed and strength of the recovery as well as long-term growth. In particular, there is a need to:
- Lift structural obstacles to stronger competitiveness on world markets;
 - Facilitate employment of young and low-skilled workers; and
 - Deal with the impact of an aging population in a sustainable manner. The recent pension reform is an important step in the right direction.

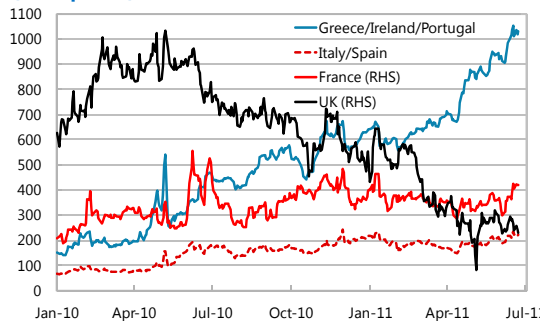
Box 1. Co-movement Between French and Selected Sovereign Yield and CDS Spreads

Amid heightened sovereign risks in the euro area, France's sovereign CDS spread and its 10-year government bond yield spread (relative to the German Bund) have increased during 2010.

The extent of increases of the 10-year bond yield spread, however, has been much more moderate than those of the sovereign CDS spread, likely reflecting the shallowness of the CDS markets. Compared to the euro program countries (Greece, Ireland, and Portugal) and also to Italy and Spain, the increase in France's sovereign CDS spread has been much more moderate—by around 80 basis points from trough to peak as opposed to a range between 180 and 800 basis points for these other countries. The co-movement between sovereign CDS spreads of France and these countries has increased during the past few years, while the co-movement of the bond yield spread has increased much less.

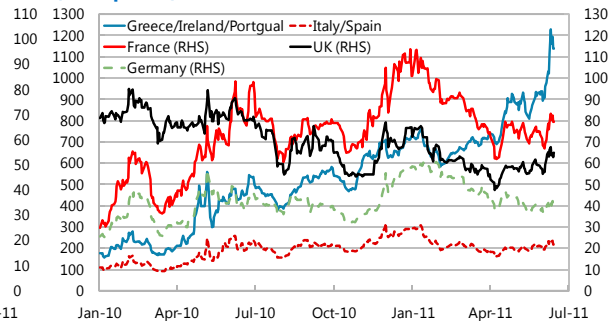
In early 2011, French and German spreads have moved in a different direction than those of Greece/Ireland/Portugal: while sovereign CDS and bond yield spreads of Greece/Ireland/Portugal continued to steadily increase during the first four months of the year, the French/German and Italian/Spanish CDS spreads declined during this period. However, co-movement increased in June 2011 amid renewed concerns about the euro area sovereign debt.

**Sovereign 10Y Yield Spreads over Bund
(Basis points)**



Sources: Bloomberg; and staff calculations.

**Sovereign CDS Spreads
(Basis points)**



Sources: Bloomberg; and staff calculations.

Degree of Concordance Between Selected 10Y Yield Spreads and Those of France and the U.K. 1/

	Concordance with Greece/Ireland/Portugal				Concordance with Italy and Spain			
	During bad times 2/		During good times 2/		During bad times 2/		During good times 2/	
	France	U.K.	France	U.K.	France	U.K.	France	U.K.
2007	60	50	50	58	64	48	57	56
2008	69	55	75	55	73	57	74	51
2009	81	45	74	44	83	46	72	44
2010	71	53	81	59	71	51	74	55
2011, Jan-Jun	68	51	67	67	78	56	67	70

Degree of Concordance Between Selected CDS Spreads and Those of France, Germany and the U.K. 1/

	Concordance with Greece/Ireland/Portugal						Concordance with Italy and Spain					
	During bad times 2/			During good times 2/			During bad times 2/			During good times 2/		
	France	Germany	U.K.	France	Germany	U.K.	France	Germany	U.K.	France	Germany	U.K.
2007	49	34		42	35		44	31		38	28	
2008	48	38		45	42		49	38		48	43	
2009	70	70	75	77	77	71	65	65	73	74	77	72
2010	75	77	68	80	78	83	76	80	70	77	78	83
2011, Jan-June	67	70	64	83	74	78	76	75	73	86	73	80

1/ Measured by the proportion of days when the spreads moved in sync with those of the selected countries.

2/ Good (bad) times refer to days when spreads of the selected countries narrowed (widened).

Box 2. Pass-Through of Food and Energy Prices

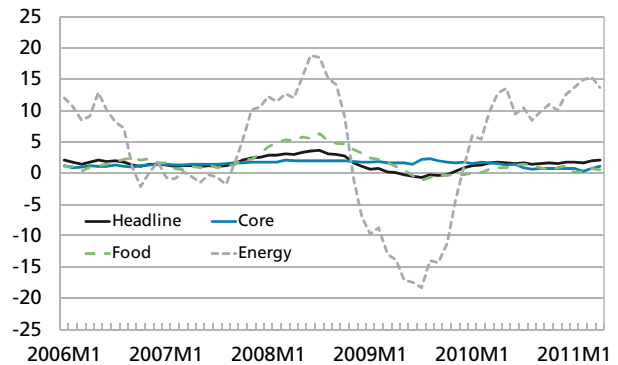
In tandem with international commodity price hikes, domestic energy prices in France have surged, although food price increases remained subdued. After declining from a peak of over 3½ percent in the summer of 2008, annual headline inflation hovered around zero throughout 2009. By 2011:Q1, headline inflation has gradually climbed above 2 percent, over half of which has been directly due to increases in fuel prices with food prices playing only a minor role. Core inflation has remained low.

Despite its high volatility and strong impact on the headline inflation, the pass-through from energy prices to core inflation has been quite small. Using data for 1995–2010, staff estimates that for every one percent increase in domestic energy inflation, core inflation would ultimately increase by 0.02 percent, compared with 0.2 percent for food price increases. This may reflect the greater importance of food in the consumption basket that would set in motion second-round effects of higher wage demands and inflation expectations.

Looking forward, headline inflation risk is on the upside, while core inflation should remain relatively moderate. Given structural commodity supply-demand imbalances and potential geopolitical factors, international oil prices are subject to upside risk, which, if realized, will likely exert upward pressures on headline inflation. The risks to core inflation, however, should be less significant given the still large output gap and the historically low pass-through.

Inflation

(Year-on-year percent change)



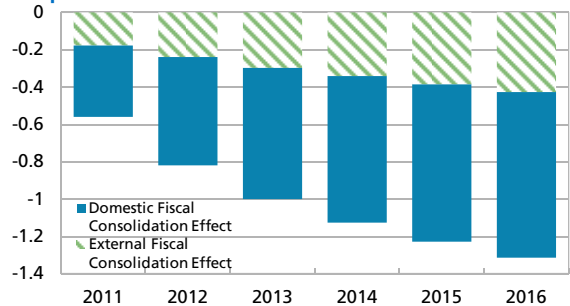
Sources: Haver Analytics; and staff calculations.

II. OUTLOOK AND RISKS

A. Short-term Output Dynamics

6. **The recovery in France is expected to be robust over the next two years as domestic demand strengthens, notwithstanding the planned fiscal consolidation in France and the rest of Europe.** Staff projects real GDP to grow by about 2 percent in both 2011 and 2012, more than foreseen earlier. The planned fiscal consolidation in France and the rest of the euro area are estimated to have a combined negative effect on France's GDP growth that increases from about ½ percent to 1¼ percent during 2011–16, of which two-thirds originates from France's own fiscal tightening.

Impact of Consolidation Plans in Europe on France's Output



Source: INSEE.

Note: For methodology, see "Note de conjoncture" March 2011 edition by INSEE.

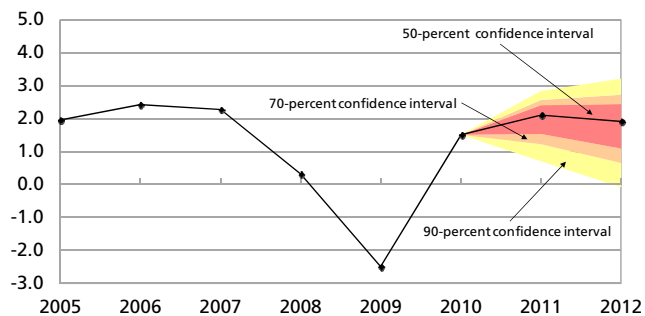
7. **Domestic demand is expected to remain the engine of growth, with net exports playing a minor role in the near term.** Private consumption growth is expected to remain dynamic in 2011–12, but is likely to face the headwind of the expiration of the car scrapping scheme, high unemployment, and uncertainty about headline inflation. Both business and household investment are expected to increase in 2011 as construction spending and housing markets recover. However, excess capacity and uncertainty about credit availability are likely to weigh on business investment. Net exports are unlikely to propel growth in the next few years, in view of the fiscal consolidation throughout Europe, competitiveness issues and the appreciation of the euro.

Contributions to Growth by Sector					
	2009	2010	2011	2012	2013
Consumption	0.7	1.1	1.0	1.0	1.3
Investment	-1.8	-0.2	0.5	0.6	0.7
Stockbuilding	-1.3	0.5	0.7	0.1	0.0
Net Exports	-0.2	0.1	-0.1	0.1	0.0
GDP	-2.6	1.4	2.1	1.9	2.0

Sources: Staff calculations

8. **Risks to the outlook are tilted to the downside.** Downside risks are particularly related to possibly renewed concerns about sovereign risks in the euro area in light of France’s high public debt and the significant exposure of French banks to the euro area periphery. A swing in investor sentiment could affect the availability and cost of financing to banks and the sovereign. A slower-than-expected recovery in trading partners linked to the European debt turbulence and intensified fiscal consolidation efforts, would weaken exports and growth. Growth spillovers to France from a shock in Spain and Italy during a period of financial stress would be significant (Box 3). Furthermore, higher commodity prices, in particular in light of heightened geopolitical risks in the Middle East and in the aftermath of Japan’s disaster, could undermine consumer confidence and dampen the recovery in France, especially if second round-effects prompt the ECB to raise interest rates faster than otherwise. On the upside, a stronger-than-expected recovery in trading partners, linked to resolution of the sovereign debt crisis in the euro area, could bolster exports while business investment could turn out stronger than foreseen. Visible progress in the reform agenda, including fiscal consolidation, financial regulation, and structural measures, would inspire confidence, induce investment, and boost demand.

Real GDP Growth: Risks to the Forecast



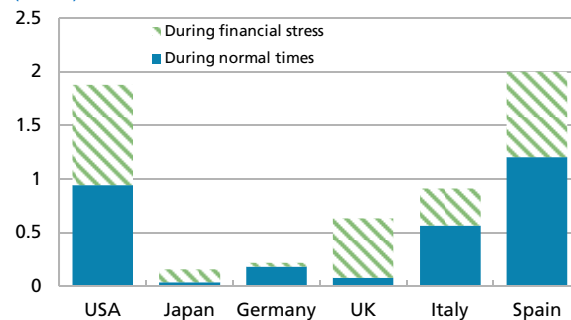
Sources: IMF staff estimates and projections.

Notes: The chart includes the following risks to the baseline growth projections in 2011 and 2012: (a) a weakening in foreign demand; (b) a smaller increase in unemployment; (c) a rise in funding costs; (d) a depreciation of the euro; and (e) a larger-than-expected rise in oil prices. The risk assessment is based on the methodology described in the IMF Working Paper WP/09/178 by Selim Elekdag and Prakash Kannan.

Box 3. Growth Spillovers to France¹

In the context of the crisis, examining international economic and financial linkages has become more important. France's growth performance is affected by growth shocks from abroad through both trade and financial linkages. In particular, growth spillover risks from the U.S. and large southern euro area countries to France are significant. France is highly vulnerable to growth spillovers from a shock in Spain while spillover effects from Italy are also relatively large. The contagion threat from the U.K. is generally small, except during financial crises when U.K. growth spillovers become more elevated. As autonomous domestic demand in Germany is rather stable and its final domestic expenditure has a low import propensity, the impact of growth shocks originating in Germany has historically been small.² However, Germany, by far France's largest trade partner, is an important transmitter to France and its other trading partners of shocks originating both within and outside the EMU, given its relatively high sensitivity to external shocks and high import propensity exports. France has little exposure to growth shocks originating in Japan in view of the limited trade linkages.

Cumulative Peak Impulse Response of France to 1 Percent Growth Shock, 1993Q1-2010Q3
(Percent)



Sources: OECD; and staff calculations.

¹ Results are based on a reduced form VAR estimation for 17 countries, which allows for both trade and financial channels of transmission. Identification is obtained via weighting different plausible orderings, and results are summarized by the average impulse response. Results for "normal times" are based on regressions that include a crisis dummy for 2008Q4–2009Q1, while the framework without the crisis dummy also reflects the relationship across growth rates in crisis times. The estimate of the role of third-country effects in the transmission of U.S. shocks for France and other European countries is based on a counterfactual analysis. See Poirson, H. and S. Weber, "European Growth Spillover Accounting from Crisis to Recovery", forthcoming IMF Working Paper.

² Pain, N., *et al.* (2005), "The New OECD International Trade Model", *OECD Economics Department Working Papers*, No. 440.

B. Medium- and Long-term Growth

9. **Boosting potential growth requires a comprehensive strategy.** The financial crisis is estimated to have resulted in a permanent potential output loss of around 1–3 percent over the medium term due to lower capital accumulation, higher structural unemployment, and reduced total productivity (Box 4). Over the longer term, the potential growth rate would converge to around 1¾ percent, a rate that would have been attained in the absence of the

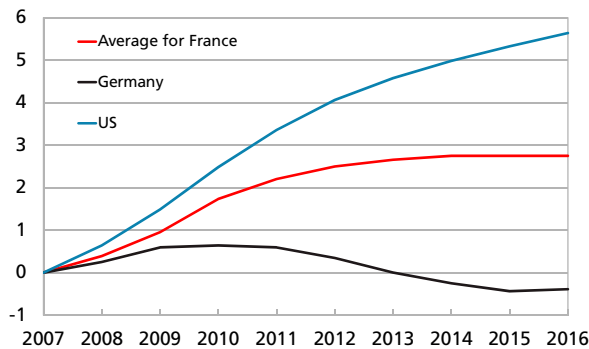
Box 4. The Impact of the Crisis on Potential Growth

The impact of the crisis on potential output in France is bigger than that of Germany, but smaller than that of the United States. Unlike the United States, France was not the epicenter of the financial crisis and, as a relatively closed economy, was not directly exposed to a market collapse or speculative attacks during the crisis. On the other hand, compared with Germany, the losses in employment during the crisis have been more pronounced in France (see Selected Issues Paper for more details). Against this background, France is estimated to have suffered a permanent output loss of around 1–3 percent, in between those of Germany and the United States.

The loss in output and slower potential growth during 2008–15 reflects the repercussions of the recession and financial stress. First, the sharp contraction of investment has resulted in a slowdown of capital accumulation, which directly lowered potential growth and indirectly reduced labor productivity and efficiency, thereby lowering total factor productivity (TFP) growth. Second, the sharp rise in unemployment and the slow job gains during the recovery suggest that the unemployment has an increasing structural component. This is also likely to reduce labor productivity and TFP growth going forward as displaced workers lose their skills.

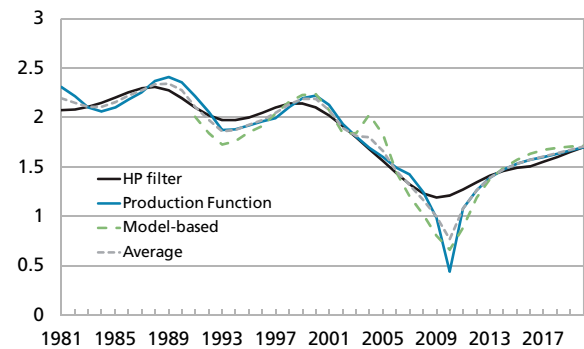
Over the longer run, potential growth is likely to be lower than the level during the past two decades, regardless of whether the crisis had occurred. The lower long-run potential growth rate reflects the aging population and the associated decline in labor force growth.

Potential Output Losses
(Percent)



Sources: Haver Analytics; and staff calculations.

Potential Output Growth
(Percent)



Sources: Haver Analytics; and staff calculations.

financial crisis. This long-term potential growth rate is lower than the average rate of around 2 percent attained over the past few decades. The decline of the potential growth rate reflects the impact of an aging population, although the recent pension reform is likely to lift the labor market participation rate of seniors. Current growth prospects still fall short of what is needed to significantly reduce the unemployment rate which is projected to gradually decline to about 8 percent by 2016, and deal with the costs of population aging. A comprehensive strategy, comprising measures to improve the functioning of the labor market, entice higher labor market participation, and strengthen incentives to invest and innovate, is needed to increase potential growth over the medium term (see Section III.C).

Long-Term Potential Growth During 1991-2016
(Annual percent change)

	France	Euro Area	Belgium	Germany	Italy	Netherlands	Spain
1991-2010	1.8	1.9	2.0	1.4	1.2	2.3	2.9
Of which:							
1991-2000	2.0	2.3	2.5	1.7	1.6	3.1	3.1
2001-2010	1.5	1.5	1.6	1.1	0.7	1.6	2.5
2011-2016 (proj.)	1.4	1.3	1.6	1.5	0.7	1.5	1.2
Of which 2016	1.6	1.4	1.6	1.3	0.7	1.8	1.7

Sources: IMF WEO; and staff calculations.

Authorities' views

10. **The authorities considered that from 2012 onwards the economy was set to achieve higher growth than projected by staff.** They expected the current momentum to carry over in 2012, with real GDP growth increasing to 2¼ percent—above current consensus. For 2013–14, more dynamic private consumption would lift the annual growth rate to 2½ percent. Over the medium term, the authorities projected potential growth at a rate of 2 percent, mainly reflecting higher total factor productivity growth than under the staff baseline.

III. POLICY CHALLENGES: SAFEGUARDING FISCAL SUSTAINABILITY, ENSURING FINANCIAL STABILITY, AND INCREASING GROWTH

11. **Fiscal, financial sector, and growth challenges are closely interlinked.** Fiscal policy needs to strike a balance between fiscal sustainability and confidence-enhancing measures on the one hand and growth considerations on the other. Financial sector policies and regulatory reform should help to further strengthen the sector's capacity to finance the economy and make it more crisis-resistant. A more competitive and growth-oriented economy is essential to raise employment, and help restore fiscal health. This places a premium on improving incentives for work, investment, and innovation through further labor and product/services markets reforms as well as a growth-friendly tax reform.

A. Achieving Fiscal Sustainability

Fiscal Consolidation Seeks a Balance between Competing Considerations

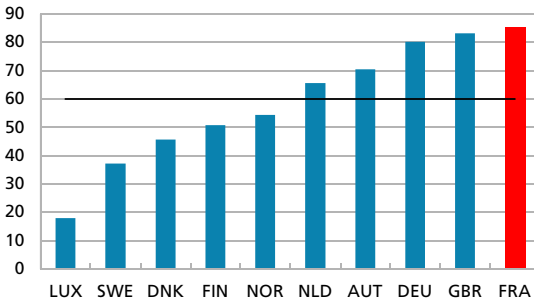
12. **A large fiscal consolidation has been set in motion.** Crisis-related costs—including the fiscal stimulus, revenue losses, and financial sector support—and declining trend growth have pushed France's government deficit and public debt to above the levels typical of other European AAA-rated countries. Aging-related spending pressures (although less than in

Fiscal Indicators for European AAA Countries

The debt level of France is the highest among all European AAA-rated countries ...

General Government Gross Debt, 2011

(Percent of GDP)

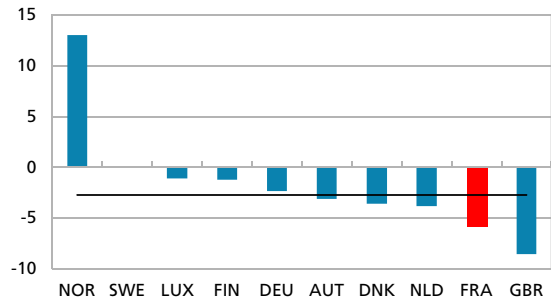


Sources: WEO; and staff calculations.

...and its deficit is the second highest.

General Government Net Lending/Borrowing, 2011

(Percent of GDP)

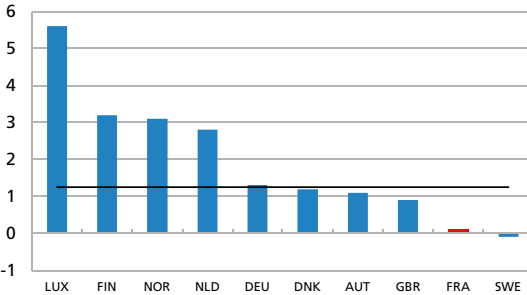


Sources: WEO; and staff calculations.

While the 2010 pension reform will help...

Projected Increase in Government Spending on Pensions, 2011-30

(Change in percentage points of GDP)

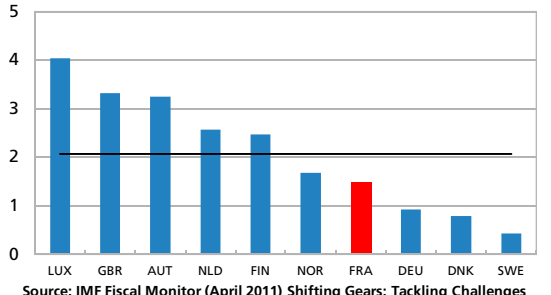


Source: OECD Pensions at a Glance 2011 and Stability Program 2011-14.

...health care spending is projected to increase.

Projected Increase in Government Spending on Health Care, 2011-30

(Change in percentage points of GDP)



Source: IMF Fiscal Monitor (April 2011) Shifting Gears: Tackling Challenges on the Road to Fiscal Adjustment and Stability Program 2011-14.

other advanced countries) further add to sustainability concerns. While the 2010 pension reform enacted in December will improve the public debt dynamics, under current policies projected health care spending growth will push up the debt ratio in the coming years. To underpin France's AAA-rating and to avoid that rising public debt would negatively affect growth, the government considers a large and determined fiscal consolidation as critical.

13. **The French Stability Program strikes an appropriate balance between growth and sustainability concerns, and aims to reduce the overall fiscal deficit to 3 percent of GDP by 2013 and 2 percent of GDP by 2014.** This planned fiscal adjustment is large both by historical standards and relative to that in other countries. The authorities seek to mitigate adverse effects on growth through a package of measures that: increases the efficiency of public services through implementation of the second phase of the review of public expenditures (*Révision Générale des Politiques Publiques*, RGPP); ensures the viability of the social security system by arresting the surge in aging-related spending; contains local government current spending through a freeze on transfers; raises public investment in innovation-related projects, including through public-private partnerships; and cuts wasteful tax expenditures. Moreover, the authorities expect the increase in the retirement age to raise potential growth through higher labor force participation. Staff observed that achieving the

fiscal targets would enhance credibility and be an important down-payment towards reducing the public debt to 60 percent of GDP by the middle of the next decade.

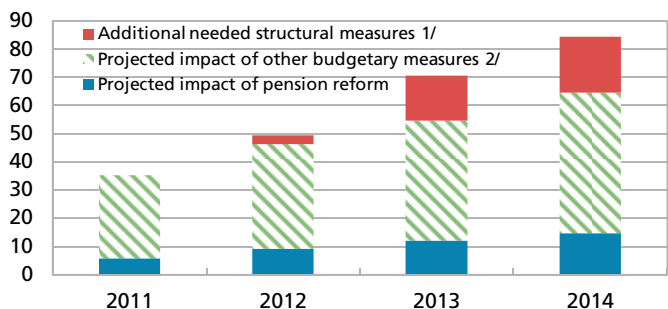
14. **Following the fiscal stimulus in 2009/10, progress is now being made in restoring fiscal sustainability.** The fiscal outcome in 2010 was better than foreseen by almost $\frac{3}{4}$ percent of GDP because of higher-than-expected revenues (0.4 percent of GDP—including from real estate transaction taxes levied by local governments), lower-than-expected spending on unemployment benefits; and capital expenditure cuts at the local government level. Instead of the expected fiscal expansion, the overall deficit was reduced to 7.1 percent of GDP from 7.5 percent in 2009, implying a small negative fiscal impulse.

15. **Building on this, the 2011 budget and 2011–14 multi-year fiscal framework provide for about 2.8 percent of GDP in adjustment measures over 2011–13.** These measures trim the overall fiscal deficit to below 6 percent of GDP in 2011, yield a permanent

reduction in spending by 1.2 percent of GDP, and expand the tax base through the elimination of 0.6 percent of GDP in tax expenditures and exemptions on social security contributions. A reform of capital taxation, which seeks to boost competitiveness, particularly in relation to Germany has been approved by parliament.¹ The reform will eliminate the first tranche of France's annual wealth tax (*Impôt sur la fortune*, ISF) in 2011 and remove the ceiling on personal taxes (*bouclier fiscal*) in 2012.²

Announced Fiscal Measures

(Billions of euros)



Sources: 2011–14 multiyear budget; Conseil d'Orientation des Retraites; and IMF staff estimates and projections.

1/ Over and above the announced measures already included in the staff's baseline scenario.
2/ Includes stimulus withdrawal and normalization of the tax position after the 2010 local business tax reform (both in 2011); freezing of non-interest, non-pension, expenditures of the central government; tighter health care spending norm; taxes on banking sector; and reductions in tax expenditures. Impact of spending freeze on local governments estimated relative to a counterfactual scenario based on 2006–09 average nominal expenditure growth.

16. **The adjustment is front-loaded and tilted toward expenditure-containment measures.** Expenditure reductions account for about 56 percent of the effort through 2013.³ Moreover, the multi-year budget implies a sizeable upfront adjustment of 1.7 percent of GDP in 2011 (followed by about $\frac{1}{2}$ percent of GDP per year in 2012–14). The adjustment effort is underpinned by the implementation of the 2010 pension reform, enforcement of a tighter

¹ A report of the Court of Accounts (*Cour des Comptes*) highlights that the burden of wealth taxation in France is much higher than the EU or OECD average, which in turn is higher than in Germany.

² Payments of personal taxes (including CSG and CRDS), ISF, and certain real estate taxes on the primary residence are capped at 50 percent of income since 2007.

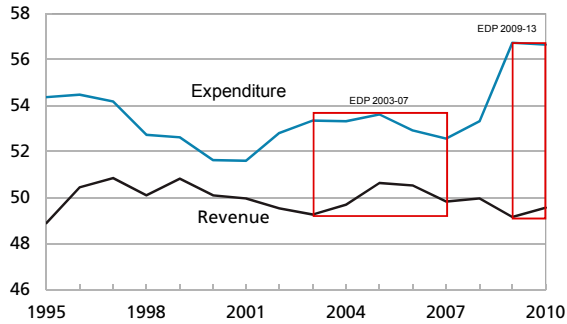
³ Excluding one-off effects from fiscal stimulus exit and the reform of the local business tax in 2011.

Figure 2. France: Fiscal Developments, 1995–2010

The fiscal deficit has decreased post-crisis....

Revenue and Expenditures

(Percent of GDP)

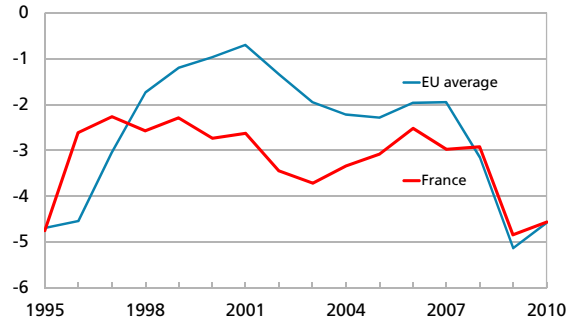


Sources: WEO; and staff calculations.

...imparting a small negative fiscal impulse in 2010.

Structural Fiscal Balance

(Percent of potential GDP)

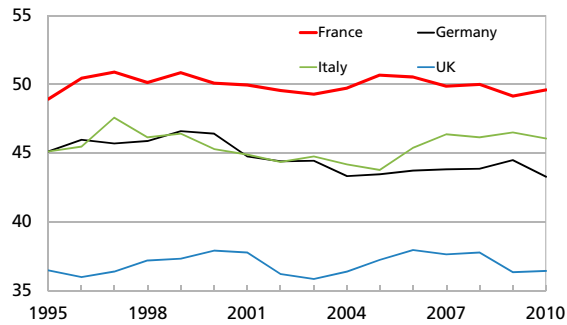


Sources: WEO; and staff calculations.

The tax burden remains high....

Revenues

(Percent of GDP)

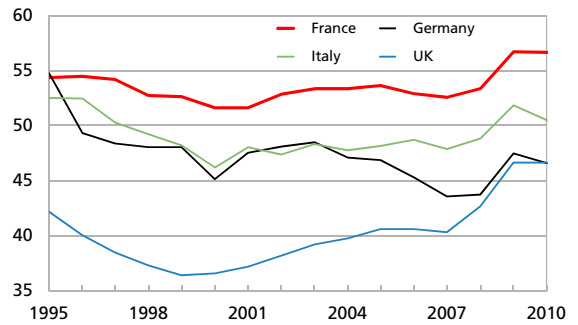


Sources: WEO; and staff calculations.

...and the crisis has pushed up expenditures sharply.

General Government Expenditures

(Percent of GDP)

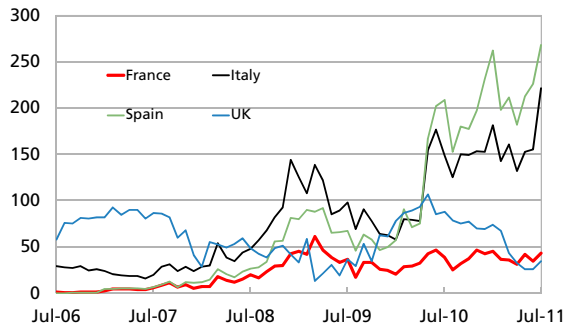


Sources: WEO; and staff calculations.

Spreads are higher than pre-crisis...

Spread with 10-Year German Bund

(Basis points)

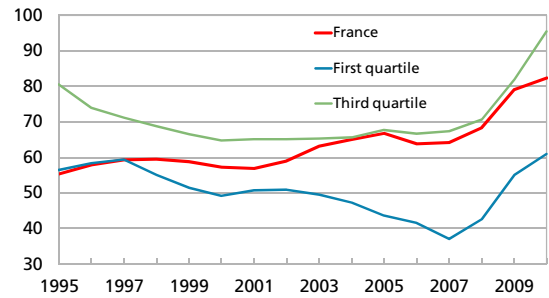


Sources: Datastream; and staff calculations.

...reflecting the surge in public debt.

Public Debt

(Percent of GDP) 1/



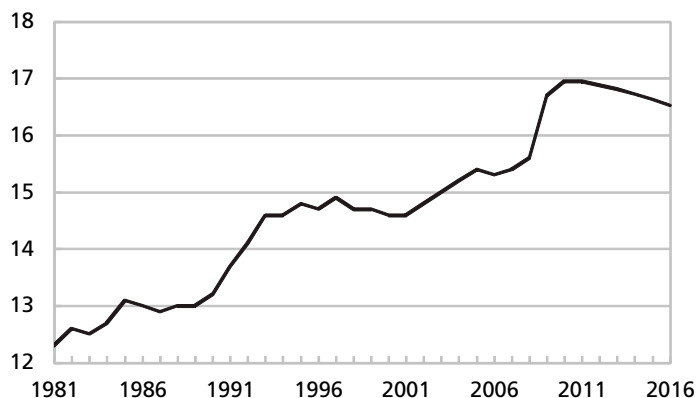
Sources: WEO; and staff calculations.

1/ Sample of twelve EU countries for which full historical data are available, classified by the ratio of debt to GDP in a given year.

health care spending norm, and restraint in central government spending—including through freezing the base wage for civil servants in 2011–12, the non-replacement of one-in-two retiring civil servants, and a freeze on transfers. However, staff expects GDP growth and revenue outcomes from 2012 to be weaker than those currently foreseen by the authorities and hence the deficit ratio to fall more slowly than envisaged. Under staff's current projections, achieving the deficit target of 3 percent of GDP by 2013 requires further measures.

Aging-Related Spending, 1981–2016

(Percent of GDP)



Sources: French authorities; and staff estimates and projections.

17. **France cannot risk missing its medium-term fiscal targets given the need to strengthen implementation of the Stability and Growth Pact (SGP) and keep borrowing costs low by securing France's AAA-rating.** Staff's baseline projections, based on less sanguine macroeconomic assumptions, suggest additional adjustment needs of about 0.2 percent of GDP in 2012 and 0.6 percent of GDP in 2013. The authorities' determination to achieve their fiscal objectives would thus be supported by preparing specific contingency measures that would secure the targeted consolidation in case growth and revenue outcomes fall short of the authorities' projections. With limited scope and desirability for raising tax rates, further efforts will need to rely mainly on limits on spending

France: Fiscal Projections, 20101–14
(in percent of GDP)

	2010	2011	2012	2013	2014
Authorities' projections 1/					
General government balance	-7.1	-5.7	-4.6	-3.0	-2.0
Primary balance	-4.6	-3.1	-1.7	-0.1	1.0
Structural balance 2/	-5.1	-3.8	-2.9	-1.6	-0.9
General government gross debt	82.3	85.4	86.9	86.4	84.8
Real GDP growth	1.4	2.0	2.3	2.5	2.5
Inflation	1.2	1.8	1.8	1.8	1.8
IMF staff's baseline					
General government balance	-7.1	-5.7	-4.8	-3.8	-2.9
Primary balance	-4.6	-2.9	-1.7	-0.6	0.3
Structural balance 2/	-4.7	-4.0	-3.4	-2.7	-2.2
General government gross debt	82.3	85.2	87.2	88.1	87.8
Real GDP growth	1.4	2.1	1.9	2.0	2.1
Inflation	1.7	2.1	1.7	1.8	1.9

Source: French authorities and IMF staff estimates and projections.

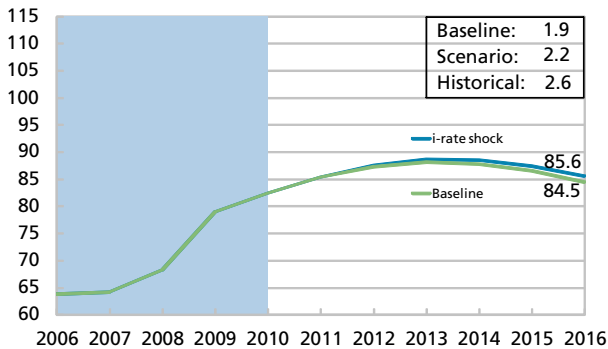
1/ INSEE for 2010, and April 2011 Stability Program and June 2011 DOFP for 2011–14.

2/ In percent of potential GDP.

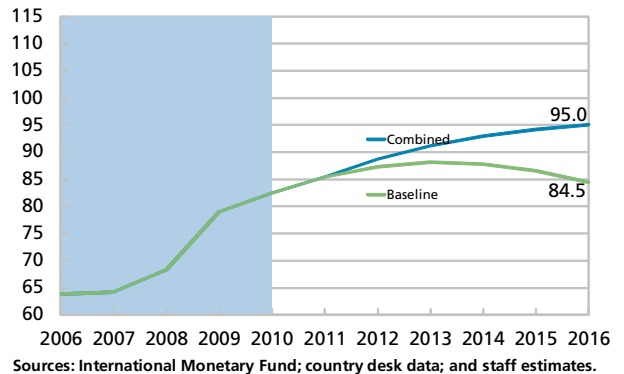
growth and a growth-oriented restructuring of the tax system. In this context, increasing the revenue yield of existing taxes through further base-broadening measures could support both cuts in the overall high labor tax wedge and provide insurance against expenditure slippages (as discussed in Section III.C).

18. **Achieving the envisaged consolidation is critical to put the public debt-to-GDP ratio on a downward path.** In the staff’s baseline fiscal projections, high deficits in 2010–12 are likely to result in further increases in the public debt ratio, which would peak at about 88 percent of GDP in 2013. In a scenario where interest rates are permanently higher by one-half standard deviation, debt would peak at almost 90 percent of GDP in 2013, and if both interest rates are higher and growth is lower, debt would continue to rise to 95 percent of GDP by 2016. Under the authorities’ fiscal consolidation plan, the public debt ratio starts to fall after 2012.

Interest Rate Shock 1/
(Percent)



Combined Shock 2/
(Percent per year)



Note: Shaded areas represent actual data.

1/ Permanent one-half standard deviation shock to real interest rate (based on the GDP deflator).

2/ Permanent one-half standard deviation shocks to real interest rate and real GDP growth (equivalent to a scenario where the growth-interest differential returns to historical levels).

19. **A credible fiscal package of additional measures to achieve the necessary consolidation and lay the foundation for a more growth-friendly tax system could include:**

- Curbs on local government expenditure growth, including through an extension of the RGPP to regional and local authorities and implementation of the recommendations of the Ballardur Committee to rationalize responsibilities of departments, regions, and municipalities;
- Improved targeting of family, housing, and other social transfers. To enforce a tighter budget constraint on spending by social security entities, consideration could be given to replacing earmarked “social taxes” (which account for almost a third of social security resources) with subsidies. This would result in less open-ended spending mandates in the social security budget and greater ability of the central

government to control the expenditure growth of social security entities and other public agencies.

- Reducing the VAT policy gap through a gradual elimination of VAT exemptions and incentives (including reduced rates). An ambitious VAT reform could yield up to 3.3 percent of GDP and be combined with the introduction of a carbon tax (Box 5), higher revenue from fuel, alcohol, and tobacco taxation, gradual hikes in recurrent immovable property taxes, and improving the efficiency of the personal income tax while further reducing personal income tax allowances to lower the still high labor tax wedge at the average wage level.⁴

Potential Options for Additional Fiscal Adjustment Over 2012–13
(in billions of euros)

	Option 6/	
	Expenditure-based	Balanced
Central government measures		
Close one-third of the VAT policy gap with respect to the G-20 average 1/	-	7.5
Introduce a carbon tax 2/	1.3	-
Further reduce tax expenditures 3/	2.4	-
Local government measures		
Higher revenue from property taxes 4/	-	1.6
Freeze spending in real terms in 2012, thereafter in nominal terms	11.2	-
Freeze spending in real terms from 2012	-	6.7
Social security measures		
Improve targeting of social transfers 5/	1.0	-
Total savings	15.8	15.8

Source: *From Stimulus to Consolidation*; and IMF staff calculations.

1/ One-third of the impact of raising VAT C-efficiency from 0.48 to 0.55, slightly above average for the Group of Twenty countries (G20).

2/ Implementing a carbon tax gradually over 2013-15.

3/ Over and above already announced reductions.

4/ One-third of the impact of increasing revenue-to-GDP to the average of the US, UK, and Canada levels.

5/ Spending freeze on family, housing, and other transfers from 2013.

6/ Expenditure measures account for 61 percent (52 percent) of the overall adjustment under the expenditure-based (balanced) option.

Institutional Reforms Can Aid Fiscal Sustainability

20. **Staff encouraged the authorities to push ahead with their efforts to adopt a fiscal rule consistent with the planned EU directive.** A fiscal rule this would entrench fiscal credibility and support euro area-wide efforts to boost fiscal discipline. With a second large core country adopting a fiscal rule, the credibility of the euro area's SGP would be significantly strengthened. The authorities have prepared a draft law that envisages

⁴ Earlier reforms aimed at decreasing employer-paid social security contributions paid at low wage levels (between 1 and 1.6 times the minimum wage) have already significantly lowered the tax wedge at the bottom of the income distribution.

Box 5. Should France Introduce a Carbon Tax?¹

Implementing a carbon tax in France would initiate an economy-wide carbon pricing strategy that ramps up over time in coordination with the EU Emissions Trading Scheme (ETS), in which France already participates. The 2009 carbon tax proposal remains attractive in several respects, and its impact on vulnerable categories and motorists could be mitigated through targeted transfers and more finely-tuned fuel taxes. Reasons to consider a carbon tax include:

First, the tax targets emission sources outside of the ETS, e.g., fuel used in homes, small- and medium-sized companies, and motor vehicles, which together account for around two-thirds of CO₂ emissions in France. With continued ETS participation, most possibilities for reducing carbon emissions would thus be exploited. Moreover, the proposed tax rate of €17 per ton of CO₂ was in line with prevailing emissions prices in the ETS. Price harmonization promotes cost-effectiveness by equating the cost of the last ton reduced across ETS and non-ETS emissions. The emissions price is also broadly consistent with recommendations derived from an estimate of the future damages from CO₂ emissions.²

Second, the tax would provide annual revenue of around €4 billion (about 0.2 percent of GDP). This revenue could be used to support the planned fiscal consolidation, or recycled to finance reforms aimed at reducing labor taxation. While any employment gains from revenue-recycling would tend to be offset as higher energy costs cause a slight contraction in economic activity,³ overall the revenue-recycling would keep the costs of the tax modest.

Third, a carbon tax removes uncertainty related to the future emissions price. In contrast, volatile allowance prices in cap-and-trade systems may deter clean technology investments.

The 2009 carbon tax proposal was rejected by the Constitutional Court in 2010 on the grounds that it had too many exemptions and would have adverse distributional and competitiveness effects. However, the majority of exempt sources were already covered by the ETS. Helping low-income households and vulnerable firms through targeted adjustments to the broader tax and benefit system, is generally preferred to holding down energy prices below levels warranted on environmental grounds. In April 2011, the EU proposed a minimum carbon tax (for heating and transport fuels) of €20 per ton which is yet to be approved. Denmark, Ireland, and Finland already impose carbon taxes (mainly on transportation and heating fuels) of €12, €15, and €20 per ton, respectively, while Sweden imposes a much higher tax of €108 per ton.

The tax would increase (by about €0.04 per liter) the burden on motorists, who already pay excise taxes of €0.61 per liter for gasoline and €0.43 per liter for diesel. However, high taxation of vehicle use is warranted because of other adverse side-effects (e.g., traffic congestion), though fuel taxes could be partly replaced with more finely tuned taxes to address other side-effects of vehicle use (e.g., per mile tolls that vary with location and time of day according to the degree of road congestion).

¹ Prepared by Ian Parry, FAD.

² U.S. Interagency Working Group on Social Cost of Carbon, 2010. *Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis Under Executive Order 12866*. United States Government, Washington, DC.

³ Goulder, Lawrence, 2002 (ed.). "Environmental Policy Making in Economies with Prior Tax Distortions." Edward Elgar, Northampton, MA, USA.

enshrining a fiscal rule comprising the general government in the constitution.⁵ In line with the recommendations of the Camdessus working group⁶, the draft law would provide for:

- **A binding medium-term budget framework**, including multi-year expenditure ceilings and minimum annual revenue measures, and restriction of new tax measures to budget laws. The 2011–14 multi-year fiscal framework already specifies objectives for budgetary aggregates, consistent with the European fiscal rules, and since June 2010 a directive of the Prime Minister ensures the monopoly of budget laws on tax policy. However, enshrining those provisions in a national fiscal rule will lend greater credibility to the fiscal targets, ensure continuity of policy across governments, and reduce the uncertainties associated with consolidation.
- **A post-consolidation anchor for fiscal policies.** The medium-term budget projections under the proposed fiscal rule would need to be consistent with a return to general government structural balance, ensuring that any temporary deficits are eventually corrected.⁷ Unlike Germany’s debt-brake rule, the target year for achieving budget balance would not be set in the constitution but would be implied by the consolidation path voted by parliament.

21. To enhance its credibility, the multi-year budget should be based on independent macroeconomic forecasts and be backed by contingency spending and revenue plans.

EU experience suggests that the impact of fiscal rules on budgetary outcomes depends on the strength of enforcement mechanisms (Box 6). Staff encouraged the authorities to establish an independent public institution or fiscal council to provide forecasts that would be mandatory for budget preparation and medium-term planning. Alternatively, the council could review ex ante government projections of macro-economic variables and tax revenues to ensure their realism and credibility; however, this option would enhance policy credibility only to the extent that mechanisms are in place to enforce the council’s recommendations.⁸ The same institution could also assess the long-term sustainability of public finances on a regular basis, to increase public awareness of fiscal challenges.

⁵ The draft law has been approved by the National Assembly and is being considered by the Senate. Once passed by the Senate, the constitutional change will require a three-fifths majority vote in Congress to become law.

⁶ *Réaliser l’Objectif Constitutionnel d’Equilibre des Finances Publiques*, Report of the Working Group headed by Michel Camdessus, June 21, 2009.

⁷ Local governments already have a “golden rule,” allowing them to borrow only to finance investment. However, this rule does not ensure the consistency of their fiscal policy with the Stability Program.

⁸ An independent technical group of the national economic committee already prepares alternative macroeconomic forecasts, which are compared with those of the government in the economic, social, and financial report annexed to the draft budget bill. The budget however relies on government-prepared forecasts.

Box 6. Numerical Fiscal Rules in the EU

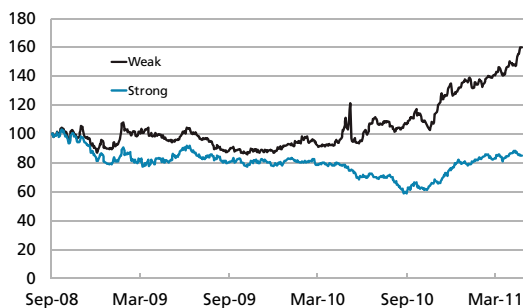
Fiscal rules have become a wide-spread policy tool across EU member states. In 2008, 67 national fiscal rules were in place, up from less than 20 in 1990. About half of the total number of rules applied to the general and central governments in 2008, up from a quarter in 1990. More than a third of the existing fiscal rules in the EU countries are budget balance rules (including golden rules) while expenditure and debt rules represent about a quarter each. Revenue rules (that pre-define the allocation of windfall revenues) account for the remainder. Expenditure rules apply more often to the central government and social security funds, and are evenly distributed between nominal ceilings and targeted growth rates. Local governments are more often subject to budget balance and debt limits according to repayment capacity.

The strength of fiscal rules depends to a large extent on its institutional features. To capture the influence of these features, the European Commission has developed a fiscal rule strength index, which is based on: (i) the statutory base of the rule; (ii) room for setting or revising its objectives; (iii) the body in charge of monitoring implementation of the rule; (iv) the enforcement mechanisms relating to the rule; and (v) the media visibility of the rule. Strong rules (with a value of the fiscal rule strength index above the median) are in place in Denmark, Finland, Germany, the Netherlands, Spain, Sweden, and the U.K. Weak rules apply in Austria, Belgium, France, Greece, Ireland, Italy, and Portugal.

Only few EU rules include independent monitoring and enforcement mechanisms in case of non-compliance. Strong rules, enshrined in law or constitution, with broad coverage, and supported by pre-defined enforcement mechanisms, seem to have a larger impact on borrowing costs than weak rules, suggesting that market participants favorably discount the effect of the rules on fiscal discipline. Strong rules are also associated with more favorable budgetary outcomes.

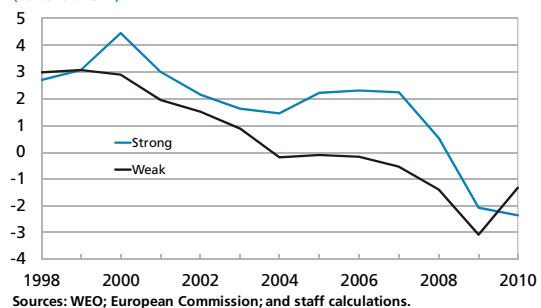
Average Yield and the Strength of Fiscal Rules

(2008M9=100)



Primary Cyclically Adjusted Balance and the Strength of Fiscal Rules

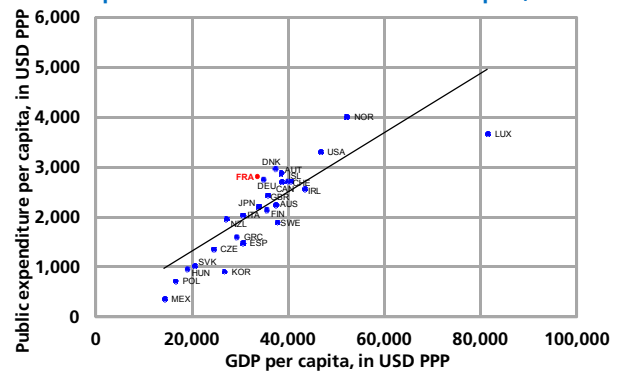
(Percent of GDP)



22. Securing long-term fiscal sustainability will require deeper reforms of key pension and health care parameters.

- On the pension side, further increasing the legal retirement age in the future in line with life expectancy would prevent continued fiscal pressures from increases in time spent in retirement as medical advances continue to lengthen life spans.⁹ With the tenth-highest worldwide life expectancy and one of the lowest effective retirement ages in the OECD, French workers spend the longest time in retirement among advanced countries. Further efforts to increase senior workers' labor force participation rate, including through targeted tax incentives, would also help moderate the fiscal and growth consequences of aging (as discussed in Section III.C). Another evaluation of the long-term financial viability of the pension system is planned for 2013.
- On the health care front, the rise in living standards and technical progress will continue to put pressure on public expenditures, which is already higher in per capita terms than predicted by France's income levels. Continued efficiency gains are necessary to prevent an unsustainable rise in health and long-term care spending, while at the same time maintaining France's OECD best performer status on amenable mortality and the high quality of its health services. A planned reform of long-term care would be initiated in 2012.

Public Expenditure on Health and GDP Per Capita, 2007



Sources: OECD; WEO; and IMF staff estimates.

Authorities' views

23. The authorities reaffirmed their full commitment to the fiscal adjustment path outlined in France's Stability Program. They considered that growth could surprise on the upside and noted that their macroeconomic forecasts in recent years had proven realistic. Strong revenue performance on the back of the increasing employment could result in a slightly better-than-expected budgetary outcome in 2011. Should downside risks materialize, there was room for contingency measures (including further cuts in tax expenditures). The authorities agreed in principle on the desirability of "green taxes", including a carbon tax, but

⁹ French workers now spend about two and half times as many years in retirement as they did in the early 1970s. The effective retirement age will remain below the OECD average even with the planned increase in the retirement age to 62 (assuming labor market exit continues to occur close to the retirement age).

viewed the scope for raising consumption taxes as limited in light of the potential negative impact on demand and inflation. They were confident that the 2010 reform of the local business tax and the legislated freeze in transfers would limit local government spending growth. Social security finances would benefit from the positive impact of the recent and previous pension reforms, the labor market recovery, and cost containment measures under way in health care. Although current borrowing costs were still exceptionally low from an historical perspective, the authorities considered the current spreads versus Germany to be higher than warranted by France's credit fundamentals, and expected tighter spreads as the crisis is resolved.

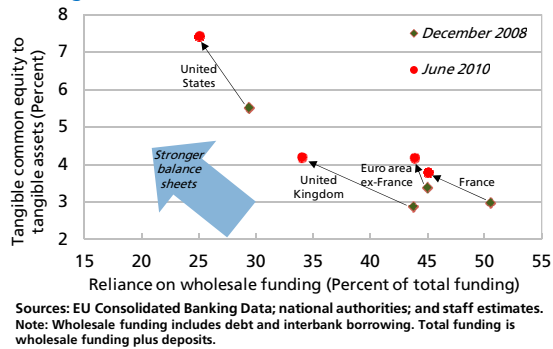
24. **The authorities highlighted the recent advances made in strengthening the medium-term budgetary framework.** In the near term, they considered that the current fiscal framework—including the approval of the Stability Program by parliament, the “golden rule” at local government level, and strictly enforced spending rules for the central government (along with the pension reform and the tightened health care spending growth norm)—provided strong safeguards against the risk of fiscal slippages. They noted the broad support for the proposed fiscal rule. It is nevertheless uncertain whether the required super-majority for a constitutional change will be secured ahead of the presidential elections in 2012.

B. Financial Stability: Further Strengthening the Financial Sector

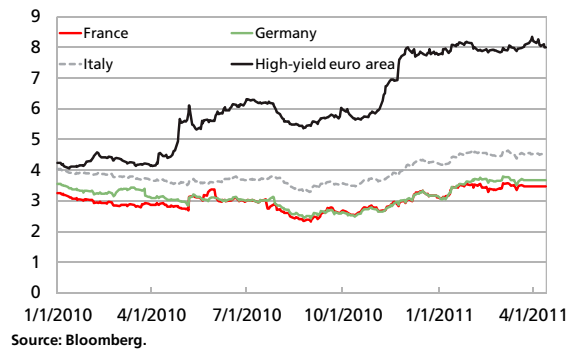
25. **Earnings of major French banks have recovered strongly in 2010 and profitability now exceeds its pre-crisis level.** Operating profit more than doubled in 2010 to reach 14 percent of equity as banks continued to recover from the financial crisis. Both operating profit and net income now exceed their 2007 level. Return on equity averaged 9.5 percent for the largest French banks, in line with their European peers. France has requested an FSAP update, which is planned to start in late 2011.

26. **The major French main banks have reduced their reliance on wholesale funding but it remains high.** By mid-2010, the share of wholesale funding in total bank funding remained above the average level of euro area, U.K., and U.S. banks. Deposits account for 85 percent of loans, comparable to the funding pattern of the largest European banks but still lower than pre-crisis levels and much lower than for U.S. and U.K. banks. Short-term funding relies heavily on U.S. dollar liabilities from U.S. money market funds. One-fourth of the 2011 medium- and long-term issuance needs of the major French banks were already covered by mid-February.

Banking System Capital and Reliance on Wholesale Funding



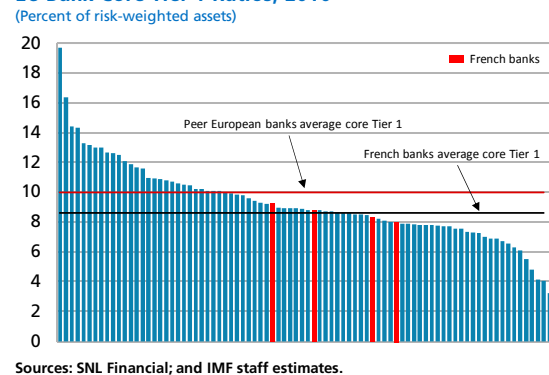
Bank Debt Yields



27. Capital adequacy has improved but major French banks remain less capitalized

than their European peers. Although their core Tier 1 ratio improved to 8.8 percent, French banks are lagging other large European banks which are increasing their capital in order to meet and even exceed Basel III capital requirements at an accelerated pace. Market participants are increasingly using a 10 percent core Tier 1 threshold for large banks and French banks have among the largest capital deficit to this threshold in their peer group.

EU Bank Core Tier 1 Ratios, 2010

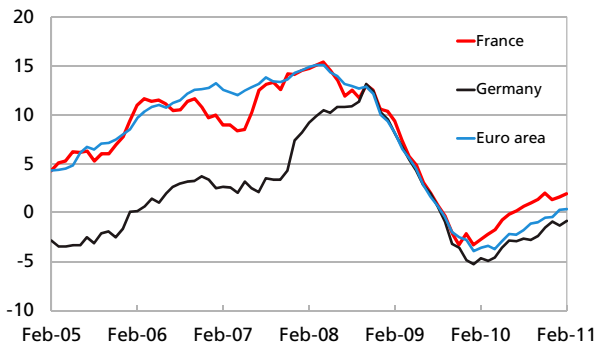


28. **Asset quality is still below its pre-crisis level.** Impaired loans at the main banking groups increased slightly in 2010 to reach about 5 percent of gross loans. Coverage ratios have been decreasing as banks expect the economic recovery to improve borrowers' credit risk. French banks have inherited limited legacy exposures on U.S. underlying assets from the crisis, which they are actively reducing. The French (and Belgian) authorities have put in place a guarantee mechanism for potential losses on the legacy assets of a small bank in case such losses would exceed \$4.5 billion.

29. **Overall credit growth remains sluggish but mortgage lending is recovering at a fast pace.** Corporate and consumer credit growth have both moved to positive territory in 2011 and bank surveys indicate a willingness to lend. At the same time, residential mortgage loans grew by 8.3 percent in February 2011 (y-o-y, from 4.1 percent a year ago) as households locked in low fixed-term interest rates and took advantage of fiscal incentives to invest in the property markets (such as the 2009 *Loi Scellier*).

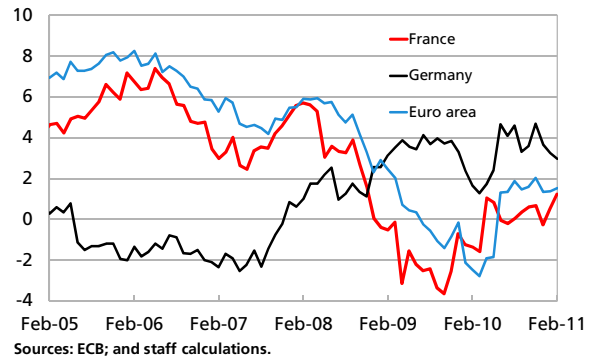
Corporate Loans

(Year-on-year percent change)



Consumer Credit

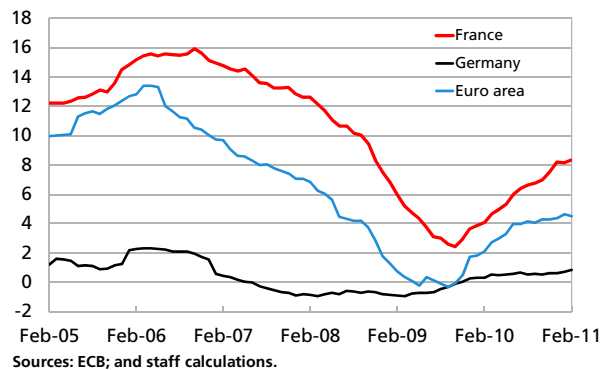
(Year-on-year percent change)



30. **House purchases have rebounded in 2010 and the first part of 2011, bringing housing prices to their previous peak levels** (Box 7). The growth rate of house purchases doubled during 2010, amid an inadequate increase in housing supply relative to the growth in the number of households. As a result, house prices grew by 8.5 percent to reach their pre-crisis peak. This average masks regional differences as prices have increased by 12.8 percent for Ile de France and by 18.7 percent in the 20 Paris *arrondissements* in 2010. According to staff estimates, France's house prices were 10–25 percent overvalued at end-2010, and achieving a soft landing would be desirable.¹⁰

Housing Loans

(Year-on-year percent change)



31. **Risks from the regained exuberance of the French property market are mitigated by banks' lending practices and moderate household indebtedness.** French banks rely less on the value of collateral and more on the income of borrowers to assess credit risk, and do not extend home equity loans. Banks typically offer mortgage products to their own clients, which is another way to mitigate credit risk. Mortgages have long-term fixed-rates which reduces interest rate risk for borrowers. Moreover, mortgage loans account for about 40 percent of French GDP in 2010, less than half of the levels in the U.K. and Ireland, and lower than the European average.

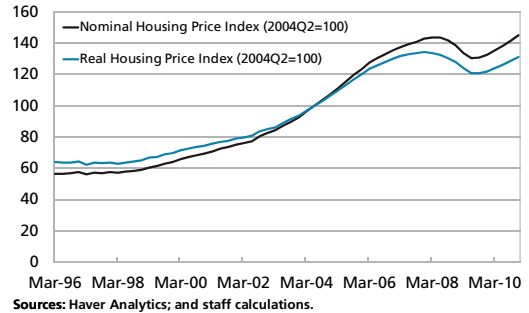
¹⁰ The assessment of house price valuation is based on a methodology developed in Deniz, I. and P. Loungani, Global Housing Cycles, forthcoming IMF Working Paper.

Box 7. The French Housing Market During the Crisis and Recovery

The financial crisis had little impact on the French housing market. After declining by less than 10 percent from their pre-crisis peak, house prices in France have rebounded since mid-2009 and regained their pre-crisis peak, both in real and nominal terms. There are a number of noteworthy stylized facts:

- Before the crisis, the extent of increases in French housing prices (44 percent from 2004 to the pre-crisis peak) was greater than in most advanced economies.
- During the crisis, the decline in house prices was relatively mild compared to for example those in the U.S. and Ireland. Furthermore, the duration of its downturn in housing prices—only 4 quarters—was relatively short and France was among the earliest advanced economies—along with Australia—where house prices recovered.
- The ratio of house prices to household disposable income (affordability ratio) was one of the highest among the advanced economies. Furthermore, unlike most other economies that saw houses becoming more affordable after the crisis, France saw a small increase in the affordability ratio.

France: Nominal and Real House Price Indices (2004Q2=100)

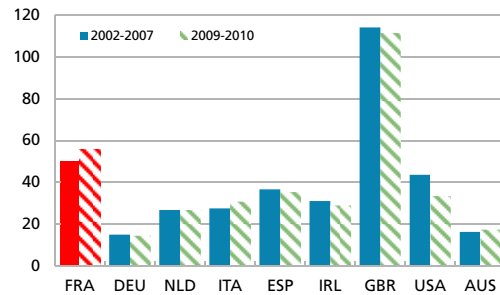


	Nominal House Prices (Percent change, except duration)					
	2004 to Pre-crisis peak	Duration 1/	Pre-crisis peak to trough	Duration 1/	Trough to most recent	Duration 1/
France	43.7	16.0	-9.2	4.0	11.2	6.0
Germany	7.2	17.0	-1.7	5.0	2.5	3.0
Netherlands	18.1	17.0	-6.7	9.0	0.0	0.0
Italy	27.4	16.0	-6.5	10.0	0.0	0.0
Spain	37.5	15.0	-13.4	11.0	0.0	0.0
Ireland	34.2	9.0	-38.0	13.0	17.2	3.0
United Kingdom	25.2	14.0	-17.9	5.0	8.0	7.0
United States	27.5	8.0	-31.5	12.0	1.1	6.0
Australia	31.6	15.0	-5.7	3.0	20.5	8.0
China	48.3	17.0	-1.8	1.0	30.1	8.0

Sources: Haver Analytics; and staff calculations.

1/ Number of quarters

House Prices to Household Disposable Income Per Capita (Percent)



The resilience of France's housing market has reflected a confluence of fundamental and macroeconomic factors:

- *Fundamental factors*—Housing supply has been structurally constrained by insufficient production capacity in the construction sector, reflecting scarcity of buildable land in dense area metropolitan areas and regulatory barriers to new housing construction. On the demand side, the strong increase in the number of households in recent years—reflecting the trend of de-cohabitation and an aging population (as seniors tend to live alone)—has further exacerbated the housing market imbalances.

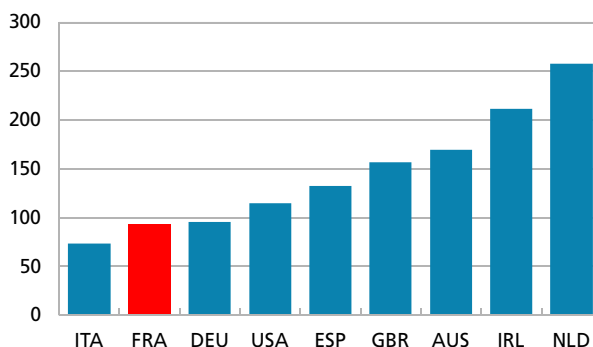
Box 7. The French Housing Market During the Crisis and Recovery (concluded)

- *Macroeconomic factors*—Home purchases have been partly spurred by the very low interest rate environment. Furthermore, certain tax incentive schemes—notably the *Loi Scellier*—have further encouraged home purchases.
- *Asset allocation factors*—In view of relatively limited financial investment opportunities and heightened risk aversion after the financial crisis, investors appear to consider real estate an attractive safe haven.

Despite the recent increases in housing prices, the risk to financial stability remains moderate:

- *Household debt is moderate*—Despite an increase in household indebtedness in recent years, household debt remains sustainable in France—at 93 percent of disposable income—and is well below the levels in other advanced countries.
- *Bank lending practices are sound*—Mortgage lending conditions in France are based on the borrower's capacity to service the loan until maturity, and therefore on the stability of the borrower's income. French banks tend to set a maximum mortgage service payment ratio equal to one-third of household disposable income. This method of lending criteria is thus independent of changes in home prices and the resulting wealth effect, unlike the U.S. and the U.K., as well as Spain, Denmark, and the Netherlands. Furthermore, most of mortgages have been set in fixed rates and mortgage insurance is mandatory. Therefore, homeowners are less likely to default when the interest rate rises. Against this background, residential mortgage loss rates incurred by lending institutions have been structurally low in France.
- *Adverse macro-financial repercussions of a price drop should be limited.* In France, unlike the case in the U.S. and the U.K., mortgage lending takes the form of recourse loans. This implies that borrowers have no incentive to default even when the market price of the house falls below the loan value. Second, French households cannot make mortgage equity withdrawals against their property. This suggests that the wealth effect of house prices is not amplified and the negative effect of a house price decline on real activity would be smaller.

Household Debt to Disposable Income, 2010 1/
(Percent)



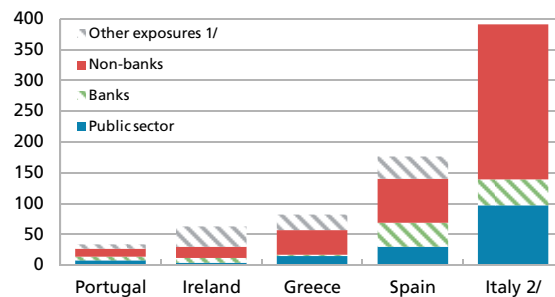
Sources: Haver, and staff calculations.

1/ Includes non-profit institutions serving households. Ireland and US, 2009.

32. **Yet in a highly competitive mortgage finance market, risks to the financial sector need to be contained.** French banks have been extending mortgages at historically record low interest rates and lengthened maturities. In an environment of monetary tightening, the authorities should stand ready to use appropriate micro-prudential tools to ensure sound lending practices and sound risk management. Should house price increases continue and cause broader concerns macro-prudential measures (such as loan-to-value ratios) could be useful. In this regard, further work to build a macro-prudential framework would be helpful. In the context of limited supply, public policies to support house purchases may need to be reviewed to avoid putting additional pressures on already high prices. Regulatory barriers and other disincentives to new housing construction should also be reviewed.

33. **French banks are significantly exposed to peripheral euro area countries and are second only to those of German banks.** French banks' total exposure (including other exposures) to Greece, Ireland, and Portugal stood at \$179 billion (7½ percent of GDP or 1¾ percent of bank assets) as of end-2010. Total claims on Spain and Italy, excluding other exposures, amounted to \$531 billion (22 percent of GDP or 5 percent of bank assets) at end-2010. When only sovereign debt is considered, the exposure of French banks to the southern part of Europe is 38 percent of Tier 1 capital (excluding Italy, 13 percent) as of April 2011. These data do not take into account indirect exposures of French banks to peripheral Euro countries. For instance, Belgian and Portuguese banks' exposures to Greece reached 14 and 9 percent of Tier 1 capital, respectively, according to last year's CEBS stress test. The extent of spillover effects from a widening of the sovereign debt crisis depends on the related impact on the corporate and banking sectors in these countries.¹¹ French banks also have large global banking and capital markets activities. The major groups have subsidiaries in Russia and other Central and Eastern European countries, Turkey, and North Africa. These operations constitute an outward spillover channel from France to the rest of the world.

France: Bank Exposures to Selected Euro Area Countries
(Billions of U.S. dollars, end-2010)



Sources: Banque de France; BIS; and staff calculations.
1/ Other exposures data are from the BIS and include the positive market value of derivatives, guarantees, and credit commitments.
2/ Other exposures data not available for Italy.

34. **Comprehensive, stringent, and transparent stress tests should help reduce uncertainty about asset quality and sovereign risk.** The 2010 Committee of European Banking Supervisors stress tests found that adverse shocks would lead to a limited reduction in the Tier 1 capital of the four largest French banks of 0.5–0.7 percentage points relative to

¹¹ In the context of the Greece program, the French authorities have proposed that bondholders roll over their holdings of Greek debt on a voluntary basis; institutions are considering the proposal and negotiations are ongoing.

their starting level at end-2009. The European Banking Authority (EBA) is coordinating new stress tests of the major European banks and publication of the results is expected in mid-2011. The stress tests will assess credit and market risks of the banks under hypothetical adverse economic conditions in 2011–12 with a special focus on sovereign risk. Results from national stress tests undertaken by the French authorities and shown to the mission indicate that the French banking system is resilient to shocks that could emerge from direct exposures to European crisis countries. Indirect effects, however, are not taken into account and may pose additional downside risks. The forthcoming FSAP will provide an opportunity to further review the resilience of the French banking system to a wide range of shocks in light of the vulnerabilities identified above.

35. **The authorities continue to adapt the supervisory framework.** The unification of banking and insurance supervision and the addition of a consumer protection mandate in the *Autorité de Contrôle Prudentiel*, and the creation of a national systemic risk board (*Conseil de Régulation Financière et du Risque Systémique*) have further strengthened the supervisory arrangements in France. The newly created European Supervisory Authorities (ESAs) and European Systemic Risk Board (ESRB) will have additional benefits for the operating environment.

36. **Going forward, French banks will need to reduce their reliance on short-term wholesale funding.** Options include increasing deposits, especially for banks that are not part of mutual groups, and acquisitions. In the shorter-term and depending on market conditions, banks can improve their liquidity position by lengthening maturities when refinancing existing debt. In addition, further reducing legacy assets would not only improve asset quality but also raise cash.

37. **On liquidity rules, a number of calibration issues remain to be decided at the international or European level.** Basel III liquidity requirements, still being worked out, point to some notable differences with current liquidity rules set by the *Banque de France*, which would require French banks to raise additional liquidity. For instance, off-balance sheet commitments under the Basel III Liquidity Coverage Ratio (LCR) carry a 100 percent factor compared to 5 percent under current French rules. Another operational issue is that the Basel III Net Stable Funding Ratio (NSFR) will require additional liquidity for French banks because of their practice to book life assurance products—42 percent of overall household financial investments at end-2009—in their insurance arms rather than having these long-term deposits on their balance sheets. The Basel Committee will use the observation period in place until 2013 to perform quantitative impact studies based on country submissions to determine whether any recalibration is needed.

38. **French banks should adapt swiftly to emerging international capital adequacy regulations.** Major French banks have increased their capital since the crisis but capital levels need to increase further to reach Basel III levels. Banks and the supervisor agree on a timetable to reach Basel III capital levels by 2013/14, and supervisors should continue to

ensure that the banks implement their announced capital augmentation programs. Front-running the Basel III capital targets, both in timing and magnitude, would add to the credibility of the process, and reduce potential downside risks from the direct and indirect exposures to European program countries. Also, France's major banks are large and of global systemic importance (G-SIFIs). Ongoing international discussions point to the need to mitigate systemic risk through tailored and internationally consistent measures.¹²

39. With key parameters of regulatory reform still to be defined, France should play a constructive role in the international and European debate (Box 8). A range of rules under Basel III, in particular on liquidity, as well as the prospective Capital Requirement Directive 4 (CRD4)—the transposition of Basel III to the EU level—remain to be agreed upon. CRD4 should implement Basel III swiftly and without exceptions with capital requirements set ambitiously high to reflect prevailing balance sheet uncertainties, a high degree of interconnectedness and the lack of an effective resolution framework for banks operating cross-border. Capital regulations must also be sufficiently flexible to allow for the introduction of macro-prudential tools to mitigate systemic risk. International collaboration between macro-prudential bodies will be important to ensure home-host coordination and reciprocity where appropriate. As an important party in these debates, France should work toward an ambitious package of international reform along these lines, and thus help achieve early clarity for the French financial sector on the nature and scope of future regulations.

Authorities' views

40. The authorities supported improving global and European regulatory standards. They stressed that the Basel III capital standards constitute a significant advance that harmonizes the definition of regulatory capital and strengthens the prudential framework for banks, thereby helping to avoid the significant costs of financial crises. However, they also emphasized the key role of supervisory arrangements, the importance of an internationally level playing field, and the need for sufficient phase-in time to allow systems to adapt without excessive economic costs. Regarding globally systemically important financial institutions, they remain actively involved in the ongoing international discussions.

¹² Measures would include: (i) a methodology for assessing systemic importance based on size, interconnectedness, lack of substitutability, global (cross-jurisdictional) activity, and complexity; (ii) an additional Common Equity Tier 1 (CET1) capital requirement ranging from 1 percent to 2.5 percent, depending on a bank's systemic importance, and an additional 1 percent capital surcharge to provide a disincentive for banks facing the highest charge to increase materially their global systemic importance in the future; and (iii) phase-in arrangements in parallel with the Basel III capital conservation and countercyclical buffers between January 1, 2016 and year-end 2018.

Box 8. Financial Sector Reform

France is actively involved in the major initiatives to reform the financial sector in the aftermath of the global financial crisis. One of the key priorities of the French presidency of the G20 is to strengthening financial oversight. In addition to EU regulatory bodies, France is also a member of the Basel Committee for Banking Supervision and the Financial Stability Board (FSB).

At the national level, the French authorities have adopted a number of key measures.

- A new supervisory structure to respond to the need for systemic supervision, the *Autorité de Contrôle Prudentiel*, was established in 2010 by merging banking and insurance supervision, licensing, and consumer protection.
- The *Conseil de Régulation Financière et du Risque Systémique* also created in 2010 is one of the first systemic board to be created in Europe and includes all relevant supervisors and government bodies, as well as independent board members. Its main role is to improve cooperation between the relevant regulatory bodies and strengthen financial stability oversight.
- One-time taxes on bonuses granted in 2009 were introduced, and G20 recommendations for sound compensation practices implemented. France is also planning to impose a financial levy to protect taxpayers for the costs of future potential financial crises.

At a multilateral level, progress has been made on the regulatory front but important steps with implications for the French financial system remain outstanding. The FSB and Basel Committee have adopted stricter rules for banks on capital and liquidity, to be implemented over the next several years. Key outstanding issues include measures to:

- Limit the risks from global systemically important financial institutions;
- Calibrate the proposed liquidity requirements under Basel III;
- Set a high common bar for minimum capital requirements that minimizes the scope for regulatory arbitrage in the EU Capital Requirements Directive (CRD4) that will translate Basel III for the EU; and
- Establish a European framework for crisis prevention, management, and deposit insurance, with a European Resolution Authority backed by an area-wide fiscal backstop.

41. **The authorities agreed that house prices were relatively high but stressed that the risk of negative fallout from a correction in the property market were low**, given sound lending practices and intrusive banking supervision. They noted that the systemic risk board (*Conseil de Régulation Financière et du Risque Systémique*) is a useful forum for all relevant supervisors and government bodies to continue monitoring property market developments, and consider tools, including macro prudential ones, to manage associated risks.

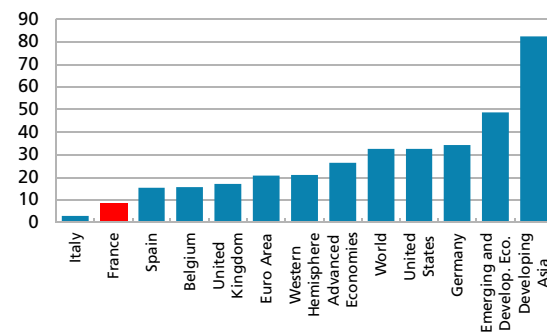
C. Promoting Inclusive Growth

42. **Lifting inclusive trend growth will have significant effects on living standards and fiscal sustainability.** To this end, a comprehensive strategy is needed that shifts incentives in the economy towards work, investment in more productive activities, and innovation. Staff estimates suggest that further labor and product market reforms that would bring France in line with best practices could raise growth by about $\frac{3}{4}$ percent per year over the medium term.

Strengthening competitiveness

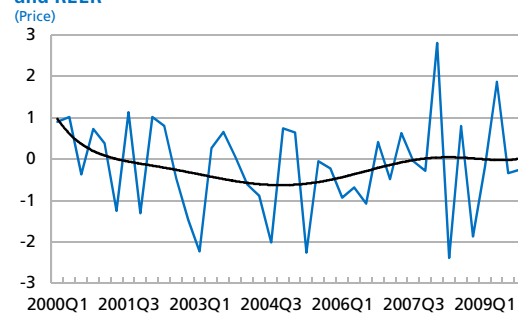
43. **Strengthening the competitiveness of the French economy is an important ingredient in a growth strategy.** Like most advanced economies, France has experienced a decline in foreign market shares over the last decade as emerging market economies have expanded their presence on world markets. However, French export performance over last decade also lagged compared to its main competitors while relatively few new products gain market share. The overall exchange rate assessment based on CGER methodologies suggests that there may indeed be some real effective exchange rate overvaluation. This is driven in part by the dynamics of euro, but it also indicates the need for wage moderation and cost containment. In addition, non-price factors have been significant in explaining French export performance until the crisis when demand factors became dominant. Restoring competitiveness along these dimensions calls for promoting innovation and creating favorable conditions for business to better penetrate growth markets and sectors.

Real Export Growth, 2001-05 to 2006-10 1/
(Percent)



Sources: IMF WEO; and staff calculations.
1/ Period averages.

Contributions of Factors Other than Foreign Demand and REER
(Price)



Sources: IMF WEO; and staff calculations.

Estimates Applying the CGER Methodology 1/

	France			Euro area	Germany	Italy
	Current Estimate (April, 2011)	Previous Article IV (April, 2010)	Previous Article IV (April, 2009)	Current Estimate (April, 2011)	Current Estimate (April, 2011)	Current Estimate (April, 2011)
Current account norm (macro balance)	5	-7	-6	4	1	10
Equilibrium exchange rate (ERER)	4	7	4	5	-8	8
NFA stabilizing (external sustainability)	9	1	9	1	-6	7
Average	6	0	2	3	-5	9

Source: IMF staff estimates.

1/ Positive number indicates that REER is above equilibrium.

44. **Efforts to foster innovation should be pursued in a cost-effective manner.** The tax credit for research and development activities (*Crédit Impôt Recherche*) provides generous incentives and the *Grand Emprunt* supports a variety of university-based and other research efforts. While spurring innovation has the potential to increase competitiveness and growth, the cost effectiveness of these measures needs to be evaluated within an appropriate time frame. In addition, other obstacles to innovation should be evaluated, such as those possibly arising from the relative paucity of medium-sized firms.

45. **Restoring competitiveness and achieving higher potential growth will also require policies to improve competition, notably in the service sector.** Welcome steps have been taken to increase competition in the electricity, telecommunications, and retail sectors but the regulation of product and services markets remains more restrictive in France than in many other countries.¹³ Notably, professional services have become more regulated over the past decade, in contrast with the deregulation of this sector in most other advanced countries. France is transposing the EU services directive into national law, but has—like other European countries—not yet fully done so. The activities of the Competition Authority should be focused on areas where progress has so far been limited. Increasing competition in the services sector, in particular professional services, would contribute significantly to productivity growth in the whole economy and to job creation. Empirical studies estimate that if France aligned its regulation to best practices in the OECD, the long-run employment rate would increase by 1.2 percentage point and multifactor productivity would increase by between 0.2 and 0.6 percent per year over the medium term.¹⁴

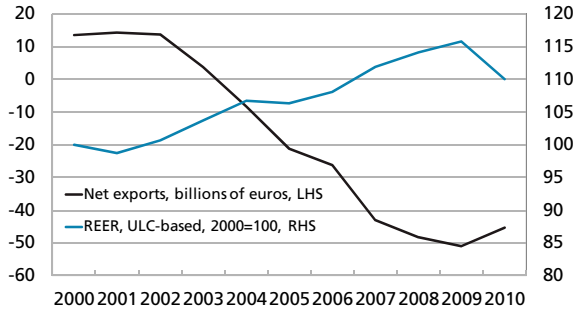
¹³ See OECD, Indicators of Product Market regulation, available at www.oecd.org/eco/pmr.

¹⁴ J. Høj and M. Wise “Product Market Competition and Economic Performance in France,” Paris: OECD, Economic Department Working Paper 473, 2006; R. Boursès, G. Cette, J. Lopez, J. Mairesse, and G. Nicoletti “The Impact on Growth of Easing Regulation in Upstream Sectors” CESifo DICE Report, vol. 8(3), 2010.

Figure 3. France: Competitiveness and External Performance

Net exports have declined, amid the impact of the appreciation of the euro.

Net Exports and Real Effective Exchange Rate

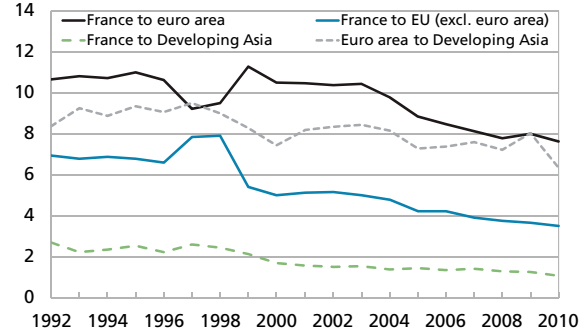


Sources: WEO; GAS; and staff calculations.

Like other euro area countries, France has been losing export market shares.

Trade Market Shares

(Percent of trade partner's total imports from world)

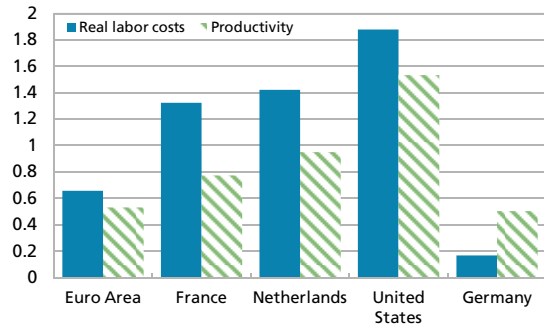


Sources: Direction of Trade Statistics; and staff calculations.

Labor cost in France has grown faster than productivity and the gap between growth rates in cost and productivity is higher than in its main trading partners.

Real Labor Costs and Productivity

(2002-10 annual average increase, percent)

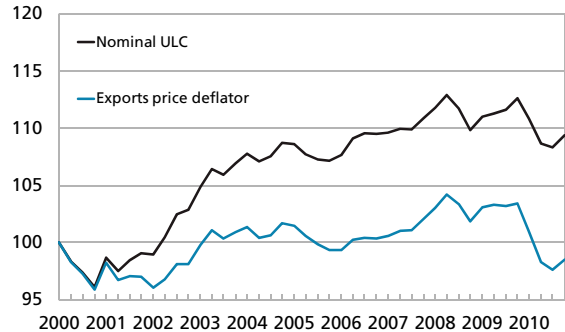


Sources: Haver Analytics; and staff calculations.

Both unit labor cost and export prices have increased recently.

Unit Labor Cost and Exports Price Deflator Indices

(2000Q1=100)

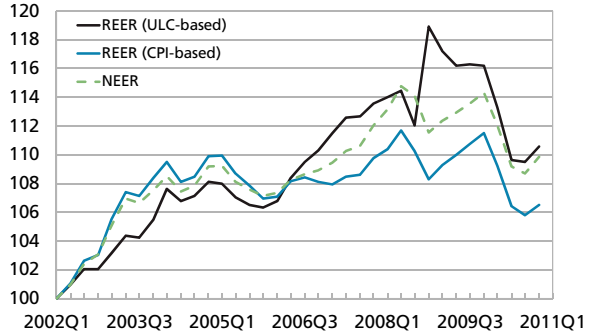


Sources: European Commission; and staff calculations.

The REER appreciation has broadly followed the NEER dynamics of the euro.

REER and NEER Indices

(2002Q1=100)

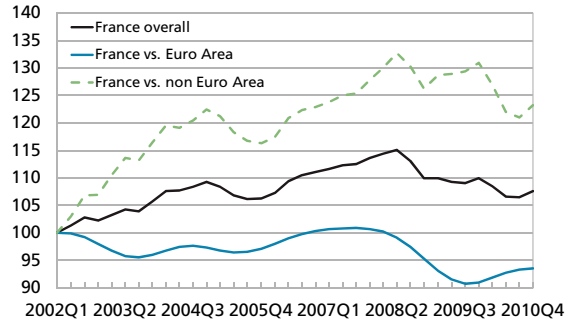


Sources: Haver Analytics; and staff calculations.

The REER appreciated against the world slightly in recent months.

Real Effective Exchange Rates

(ULC based, 2002=100)



Source: European Commission; and staff calculations.

Tax Reform

46. **Closer EU integration and globalization have led to pressures to reform France’s labor and business income taxation.** Last year’s reform of the local business tax (*taxe professionnelle*) is an important first step but staff noted that a more comprehensive tax overhaul to improve incentives for employment and growth is warranted. The main concerns include: (i) a still high labor tax wedge at the average wage level, due to a heavy reliance on social security contributions, which hampers job creation and participation; (ii) a relatively high corporate tax rate faced by firms which do not benefit from special allowances and incentives; and (iii) the bias of the present system toward certain sources of finance and sectors, which is prone to encourage excessive financial leverage, contribute to a dearth of equity financing for innovative projects, and discourage firms’ growth. A reform that offsets tax cuts by base broadening and improved compliance, including through the removal of the least efficient tax expenditures, would ensure that growth-friendly tax reforms support fiscal consolidation.¹⁵

47. **Reducing high tax wedges could decrease aggregate unemployment and boost employment prospects.** France’s welfare arrangements require a relatively high level of social security contributions and social welfare taxes, resulting in the fourth-highest tax wedge for singles in the OECD. Empirical studies for EU countries find that a high tax wedge increases unemployment by reducing incentives for formal sector employment and by inducing higher wage claims by unions.¹⁶ A reduction in labor taxes by 1 percentage point could lower unemployment by 0.3 percentage points. The impact of the tax wedge on unemployment is even higher when high and long-lasting unemployment benefits—as present in France—further reduce incentives for job search.

48. **To maximize labor supply dividends, a reform of the tax-benefit system could target work incentives for elderly workers and women with school-age children.** The participation rate of workers aged 55–64 years in France is the lowest among advanced countries; and while the employment rate of prime-aged women (30–54 years) has increased in line with that of other OECD countries, French women’s mean hours worked have declined markedly since the late 1970s. The U.S. experience illustrates the scope for a supply response, with almost a quarter of the increase in hours worked between 1977 and 2007 explained by higher participation of older workers (55–74 years) and about 10 percent by higher hours worked of employed prime-aged women.¹⁷ Work incentives targeted at these

¹⁵ See Poirson, H., *Toward a Growth-Oriented Tax System for France*, Selected Issues Paper.

¹⁶ Daveri F. and G. Tabellini, 2000, “Unemployment, Growth, and Taxation in Industrial Countries,” *Economic Policy*, Vol. 15, No. 30, pp. 47–104.

¹⁷ Blundell, R., A. Bozio, and G. Laroque, 2011, “Labour Supply Responses and the Extensive Margin: the US, UK, and France,” mimeo, University College of London and Institute for Fiscal Studies.

high labor supply margins are likely to be most effective and cost-efficient.¹⁸ They can be implemented by making earned income tax credits more generous for older workers (as in the Netherlands) and for women with school-aged children. Alternatively, employers could receive special credits for social security contributions paid for these categories of workers. Based on the experience of other EU countries, further increases in the retirement age to ensure long-term equilibrium of the pension system could also have a favorable impact on labor force participation.¹⁹

49. A corporate tax reform that reduces the statutory rate along with base broadening would make the system fairer and simpler, and deter profit- and investment-shifting. Staff noted that the relatively large elasticity of profit shifting offers an argument in favor of harmonization and, in this context, welcomed the authorities' intention to seek convergence with Germany.²⁰ A lower statutory rate across the board would reduce the need for special rates and tax treatment, e.g. for SMEs and innovative firms, and reduced complexity would make the system less biased against small firms which do not have the resources to engage in extensive tax planning and fiscal engineering. Reducing the debt bias from interest deductibility would facilitate banks' deleveraging and promote greater reliance on equity finance (which could ultimately boost innovative investments).

Labor Market Reforms

50. Labor market policies should focus on re-absorbing the unemployed and on increasing labor force participation.

- Further strengthening activation policies and the unified job placement agency (*Pôle Emploi*) would better support the unemployed in their job search and broaden training opportunities, and should be accompanied by strict enforcement of job-search requirements. Efforts to foster apprenticeship programs are well placed. In addition to reducing the labor-tax wedge, consideration should be given to easing the high

¹⁸ Simulations of a tax benefit model for the U.K. find that the overall hours elasticity for the age 30–54 group (i.e., the decrease in hours worked in response to a 1 percent increase in implicit tax rates) ranges from 0.3 to 0.44. Women with children have higher elasticities of around 0.5 on average. See Blundell, R., 2010, *Tax by Design: The Mirrlees Review, Earnings Taxation and Work Incentives*, available at www.ifs.org.uk.

¹⁹ According to simulations for the Netherlands, increasing the retirement age by 3 years could raise the employment rate by 1.6 percent and the labor supply by 0.8 percent. See Euwals, R., R. de Mooij, and D. van Vuuren, 2009, "Rethinking Retirement: from Participation towards Allocation," No. 80, CPB Netherlands Bureau for Economic Policy Analysis.

²⁰ Germany's 2008 corporate tax reform is estimated to have lowered the tax burden on corporations by about 9 percentage points to below 30 percent, boosting its attractiveness as a location for enterprises. The reform has also reduced complexity and the unintentional heterogeneity of the tax burden across firms.

employment protection, in order to entice firms to create more jobs.²¹ Reducing the comparatively long duration of unemployment benefits or a lowering of the benefit level over time could strengthen incentives for job search and increase the effective labor supply.

- Policies to draw young and low-skilled workers into the labor force should be stepped up. The high minimum wage (SMIC)²² bars especially young and low-skilled workers from employment. Tax relief and reduced social contributions have lowered the labor cost for low-skilled workers and halted the decline in their share in total employment. Also, over the past 5 years, the authorities have not granted discretionary increases in the SMIC (*coup de pouce*), thereby increasing the distance between minimum and median wages. Because the SMIC is indexed on inflation, the progress achieved could be jeopardized by current inflationary pressures, especially in light of an overall wage moderation led by the wage freeze for civil servants. Hence, the indexation formula of the SMIC should be reviewed.
- The phasing out of pre-retirement benefits, relaxation of constraints on combining employment and retirement benefits, and pension reform have succeeded in lifting the labor force participation of seniors, despite the crisis. However, the participation rate of seniors remains one of the lowest in Europe and efforts in this area should continue.²³

Authorities' views

51. **The authorities broadly agreed with the need for structural reform to boost competitiveness and growth but cautioned that the political environment is not always conducive.** They were convinced of the large growth potential of measures to stimulate innovation and agreed that the cost effectiveness of current policies will need to be evaluated. The authorities reiterated their commitment to transpose the EU Services Directive into French law, indicating that the sectoral approach taken requires time and that liberalization of regulated services can be politically challenging. Although there are signs that labor market reforms are starting to bear fruit, it is difficult to assess their contribution to the rebound in

²¹ COE Rexecode, "*Mettre un terme à la divergence de compétitivité entre la France et l'Allemagne*," January 2011, notes that as a result of relatively high labor costs and labor market rigidities, French firms are reluctant to grow and the average French firm employs just 14 people compared with 35 in Germany.

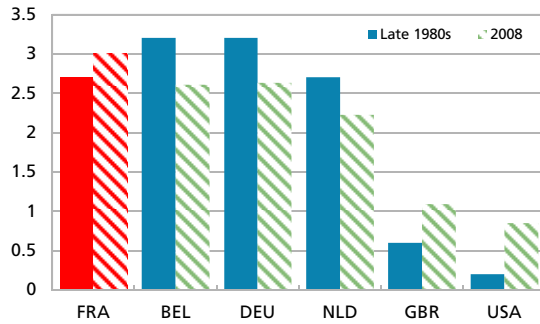
²² The SMIC was increased in January 2011 to €9 per hour (€1,365 gross or €1,073 net for a 35 hour work week).

²³ The labor force participation rate of senior workers (55 to 64 years) increased despite the crisis from 38.1 percent at end-2007 to 40.3 percent in early 2011. The average participation rate of seniors is 46.5 percent in the European Union and 46.0 percent in the Euro area.

Figure 4. France: Labor Market Indicators

Employment protection remains high.

Overall Employment Protection Index

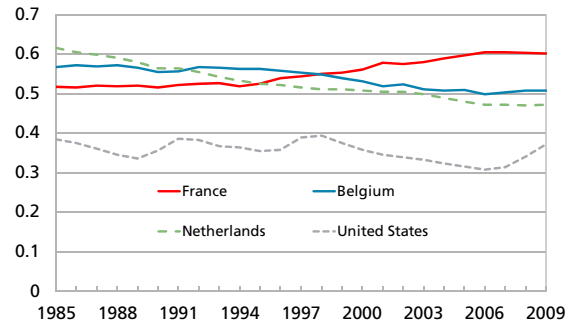


Source: OECD.

The minimum wage is high and rising.

Minimum Wage

(Percent of median wage)

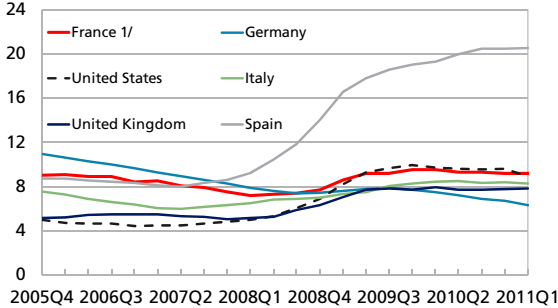


Source: OECD.

Unemployment remains a problem...

Unemployment Rates

(Percent)



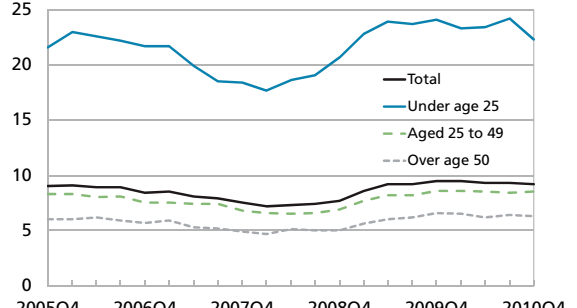
Source: Haver Analytics.

1/ Metropolitan France, excluding overseas departments.

...particularly among the young.

Unemployment Rate by Age

(Percent)

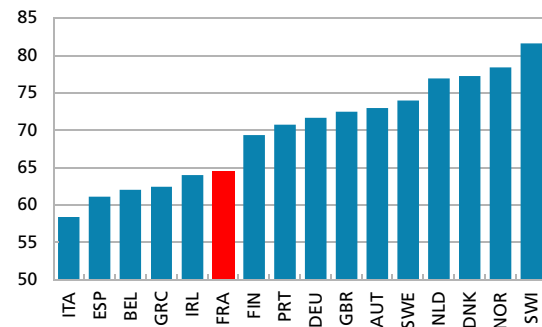


Source: Haver Analytics.

Employment rate is among the lowest.

Employment Rate, 2009

(Percent of working age population)

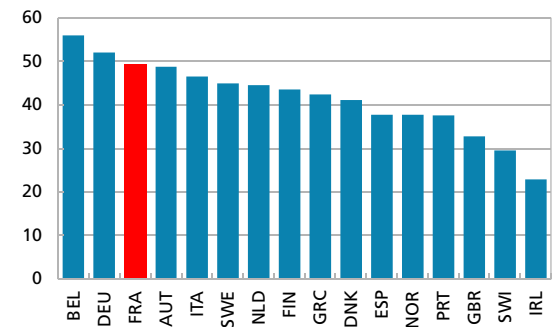


Sources: OECD; and staff calculations.

Labor taxation is among the highest.

Tax Wedge on Labor, 2008

(Percent of total labor costs)



Source: OECD.

employment during the recovery. While acknowledging the need for reforming unemployment benefit schemes, the authorities stressed the political difficulties in doing so.

52. **The authorities concurred with the need to modernize the tax system, although they were cautious on the timing of a broad-based reform in the midst of fiscal consolidation.** They also noted the limited scope for further decreasing the tax wedge for low-wage earners, and were doubtful that a reduced tax wedge for mostly higher-earning workers would have a large impact on employment and growth. However, they reaffirmed their commitment to lifting tax obstacles to competitiveness, in particular through seeking increased harmonization of the corporate tax base and statutory tax rates with Germany and other European countries.

IV. STAFF APPRAISAL

53. **Supportive policy measures and key reforms contributed to a gradual recovery from the crisis.** The French economy started to expand in mid-2009, and 2011 outcomes to date surprised on the upside. Unemployment remains a problem, but employment is increasing and confidence also benefited from stronger activity in core Europe. Adoption of a key pension reform in 2010 and earlier structural measures to increase labor supply are starting to bear fruit. Macroeconomic risks remain, however, amid lingering problems on European sovereign debt markets, and uncertainty about energy and commodity prices.

54. **The fiscal stimulus during the crisis was appropriate but debt sustainability and market perception now call for credible consolidation.** The impact of the crisis weakened France's fiscal position, bringing the debt burden to above 80 percent of GDP, and debt servicing costs to about 2½ percent of GDP in 2010. As an AAA-rated country, France's fiscal position remains subject to high scrutiny, while the rating itself is an important factor for keeping borrowing costs low. French banks' strong exposures to some of the euro area crisis countries have renewed market attention to French sovereign debt. Against this background, a broad consensus among policy makers in support of consolidation has emerged.

55. **The consolidation targets set out in France's Stability Program and the 2011–14 multi-year budget framework strike the right balance between speed and sustainability.** The fiscal outcome in 2010 was better than foreseen and a sizeable upfront adjustment is being made in 2011 to restore healthy public finances. Preparing specific contingency measures is important to ensure reaching the 2012–14 fiscal targets in case growth is less strong or spending of local governments and social security is more buoyant than foreseen by the authorities. Achieving the fiscal targets and further entitlement reform are important to lower the public debt to 60 percent of GDP by the middle of the next decade. A fiscal rule currently debated in the Senate would help to unequivocally signal the authorities' commitment to the adjustment path. Other measures, such as using independently prepared

growth forecasts to estimate future adjustment needs, or establishing an independent fiscal council would further support the credibility of the adjustment path.

56. **The French banking sector has overcome most of the crisis legacies and has returned to strong profitability.** Stress tests undertaken by the French authorities and shared with the mission attest to the overall resilience of the system, including to shocks that could emerge from exposures to European crisis countries. The unification of banking and insurance supervision and the addition of a consumer protection mandate in the *Autorité de Contrôle Prudentielle (ACP)* and the creation of a national systemic risk board have further strengthened the supervisory arrangements in France. The newly created European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB) will have additional benefits for the operating environment.

57. **Financial stability risks linked to rapid house price increases seem at this stage contained but vigilance is required.** House prices in France increased rapidly over the past year, particularly in urban areas where supply remains constrained. While low household debt and conservative lending practices limit risks, supervisors should continue to use appropriate micro-prudential tools. Should house price increases continue and cause broader concerns, the authorities' intention to use macro-prudential tools is appropriate. In the context of limited supply, public policies to support house purchases may need to be phased out. Regulatory barriers and other disincentives to new housing construction should also be reviewed.

58. **French banks should adapt swiftly to emerging international regulations.** All French banks have increased capital since the crisis. But capital levels need to increase further, and should reach Basel III levels by 2013/14, a timeframe well before the end of the phase-in period, but nevertheless sufficiently long to avoid excessively negative impact on lending. Both banks and the supervisor support this timetable; the supervisor should continue to ensure that banks implement their announced capital augmentation plans. Liquidity risk should be limited by reducing reliance on wholesale funding markets. France's major banks are large and of global systemic importance. Ongoing international discussions point to the need to mitigate systemic risk through tailored and internationally consistent measures, including capital surcharges.

59. **Broad efforts are needed to increase employment, especially for the young, unskilled, and senior workers.** Structural unemployment remains high and, in the context of falling unemployment, renewed emphasis should be placed on addressing the particular problems of groups with the highest levels of unemployment, including through targeted job search support and training opportunities. While the employment of seniors has increased, efforts to further lift the participation rate of senior workers should be sustained. Continued minimum wage moderation would support employment creation. Further modernization of the French tax system could reduce reliance on labor based taxes and help increase labor demand.

60. **The medium-term prospects for the French economy depend on improved competitiveness.** Exchange rate based measures of competitiveness suggest only a minor overvaluation, driven in part by the dynamics of the euro. Yet, the world market share of French exports has been declining and comparatively few new French products gain market share. A multipronged strategy is needed to improve competitiveness of the economy and lift potential growth, including through keeping real wage increases in line with productivity improvements, increasing labor market participation and raising productivity growth. Critical elements of a growth strategy are already under way, in particular in supporting innovation. Fostering more competition in growth-critical services would increase potential growth.

61. **It is proposed that the next Article IV should be held on the standard 12-month cycle.**

Table 1. France: Selected Economic and Social Indicators, 2008–16

	2008	2009	2010	Projections					
				2011	2012	2013	2014	2015	2016
Real economy (change in percent)									
Real GDP	-0.2	-2.6	1.4	2.1	1.9	2.0	2.1	2.1	2.1
Domestic demand	0.1	-2.4	1.3	2.2	1.7	2.0	2.1	2.1	2.1
CPI (year average)	3.2	0.1	1.7	2.2	1.7	1.8	1.9	1.9	1.9
Unemployment rate (in percent)	7.8	9.5	9.7	9.3	8.8	8.6	8.2	7.9	7.8
Gross national savings (percent of GDP)	20.1	17.5	18.6	18.6	19.2	19.5	19.7	20.0	20.2
Gross domestic investment (percent of GDP)	21.9	19.0	20.4	20.8	21.2	21.4	21.5	21.8	22.0
Public finance (percent of GDP)									
Central government balance	-3.3	-6.2	-6.3	-4.4	-3.8	-3.0	-2.5	-1.8	-1.2
General government balance	-3.3	-7.5	-7.1	-5.7	-4.8	-3.8	-2.9	-2.0	-1.1
Structural balance (percent of potential GDP)	-2.9	-4.8	-4.6	-3.9	-3.3	-2.6	-2.2	-1.6	-1.0
Primary balance	-0.6	-5.3	-4.9	-3.1	-2.0	-0.9	0.1	1.2	2.1
General government gross debt 1/	68.2	79.0	82.3	85.2	87.2	88.1	87.8	86.5	84.4
Money and interest rates (in percent)									
Money market rate	3.8	1.0	0.8	...	...	...	...	...	...
Government bond yield	4.2	3.6	3.1	...	...	...	...	...	...
Balance of payments (in percent of GDP)									
Exports of goods	21.3	18.1	20.2	22.6	23.0	23.0	22.9	23.0	23.0
Volume growth (in percent)	-0.6	-12.2	9.4	6.4	4.6	3.8	3.9	3.9	3.8
Imports of goods	24.3	20.4	23.0	25.8	26.0	25.9	25.8	25.8	25.8
Volume growth (in percent)	0.6	-10.6	8.3	6.5	3.9	3.7	3.8	3.8	3.8
Trade balance	-3.1	-2.3	-2.8	-3.1	-3.0	-2.9	-2.9	-2.8	-2.8
Current account	-1.7	-1.5	-1.7	-2.1	-1.9	-1.9	-1.8	-1.8	-1.7
FDI (net)	-3.2	-2.6	-2.0	-1.9	-1.8	-1.7	-1.6	-1.5	-1.4
Official reserves (US\$ billion)	33.6	46.6	...	...	...	...	...	...	...
Fund position (as of April 30, 2011)									
Holdings of currency (percent of quota)	86.3	80.8	79.7	73.1	...	...	...	...	...
Holdings of SDRs (percent of allocation)	58.1	95.9	96.1	96.1	...	...	...	...	...
Quota (SDRs million)	10739	10739	10739	10739	...	...	...	...	...
Exchange rates									
Euro per U.S. dollar, period average 1/	0.68	0.72	0.75	0.70	...	...	...	...	...
Nominal effective rate, ULC-styled (2000=100) 1/	113.8	113.7	110.4	111.2	...	...	...	...	...
Real effective exchange rate, ULC-based (2000=1)	113.9	115.2	109.8	111.5	...	...	...	...	...
Potential output and output gap									
Potential output	1.2	1.0	0.8	1.1	1.3	1.4	1.5	1.5	1.6
Output gap	-0.7	-4.2	-3.6	-2.7	-2.1	-1.6	-1.0	-0.4	0.0
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/ For 2011, average for January-April.

Table 2. France: Balance of Payments, 2008-16
(Percent of GDP)

	2008	2009	Projections						
			2010	2011	2012	2013	2014	2015	2016
Balance on current account	-1.7	-1.5	-1.7	-2.1	-1.9	-1.9	-1.8	-1.8	-1.7
Balance on goods and services	-2.2	-1.7	-2.3	-2.4	-2.2	-2.2	-2.1	-2.1	-2.1
Balance of trade (f.o.b., c.i.f.)	-3.1	-2.3	-2.8	-3.1	-3.0	-2.9	-2.9	-2.8	-2.8
Exports of goods and services	27.1	23.6	25.9	28.8	29.3	29.2	29.2	29.2	29.2
Exports of goods	21.3	18.1	20.2	22.6	23.0	23.0	22.9	23.0	23.0
Exports of services	5.8	5.5	5.7	6.2	6.3	6.2	6.2	6.2	6.2
Imports of goods and services	-29.3	-25.3	-28.1	-31.2	-31.5	-31.4	-31.3	-31.3	-31.3
Imports of goods (f.o.b.)	-24.3	-20.4	-23.0	-25.8	-26.0	-25.9	-25.8	-25.8	-25.8
Imports of services	-5.0	-4.9	-5.2	-5.5	-5.5	-5.5	-5.5	-5.5	-5.5
Income, net	1.7	1.7	1.9	1.6	1.6	1.6	1.6	1.6	1.6
Current transfers, net	-1.3	-1.4	-1.4	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
Balance on capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance on financial account	0.9	2.2	0.9	2.1	1.9	1.9	1.8	1.8	1.7
Direct investment, net	-3.2	-2.6	-2.0	-1.9	-1.8	-1.7	-1.6	-1.5	-1.4
Portfolio investment, net	1.3	13.3	6.2	8.4	8.0	7.6	7.3	7.0	6.6
Other investment, net	3.3	-7.8	-4.8	-4.5	-4.3	-4.1	-3.9	-3.7	-3.5
Reserve assets	0.4	0.2	-0.3	0.1	0.0	0.0	0.0	0.0	0.0
Errors and omissions, net	0.8	-0.7	0.8	0.0	0.0	0.0	0.0	0.0	0.0

Sources: French authorities; IMF staff estimates and projections.

Table 3.a. France: General Government Statement of Operations, 2008-16
(Percent of GDP, unless otherwise indicated)

	2008	2009	Projections						
			2010	2011	2012	2013	2014	2015	2016
Revenue	49.9	48.8	49.7	50.1	50.4	50.6	50.6	50.7	50.7
Taxes	26.7	25.4	26.0	26.6	26.7	26.9	26.9	27.1	27.0
Social contributions	18.1	18.6	18.7	18.6	18.7	18.7	18.7	18.6	18.7
Grants	...	...	...	...	...	...	...	...	...
Other revenue	...	...	...	...	...	...	...	...	...
Expenditure	53.2	56.5	56.8	55.9	55.2	54.4	53.5	52.7	51.8
Expense	52.4	55.7	56.1	55.1	54.4	53.6	52.8	52.0	51.2
Compensation of employees	12.8	13.5	13.4	13.1	12.8	12.5	12.2	11.9	11.6
Use of goods and services	5.0	5.5	5.5	5.2	5.0	5.0	4.9	4.9	4.9
Consumption of fixed capital	2.6	2.7	2.8	2.7	2.6	2.5	2.5	2.4	2.4
Interest	2.9	2.4	2.5	2.8	3.0	3.1	3.2	3.3	3.4
Subsidies	1.4	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Grants	...	...	...	...	...	...	...	...	...
Social benefits	23.5	25.3	25.5	25.3	25.1	24.9	24.7	24.4	24.3
Other expense	...	...	...	...	...	...	...	...	...
Net acquisition of nonfinancial assets	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Acquisitions of nonfinancial assets	...	...	...	...	...	...	...	...	...
Disposals of nonfinancial assets	...	...	...	...	...	...	...	...	...
Consumption of fixed capital	2.6	2.8	2.8	...	...	...	...	...	...
Gross Operating Balance	0.1	-4.1	-3.6	...	...	...	...	...	...
Net Operating Balance	-2.6	-6.8	-6.3	...	...	...	...	...	...
Net lending (+)/borrowing (-)	-3.4	-7.6	-7.1	-5.7	-4.8	-3.8	-2.9	-2.0	-1.1
Net acquisition of financial assets	2.1	2.2	-1.3	...	...	...	...	...	...
Monetary gold and SDRs	0.0	0.0	0.0	...	...	...	...	...	...
Currency and deposits	0.9	0.9	-1.1	...	...	...	...	...	...
Debt securities	0.7	-0.2	-0.1	...	...	...	...	...	...
Loans	-0.1	0.4	0.1	...	...	...	...	...	...
Equity and investment fund shares	0.3	0.5	-0.4	...	...	...	...	...	...
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	...	...	...	...	...	...
Financial derivatives and employee stock options	0.1	0.0	0.0	...	...	...	...	...	...
Other accounts receivable	0.2	0.7	0.1	...	...	...	...	...	...
Net incurrence of liabilities	5.4	9.8	5.8	...	...	...	...	...	...
SDRs	0.0	0.0	0.0	...	...	...	...	...	...
Currency and deposits	0.2	-0.2	0.0	...	...	...	...	...	...
Debt securities	5.1	8.7	4.8	...	...	...	...	...	...
Loans	0.1	1.0	0.8	...	...	...	...	...	...
Equity and investment fund shares	0.0	0.0	0.0	...	...	...	...	...	...
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	...	...	...	...	...	...
Financial derivatives and employee stock options	0.0	0.0	0.0	...	...	...	...	...	...
Other accounts payable	0.0	0.2	0.2	...	...	...	...	...	...
<i>Memorandum items:</i>									
Structural balance	-2.9	-4.8	-4.6	-3.9	-3.3	-2.6	-2.2	-1.6	-1.0
Structural balance (in percent of potential GDP)	-2.9	-5.1	-4.7	-4.0	-3.4	-2.7	-2.2	-1.6	-1.0
Structural primary balance 1/	-0.3	-3.2	-3.0	-1.8	-0.9	-0.1	0.6	1.4	2.0
Central government net lending/borrowing	-3.3	-6.2	-6.3	-4.4	-3.8	-3.0	-2.5	-1.8	-1.2
General government Maastricht balance	-3.3	-7.5	-7.1	-5.7	-4.8	-3.8	-2.9	-2.0	-1.1
Gross debt (Maastricht definition)	68.2	79.0	82.3	85.2	87.2	88.1	87.8	86.5	84.4

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

1/ Excludes cyclical effects.

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

	2002	2003	2004	2005	2006	2007	2008	2009	2010
STOCK POSITIONS:									
Net worth	...	...	...	...	...	...	...	...	...
Nonfinancial assets	...	...	...	...	...	...	...	...	...
Net financial worth	-42.0	-44.4	-45.3	-43.3	-37.4	-35.0	-43.0	-49.8	-57.1
Financial assets	25.6	27.4	28.7	32.6	33.9	37.6	35.3	40.4	37.7
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	2.5	3.2	3.4	3.1	1.3	1.3	2.1	3.0	1.9
Debt securities	1.2	1.2	1.0	1.1	1.5	1.3	2.0	1.8	1.8
Loans	2.1	2.0	2.1	1.9	1.7	1.6	1.5	2.0	2.1
Equity and investment fund shares	12.4	14.0	16.0	19.8	22.6	23.7	19.9	22.7	21.5
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2
Other accounts receivable	7.2	7.0	6.1	6.7	6.8	9.6	9.6	10.7	10.1
Liabilities	67.6	71.8	74.0	76.0	71.3	72.6	78.3	90.1	94.8
Monetary gold and SDRs	...	...	...	...	...	0.0	0.0	0.0	0.0
Currency and deposits	1.3	0.9	0.8	0.8	1.0	1.2	1.4	1.2	1.2
Debt securities	52.1	55.9	59.2	61.2	56.1	55.1	60.9	71.3	75.4
Loans	9.4	10.0	9.8	9.9	9.6	10.0	9.8	11.0	11.5
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other accounts payable	4.8	5.0	4.2	4.2	4.5	4.9	5.0	5.3	6.7
<i>Memorandum items:</i>									
Debt (at market value)	67.6	71.8	74.0	76.0	71.3	70.3	76.4	88.0	...
Debt at face value	63.9	68.2	69.3	70.8	68.5	70.5	74.4	85.6	89.0
Maastricht debt	59.0	63.2	65.0	66.7	64.0	64.2	68.2	79.0	82.3
OTHER ECONOMIC FLOWS:									
Change in net worth from other flows	...	...	...	...	...	...	...	...	...
Nonfinancial assets	...	...	...	...	...	...	...	...	...
Net financial worth	-3.2	0.6	0.9	3.3	6.3	4.4	-7.2	1.2	...
Financial assets	-2.2	0.8	2.1	3.8	4.2	3.2	-5.0	1.4	...
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Currency and deposits	0.0	0.0	0.1	-0.1	0.0	0.0	0.0	0.0	...
Debt securities	0.0	0.1	-0.1	0.0	-0.1	0.0	0.0	-0.1	...
Loans	-0.1	-0.3	0.0	-0.1	0.0	0.0	0.0	0.0	...
Equity and investment fund shares	-1.7	0.8	2.2	3.9	4.3	3.2	-4.8	1.4	...
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.1	...
Other accounts receivable	-0.4	0.1	-0.1	0.1	0.0	0.0	0.0	0.0	...
Liabilities	1.0	0.2	1.2	0.5	-2.1	-1.2	2.2	0.3	...
Monetary gold and SDRs	...	...	...	...	...	0.0	0.0	0.0	...
Currency and deposits	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Debt securities	1.1	0.0	1.1	0.5	-2.0	-1.2	2.2	0.3	...
Loans	0.0	0.0	0.1	0.1	-0.1	0.0	0.0	0.0	...
Equity and investment fund shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Insurance, pensions, and standardized	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Financial derivatives and employee stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...
Other accounts payable	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0	...

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

Table 4. France: High-Frequency Indicators

	Jun 13, 2011	Change since:			
		4 weeks	Jan 1, 2010	Sep 1, 2008	Jan 1, 2008
Financial institution equity prices 1/					
BNP Paribas	51.6	-2.7	-7.6	-14.1	-28.4
Credit Agricole	10.1	-8.0	-18.6	-29.6	-52.7
Societe Generale	39.2	-6.6	-20.0	-37.4	-55.4
Credit default swap spreads 2/					
BNP Paribas	119.7	19.4	58.8	56.1	91.9
Credit Agricole	152.7	24.8	73.0	57.9	111.7
Societe Generale	146.4	26.1	70.5	57.2	116.7
Stock indices 3/					
CAC 40	3,812.1	-4.5	-3.2	-14.8	-32.1
Euro stoxx 50	2,733.7	-5.1	-7.8	-18.7	-37.9
Interbank interest rates 4/					
Overnight	1.5	37.2	277.8	-63.9	-60.4
3-month	1.5	3.2	110.1	-70.3	-68.6
Government interest rates 4/					
3-month	1.1	9.4	196.2	-75.1	-71.6
10-year	3.3	-3.5	-7.2	-23.0	-24.5
Money market risk spread 5/	39.7	44.4	33.7	64.1	89.4

Sources: Bloomberg; Datastream.

1/ Euros; change in percentage points.

2/ Basis points, 5 Yr 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 5. France: Vulnerability Indicators, 2003–10
(In percent of GDP; unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	Estimate 2010	Date
External Indicators									
Exports (annual percentage change, in U.S. dollars)	19.7	18.7	9.0	12.1	6.8	1.4	-6.4	...	Q1
Imports (annual percentage change, in U.S. dollars)	21.6	19.6	12.4	12.3	8.0	3.8	-6.0	...	Q1
Terms of trade (annual percentage change)	0.0	-0.9	-1.3	-1.5	1.3	-0.7	1.9	...	...
Current account balance	0.7	0.5	-0.5	-0.6	-1.0	-1.7	-3.0	...	Q1
Capital and financial account balance		-0.4	-1.1	-0.8	1.3	2.9	3.0	...	...
<i>Of which</i>									
Inward portfolio investment (debt securities, etc.)	11.1	8.0	10.5	10.1	1.5	6.2	6.3	...	...
Inward foreign direct investment	2.4	1.5	3.0	2.8	6.1	4.5	4.6	...	...
Other investment (net)	1.4	3.8	1.2	1.1	10.8	2.9	2.9	...	...
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	46.6	48.1	March
Euros per U.S. dollar (period average)	0.8	0.7	0.8	0.8	0.8	0.8	0.7	0.7	March
Market Indicators									
Financial Markets									
Public sector debt 1/	63.2	65.0	66.7	64.0	64.2	68.2	71.9	...	Q1
3-month T-bill yield (percentage points, eop)	2.1	2.0	2.3	3.5	3.8	1.9	0.4	0.3	March
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	...	...
US 3 month T-bill	0.9	2.2	3.9	4.8	3.1	0.0	0.1	0.2	March
Spread with the US T-bill (percentage points, eop)	1.2	-0.2	-1.6	-1.4	0.7	1.9	0.3	0.2	March
5- to 8-year government bond (percentage points, eop)	4.3	3.6	3.4	3.8	4.4	3.5	3.5	3.4	March
10-year government bond (United States)	4.3	4.2	4.5	4.6	4.1	2.4	3.6	3.7	March
Spread with US bond (percentage points, eop)	0.1	-0.6	-1.1	-0.8	0.3	1.1	-0.1	-0.3	March
Yield curve (10 year - 3 month, percentage points, eop)	2.3	1.6	1.1	0.3	0.5	1.6	3.1	3.1	March
Stock market index (period average)	166.5	196.9	228.0	273.1	306.1	232.0	205.8	209.6	March
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	15.5	15.4	16.2	...	...
Household financial savings ratio	6.6	6.2	5.0	4.7	4.8	4.8	6.8	...	...
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	38.5	38.1	36.4	...	...
Investment ratio	17.0	17.3	17.8	18.3	19.2	19.6	18.7	...	...
Savings ratio	15.9	14.7	13.8	13.8	15.5	13.6	12.8	...	...
Self-financing ratio	87.4	79.1	72.2	70.2	75.3	64.4	63.6	...	...
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	3.6	...	...
Ratio of nonperforming loans net of provisions to capital	11.6	9.8	8.6	6.8	6.6	8.2	10.8	...	...
Liquid assets to total short-term liabilities	153.7	155.1	150.1	146.7	150.3	139.6	150.1	...	...
Return on assets	0.4	0.5	0.6	0.6	0.4	0.0	0.4	...	...
Return on equity	8.5	10.6	11.8	14.0	9.8	-1.0	8.2	...	...
Regulatory capital to risk-weighted assets	11.9	11.5	11.3	10.9	10.2	10.5	12.4	...	...

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 6. France: The Core Set of Financial Soundness Indicators, 2003-10

	2003	2004	2005	2006	2007	2008	2009	Estimate 2010
Deposit-taking institutions 1/								
Regulatory capital to risk-weighted assets	11.9	11.5	11.3	10.9	10.2	10.5	12.4	12.5
Regulatory Tier I capital to risk-weighted assets	9.0	8.8	8.2	8.2	7.7	8.5	10.2	10.7
Nonperforming loans net of provisions to capital	11.6	9.8	8.6	6.8	6.6	8.2	10.8	9.9
Bank provisions to Nonperforming loans	n.a.	n.a.	n.a.	170	158.3	131.0	109.5	111.9
Nonperforming loans to total gross loans	4.8	4.2	3.5	3.0	2.7	2.8	3.6	3.5
Sectoral distribution of loans to total loans, of which								
Deposit-takers	34.2	34.0	30.1	30.6	32.2	33.6	34.1	36.5
Nonfinancial corporation	18.9	18.7	18.8	18.6	18.1	18.3	17.5	20.5
Households (including individual firms)	24.5	24.9	26.5	26.6	24.8	24.1	24.5	30.5
Nonresidents (including financial sectors)	4.3	4.2	4.7	4.2	4.7	4.7	4.6	6.1
ROA (aggregated data on a parent-company basis) 2/	0.44	0.5	0.6	0.6	0.4	0.0	0.4	0.3
ROA (main groups on a consolidated basis) 3/	0.39	0.53	0.49	0.57	0.35	0.1	0.3	0.5
ROE (aggregated data on a parent-company basis) 2/	8.50	10.6	11.8	14.0	9.8	-1.0	8.2	7.9
ROE (main groups on a consolidated basis) 3/	10.0	12.7	13.5	17.22	13.34	3.8	6.4	11.5
Interest margin to gross income	35.5	33.2	32.4	28.2	25.3	40.4	34.9	49.5
Noninterest expenses to gross income	64.4	63.9	64.3	62.4	68.4	84.2	63.1	65.5
Liquid assets to total assets	21.6	21.3	20.5	19.9	18.9	18.3	18.3	22.7
Liquid assets to short-term liabilities	153.7	155.1	150.1	146.7	150.3	139.6	150.1	144.7
Net open position in foreign exchange to capital								
Net open positions in FX (in millions of euros) 4/	4,772	6,669	5275	5,283	7,058	n.a.	n.a.	n.a.
Net open positions in equities to Tier I capital	3.5	4.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Banque de France; and ACP.

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

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

3/ Consolidated data for the seven main banking groups (2005, IFRS).

4/ Impact of the creation of the euro has to be taken into account.

Table 7. France: Encouraged Financial Soundness Indicators, 2003-10
(Percent, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008	2009	Estimate 2010
Corporate sector								
Total debt to equity	33.1	30.4	28.4	24.3	23.1	37.3	31.2	31.6
Return on equity	9.2	8.5	7.8	6.6	6.4	9.6	7.2	7.2
Interest paid to financial firms 1/	8.3	8.1	8.1	8.8	10.2	11.2	8.7	7.78
Corporate net foreign exchange exposure to equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Number of enterprise bankruptcies (thousands)	41.117	42.255	43.468	40.625	43.704	49.752	53.457	52.103
Number of enterprise creations (thousands)	240.3	266.3	271.3	286.6	326.6	331.0	581.6	622.60
Deposit-taking institutions								
Capital (net worth) to assets	5.4	5.1	4.4	4.5	4.1	4.2	4.5	4.9
International consolidated claims of French banks, <i>of which</i> (BIS data, as percent of total international claims)								
Advanced countries	85.3	84.2	83.7	85.1	84.0	84.2	83.3	82.1
Developing Europe	2.7	2.6	2.8	3.2	4.0	4.3	4.6	4.7
Latin America and Caribbean	1.4	1.0	1.1	0.9	1.0	1.1	1.2	1.3
Africa and Middle East	3.3	3.1	3.1	2.6	2.6	3.1	3.5	3.7
Asia and Pacific Area	2.7	2.6	2.6	2.5	2.9	2.6	2.9	3.4
Offshore Financial Centers	4.5	6.5	6.6	5.6	5.5	4.7	4.4	4.8
Gross asset position in financial derivatives to capital	306.8	372.5	543.7	337.0	235.0	633.2	362.7	292.3
Gross liability position in financial derivatives to capital	282.7	358.5	484.7	293.0	227.0	616.3	361.9	292.8
Large exposures to capital	0.9	4.6	3.6	1.4	4.7	3.1	4.1	7.9
Trading income to total income	16.8	20.0	23.9	26.0	16.8	-63.9	16.4	10.3
Personnel expenses to noninterest expenses	56.0	56.5	58.3	54.0	53.3	51.6	61.1	44.4
Spread between reference lending and deposit rates	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Spread between highest and lowest interbank rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Customer deposits to total (noninterbank) loans	82.8	80.6	83.5	80.5	77.4	78.0	85.3	74.0
FX loans to total loans 2/	11.2	10.8	12.0	11.4	11.3	10.5	10.4	9.8
FX liabilities to total liabilities	14.2	15.1	17.8	18.6	18.1	16.8	15.3	16.4
Net open position in equities to capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	52.7
Market liquidity								
Average bid-ask spread in the securities market 3/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average daily turnover ratio in the securities market	n.a.	n.a.	n.a.	7.0	7.7	5.4	3.4	4.3
Other financial corporations								
Assets to total financial system assets	15.7	16.9	17.1	17.5	17.2	16.0	16.7	17.19
Assets to GDP	131.8	148.3	163.4	181.6	188.0	162.0	180.0	192.2
Households								
Household debt to GDP	37.8	40.0	43.0	45.5	48.0	50.0	52.8	53.52
Household debt service and principal payments to income	9.05	9.16	9.62	11.16	8.66	8.02	8.59	10.65
Real estate markets								
Real estate prices	12.3	15.9	14.8	9.8	5.6	-3.0	-4.4	9.40
Residential real estate loans to total loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Commercial real estate loans to total loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Other relevant indicators that are not formally part of the encouraged set of FSIs 4/

Sources: Banque de France; ACP; BIS; and Ministère des Finances.

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

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

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

4/ Other indicators such as additional balance sheet data (e.g. maturity mismatches in foreign currency), data on the life insurance sector, or information on the corporate and household sector may be added where available and relevant.

Table 8. Financial System Structure, 2003-10

	2003	2004	2005	2006	2007	2008	2009	Estimate 2010
Number								
Banks								
Commercial Banks	333	326	316	313	312	310	302	285
Private	329	323	312	309	308	307	299	282
Domestic	138	139	131	131	130	136	137	134
Foreign	191	184	181	178	178	171	162	148
State-owned 1/	4	3	4	4	4	3	3	3
Credit unions and mutuals	129	127	125	121	111	105	102	102
Other credit institutions								
Finance companies	464	427	411	388	319	300	300	281
of which mortgage institutions	4	4	4	4	4	5	7	9
Specialized financial institutions	15	11	8	7	7	6	5	3
Municipal credit institutions	21	21	21	20	19	18	19	18
Securities firms	131	124	119	116	105	101	96	88
Insurance companies								
Life and retirement	125	119	119	115	110	107	107	102
Non-life	286	274	267	263	249	250	243	235
Reinsurance	33	30	29	29	30	29	26	20
Concentration								
Commercial Banks 2/	10	10	10	9	9	9	9	8
Securities companies 2/	4	3	2	2	2	2	2	2
Life insurance companies 2/	n.a.	n.a.	n.a.	n.a.	13	12	11	n.a.
General insurance companies 2/	n.a.	n.a.	n.a.	n.a.	23	23	21	n.a.
Pension funds 2/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assets								
(Billions of euros)								
Banks								
Commercial Banks	2,440.4	2,861.7	3,719.4	4,283.9	5,107.3	5,468.9	5188.3	5437.4
Private	2,365.3	2,850.4	3,599.6	4,159.3	4,972.6	5,343.8	5004.5	5238.9
Domestic	1,982.5	2,428.5	3,005.0	3,558.9	4,220.6	4,510.2	4180.4	4349.3
Foreign	382.8	421.9	594.6	600.4	752.0	833.6	824.1	889.7
State-owned 1/	75.1	11.3	119.7	124.6	134.7	125.0	183.8	198.5
Credit unions and mutuals	934.7	1,053.5	1,127.6	1,259.0	1,401.7	1,598.5	1674.7	1479.7
Other credit institutions								
Finance companies	536.2	432.7	405.3	476.7	530.9	573.0	620.6	681.7
of which mortgage institutions	91.9	107.2	125.7	148.6	186.0	199.2	216.7	234.2
Specialized financial institutions	46.9	40.4	21.2	19.6	19.9	20.8	23.3	19.8
Municipal credit institutions	1.9	1.9	1.7	1.3	1.2	1.2	1.2	1.3
Securities firms	218.7	215.3	270.8	353.6	542.1	486.4	339.5	349.6
Insurance companies (assets)								
Life and retirement	907.3	985.2	1103.4	1125.4	1305.8	1242.3	1476.1	1569.7
Non-life	152.2	159.8	170.5	166.7	175.2	165.5	204.0	217.0
Reinsurance	31.3	22.2	31.4	32.3	43.8	43.4	60.7	64.5
Deposits								
Banks								
Private commercial	526.8	573.9	677.1	758.1	785.5	883.7	904.6	1099.0
State-owned	7.9	0.2	92.4	92.0	92.3	91.3	148.1	150.5
Foreign-owned subsidiaries	47.7	45.2	56.6	58.9	86.2	83.5	63.4	67.0
Branches of foreign banks	20.9	19.7	26.1	24.8	30.9	27.3	28.8	31.3

Sources: Banque de France; and ACP.

1/ Including 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 2011 Article IV Consultation—Informational Annex

Prepared by the European Department

July 8, 2011

The discussions for the 2011 Article IV consultation were held in Paris during May 31–June 14, 2011. The concluding statement of the mission is available at <http://www.imf.org/external/np/ms/2011/061411a.htm>.

Staff team: Ms. Gulde-Wolf (head), Mr. De Vrijer, Mr. Cheng, Ms. Poirson Ward, Mr. Hallaert (all EUR), and Mr. Sy (MCM).

Country interlocutors: Mr. Baroin, the Minister of the Economy, Finance, and Industry; Mr. Noyer, Governor of the *Banque de France*, and his staff; the Director of Cabinet of the Minister of Economic Affairs, Finances, and Industry; the secretary general of the presidency; the director general of the treasury; 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 Prudential Supervision Authority (ACP); the Financial Market Authority (AMF); the French Banking Federation (FBF); and representatives of labor unions, employer organizations, the financial sector, and academics. Mr. Fayolle (Executive Director) and Mr. Ducrocq (Alternate Executive Director) attended most meetings.

Fund relations: The previous Article IV consultation took place on July 28, 2010. 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.

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ANNEX I. FRANCE: FUND RELATIONS

(As of May 31, 2011)

- 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 | 7,852.13 | 73.12 |
| Reserve position in Fund | 2,886.46 | 26.88 |
- III. **SDR Department:**
- | | SDR Million | Percent of Allocation |
|---------------------------|--------------------|------------------------------|
| Net cumulative allocation | 10,134.20 | 100.00 |
| Holdings | 9,745.09 | 96.16 |
- 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):
- | | <u>Forthcoming</u> | | | | |
|------------------|--------------------|-------------|-------------|-------------|-------------|
| | <u>2011</u> | <u>2012</u> | <u>2013</u> | <u>2014</u> | <u>2015</u> |
| Principal | | | | | |
| Charges/interest | <u>1.02</u> | <u>2.16</u> | <u>2.16</u> | <u>2.16</u> | <u>2.16</u> |
| Total | 1.02 | 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 the relevant EU regulations and UNSC resolutions, certain restrictions are maintained on the making of payments and transfers for current international transactions with respect to Anjouan (Union of the Comoros), Belarus, the Democratic Republic of Congo, Côte d'Ivoire, the Islamic Republic of Iran, the former government of Iraq, the Democratic People's Republic of Korea, the former government of Liberia, Myanmar, Sudan, certain individuals associated with the government of the former Federal Republic of Yugoslavia, certain individuals associated with the murder of former Lebanese Prime Minister Rafiq Hariri, and Zimbabwe. Financing of and financial assistance related to

military activities in Somalia, Sudan, and Uzbekistan are prohibited. Restrictions also apply to 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 July 28, 2010. The associated Executive Board assessment is available at <http://www.imf.org/external/np/sec/pn/2009/pn0996.htm> and the staff report at <http://www.imf.org/external/pubs/ft/scr/2009/cr09232.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, 10/29/03

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.

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

Summary: The report concluded that France’s financial sector is strong and well supervised. No weaknesses that could cause systemic risks were identified. The strength of the system is supported by the financial soundness indicators and the strong conformity to the supervisory and regulatory standards approved by the Basel Committee, IAIS, IOSCO, FATF, and CPSS.

The degree of observance of the transparency code is high in all relevant areas. The French banking sector has been modernized and restructured over the past two decades and is well capitalized. Systemic vulnerabilities in the important insurance sector are well contained. Securities markets are large and sophisticated.

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

This accumulation is harder to control for mutual banks, given their legal restrictions on remuneration of their members. And, for all banks, it could encourage expansion through expensive takeovers and risky new ventures; (v) the supervisory system of the financial sector is composed of specialized segments. Coordination mechanisms need to be further adapted. Additional steps should be considered in the future as cross-sectoral financial groups become more prevalent; (vi) the consolidation of the French stock and futures markets with others in Europe has increased the importance of effective cooperation across national jurisdictions. Moreover, the authorities face the challenge of adjusting to and effectively implementing the significant regulatory overhaul that took place in late 2003; and (vii) the infrastructure for the clearing and settlement of payments and securities is generally sound and modern. However, there is some room for improvement in the clearing and settlement of retail payments and securities, where the multilateral netting systems lack fully adequate safeguards to ensure timely settlement in case of default.

ANNEX II. FRANCE: STATISTICAL ISSUES

The economic database is comprehensive and of high quality, and data provision to the Fund is adequate for surveillance. The authorities regularly publish a full range of economic and financial data, and calendar dates of main statistical releases are also provided. France subscribes to the Fund's Special Data Dissemination Standard. The transmission of data in electronic form from INSEE (*Institut national de la statistique et des études économiques*) and the profusion of data from various institutions (*Banque de France*, INSEE, ministry of finance, ministry of labor and solidarity) have helped to build an infrastructure, in which all data can be easily accessed through the Economic Data Sharing System. A data ROSC mission conducted an assessment of the statistical system in March 2003, and the report was published in October 2003. A factual update to the main report was published in November 2004.

France's monetary and banking statistics methodology conforms with the European Central Bank framework, which provides comparable details as the Standardized Report Forms developed by STA. Statistics for *International Financial Statistics* on banking institutions and monetary aggregates are prepared on a monthly basis and are timely. Monetary data are also disseminated in the quarterly *IFS Supplement* on monetary and financial statistics.

France follows the European System of Integrated Economic Accounts 1995 (ESA95). Data for GDP and its expenditure components are available from 1978 onwards. Both annual and quarterly accounts provide reliable information, although estimates from the two accounts differ slightly before the quarterly accounts are revised to be aligned to the annual ones. In 2005, national accounts estimates were rebased to 2000 prices.

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

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

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

(As of June 30, 2011)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	05/11	06/11	Monthly	Monthly	Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	05/11	06/11	Monthly	Monthly	Monthly
International Investment Position	2010	Q1:2011	Annual	Annual	Annual
Reserve/Base Money	05/11	06/11	Monthly	Monthly	Monthly
Broad Money	05/11	06/11	Monthly	Monthly	Monthly
Central Bank Balance Sheet	05/11	06/11	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	05/11	06/11	Monthly	Monthly	Monthly
Interest Rates ²	05/11	06/11	Monthly	Monthly	Monthly
Consumer Price Index	05/11	06/11	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	Q1:2011	06/11	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government ⁵	04/11	05/11	Monthly	Monthly	Monthly
Stock of Central Government Debt	05/11	06/11	Monthly	Monthly	Monthly
Stock of Central Government-Guaranteed Debt	Q1:2011	06/11	Quarterly	Quarterly	Quarterly
External Current Account Balance	Q1:2011	06/11	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q1:2011	06/11	Quarterly	Quarterly	Quarterly
GDP/GNP	Q1:2011	06/11	Quarterly	Quarterly	Quarterly
Gross External Debt	Q1:2011	06/11	Quarterly	Quarterly	Quarterly
¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. ² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. ³ Foreign, domestic bank, and domestic nonbank financing. ⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. ⁵ This information is provided on a budget-accounting basis (not on a national accounts basis).					

**Statement by the IMF Staff Representative on France
July 25, 2011**

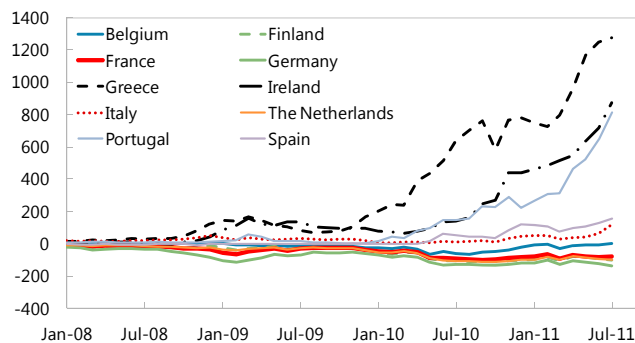
1. **This note reports on information that has become available since the staff report was issued and does not alter the thrust of the staff appraisal.**

2. **Following stronger-than-foreseen activity in early 2011, growth appears to have weakened over the second quarter.** Incoming data indicate a slowdown in household consumption and industrial production as well as weaker business confidence. Meanwhile, annual headline inflation rose to 2.1 percent in June, mainly reflecting higher food prices. Staff has revised 2011 real GDP growth to 2.0 percent from 2.1 percent, reflecting an official downward revision of first quarter growth by 0.1 percent.

3. **Recent market turbulence related to the euro area crisis and U.S. sovereign debt problems has affected French sovereign and banks CDS spreads.** Reflecting their

significant exposure to Greece, equity prices for major French banks have declined by over 15 percent since July 1, with their CDS spreads widening by more than 40 basis points during the period. Sovereign CDS spreads reached over 100 basis points and the 10-year bond yield spread (relative to the Bund) widened to over 70 basis points in mid-July, but both have somewhat retracted more recently. However, France's financing costs remain among the lowest in the euro area and yield spreads remain tight relative to other core euro area countries. Aside from the banks and insurance companies, there have been no signs of significant negative spillovers to the nonfinancial corporate sector.

10-Year Sovereign Yield Spread over Bund 1/
(Basis points, difference from median spread)



Sources: Bloomberg; and staff calculations.

1/ Shown as a country's spread minus the median spread. For Germany, the negative of median spread (zero minus median spread) is shown.

4. **Other important recent developments not reflected in the staff report include:**

- All four banks that are subject to the European stress tests passed the tests by a significant margin, with a post-stress test core tier 1 ratio of 7.5 percent in comparison to the 5-percent threshold.
- A draft bill to incorporate a national fiscal rule in the constitution has been approved by Parliament on July 13. However, the draft law will require either a three-fifths majority vote by Congress or a national referendum vote, both to be called by the President, to enter into force.



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IMF Executive Board Concludes 2011 Article IV Consultation with France

On July 25, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with France.¹

Background

The gradual recovery of the French economy is progressing, with growth in 2011 expected to be around 2 percent. Although the unemployment rate remains high at 9½ percent, employment has been increasing and confidence benefited from stronger activity in core Europe. Growth in early 2011 was led by robust private consumption and stock-building, and supported by a recovery in investment, although net exports have remained lackluster. An unsettled external environment continues to pose risks, especially related to possible spillovers from lingering euro area sovereign debt problems, and uncertainty about energy prices.

A sizeable fiscal consolidation has been set in motion. The fiscal deficit in 2010 was 7.1 percent, better than foreseen, and a sizeable upfront adjustment is being made in 2011 to restore sustainable public finances. The overall budget deficit is to be reduced to 3 percent of Gross Domestic Product (GDP) by 2013 and 2 percent of GDP by 2014. The planned adjustment is to be implemented through binding multi-year restrictions on more than three-quarters of central government expenditures and minimum yearly targets for the reduction in tax expenditures. The ability to achieve the targeted adjustment also hinges on the pace of the economic recovery,

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

and more efforts might be needed to achieve the 2012–13 targets if actual growth outcomes fall short of the authorities' projections.

The French banking sector has overcome most of the crisis legacies and has returned to strong profitability. Bank capital remains below some European peers, but is increasing, and the major French banks should be able to meet the Basel III capital requirements by 2013/14. At the same time, the large French banks remain highly reliant on wholesale funding and exposed to peripheral Euro countries. Institutional reforms, including the unification of banking and insurance supervision and inclusion of consumer protection mandates, as well the creation of a national systemic risk board have further strengthened the supervisory arrangements in France, which will also benefit from the ongoing European reforms aimed at strengthening cross-border elements of supervision. House prices in France increased rapidly over the past year, but financial stability risks linked to rapid house price increases seem at this stage contained.

Going forward, France is challenged to lift potential growth and reduce unemployment, in particular the lack of jobs for young, unskilled, and senior workers. The reduction in unemployment is, in part, due to labor market reforms. A number of government programs provide incentives for education and innovation. Efforts are also under way to improve competition in product and services markets where progress remains limited.

Executive Board Assessment

Executive Directors noted that supportive policy measures and key reforms in the pension system and labor market have underpinned a gradual, more broad-based recovery. Consumption has been robust, investment has picked up, and employment is rising. Directors noted that, while the economic outlook is favorable, risks are tilted to the downside, amid the sovereign debt crisis in the euro area, and uncertainty about energy and commodity prices. The main policy priorities are to restore fiscal sustainability, safeguard financial sector stability, and reduce unemployment. At the same time, it is important to build on the momentum of structural reforms to promote competitiveness and inclusive growth.

Directors stressed that credible fiscal consolidation is necessary for debt sustainability. They agreed that the consolidation targets set out in France's Stability Program and the 2011–14 multi-year budget framework strike the right balance between growth and sustainability considerations, with front-loaded and expenditures-based measures. Directors recommended preparing specific contingency measures in case growth outcomes fall short of expectations, and using windfall revenue to accelerate deficit and debt reduction. They looked forward to the enactment of a fiscal rule, signaling France's commitment to fiscal sustainability. Using conservative growth forecasts and capping the autonomous spending of local governments and social security would further enhance the credibility of the adjustment strategy. Directors encouraged deeper reforms of the pension and health care systems, building on recent progress.

Directors welcomed the overall resilience of the French financial system, as confirmed by stress tests undertaken by the European Banking Authority. They commended the authorities for further strengthening supervisory arrangements, particularly the unification of banking and insurance supervision, the introduction of a consumer protection mandate, and the creation of a national systemic risk board. While acknowledging that risks related to rapid house price increases seem contained at this stage, Directors called for continued vigilance, and in this regard welcomed the authorities' readiness to take measures as necessary, including macro-prudential tools. Directors agreed that banks would benefit from swiftly raising their capital levels, with the aim of meeting Basel III requirements by 2013/14, ahead of the official implementation period. Given the global systemic importance of France's major banks, there is a need for tailored and internationally consistent measures, including capital surcharges. Directors welcomed France's active involvement in the ongoing international debate on financial regulatory reform.

Directors highlighted the importance of pressing ahead with the structural reform agenda to boost competitiveness, job creation, and productivity growth. They supported an ambitious multi-pronged strategy, carefully articulated in light of the ongoing fiscal consolidation. Key elements should include keeping real wage increases in line with productivity improvements, increasing labor force participation, and fostering competition in the service sector. Sustained efforts are also needed to reduce high structural unemployment, focusing on targeted job search support and training opportunities, and modernization of the tax and benefit systems.

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 2011 Article IV Consultation with France is also available.

France: Selected Economic and Social Indicators, 2008–16

	2008	2009	2010	Projections					
				2011	2012	2013	2014	2015	2016
Real economy (change in percent)									
Real GDP	-0.2	-2.6	1.4	2.1	1.9	2.0	2.1	2.1	2.1
Domestic demand	0.1	-2.4	1.3	2.2	1.7	2.0	2.1	2.1	2.1
CPI (year average)	3.2	0.1	1.7	2.2	1.7	1.8	1.9	1.9	1.9
Unemployment rate (in percent)	7.8	9.5	9.7	9.3	8.8	8.6	8.2	7.9	7.8
Gross national savings (percent of GDP)	20.1	17.5	18.6	18.6	19.2	19.5	19.7	20.0	20.2
Gross domestic investment (percent of GDP)	21.9	19.0	20.4	20.8	21.2	21.4	21.5	21.8	22.0
Public finance (percent of GDP)									
Central government balance	-3.3	-6.2	-6.3	-4.4	-3.8	-3.0	-2.5	-1.8	-1.2
General government balance	-3.3	-7.5	-7.1	-5.7	-4.8	-3.8	-2.9	-2.0	-1.1
Structural balance (percent of potential GDP)	-2.9	-4.8	-4.6	-3.9	-3.3	-2.6	-2.2	-1.6	-1.0
Primary balance	-0.6	-5.3	-4.9	-3.1	-2.0	-0.9	0.1	1.2	2.1
General government gross debt 1/	68.2	79.0	82.3	85.2	87.2	88.1	87.8	86.5	84.4
Money and interest rates (in percent)									
Money market rate	3.8	1.0	0.8	...	...	...	...	...	...
Government bond yield	4.2	3.6	3.1	...	...	...	...	...	...
Balance of payments (in percent of GDP)									
Exports of goods	21.3	18.1	20.2	22.6	23.0	23.0	22.9	23.0	23.0
Volume growth (in percent)	-0.6	-12.2	9.4	6.4	4.6	3.8	3.9	3.9	3.8
Imports of goods	24.3	20.4	23.0	25.8	26.0	25.9	25.8	25.8	25.8
Volume growth (in percent)	0.6	-10.6	8.3	6.5	3.9	3.7	3.8	3.8	3.8
Trade balance	-3.1	-2.3	-2.8	-3.1	-3.0	-2.9	-2.9	-2.8	-2.8
Current account	-1.7	-1.5	-1.7	-2.1	-1.9	-1.9	-1.8	-1.8	-1.7
FDI (net)	-3.2	-2.6	-2.0	-1.9	-1.8	-1.7	-1.6	-1.5	-1.4
Official reserves (US\$ billion)	33.6	46.6	...	...	...	...	...	...	...
Fund position (as of April 30, 2011)									
Holdings of currency (percent of quota)	86.3	80.8	79.7	73.1	...	...	...	...	...
Holdings of SDRs (percent of allocation)	58.1	95.9	96.1	96.1	...	...	...	...	...
Quota (SDRs million)	10739	10739	10739	10739	...	...	...	...	...
Exchange rates									
Euro per U.S. dollar, period average 1/	0.68	0.72	0.75	0.70	...	...	...	...	...
Nominal effective rate, ULC-styled (2000=100) 1/	113.8	113.7	110.4	111.2	...	...	...	...	...
Real effective exchange rate, ULC-based (2000=100)	113.9	115.2	109.8	111.5	...	...	...	...	...
Potential output and output gap									
Potential output	1.2	1.0	0.8	1.1	1.3	1.4	1.5	1.5	1.6
Output gap	-0.7	-4.2	-3.6	-2.7	-2.1	-1.6	-1.0	-0.4	0.0
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/ For 2011, average for January-April.