INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/18

FRANCE

January 2022

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR FRANCE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with France, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 19, 2022 consideration of the staff report that concluded the Article IV consultation with France.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 19, 2022, following discussions that ended on November 9, 2021, with the officials of France on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 14, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for France.

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

Selected Issues

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

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR22/15

IMF Executive Board Concludes 2021 Article IV Consultation with France

FOR IMMEDIATE RELEASE

Washington, DC – **January 26, 2022**: On January 19, 2022 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

France was among the most affected European countries from the COVID crisis. Strong progress on vaccination has helped effectively contain the COVID virus and has supported a fast normalization of activity in 2021. Widespread inoculation has also ensured that hospitalizations and fatalities remained low in contrast to previous waves. In recent days, Covid-19 infections have risen again substantially due to the rapid spread of the Omicron variant.

A robust economic recovery is underway, bolstered by public support and by solid private sector investment. Overall, output is estimated to have increased by about 6¾ for the year. Headline inflation is projected to increase to about 2.1 percent driven by base effects and an increase in energy prices. Employment growth is robust, and the unemployment rate has remained relatively stable. The financial sector has withstood the crisis well and provided ample credit to the economy, with continued support from a range of prudential and monetary measures.

To address the crisis, the government put in place a large fiscal package in 2020 and further expanded relief programs during the first half of 2021. These are being increasingly targeted and scaled down as the recovery progresses but have been appropriately expanded amidst the new epidemic wave. For 2022, the government plans to continue implementing France's recovery plan, together with additional measures for vulnerable youth and for tackling skills shortages. The authorities have also kickstarted a new five-year investment plan, "France 2030", aimed at reestablishing a technological lead in selected industries through targeted interventions.

Growth in 2022 is forecast at 3.5 percent, but medium-term output is projected to remain below the pre-crisis trend, reflecting some limited productivity loss from the uneven pace of recovery. Near-term risks to the outlook are tilted to the downside, dominated by the evolution of the pandemic and supply-chain issues. On the upside, a faster rundown of accumulated

[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.

savings or stronger demand recovery in hard-hit sectors could raise growth in the near term and reduce scarring in the medium term.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that a strong economic recovery is underway in France, bolstered by progress on vaccination, strong fiscal support, and solid private sector-led investment. Directors commended the authorities for their strong and flexible fiscal support, which helped protect households and firms during the crisis. They noted that the growth outlook remains favorable, but uncertainty persists related to COVID-19 developments and supply disruptions.

Directors recommended supporting the recovery in the near-term through a moderately expansionary fiscal stance, as planned by the authorities, focused on boosting worker skills, investment in green and digital transformation, and innovation to stimulate potential growth. Emergency measures should be increasingly targeted, but the authorities should retain flexibility. In response to higher inflation, Directors supported compensating vulnerable households through targeted and temporary instruments but advised against broad-based transfers and long-lasting price-control measures, which are more costly and distort price signals. In this context, they welcomed the authorities' assurances that the measures will be temporary.

As the recovery continues, Directors urged rebuilding buffers through a large, but gradual and sustained, spending-based fiscal consolidation, anchored around France's previous medium-term objective. Some Directors suggested avoiding an excessive backloading of adjustment. The commitment to the fiscal adjustment path should be backed by a strong expenditure rule and enhanced responsibilities of the fiscal oversight body. Grays welcomed in this context the parliamentary approval of the related organic law.

Directors noted that the banking sector withstood the crisis well and supported the economic recovery. Widespread corporate defaults have not materialized. Nevertheless, Directors emphasized the need to continue monitoring bank asset quality closely, as some sector-specific solvency risk could still emerge as emergency support phases out. While the macroprudential stance remains broadly appropriate, Directors supported a timely re-activation of the counter-cyclical capital buffer and fine-tuning, if necessary, existing borrower-based measures to limit excessive risk-taking, including in real estate.

Directors commended the quick and strong employment rebound, but noted some tightening of labor market conditions in recent months. To prevent the buildup of labor mismatches from slowing the recovery, Directors recommended deploying additional policies aimed at alleviating skills shortages, such as combining job-search assistance schemes with training

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings-up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

programs. They also stressed the need for further rectifying long-standing educational disparities affecting youth employment, through measures to strengthen the school-to-work transition.

Directors supported productivity enhancing policies to raise competitiveness and increase external sector resilience, such as additional product market reforms and targeted efforts to foster innovation. Directors welcomed the authorities' push for carbon neutrality and the strategy set out in their Climate and Resilience Law and in the *France Relance* and *France 2030* plans. They encouraged the authorities to strengthen green policies to reduce emissions, including adequate carbon pricing with mitigating measures for vulnerable households. They noted that improved worker training and skills matching will be particularly important to facilitate the green transition without generating employment losses.

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

			Projections	
	2019	2020	2021	2022
Real economy (change in percent)				
Real GDP	1.8	-8.0	6.7	3.5
Domestic demand	2.1	-6.8	6.1	2.5
Foreign balance (contr. to GDP growth)	-0.3	-1.1	0.4	0.9
CPI (year average)	1.3	0.5	2.1	2.4
GDP deflator	1.3	2.7	0.2	2.0
Public finance (percent of GDP)				
General government balance	-3.1	-9.2	-8.3	-5.2
Revenue	52.3	52.6	52.0	51.2
Expenditure	55.4	61.8	60.3	56.4
Primary balance	-1.7	-8.0	-7.1	-4.2
Structural balance (percent of pot. GDP)	-2.1	-6.0	-7.0	-5.0
General government gross debt	97.5	115.0	114.6	113.5
Labor market (percent change)				
Employment	0.8	-0.7	1.2	0.2
Labor force	0.2	-1.1	1.2	0.3
Unemployment rate (percent)	8.4	8.0	8.0	8.1
Credit and interest rates (percent)				
Growth of credit to the private non-financial sector	5.3	8.1	2.5	3.8
Money market rate (Euro area)	-0.4	...	...	...
Government bond yield, 10-year	0.1	...	...	...
Balance of payments (percent of GDP)				
Current account	-0.3	-1.9	-1.4	-1.4
Trade balance of goods and services	-0.9	-1.9	-1.6	-1.4
Exports of goods and services	32.7	28.8	31.7	33.8
Imports of goods and services	-33.7	-30.7	-33.3	-35.2
FDI (net)	0.2	1.6	0.8	0.9
Official reserves (US$ billion)	69.7	...	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.89	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	97.1	...	...	...
REER, ULC-based (2005=100, +=appreciation)	90.2	...	...	...
Potential output and output gap				
Potential output (change in percent)	1.0	-3.3	3.7	1.7
Memo: per working age person	1.2	-3.2	3.8	1.7
Output gap	0.0	-4.8	-2.1	-0.4

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

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

December 14, 2021

KEY ISSUES

Context: A strong economic recovery is underway in France, bolstered by progress on vaccination, strong fiscal support and solid private sector led investment. Employment has recovered to above pre-crisis levels and unemployment is virtually stable. Inflation is increasing, mainly driven by a rise in energy prices but also due to supply-chain disruptions. The public deficit and debt ratio surged in 2020, reflecting the large amount of emergency support deployed and the drop in activity.

Outlook: Output is expected to grow by around 6¾ percent in 2021. The recovery is expected to continue into 2022 with GDP projected to rise by about 3.7 percent. The fiscal deficit is expected to decline as emergency support is phased out and the economy recovers, but will remain above 3 percent of GDP over the forecast horizon under unchanged policies. Near-term risks to the outlook are tilted to the downside, with much of Europe in the throes of another pandemic wave and continued disruptions to supply-chains.

Policies: Key policy priorities are:

- *Support the recovery in 2022 through a moderately expansionary fiscal stance while winding down emergency programs.* Fiscal support should focus on boosting worker skills, investment, and innovation to secure the recovery and stimulate potential growth. Emergency measures should be increasingly targeted, but the authorities should retain flexibility to respond if the virus caseload rises again as it presently does elsewhere in Europe.
- *Rebuild fiscal buffers through a large, but gradual and sustained, fiscal adjustment beginning in 2023.* A spending-based consolidation plan should target reducing the deficit to around 2 percent of GDP by 2026 and to France's previous medium-term objective of 0.4 percent of GDP by about 2029. This adjustment would be politically feasible and would strike a balance between the need to rebuild fiscal space to respond to future shocks, and the necessity of maintaining growth and leaving space for building forward better. The commitment to the fiscal adjustment path should be backed by a strong expenditure rule and enhanced responsibilities of the fiscal oversight body.

- *Closely monitor financial sector performance as emergency support winds down and proactively address pockets of financial vulnerability.* With private sector balance sheets emerging relatively unscathed, corporate and financial sector support measures should continue to be normalized gradually as the economy gains traction. Heightened scrutiny will be needed as measures are phased out and grace periods end. Conglomerate intragroup transactions should be closely monitored, and concentration thresholds developed to limit risk from highly indebted firms. The macroprudential stance remains broadly appropriate but may require tightening if risks from debt-driven asset valuations increase further.
- *Remove structural barriers to growth to facilitate an equitable and resilient recovery.* To prevent labor market mismatches from slowing the recovery, policies should aim to alleviate skills mismatches, including by combining job-search assistance schemes with training programs. Further rectifying educational disparities affecting access to employment, through measures strengthening the school-to-work transition, will also ensure that the growth dividends are equitably and sustainably distributed. A renewed emphasis on measures to raise competitiveness, including through human capital investment and boosting innovation, will enable France to strengthen its external position and increase resilience to external shocks. The accelerated drive for achieving climate neutrality by 2030 is welcome. Improved worker training and skills matching will be particularly important to facilitate the green transition without generating employment losses.

Approved By
Jörg Decressin (EUR) and Maria Gonzalez (SPR)

Discussions took place virtually and in Paris from October 26–November 9, 2021. The staff team comprised J. Franks (mission head), M. Patnam (both EUR), B. Gruss (AFR, formerly EUR), S. Weber (MCM, formerly EUR) and was assisted at headquarters by P. Castillo and K. Cerrato (both EUR). Arnaud Buisse (Executive Director), Diane de Waziers (Advisor to the Executive Director), Vincent Grossmann-Wirth (Senior Advisor to the Executive Director) and Clement Roman (Alternate Executive Director) joined the mission. Staff met with the Central Bank Governor Galhau; senior officials in the president and prime minister's offices, various ministries, and the *Cour des Comptes*; financial sector interlocutors, think tanks, and academics; trade union and employer association representatives; and had a conference call with the SSM. A press conference was held at the end of the mission.

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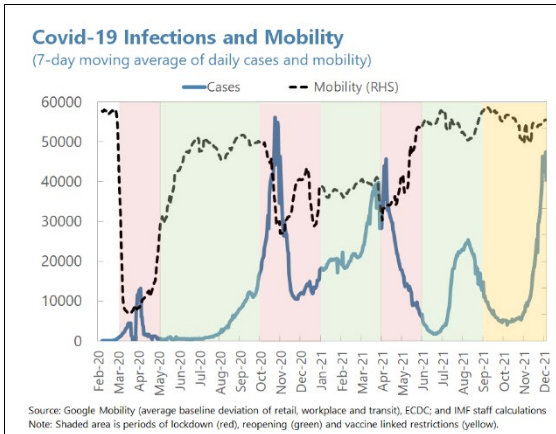
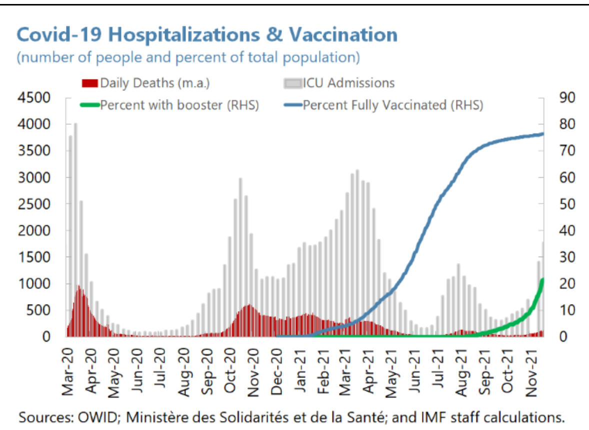
TABLES

ANNEXES

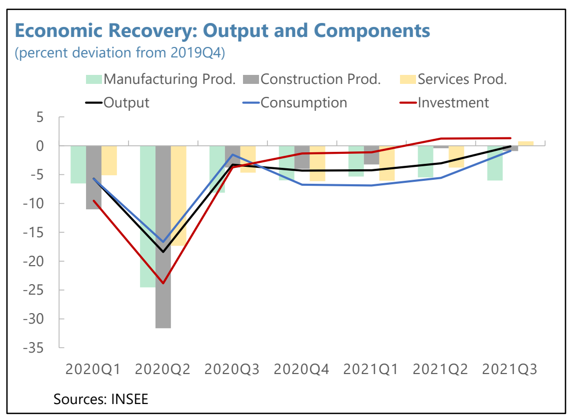
CONTEXT AND RECENT DEVELOPMENTS

1. **The Covid-19 pandemic exacted a heavy economic and health toll in France but strong progress on vaccination has helped limit further damage.** In early 2021, the authorities introduced a third partial lockdown to contain the third wave of infections. While a fourth wave of infections, linked to the spread of the Delta variant, did materialize, widespread inoculation ensured that fatalities remained low in contrast to previous waves. A fifth wave of infections is currently underway but there is uncertainty on its impact and evolution, especially with regards to the spread of the new highly transmissible Omicron variant. The government implemented measures to increase vaccination rates, including the requirement to use a vaccine or test linked health pass at various venues and mandatory vaccinations for certain occupations. The link between health restrictions and economic activity is weakening over time, with mobility levels relatively unaffected during recent infection waves. About 76 percent of France's population was fully vaccinated by mid-December 2021, and over 20 percent received additional booster shots.



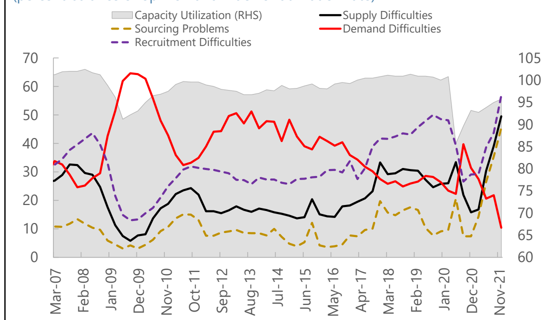


2. **A strong investment-led recovery is underway, but progress is uneven across sectors.** While output contracted by 8.0 percent in 2020—more than the European average—it has since rebounded, with the gap relative to pre-crisis levels nearly closed by 2021Q3. Investment rebounded more quickly than consumption and already exceeds its pre-crisis level (Box 1). Across sectors, manufacturing production lags behind its pre-crisis level, while construction and services have nearly recovered all their losses.



3. While capacity utilization is still below pre-crisis levels, indicating some slack in the economy, supply constraints are starting to bind. For the first time since the onset of the crisis, supply difficulties have exceeded demand difficulties, with almost twice as many firms reporting supply issues as during the pre-crisis period. Sourcing problems and recruitment difficulties are the main contributing factors. Sourcing difficulties are particularly acute for the transportation and electronics sector which are more affected by ongoing global supply chain disruptions, given their high dependence on international inputs (¶37).

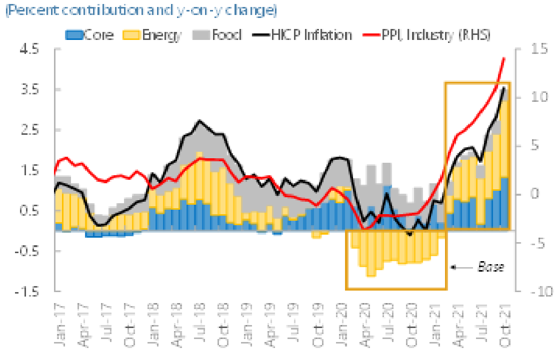
Supply & Demand Difficulties in the French Industry
(percent balance of opinion and index of utilization rate)



Sources: INSEE
Notes: Index of capacity utilization rates takes December 2019=100.

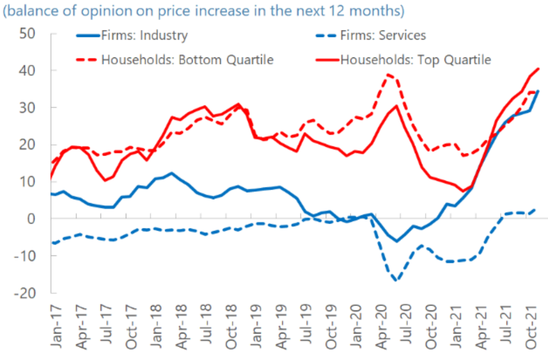
4. Consumer prices are increasing, mostly driven by a rise in energy prices. Since March 2021, the rebound in energy prices has accounted for over 50 percent of the inflation rise.[1] Inflation pressures continue to inch up, with the producer price index and price expectations increasing. The minimum wage automatically increased by 2.2 percent in late 2021 due to the exceptional rise in inflation and is expected to be adjusted further in 2022. Survey evidence and wage negotiation prospects by employers' associations point to a likely 2½ percent increase in salaries for 2022. The market-implied breakeven inflation rate has risen to 1.5 percent but remains below the ECB's medium-term target of 2 percent for the euro area as a whole.

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



Sources: Haver Analytics; and IMF staff calculations.

Price Expectations: Firms and Households
(balance of opinion on price increase in the next 12 months)



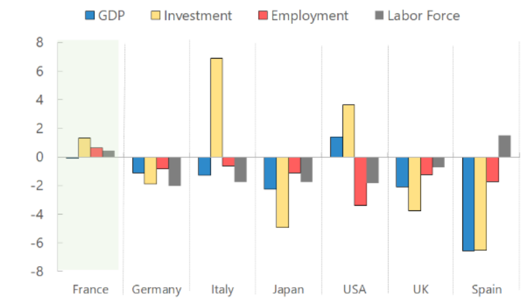
Sources: European Commission

[1] Much of the increase is also linked to base effects, accounting for about 51 percent of the projected increase in overall inflation for 2021.

Box 1. A Balanced Recovery in France: Growth, Investment and Employment

A surprising upside of France's economic recovery was its limited adverse impact on investment and jobs. In 2021Q3, output was almost at par with pre-crisis levels while investment and employment had fully recovered. Labor force participation actually exceeded its pre-crisis level by about 0.5 percent, and given the recovery in employment, led to stable unemployment. In contrast, the recovery in other countries was less balanced, with employment levels yet to fully rebound or investment depressed.

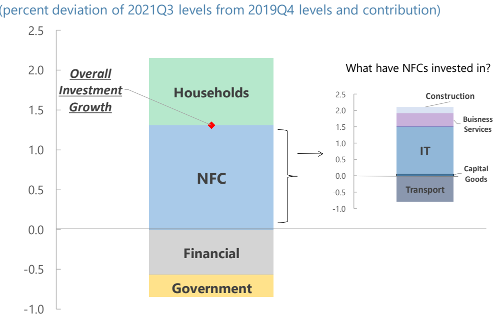
Economic Recovery in Advanced Countries
(percent deviation of 2021Q3 levels from 2019Q4 levels)



Sources: Haver Analytics; and IMF Staff Estimates
Note: Seasonally adjusted data. For EU countries employment uses national accounts concept while labor force is from the LFS.

Investment remained resilient throughout the crisis, supported by government measures and the need to adapt to new work conditions. Compared to the global financial crisis, when investment fell more strongly than output, in 2020 it fell by the same amount (about 8 percent). For Non-Financial Corporates (NFCs) the investment loss was concentrated in a few sectors, such as real estate, and the corporate investment rate was largely unchanged. The government's emergency measures prevented a more severe impact on investment, which could have fallen by over 30 percent in the absence of support (INSEE, 2021). Investment surpassed its pre-crisis level in 2021Q3 by 1.3 percent. A further breakdown shows that NFCs invested mainly in IT services, reflecting the need to adapt to virtual working, as well as construction and business services. The government's recovery plan also included several elements that likely boosted NFC investment in 2021 such as lower taxes on production and subsidies for investment and innovation.

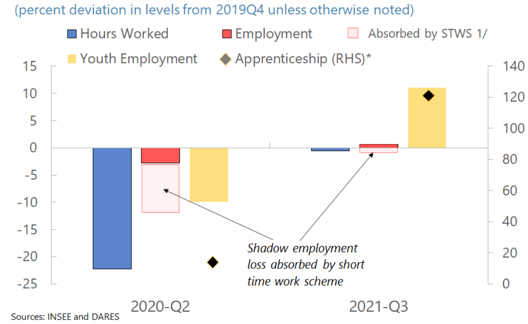
Investment Recovery Contributors
(percent deviation of 2021Q3 levels from 2019Q4 levels and contribution)



Sources: INSEE Quarterly National Accounts

The impact of the crisis on employment was also buffered by extensive support provided through the job-retention scheme. The short-time work scheme (STWS) launched at the beginning of the crisis absorbed much of probable employment losses. By preserving the employment relationship, the labor market adjusted via hours worked, rather than the number of workers. In the recovery phase, despite the scheme being phased down, working hours rebounded strongly. Part of the limited impact on employment can be attributed to targeted measures in the recovery plan, such as the hiring subsidies for the youth which were found to have increased youth job creation (Martin et. al. 2021), especially through boosting apprenticeships.

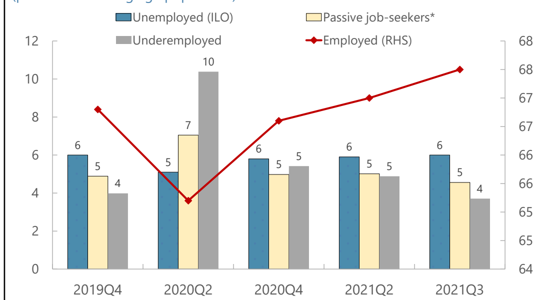
Evolution of Employment
(percent deviation in levels from 2019Q4 unless otherwise noted)



Sources: INSEE and DARES
1/ Level of additional employment loss absorbed by STWS taking average full-time equivalents on STWS over the quarter;
*difference in cumulative apprenticeship flow until Aug-2021 and Aug-2020 relative to Aug-2019.

5. The unemployment rate has remained virtually stable at pre-crisis values and employment rebounded. By the end of 2021-Q3, employment and labor force participation both exceeded their pre-crisis levels. The share of people inactive but passively seeking work has also fallen, after spiking during the acute phase of the crisis. While underemployment has also decreased, it remains high at around pre-crisis levels. Overall while conditions are improving, labor frictions persist, with about one in five labor market participants (active and passively seeking jobs) constrained either by the absence of a job or in a situation of underemployment.

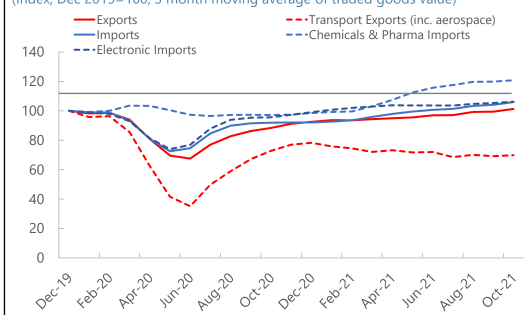
Unemployment and Labor Supply Constrained
(percent of working age population)



Sources: INSEE Labor Force survey.
Note: * Passive job-seekers are those in the "unemployment halo" who are inactive as defined by the ILO, but close to the labour market (e.g., those seeking a job but not available for work or those who want to work but not actively seeking work).

6. The current account deficit is gradually normalizing, led by an increase in services exports. In 2020, the current account deficit widened to 1.9 percent of GDP, driven by a reduction in non-oil goods and services exports. The quarterly trade balance points to some normalization in 2021, with the non-oil goods deficit shrinking and the services surplus increasing, especially in maritime transport. However, exports in the automotive and aeronautics sectors remain depressed. A preliminary assessment of current trends suggests that France's external position is broadly in line with fundamentals and desirable policies for 2021, after adjusting for the impact of one-off factors related to the pandemic (Annex III)[2]. The general SDR allocation of 1.1 percent of GDP has increased gross international reserves and France has committed to channel some of its allocation to support the recovery of other countries.

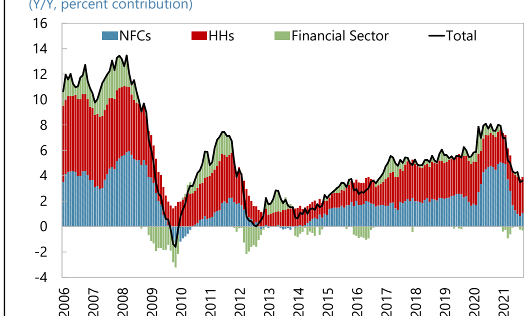
Goods Trade
(Index, Dec 2019=100, 3 month moving average of traded goods value)



Sources: Direction Générale des Douanes et des Droits indirects

7. Credit was buoyant throughout the crisis. Credit to households and NFCs increased by 4.7 and 13 percent, respectively, in 2020. This was despite a slight tightening in credit standards in 2020H2 due to a higher perception of risks, especially for SME investment projects (Bpifrance, 2021), and due to supervisory recommendations on stricter mortgage lending standards. Amidst NFCs' declining demand for and low repayment of treasury loans, credit growth to NFCs eased to 2.7 percent by July 2021. Household credit growth accelerated to 6 percent supported by low mortgage rates and base effects.

French Banks: Credit to the Private Sector
(Y/Y, percent contribution)

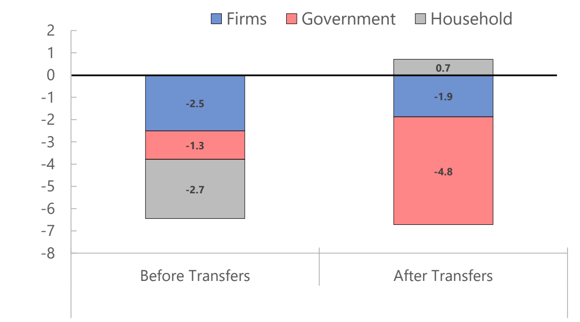


Source: Haver Analytics.

[2] This preliminary assessment is subject to revisions ahead of the 2022 External Sector Report.

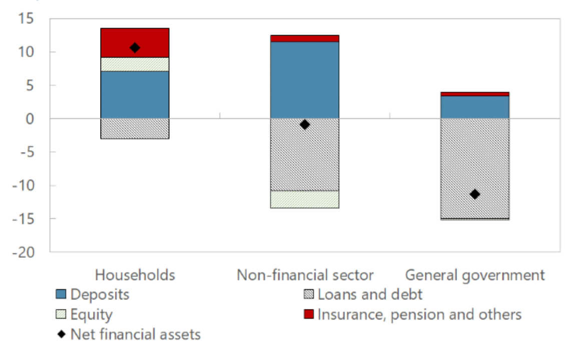
8. Strong public sector support has helped protect households and firms during the crisis. The government is estimated to have absorbed over 80 percent of the overall income shock through transfer measures, including automatic stabilizers and measures supporting cheap debt. Direct transfers–especially through the STWS and grants from the solidarity fund—reduced firms' operational costs and preserved profits. Tax and social security payment deferrals and the state-guarantee scheme for bank loans (*Prêt garanti par l'État,* or PGE) provided ample liquidity to firms. With investment and consumption falling, but household incomes largely maintained, households are estimated to have accumulated excess savings worth about €165 bn (6¾ percent of GDP) by 2021Q3, concentrated among the higher income deciles (Box 2). Initial estimates suggest that poverty did not increase significantly during the crisis, with the poverty rate remaining stable at about 14.6 percent in 2020 (INSEE, 2021).

Change in Income: 2019-2020
(in percent of GDP)



Sources: National Accounts.
Notes: *Before transfers* coresponds to primary income while *after* transfers corresponds to disposable income.

Change in Net Financial Assets: 2019-2020
(in percent of GDP)



Sources: Banque de France; and IMF staff calculations.

9. In 2021, the fiscal balance is estimated to have improved by around 1 percent of GDP, with public debt broadly stable. After widening to about 9 percent of GDP in 2020 due to the recession and to crisis-related fiscal support, the fiscal deficit is expected to decline to 8.3 percent of GDP in 2021. The improvement is due to the rebound in revenues that, together with the first tranche of Next Generation EU (NGEU) grants, are estimated to have more than offset additional crisis-related spending (about 1 percent of GDP). The debt ratio is expected to remain broadly stable at about 115 percent of GDP.

10. The authorities further expanded Covid-19 relief programs during 2021, bringing the total envelope for crisis and recovery measures to about 28 percent of GDP. A small expansion planned in the 2022 budget brought the total envelope for relief programs to around 24 percent of GDP. This included 6 percent of GDP in above-the-line measures, a large provision for state guarantees (14.2 percent of GDP, mostly through the PGE program)[3], and below-the-line interventions (0.9 percent of GDP) that provided reassurance to the private sector but remained largely untapped. In addition to emergency support, France's recovery plan (*France relance*) included 3½ percent of GDP of above-the-line stimulus —about half covered by NGEU grants—and 0.3 percent of GDP in public guarantees.

[3] Out of a legislated envelope of €300 billion, about €140 billion PGE loans had been granted by October 2021.

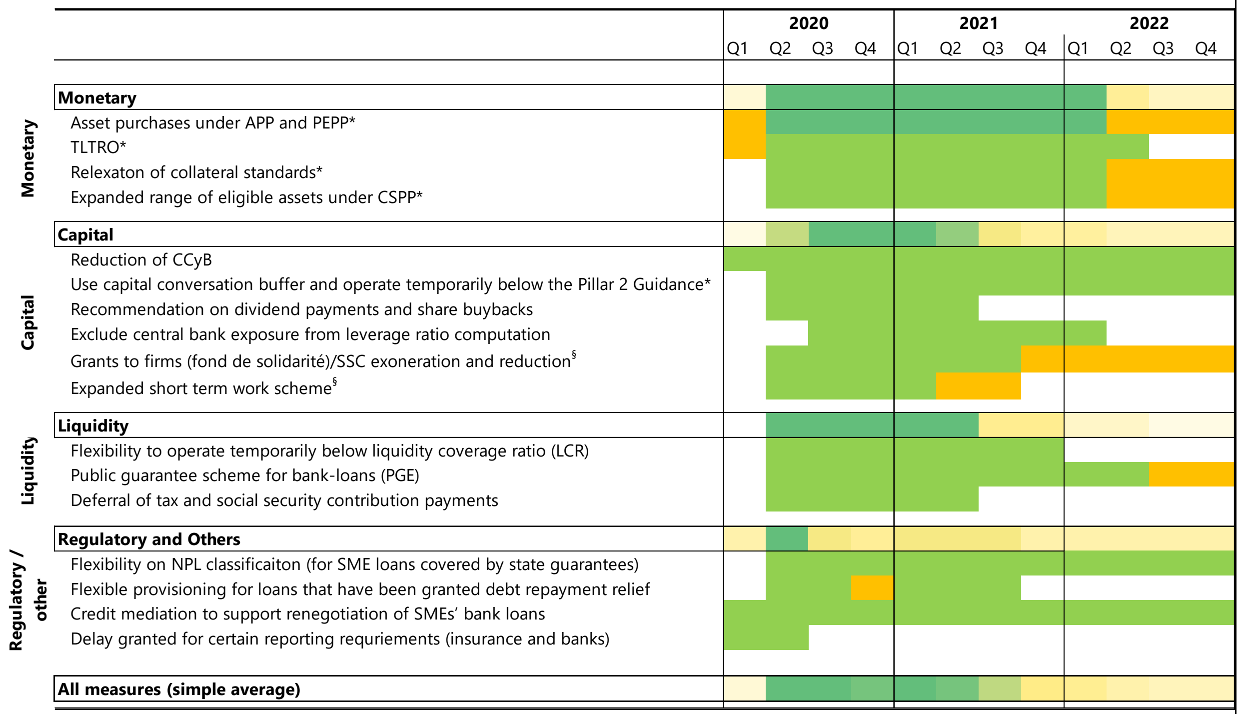
Emergency and Recovery Response to the Covid-19 Crisis

(Percent of 2020 GDP)	2020	2021	2022+	Total 1/
Emergency Programs				**24.2**
Above-the-line measures	3.2	2.6	0.2	6.0
Short-time Work Scheme (Activité partielle)	*1.2*	*0.4*	*0.0*	*1.6*
Grants (Fonds de solidarité)	*0.7*	*1.0*	*0.0*	*1.7*
Other	*1.3*	*1.2*	*0.2*	*2.8*
Public guarantees (envelope approved)				14.2
Bank loans (Prêt garanti par l'État, PGE)				*13.0*
Other				*1.2*
Below-the-line measures (e.g., equity injections; envelope initially approved)				0.9
Liquidity support (e.g., tax deferrals)				3.0
Recovery Plan /2				**3.8**
Above-the-line measures		1.7	1.8	3.5
Revenue (cut in production taxes) 1/		*0.5*	*0.5*	*0.9*
Spending (e.g., hiring and investment subsidies)		*1.3*	*1.3*	*2.6*
o.w. covered by EU grants				*1.7*
Public guarantees (envelope approved)				0.3
Overall Envelope of Emergency and Recovery Plans				**28.0**

Sources: IMF staff estimates.
1/ The total envelope considers the effect of tax cuts included in the recovery plan in 2021-22 only, but the measure is permanent.
2/ The amount shown for the Recovery Plan only includes measures with impact at the General Government level (about 88 billion euros).

11. As the recovery progressed, the authorities have scaled down and increasingly targeted their emergency support. In June 2021, the authorities announced a schedule to reduce the generosity or phase out key emergency programs, with exceptional support maintained for the most affected activities. While some measures were extended due to the new infection variants, most emergency programs had been phased out by October 2021, amid much reduced demand for support—as evidenced by the decline in firms' take-up of the STWS even before its generosity was reduced (Box 1).

Availability of National and Union-wide Financial Sector and Related Programs



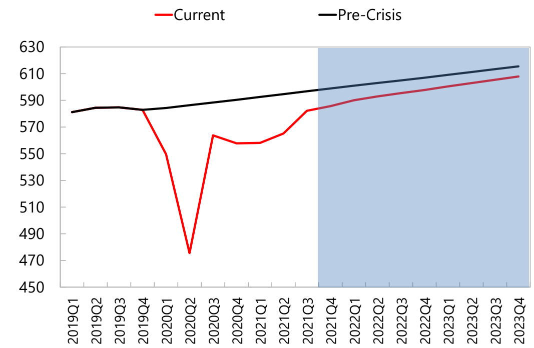
Source: ECB, national authorities and IMF, based on information as of November 9th 2021.

Note: "*" refers to measures taken exclusively at EU/euro area level;§ the level and phasing out of support for these schemes differed across firms (by those affected by containment measures, those in protected sectors and those in non-protected sectors). Color coding reflects announced, implicit or likely adjustment and end dates. **Color coding is subjective and reflects (i) episodes of full availability of measure (green), (ii) adjusted / more restricted availability of measure (yellow), (iii) no (planned/announced) availability of measure (white).**

OUTLOOK AND RISKS

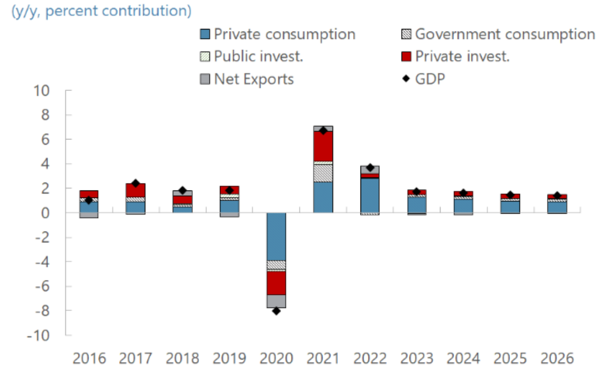
12. **Staff expects output to increase by 6¾ percent in 2021 with GDP surpassing pre-crisis levels by end-2021.** Growth is projected at about 3.7 percent next year before easing to around 1.7 percent in 2023, driven primarily by private consumption, with households expected to draw down about 10 percent of their excess savings. The baseline scenario assumes accommodative financial conditions and continued containment of infection outbreaks, albeit with increased uncertainty around the new Omicron variant whose impact is still hard to assess. Headline inflation is estimated at about 2.1 percent, on average, in 2021. For 2022, while average inflation is projected at 2.4 percent due to the prolongation of supply-chain issues, transitory factors are expected to dissipate during the year, bringing end-year inflation below 2 percent. The unemployment rate is expected to remain stable at about 8 percent in the near term with increasing labor force participation absorbed into employment. The current account deficit is estimated to narrow to 1.4 percent in 2021 and gradually normalize thereafter.

Output Forecast: Current Level vs. Pre-Crisis Trend
(Real output level)



Sources: IMF Staff Calculations. Shaded area is forecast.

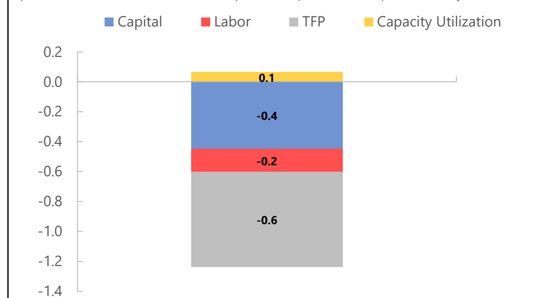
Real Output Growth and Contributors
(y/y, percent contribution)



Sources: IMF Staff Calculations.

13. Over the medium term, output is projected to grow near potential but remain below its pre-crisis trend. While most sectors of the economy are expected to fully recover by 2022, a few key sectors such as automotive, aeronautics, and tourism are likely to lag due to external supply disruptions (¶5) and a more lasting demand downturn. Reflecting the uneven pace of recovery, staff project some loss of productivity, including from inefficient labor and capital allocation[4], with potential output remaining below its pre-crisis trajectory by about 1.1 percent.

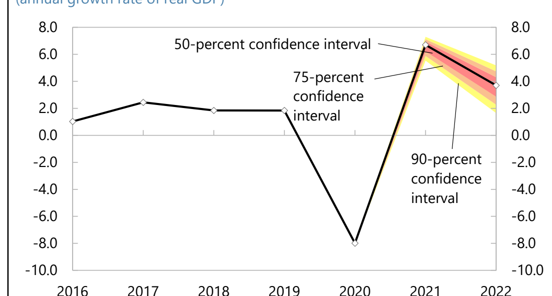
Medium Term Potential Output Loss
(percent contributions, relative to pre-crisis potential output level at year 2025)



Sources: IMF Staff Estimates
Note: Potential output loss is measured based on the difference between the current and pre-crisis projection of potential growth. The decomposition is derived from a standard Cobb-Douglas production function augmented with capacity utilization.

14. Amid escalating numbers of infections throughout Europe, near-term risks to the outlook are tilted to the downside. New containment measures linked to virulent new virus strains, waning vaccine effectiveness, and more persistent and widespread supply-chain bottlenecks could slow the recovery, weaken the external position and lead to higher inflation. On the upside, a faster rundown of accumulated savings or stronger demand recovery in hard-hit sectors could raise growth in the near term and reduce scarring in the medium term. Over the forecast horizon, other downside risks loom, such as weaker corporate balance sheets (¶27), disorderly transformations with adverse social/political consequences, and lower trade partner demand from unresolved supply disruptions (see Annex IV *Risk Assessment Matrix for further details and associated policy responses*).

Real GDP Growth: Risks to the Forecast
(annual growth rate of real GDP)



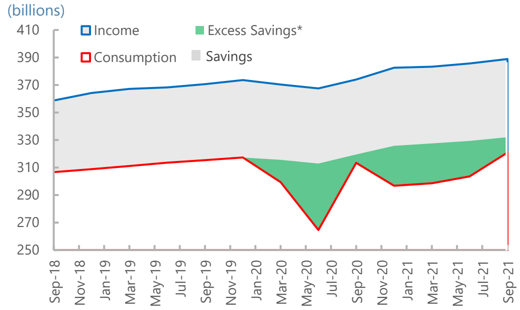
Sources: IMF staff estimates and projections.
Notes: The chart includes the following subjective risks to the baseline growth projections in 2021 and 2022: (a) Covid-19 infection resurgence from new variants; (b) faster run-down of excess savings.; (c) supply chain difficulties with higher inflation; (d) lower trade partner demand. The risk chart is based on the methodology described in the IMF Working Paper WP/09/178.

[4] See Selected Issues Paper 21/16 for a discussion of resource misallocation in France. The analysis showed that negative allocative efficiency of heavily indebted firms was found to be a key driver for misallocation, pointing to the role of capital.

Box 2. Household Savings and Spending Expectations

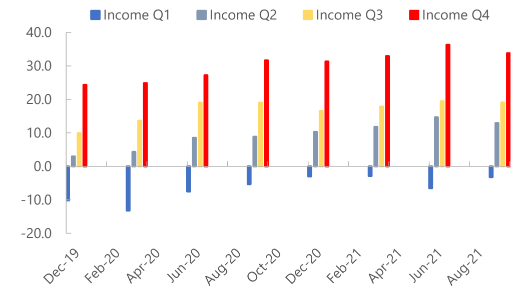
Households accumulated substantial excess savings during the crisis, which appear to be concentrated among the top income deciles. While government support successfully preserved household incomes, consumption was constrained by repeated containment measures. Overall, staff estimates that households saved approximately €165 billion beyond pre-crisis savings levels by 2021Q3, mostly in deposits and equity (¶8). Early evidence from credit card transactions suggests that more than 50 percent of the excess savings accrued to the top income decile, while the bottom decile dissaved (Bounie et. al., 2020). This is also supported by evidence from the consumer expectations survey showing that top income households accumulated savings, both in absolute and relative terms (text figure). This distributional trend could affect wealth inequality dynamics going forward, if it is accompanied by a persistent widening of the savings rate differential between the top and bottom income deciles (see Garbinti, Goupille-Lebret and Piketty, 2021).

Income, Consumption & Savings
(billions)



Sources: INSEE, IMF staff estimates.
Note: *Excess savings is the difference between actual savings and pre-crisis projections of savings.

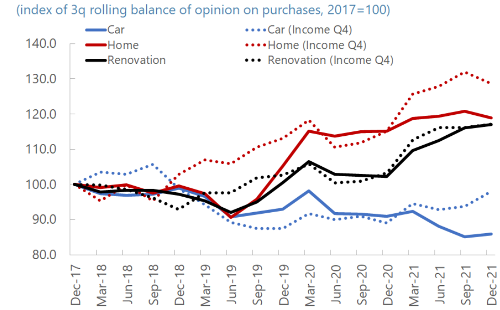
Household Savings/Dissavings
(balance of opinion on HH financial situation; + indicates savings accumulation)



Sources: EC Consumer Expectations Survey.
Note: Income Q1 (Q4) refers to the bottom (top) quartile of the income distribution.

Favorable labor market conditions and buoyant spending intentions support a gradual drawdown of excess savings. Households' spending intentions continue to increase, especially for home purchases and renovation, and among the uppermost income decile. This suggests that despite the rich traditionally having a lower marginal propensity to consume, some drawdown of excess savings could occur through increased home investments. Staff project the savings ratio to dip below its pre-crisis level in 2022 and gradually decline thereafter, driven by strong consumption and residential construction growth (Table 1) which together account for about 60 percent of French GDP. The extent of savings drawdown—obtained by differencing the 2022-2023 savings level to a counterfactual level implied by the pre-crisis savings rate—is estimated at around 10 percent of accumulated excess savings. There is considerable uncertainty around this estimate relating to the path of disposable income and the persistence of supply disruptions that could constraint consumption growth, notably for automobiles and electronics. While a larger than expected savings drawdown could further increase growth on the upside, this could induce a rise in inflation if all excess savings are directed towards consumption (see Annex IV).

Household Spending Intentions (next 12 months)
(index of 3q rolling balance of opinion on purchases, 2017=100)



Sources: EC Consumer Confidence Survey and IMF Staff Estimates

Authorities' Views

15. There was broad agreement on the outlook, with differences in views relating only to the profile of recovery and the tilt of near-term risks. The government had penciled in growth of about 6 ¼ percent in 2021 in their draft budget submitted to the European Commission in October, before the release of the quarterly national accounts for 2021Q3. The authorities were slightly more optimistic on the outlook for next year, expecting growth of about 4 percent, with relatively higher consumption and investment growth. While taking note of the preliminary external sector assessment, the authorities were also more optimistic about the recovery of net exports, given the rebound already observed, and viewed the difficulties in the aeronautics sector as mostly a temporary phenomenon. There was agreement that risks from the virus still loomed large, but the authorities noted that the high vaccination rate is a strong mitigating factor and viewed near-term risks as balanced. They shared staff's view on downside international risks, mainly those pertaining to supply-chain disruptions, but felt that these would gradually dissipate over the course of next year and that the French economy was relatively less exposed to these disruptions.

POLICY DISCUSSIONS

Policies should focus on securing the recovery in the near term while rebuilding fiscal buffers over the medium term. As downside risks persist, a supportive fiscal policy is warranted in 2022. Subsequently, a gradual—but substantial—expenditure-based fiscal consolidation should be pursued to rebuild policy space and put public debt on a firmly declining path. If the recovery is stronger than expected, revenue windfalls should be used to accelerate the adjustment. Continued efforts to boost worker skills and reduce the inequality of opportunities for youth during the digital and ecological structural transformations will be critical. Reforms should also be pursued to boost France's international competitiveness and productivity growth. Overall, the financial sector has performed well during the crisis, but continued vigilance is warranted.

A. Fiscal Policies

16. The 2022 budget appropriately targets a moderately expansionary fiscal stance. The draft budget targets a deficit of about 5 percent of GDP, down from around 8.3 percent of GDP in 2021 due to the cyclical recovery and the expiration of temporary measures (which improves the deficit by about 2½ percent of GDP). Staff projects the structural primary balance will narrow by 1.7 percent of GDP in 2022. Once one-off crisis measures are stripped out, staff estimate that the draft 2022 budget constitutes a moderate loosening of the fiscal stance, with an additional impulse of around 0.7 percent of GDP, which staff judges appropriate considering near-term risks are tilted to the downside and the investment shortfall during the crisis and increasing mismatches in the labor market can weigh on already low potential growth. Moreover, despite its high debt level, France has some fiscal space given the low financing costs it faces and support from NGEU. Policy should remain flexible throughout the year, providing targeted and temporary additional relief support if downside risks materialize.

17. The additional spending envisaged to boost worker skills, investment, and innovation is welcome. The 2022 budget ratifies further reductions in corporate income and housing taxes legislated before the crisis (about ¼ percent of GDP) and provides a push towards implementing France's recovery plan (about 1.2 percent of GDP above-the-line measures), which is rightly focused on the green and digital transformation of the economy.[5] It also includes temporary additional spending (about 0.1 percent of GDP) to tackle skills shortages in certain activities (*mesures pour le développement des compétences et l'insertion dans l'emploi*) and to aid labor market integration of youth that are neither working nor studying (*contrat d'engagement*). The authorities further plan to kick-start a new five-year investment plan (*France 2030*), worth 1.2 percent of GDP, with 0.1 percent of GDP in spending in 2022. The plan is aimed at reestablishing a technological lead in selected industries (e.g., energy, automobile, aeronautics, health, food) through targeted interventions (e.g., subsidies, direct loans, and equity injections). While the plan can help boost critical innovation and investment, its governance structures, yet to be defined, should include a significant independent private sector component to assure that the state's role remains limited and that investments are subject to market forces.

Box 3. Policy Response to Rising Energy Prices

The authorities took several measures to offset the effect of rising energy prices costing about €12 billion (½ percent of GDP):

- **Energy vouchers (*chèque énergie*), €0.6 billion** - An additional one-off €100 check was distributed in December 2021 to low-income households regularly receiving energy vouchers (about 5.8 million people). The vouchers can be used to pay energy bills or to cover energy-saving investments but cannot be used to pay for motor fuel.

- **Temporary cut in electricity taxes (TICFE), €5.9 billion** – An untargeted measure containing the increase in electricity tariffs to around 4 percent.

- **Temporary freeze in gas prices, €1.7 billion** – A freeze on natural gas tariff until summer 2022, compensating producers for the gap vis-à-vis market prices.

- **One-off inflation-compensation transfers (*indemnité inflation*), €3.8 billion**. – A €100 one-time cash transfer to all individuals (workers, self-employed, retirees, and students) earning less than €2000 net per month (38 million people, about ½ the population).

18. The government took measures worth ½ percent of GDP in response to rising energy prices (Box 3). Given the distributional impact of higher energy prices, compensating vulnerable households through targeted, temporary transfers is appropriate. The additional one-off support for lower-income households channeled through the existing and well-targeted energy voucher program (*chèque énergie*) is thus welcome. However, the cap on gas prices and the cut on electricity taxes are poorly targeted—and thus more costly—and distort price signals in the economy, besides running contrary to the objective of greening of the economy. While the broad-based transfers

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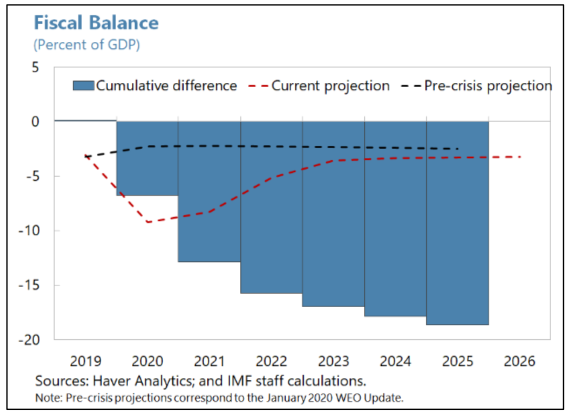
[5] While the total envelope of the recovery plan has remained unchanged, some funding was redirected to programs deemed successful, including subsidies for thermal renovation of buildings and to hire apprentices.

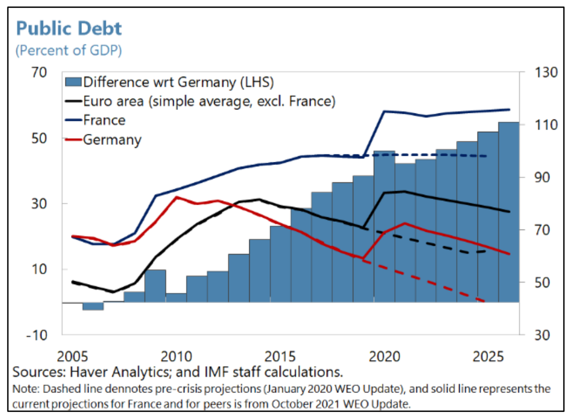
through the inflation compensation program (*indemnité inflation*) help offset the effect of other higher prices, such as food and fuel, the program is not sufficiently means-tested and partially overlaps with other support measures. These measures should remain strictly temporary and larger transfers through the *chèque énergie* would be more appropriate.

19. In the medium-term, staff projects that the overall fiscal deficit will decline but remain above 3 percent of GDP throughout the forecast horizon under unchanged policies. The primary deficit is projected to stabilize at around 2½ percent of GDP—about 1 percentage point of GDP larger than before the crisis due to permanent expansionary measures (e.g., production tax cuts) and persistent output losses. The overall deficit would decline to around 3.3 percent of GDP over the medium term.



Sources: Haver Analytics; and IMF staff calculations.
Note: Pre-crisis projections correspond to the January 2020 WEO Update.

20. France's debt ratio is projected to continue rising and will increasingly diverge from its euro area peers, putting more strain on the union. After easing in 2022 due to favorable growth dynamics, the debt ratio is projected to trend upwards under the baseline scenario, reaching about 115½ percent of GDP over the medium term. The debt ratio gap with respect to Germany and the euro area average, which was large before the crisis, would widen further over the medium term. While France's large institutional investor base, home bias, lack of foreign currency debt, and long debt maturity, are notable attenuating factors, its debt trajectory is also subject to increased risks (Annex VI), some of which are rooted in deficit and debt divergences within the euro area and tend to flare up during periods of economic crises or political upheavals. A faster-than-expected tightening monetary cycle could pose a risk to the debt outlook both directly, from the higher funding costs, and indirectly, from private balance sheet problems. The large increase in contingent liabilities during the crisis is another source of risks.



Sources: Haver Analytics; and IMF staff calculations.
Note: Dashed line dennotes pre-crisis projections (January 2020 WEO Update), and solid line represents the current projections for France and for peers is from October 2021 WEO Update.

21. Starting in 2023, France should embark on multiyear fiscal consolidation to rebuild buffers and sustainably lower debt. France will need to increase its medium-term fiscal space to respond to future shocks. The adjustment should strike the right balance between rebuilding buffers, supporting the recovery and boosting potential growth. A blueprint for a gradual expenditure-based consolidation effort that can strike this balance should include the following elements: [6]

[6] Staff's recommendations should be adjusted as needed to be consistent with any revisions in the European fiscal framework.

- **Timing**. Given that uncertainty remains high in 2022 and the shortfall in output with respect to precrisis trends remains important, fiscal consolidation should only start in 2023.

- **Anchor**. Before the crisis, the authorities targeted a structural deficit of 0.4 percent of GDP as their medium-term objective (MTO) for public finances. Staff believes that this remains an appropriate anchor for France's public finances. A cumulative fiscal effort of about 4½ percentage points of GDP would be needed to reach this target, which represents an additional effort of 3.7 percent of GDP compared to staff projections under unchanged policies.[7] However, to minimize the risk of derailing the recovery, the adjustment should be spread out over a period of around 7 years, with the MTO attained by 2029.

- **Pace and composition.** The adjustment should be gradual and somewhat backloaded, targeting an average annual effort of 0.6 percent of GDP over 2023-26, rising to about 0.8 percent of GDP until reaching the MTO.[8] The recommended adjustment would bring the overall deficit to about 2 percent of GDP by 2026 (after a cumulative effort of 2½ percent of GDP), before reaching the MTO around 2029.[9] The debt ratio would peak around 2024 and decline thereafter, falling to its pre-crisis level in slightly more than a decade in the absence of new shocks.[10] In line with previous staff recommendations, consolidation efforts should focus on reducing France's high expenditure ratio, and should be underpinned by structural fiscal reforms. Crisis related scarring amidst already low potential growth emphasizes the need to maintain investment support, particularly for the green and digital transformations, and to alleviate misallocation problems. The adjustment efforts should therefore concentrate on current expenditures, preserving investment plans as under the baseline.

22. A strong fiscal expenditure rule and enhanced responsibilities of the fiscal council would reinforce the commitment to the adjustment path and ensure a faster consolidation if the recovery is stronger. France's track record on meeting its medium-term budget objectives has been weak, mainly due to persistent underestimation of spending growth.[11] Adopting a multi-year spending rule would provide a transparent metric for adjustment, avoid incentives to further raise France's already high tax burden, and provide automatic revenue stabilization, ensuring that revenue windfalls reduce the deficit and reach the MTO earlier should a stronger-than-expected recovery materialize. The rule could constrain the growth of primary or total general government expenditure

[7] Staff projects that the structural primary balance will improve by about 1 percent of GDP over 2023-26 under unchanged policies. The improvement in 2023 largely reflects the expiration of inflation measures (about 0.4 percent of GDP).

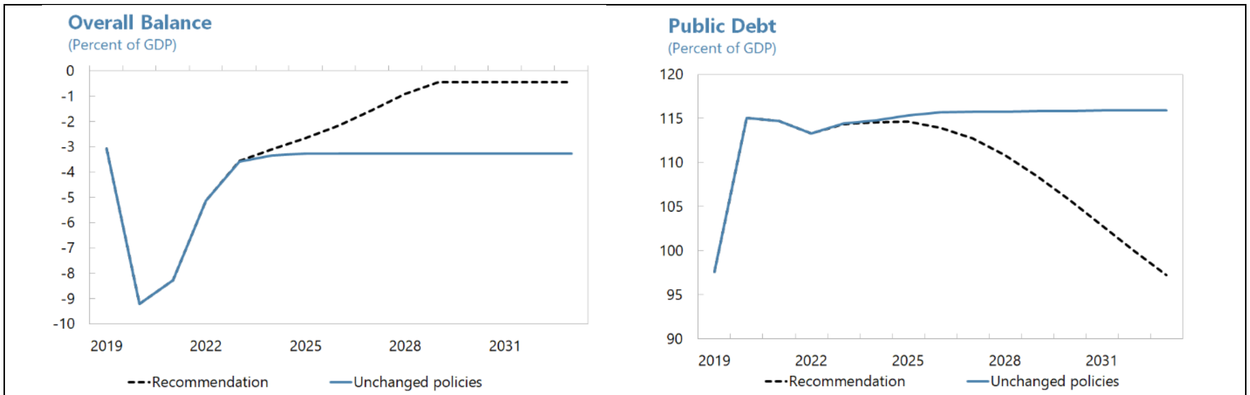
[8] As the structural primary balance is projected to improve under the baseline, the additional recommended effort would be smaller (see Text table).

[9] The authorities' medium-term projections presented in the context of the 2022 budget discussions foresee a smaller consolidation, targeting a fiscal deficit of 2.7 percent of GDP in 2027.

[10] Staff recommendation is consistent—albeit less aggressive—with simulations from a structural model calibrated to France (see Selected Issues Paper *Rebuilding Fiscal Buffers After COVID-19: Anchor, Path, and Institutional Framework*).

[11] Selected Issues Paper *Rebuilding Fiscal Buffers After COVID-19: Anchor, Path, and Institutional Framework*.

(net of discretionary revenue measures), at a rate consistent with reaching the MTO by 2029.[12] The rule should include a mechanism to monitor deviations between spending outcomes and objectives set in previous years, and ensure that these are offset in revised commitments for subsequent years. To improve the visibility of fiscal commitments and eventual deviations, the medium-term path for expenditure under the rule should be translated into explicit aggregate nominal spending targets, during each annual budgetary exercise.[13] Strengthening the competencies and capacities of the Fiscal Council (HCFP), including by providing sufficient resources and giving it a clear mandate to provide views on debt sustainability, would help ensure compliance and help build political consensus to redress France's public finances. The plans to reforming France's fiscal framework under parliamentary consideration are a step in the right direction.[14]



Sources: IMF staff calculations.

Sources: IMF staff calculations.

23. Implementing the authorities' previous reform agenda would contribute towards consolidation, but a stronger effort will be needed to sustainably contain spending growth. Staff previously endorsed reforms to equitably improve long-term growth and generate significant fiscal savings.[15] The unemployment benefits reform is being implemented with a delay. However, prospects for the pension reform remain uncertain given social opposition and still challenging economic conditions. The adoption of the civil service reform provided an important tool to streamline the public sector workforce, but initial plans to reduce the number of public employees by 120,000 during the administration's tenure were later abandoned. Previous analysis pointed to several categories in which France's expenditure is well above its peers and where there should be scope to scale back spending without impeding public service delivery. One such area includes streamlining tax expenditures (about 3.7 percent of GDP), especially those hindering achievement of

[12] Staff's recommendation is consistent with nominal primary expenditure growing on average at around 1.6 percent per year throughout the adjustment horizon. Once the deficit reaches the MTO, the spending rule could be adjusted to allow expenditure growth (net of discretionary revenue measures) at long-run nominal GDP growth.

[13] A commission appointed by President Macron and the *Cour de Comptes* also proposed multiyear expenditure targets.

[14] A draft organic law for public finances is being discussed in parliament but the outcome is still uncertain.

[15] IMF Country Report 19/245.

climate objectives.[16] Simplifying and unifying social minima schemes could improve incentives to increase activity, improve targeting to those most in need, and generate efficiency savings.[17] Reducing overlaps between different levels of government would also improve the efficiency of public services while generating savings. In the future, revenue from higher carbon pricing—critical to the green transition—could help finance appropriate environmental investments and provide compensation for the most vulnerable, while potentially generating additional savings. Implementing the structural reform agenda to boost innovation, competitiveness, and productivity (¶37), should also play a role towards redressing France's public finances.

Projected Fiscal Scenarios (Percent of GDP, unless otherwise noted)

	2018	2019	2020	2021	2022	2023	2024	2025	2026
Baseline									
Real GDP growth (percent)	1.8	1.8	-8.0	6.7	3.7	1.7	1.6	1.5	1.4
Output gap	-0.8	0.0	-4.8	-2.1	-0.2	-0.1	0.0	0.1	0.1
Revenue	53.4	52.3	52.6	52.0	51.2	51.0	51.0	50.7	50.7
Expenditure	55.6	55.4	61.8	60.3	56.3	54.6	54.3	54.0	53.9
Overall balance	-2.3	-3.1	-9.2	-8.3	-5.1	-3.6	-3.3	-3.3	-3.3
Primary balance	-0.7	-1.7	-8.0	-7.1	-4.1	-2.8	-2.6	-2.5	-2.5
Fiscal effort 1/					-0.7	0.7	0.2	0.1	0.0
Public debt	98.0	97.6	115.1	114.7	113.3	114.4	114.8	115.3	115.7
Recommended									
Real GDP growth (percent)	1.8	1.8	-8.0	6.7	3.7	1.7	1.5	1.2	1.1
Output gap	-0.8	0.0	-4.8	-2.1	-0.2	-0.1	-0.1	-0.3	-0.6
Revenue	53.4	52.3	52.6	52.0	51.2	51.0	51.0	50.7	50.7
Expenditure	55.6	55.4	61.8	60.3	56.3	54.6	54.1	53.4	52.8
Overall balance	-2.3	-3.1	-9.2	-8.3	-5.1	-3.6	-3.1	-2.7	-2.2
Primary balance	-0.7	-1.7	-8.0	-7.1	-4.1	-2.8	-2.3	-1.7	-1.0
Fiscal effort 1/					-0.7	0.8	0.5	0.6	0.7
Cumulative fiscal effort since 2023						*0.8*	*1.2*	*1.8*	*2.5*
Recommended additional fiscal effort 1/						0.1	0.3	0.5	0.7
Cumulative recommended additional fiscal effort since 2023						*0.1*	*0.4*	*0.9*	*1.5*
Public debt	98.0	97.6	115.1	114.7	113.3	114.4	114.6	114.6	114.0

Source: IMF staff calculations.

1/ Computed as the change in the structural primary balance excluding the effect from temporary COVID-related measures. Recommended additional fiscal effort is relative to the baseline projections.

24. Staff welcome the authorities' continued commitment to strengthen transnational aspects of fighting corruption and transparency in public spending. Data on government contracts is publicly accessible (legifrance.gouv.fr) and includes information on the beneficial owners of entities contracting with the state. To further improve the quality of public spending several databases have been created. France is a voluntary participant in the Fund's enhanced governance framework on the supply and facilitation of corruption. France was assessed by the OECD's Working Group on Bribery in 2012, with a new assessment to be published in December 2021. France should

[16] See IMF Country Report 21/15 and Selected Issues Paper 21/16. The 2022 green budget identified 0.3 percent of GDP in tax expenditures with negative environmental impact, most of which are related to reduced fuel taxes (TICPE). The 2020 budget legislated the elimination of reduced TICPE tariffs for off-road diesel, but the measure was postponed due to the crisis and is scheduled to resume in 2023.

[17] An earlier plan to unify multiple social programs (e.g., housing subsidies, disability aid) under a single umbrella (*revenu universel d'activité*) was postponed during the pandemic. The plan aimed at making the system more simpler and equitable.

continue enhancing and leveraging its anti-money laundering measures and enforcement efforts to detect and disrupt foreign proceeds of corruption from entering and/or being laundered in France.

Areas for Fiscal Reforms

Reform Areas	Size	Potential Annual Savings by 2026
Pension system France spends 20 percent more than peers on pensions. The planned reform could aim at accelerating the gradual increase in the effective retirement already envisaged in the current system by 10 years.	13.6 percent of GDP (2019)	0.6 percent of GDP
Civil service The administration initially targeted a reduction of 120,000 public employees over 5 years. This would require halving the replacement ratio of retiring government workers (from 1¼ to ¾).	12.2 percent of GDP (compensation of GG employees in 2019)	0.2 percent of GDP
Unemployment benefit system Some of the pillars of the reform (tightening eligibility requirements, revising the rules to calculate and cumulate benefits, and introducing degressivity in benefits for high-salary workers) can generate savings over the medium term	1.6 percent of GDP (2019)	0.1 percent of GDP
Tax expenditures France spends 30 percent more than peers on tax expenditures and subsidies. Eliminating subsidies and tax expenditures on fossil fuels, where France spends significantly more than peers, and streamlining some of the rest could yield sizable savings.	4 percent of GDP in total; about 0.5 percent of GDP in fuel-related tax expenditures	1 percent of GDP
Carbon pricing Plans to increase carbon prices were paused in 2019 following protests. Increasing carbon prices to €65 ($75) per ton by 2030 would contribute to France's environmental goals and provide additional revenue.	N/A	1/4 percent of GDP

Sources: IMF staff calculations.

Authorities' Views

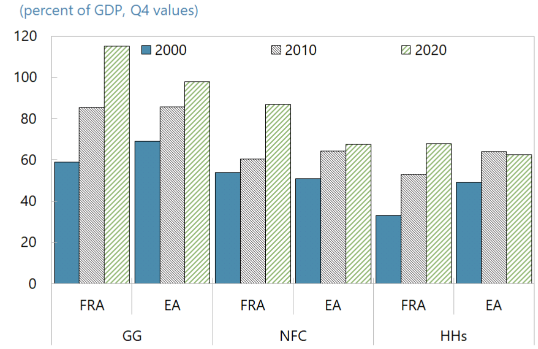
25. The authorities agreed that additional fiscal support focused on supply-side measures is warranted in 2022. They also backed the idea of a medium-term expenditure-based consolidation plan, to be implemented only once the recovery is on firm ground. They concurred that the near-term priority for fiscal policy is to support the recovery and minimize scarring by boosting workers skills and investment, and shared the view that the improvement in the fiscal deficit envisaged in the 2022 budget would not constitute a tightening of the fiscal stance but rather an appropriate scaling down of emergency support programs. While the authorities agreed that some of the measures in response to rising energy prices are widely distributed, they preferred a broader and swift approach to provide timely support to all the households significantly impacted by the surge in energy prices. They stressed that these measures would be temporary. The authorities underscored that a priority beyond 2022 is to redress France's public finances and rebuild fiscal buffers while making space for critical investment to support the green and digital transformation, and to facilitate reallocation of resources. They highlighted that the "France 2030" plan goes in this direction and agreed with staff that ensuring good governance of the program, with strong private-sector involvement, would be key. They aim at stabilizing public debt and get it on a declining path by 2026, as recommended by staff, by boosting potential growth factors and containing government expenditure, prioritizing growth-friendly expenditure. The authorities remain convinced that a reform of the pension system should play a key role. They also concurred with other priority areas for savings outlined by staff but consider that structural spending reforms will need to be implemented after a new government takes office. The authorities reiterated their commitment toward safeguarding public funds.

B. Financial Sector Policies

26. Policy interventions have allowed the financial system to provide liquidity and increase capital buffers at the same time. Banks entered the crisis with comfortable capital and liquidity buffers, and these have actually improved through mid-2021 (Table 5). Banks' core tier 1 equity ratio increased by ¾ percentage points to 15.9 percent by mid-2021, partly reflecting increased capital through profit retention. The expansion in lending since early 2020, comprised almost exclusively of PGE-based loans, and benefited from ECB's accommodative financing. A shift from stage 1 to stage 2 exposures suggests a likely but modest deterioration of the low NPL ratio going forward. Previous staff analysis showed that existing buffers appear adequate to cope with expected loan losses even under a severe downside scenario, also confirmed by the recent EBA stress test (EBA 2021)**.** Profitability of the banking sector, which was affected by asset correction and provisioning in early 2020, recently improved, reflecting a reversal of these factors. The insurance sector's solvency ratio recovered in early 2021 to 251 after dropping to 242 in 2020, but still lags its pre-crisis ratio of 267. The low interest rate environment is expected to continue weighing on financial sector performance.

27. A side effect of large public support has been increased risk from interconnectedness, interest rate changes, and asset price corrections amidst larger balance sheets. In the aggregate, households and corporates emerge from the crisis with robust—but larger—balance sheets and banks with bolstered prudential ratios. This comes at the cost of weaker public sector balance sheets. In addition, the official sector holds directly or indirectly about 10 percent of non-financial corporate debt through the CSPP and the PGE, the latter accounting for about 6 percent of GDP. Presently, ¼ percent of GDP of PGEs are expected to be called, carrying a guarantee of about 80 percent by the State with the remainder of the risk held by the financial sector.[18] While lowering near-term risks from volatile market funding, the extent of official support could raise medium-term risks around monetary taper considerations and sovereign adjustment needs. Over the last two decades, debt ratios for French institutional sectors have moved from levels below or aligned with the euro area, to threshold levels associated with negative effects for consumption and GDP growth. Furthermore, asset valuations appear stretched as (equity) price-earnings ratios are well above their long-term average.

Debt by Institutional Sector
(percent of GDP, Q4 values)



Source: Banque de France

[18] See Annex VI for a discussion of the DSA implications if a significant fraction of the PGE loans are called.

28. Wide-spread corporate defaults have not materialized although some sector-specific solvency risk could still emerge. While starting to normalize, firm failures have remained at historically low levels—even as take-up of support measures decline or expire (¶8). While in part reflecting continued very accommodative terms,[19] declining demand for credit mediation, robust firm creation, strong hiring, and a robust rebound in many sectors suggest reduced risk from corporate balance sheet scarring.[20] Aggregate accumulated deposits almost offset the increase in corporate gross debt. Hence, previous estimates of equity need of around €10-25 billion (IMF, Euler Hermes, French *Trésor*) are likely to be revised downwards and losses would be concentrated in the hardest hit sectors such as transport, hotels, and restaurants. Low demand for quasi-equity measures (*prêts participatifs*) may in part reflect the lower need, but also the complex structure and higher cost compared to publicly guaranteed loans–especially for SMEs.

29. Risks from real estate markets require continued vigilance. Over the last decade, household debt grew steadily from just below 60 percent to over 100 percent of disposable income and debt service to disposable income (DSTI) has increased. The deterioration reflects in part the need for higher debt to cover increasing housing prices, resulting in higher LTVs. Consequently, in 2019, the ESRB issued a warning related to medium-term vulnerabilities in the real estate sector, citing higher prices, weaker lending standards, elevated household debt, and rapid mortgage lending growth in France. While supervisory action by the High Council for Financial Stability (HCSF) has capped the deterioration in lending standards (¶32), low interest rates, a relatively inelastic housing supply and increased demand for home renovations (Box 2) continued to fuel real estate price growth in 2020 and 2021.

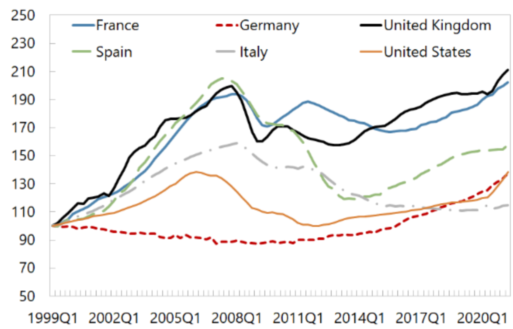
30. Several features in France can attenuate risks from market corrections to mortgage defaults, but banks' profits could be at risk. Household repayment risks are contained because, among other factors, mortgage interest rates are fixed, and employment losses are protected by unemployment insurance. Banks are partially protected from potential losses predominantly through mortgage insurance, and borrowers' legal obligations.[21] However, profit margins on housing loans are estimated to be nil or even negative since 2017 (ACPR 2021). Thus, the large volume of mortgages with long residual maturity and low fixed interest rate creates a persistent risk to bank profitability, which would intensify with selected defaults or increased funding costs of banks.

[19] Over half the PGE loans carry a grace period of two years, with repayment starting no earlier than 2022Q2 (Fédération bancaire française, 2021). The proportion is higher for SMEs (Bpifrance, 2021).

[20] Drawing on firm level data, the Cœuré Committee (2021) found that support measures compensated for more than 45 (100) percent of the profit loss in the first (second) wave of the pandemic, with the largest losses after measures registered in transport, construction, hotel/restaurant sectors.

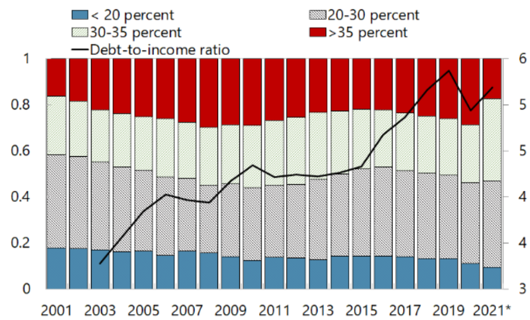
[21] In 2020, 97.5 percent of mortgage loans were covered by some guarantee (ACPR 2021). While borrowers' legal obligations are stringent, they do not guarantee that funds can be recovered in full under all contingencies (IMF, 2013).

House Price-to-Rent Ratio
(Index, 1999Q1 = 100)



Source: OECD; and IMF staff calculations

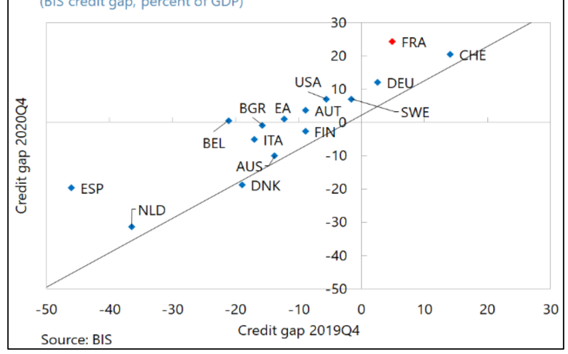
Debt-Service-to-Income and Debt-to-Income Ratios
(LHS = share of DSTI; RHS = DTI ratio)



Source: ACPR
*Note: Latest available data is August 2021.

31. The macroprudential stance remains broadly appropriate but may require tightening if the recovery remains robust and debt continues to rise. While the balance of risks has shifted, systemic risk remains similar or higher compared to pre-COVID amidst stretched asset valuations, larger balance sheets and increased debt ratios across institutional sectors. Notwithstanding the recent deceleration in credit growth, traditional metrics point to a large positive credit gap (ESRB and BIS) which is expected to persist in 2022 amidst the continued economic recovery and easy financing conditions. While credit gap metrics are blurred by the PGE-driven increase in loans and the abrupt output contraction in 2020, the level of real credit to the economy before the crisis already reflected a positive credit gap which warranted an increase in the CCyB. Unless a significant fraction of PGE-loans is repaid early as cyclical conditions improve, traditional metrics would suggest a need to tighten the macroprudential stance to fend-off systemic risk from overheating in the post-crisis period. The HCSF decided on September 14, 2021 to leave the CCyB unchanged and expects to leave it at zero until at least end-2022. Staff supports transparency on the timing of the reactivation, which can help banks better manage their assets. However, continued improvements in the outlook, strong private sector borrowing and increasing asset valuations would favor timely activation—by 2023 under the baseline.

Credit Gap Developments
(BIS credit gap, percent of GDP)



Source: BIS

32. To limit excessive risk-taking by banks, borrower-based measures should be maintained and expanded. To shield banks from loan losses, the HCSF issued recommendations (declared legally binding as of January 1, 2022) that banks must limit mortgage length to 25 years and DSTI to 35 percent (up from 33 percent in the guidance)—with up to 20 percent of new mortgage loans excluded primarily for owner-occupied housing. As a result, banks have actively adjusted their lending practices, with falling DSTI (HCSF 2021, ACPR 2021). As of August 2021, the banking sector was within the flexibility margin. [22] However, fueled by low interest rates and a

[22] Lengthening the maturity of mortgages has helped meeting the DSTI criteria.

relatively inelastic housing supply, house prices continued to increase and mortgage debt-to-income remains elevated, reflecting the need to cover increasing housing prices. In addition, downside risks from structural factors remain, such as weak banking sector profitability due to persistently low rates and high cost-to-income ratios, banks' high market risk exposure, wholesale funding risk, cyber security, and climate change risks. If these trends continue, fine tuning existing borrower-based measures or deploying complementary measures, such as the now available (sectoral) systemic risk buffer, may become appropriate to more broadly limit excessive risk-taking.

33. Corporate support and regulatory measures should continue gradual normalization, while remaining flexible to reactivate if needed. Some support measures for firms have already been phased out (tax deferrals and solidarity fund), tightened (STWS), or will expire by mid-2022 (PGE). Regulatory flexibility on loan moratoria has ended, while temporary flexibility on liquidity and capital requirements for banks is expected to expire by end-2021 and end-2022, respectively (¶8). Staff supports a gradual normalization of regulatory, capital, and liquidity measures, as risks from balance sheet scarring abate. As the recovery firms, incentives could be adjusted (e.g., tax adjustments to reduce debt-bias) to reduce the extraordinary contingent liabilities of the State in a timely manner (¶27). Bank asset quality should continue to be closely monitored. Banks should proactively engage with viable but challenged corporates to design solutions to contain emerging liquidity and solvency problems, drawing on available options including the *prêt particpatifs*, which may need to be readjusted to become more attractive to firms. Any potential banking sector losses should be reflected by deploying provisions and capital buffers. Closely monitoring conglomerate intragroup transactions and developing concentration thresholds to limit risk from highly indebted firms (in line with the FSAP recommendations) will aid efforts in strengthening resilience further. In this regard, staff supports the HCSF decision to prolong exposure limits for banks to high debt firms until June 30, 2023.[23]

Authorities' Views

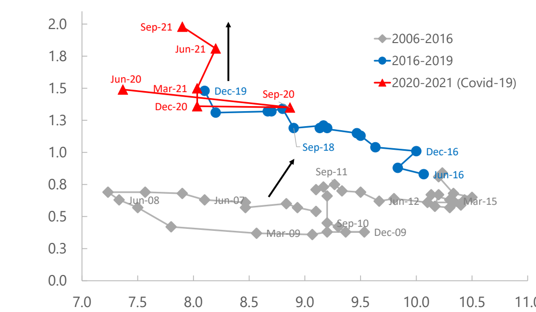
34. The authorities agreed with the need to gradually normalize emergency support measures and proactively address potential buildup of pockets of risks in the financial sector. The authorities shared staff's assessment that emergency support measures, which have underpinned the strong recovery and helped avoid wide-spread corporate failures, have run their course. They consider provisions and buffers in the banking sector robust to potential asset deterioration from selected exposures to sectors most hit by the COVID shock as support is unwound. However, they agreed that continued close monitoring is warranted, especially as concerns about banking and insurance sector profitability in the low-interest environment persist. The authorities deem risks from the real estate sector to be contained and adequately covered by existing borrower-based measures, but agree that the situation requires continued vigilance. They considered the new reporting tool for more detailed intragroup transactions and concentration risk within conglomerates an important step toward enhanced monitoring in the near future and the needed basis for future revaluation of direct and indirect intragroup exposure thresholds.

[23] The measure, first imposed in 2018 and expanded in 2020 for one year, imposes a limit on systemically important banks' individual exposure to a high debt/low ICR firm to 5 percent of bank capital.

C. Structural Policies for an Equitable and Sustainable Recovery

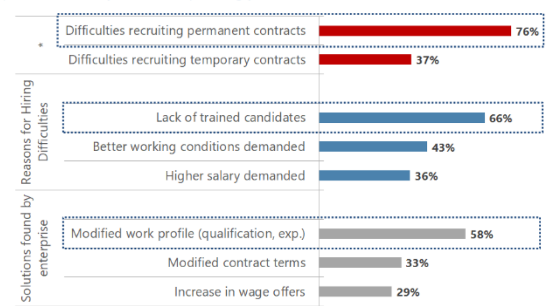
35. The French labor market has responded to the crisis better than expected, reflecting strong public support, but challenges remain. Large scale employment losses were prevented by the extensive expansion of the STWS, which preserved employment relationships and limited the drop in labor force participation (Box 1). Labor market conditions are however tightening, driven mainly by a rise in vacancies, while long-term unemployment remains high. Vacancies are indeed higher for a given level of unemployment, than that implied by past data, as reflected by an upward shift of the Beveridge curve. Firms are also reporting increased hiring difficulties, concentrated around the shortage of skilled workers, and adjusting job-offer profiles to meet increased labor needs. This labor market mismatch could slow the recovery by impacting production if shortages are not resolved, as well as by lowering potential output through productivity losses. The measures in the 2022 budget to increase skills training could help in this direction. To increase the effectiveness of training programs and further alleviate skills mismatches, efforts should also be made to combine them with job-search assistance schemes to improve the firm-worker match.[24]

Beveridge Curve: Mismatch Unemployment
(quarterly job vacancies vs unemployment rate, seasonally adjusted)



Sources: Eurostat, Ministere du Travail

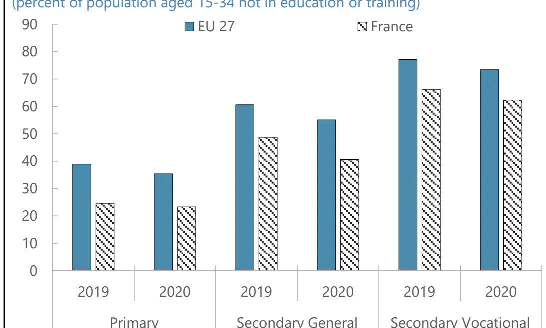
Hiring Difficulties by Firms
(percent of surveyed firms responding yes)



Sources: Dares, ACEMO Survey: October 2021

36. Policies to further rectify educational disparities affecting access to employment should be prioritized to ensure an equitable recovery. Employment access constraints are especially binding for the youth, for whom the employment rate after leaving the educational system with a general-education diploma (48 percent) was much lower than the EU average, and has fallen further to 40 percent during the crisis. This can be addressed by pursuing policies that strengthen the school-to-work transition, such as improving access to

Employment Rates of Recent Graduates
(percent of population aged 15-34 not in education or training)



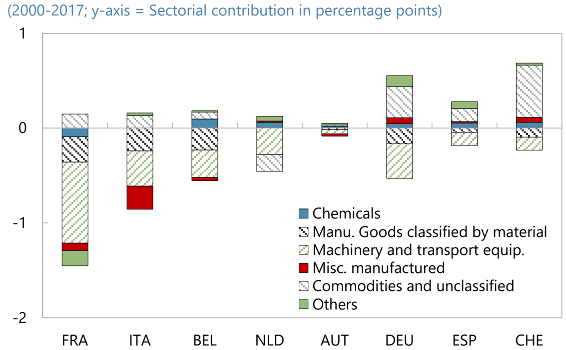
Sources: Eurostat

[24] Evidence suggests that job-search assistance programs have relatively large, short term impacts on employment, especially in Europe, while training has a limited impact in the short run but a larger effect over the medium term (Card et. al. 2018, Caliendo & Schmidl 2016). These and other recommendations were discussed in the workshop on labor reallocation needs, that staff organized in collaboration with the French *Trésor,* bringing together French academics, policy makers, and the private sector.

vocational education for the least qualified, increasing skills certification, and strengthening the link between apprenticeship and vocational training through dual education tracks.[25]

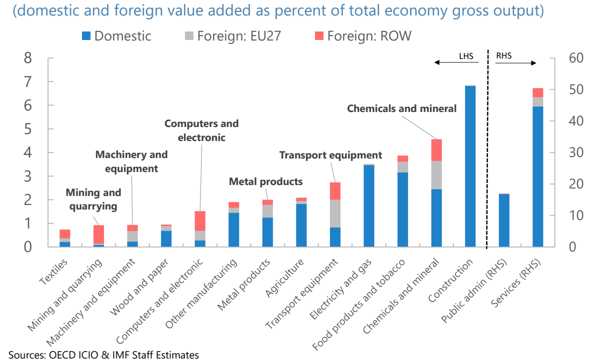
37. A renewed and more effective emphasis on measures to raise competitiveness will enable France to enhance productivity and increase external sector resilience. France has experienced a deterioration in export performance over the last decade, particularly in manufacturing, partly due to more stringent regulation and high entry barriers in the service sector.[26] Additional product and service market reforms to ease regulation and the administrative burden on start-ups could help address barriers to competition and reduce productivity scarring (¶13)[27]. Targeted efforts to foster innovation via human capital investment (¶36) and funding for basic research,[28] including in sectors at the technological frontier (¶38) as well as in a few key sectors more exposed to supply constraints (text figure), [29] would further boost competitiveness and increase resilience to external shocks. On the other hand, support for reshoring should be strictly limited to addressing national security concerns[30].

France and Peers: Change in World Export Market Share
(2000-2017; y-axis = Sectorial contribution in percentage points)



Sources: COMTRADE; and IMF staff calculations.
Notes: Data at SIC-1 level.

Domestic and Foreign Supply Linkages
(domestic and foreign value added as percent of total economy gross output)



Sources: OECD ICIO & IMF Staff Estimates
Note: Labelled sectors are those considered relatively vulnerable due to a relatively high share of ROW inputs or less diversified supplier pool based on product level analysis of customs data by Jaravel and Mejan (2021).

[25] Targeted subsidies and counselling can improve access to vocational training for the disadvantaged youth. Cahuc et. al. (2019) find that training with skills certification improves youth employment prospects. Dual tracks combining work and study programs, as in Germany, are still scarce in France (OECD, 2020). Integrating job-counselling services in schools to strengthen the school leaver's job-match, as in Japan, can also boost youth employment.

[26] Low competition can lead to high markups of non-tradable services, hurting productivity and competitiveness of downstream exporters (Bas and others, 2015; Bourlès and others, 2013).

[27] IMF Country Report 19/246.

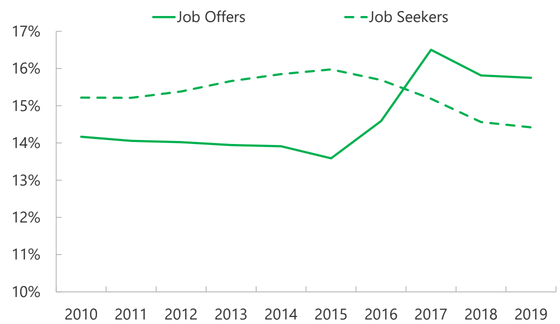
[28] See World Economic Outlook, Ch. 3, which finds that the private sector underinvests in basic research. Using data on French firms' R&D, Akcigit et. al. (2021) find that uniform R&D tax credits can accentuate the dynamic misallocation in the economy by over-subsidizing applied research, and argue instead for gearing policy towards public basic research and fostering its interaction with the private sector.

[29] Using French customs data, Jaravel and Mejan (2021) estimate that only 4 percent of French imports may be vulnerable to external shocks based on their concentration in a few supplier countries/companies outside the EU.

[30] The regulation tightening the screening of non-EU investments, lowering the threshold above which foreign investors must seek approval, was extended through 2022.

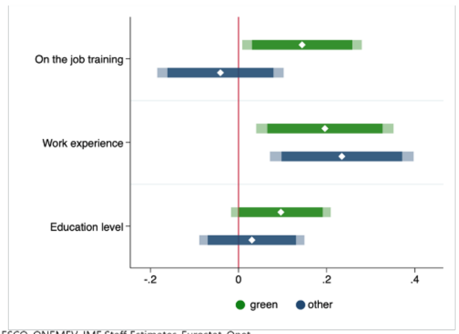
38. Staff welcome the accelerated push for achieving carbon neutrality. The EU's "Fit for 55" policies introduced more ambitious emission reduction targets to achieve the goal of carbon neutrality, in line with France's 2019 Climate and Energy Law. To achieve this challenging goal the authorities should implement additional green policies to reduce emissions and strengthen existing ones, including adequate carbon pricing with mitigating measures for low-income households. In this vein, leveraging French firms' strong presence in automobiles, power generation, and aeronautics to establish a technological lead in green energy generation and zero emission transportation would additionally aid the accelerated push. Measures to improve worker training and skills matching will be particularly important to facilitate the green transition without generating employment losses and to meet the increasing demands of the new green economy (text figure).[31]

Green Jobs: Job offers and Job Seekers
(percent of job offers/seekers)



Sources: Pole Emploi, Onemev, IMF Staff Calculations

Correlates of Occupational Transition: From Polluting Occupations to Green/Other Occupations
(standardized effects of existing job attribute on future job match)



Source: ESCO, ONEMEV, IMF Staff Estimates, Eurostat, Onet
Note: This graph plots the standardized effects and 95 percent CI of training, work experience and education on occupational match. See Selected Issues Paper for more details.

Authorities' Views

39. The authorities shared staff's concerns on labor market frictions and the need to boost competitiveness but underlined that past structural reforms helped generate the strong employment recovery in 2021. There was agreement that alleviating skills mismatches and reducing inequalities in youth employment outcomes remain key for boosting growth. The authorities concurred with staff's view that training and skills certification would further enhance labor market prospects, reallocation and reduce the inequality of opportunities. They viewed some recently launched programs targeted at youth out of work and education (*contrat d'engagement jeune*) and at boosting training for activities with skill shortages (*mesures du plan de relance pour le développement des compétences et l'insertion dans l'emploi, plan de reduction des tensions de recrutement*) to help in this regard. With respect to competitiveness, the authorities noted that France has managed to stabilize its export performance in recent years but agreed with staff that additional efforts in the areas of innovation and associated human capital enhancement would further enhance competitiveness. The authorities underscored that the support for reshoring is

[31] The demand for green workers (about 17 percent of overall vacancies) is rising, exceeding the growth of green job-seekers. An analysis of occupational networks, constructed by matching skills, competences and qualifications across several thousand jobs in the EU labor market, shows that training and work-experience can improve job transitions from polluting to green occupations. See Selected Issues Paper *An Anatomy of Occupational Pathways for the Climate Transition* for further details and an overview of green jobs in France.

strictly limited to addressing strategic autonomy concerns. The authorities also agreed with staff on the need to prepare ahead for the green transformation of the economy and emphasized that important efforts had already been made recently in this direction through the *Climate and Resilience Law* as well as the focus on green investments in the *France Relance* and *France 2030* plans.

STAFF APPRAISAL

40. Strong progress on vaccination and expansive fiscal support have played a critical role in effectively containing the COVID virus, cushioning the crisis, and fueling the recovery. The economy has nearly regained its pre-crisis level by late 2021. Supply constraints from ongoing global supply chain disruptions and recruitment difficulties are starting to weigh on production. Consumer prices are increasing, mostly driven by transitory factors that are expected to gradually dissipate in the course of next year. Employment growth is robust, and the unemployment rate has remained relatively stable. Strong growth is still expected for 2022 but the forecast depends upon the continued containment of COVID, normalization of the current supply chain difficulties, and an accommodative policy environment. The external position is preliminarily assessed to be broadly in line with medium-term fundamentals and desirable policy settings. Over the medium term, output is projected to grow near potential but remain somewhat below its pre-crisis trend. Near-term risks to the outlook are tilted to the downside with further infection waves, waning vaccine effectiveness, and more persistent supply-chain bottlenecks slowing the recovery. On the upside, a faster rundown of accumulated savings or stronger demand recovery in hard-hit sectors could raise growth in the near term and reduce scarring in the medium term; however they could also exacerbate inflationary pressures.

41. A moderately expansionary fiscal stance is warranted in 2022, but any additional stimulus should be targeted on supply-side measures to boost potential growth. Staff supports the investment policies contained in the *France Relance* and NextGen EU programs. The recently announced *France 2030* plan could also boost critical innovation and investment, provided it includes a significant independent private sector component. Fiscal policy should remain flexible and additional targeted relief support should be provided if downside risks materialize. The recent spike in energy prices has pushed inflation higher and prompted a policy response. Staff support compensating vulnerable households through targeted and temporary instruments but advise against overlapping broad-based transfers and long-lasting price-control measures which are more costly and distort price signals.

42. As the recovery continues, a gradual but comprehensive and sustained fiscal consolidation is needed. Risks to France’s public debt sustainability increased during the pandemic and, under unchanged policies, the gap between its debt and that of its European peers would widen further from already high levels. To reverse this trend and build fiscal buffers to respond to future shocks, staff recommends an ambitious structural consolidation effort gradually implemented over 7 years. A structural primary fiscal effort of around 0.6 percent of GDP per year during 2023-26, rising to around 0.8 percent of GDP thereafter until the fiscal balance reaches the authorities’ previous MTO (a deficit of 0.4 percent of GDP), would put debt on a declining path while leaving room for needed investment. If the recovery proves stronger than expected, revenue windfalls should be fully used to reduce the deficit and reach the MTO earlier. Much can be achieved by pursuing already planned reforms, such as in pensions, but further efforts will be needed to sustainably contain current expenditure growth. Fiscal commitments should be backed by a strong expenditure rule, based on a multiyear commitment for expenditure at the general government level and should include a mechanism to clearly monitor deviations and assure compliance with the medium-term objectives. Strengthening the competencies and capacities of the HCFP, including to assess France's debt sustainability, would be critical in this regard.

43. The banking sector has withstood the crisis well and provided ample credit to the economy. Widespread corporate defaults have not materialized, although sector-specific solvency risk could still emerge as emergency support measures phase out. In this context, bank asset quality should continue to be monitored and banks should proactively engage with viable but challenged corporates to design solutions. Any potential banking sector losses should be reflected by deploying provisions and capital buffers. Closely monitoring conglomerate intragroup transactions and developing concentration thresholds to limit risk from highly indebted firms will aid efforts in strengthening the sector's resilience further. As the recovery firms, incentives could be adjusted to reduce the extraordinary contingent liabilities of the State in a timely manner.

44. The macroprudential stance remains broadly appropriate but may require tightening if risks from debt-driven asset valuations increase. Staff supports a timely re-activation of the counter-cyclical capital buffer—possibly in 2023— if the recovery remains robust . Measures by the supervisory authority have limited and partially reversed a deteriorating trend in mortgage lending standards, but risks from the real estate market require continued vigilance. Fueled by low interest rates and a relatively inelastic housing supply, real estate price growth remained dynamic which could further increase household debt. If these trends continue, fine tuning existing borrower-based measures or deploying complementary measures may be appropriate to limit excessive risk-taking.

45. Continued action to address labor-market frictions and ensure equitable opportunities for the youth will enable a speedy and durable recovery. Job creation rebounded quickly as containment measures were removed, possibly reflecting dividends from earlier labor market reforms. Labor market conditions are tightening, as reflected in the rise in vacancies and increased recruitment pressures faced by firms. To prevent labor mismatches from slowing the recovery, additional policies should be aimed at alleviating skills shortages, such as combining job-search assistance schemes with training programs. Further rectifying educational disparities affecting access to employment, through measures strengthening the school-to-work transition, will also enable growth dividends to be equitably and sustainably distributed.

46. Policies to raise competitiveness will help enhance productivity and increase external sector resilience. After a marked deterioration in the early 2000's, France has managed to stabilize its export performance in recent years, but further improvement is needed. Additional product market reforms to ease regulation and entry barriers in non-tradable service sectors would help boost export growth and productivity. Targeted efforts to foster innovation via human capital investment and funding for basic research, including in sectors at the technological frontier, would also enhance competitiveness and increase production capacities. If properly designed and managed, the *France 2030* program could also help.

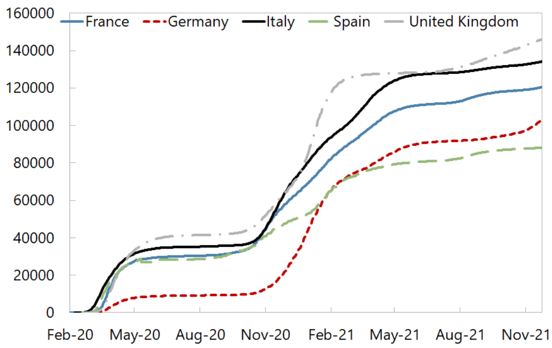
47. The authorities' accelerated push for carbon neutrality is welcome. To achieve this challenging goal of climate neutrality, enshrined in the 2019 French Climate and Energy Law, the authorities should implement additional green policies to reduce emissions and strengthening the existing ones, including adequate carbon pricing with mitigating measures for low-income households. In this vein, leveraging French firms' strong presence in automobiles, power generation, and aeronautics to establish a technological lead in green energy generation and zero emission transportation would additionally aid the accelerated push. Improved worker training and skills matching will be particularly important to facilitate the green transition without generating employment losses.

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

Figure 1. Covid-19 Developments

France was heavily affected by Covid-19 with mortality exceeding 115,000..

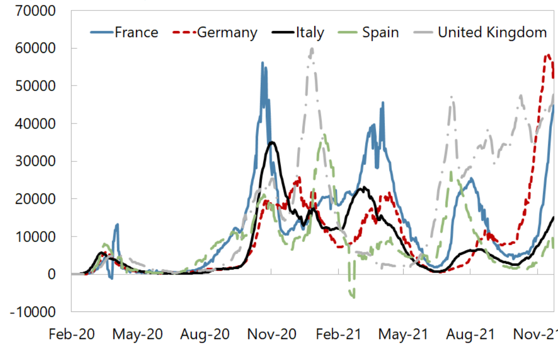
Cummulative Deaths
(Number of deaths)



Sources: ECDC; Our World in Data; and IMF staff calculations.

.. and experiencing several infections waves with a fifth wave currently underway.

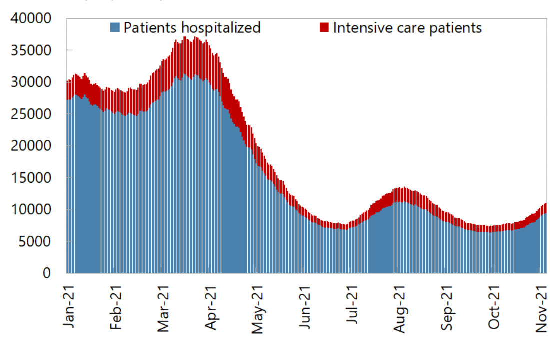
Cases 7-Day Moving Average
(Number of cases)



Sources: ECDC; and IMF staff calculations.

Despite a rise in cases, recent infections waves were associated with lower hospitalizations compared to previous waves.

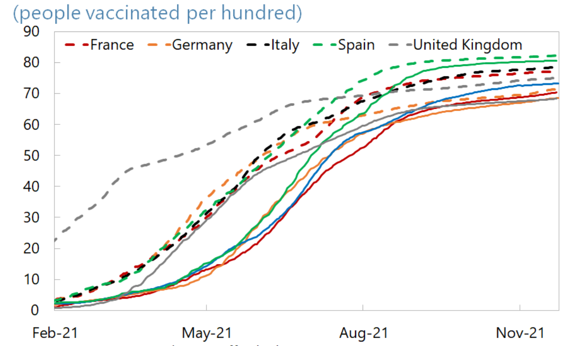
COVID-19 Daily Inflow of Hospitalized and Intensive Care
(Number of people hospitalized)



Sources: National authorities; and IMF staff calculations.

... likely as a result of the progress on vaccinations.

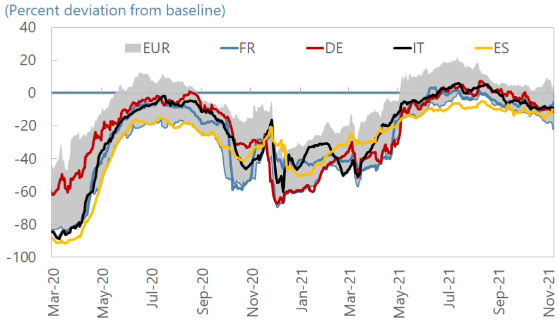
Vaccinations
(people vaccinated per hundred)



Sources: ECDC; and IMF staff calculations
Notes: Solid lines are fully vaccinations, doted lines are partial vaccinations.

Activity plummeted as a result of last year's containment measures, but was more resilient during the recent round of restrictions...

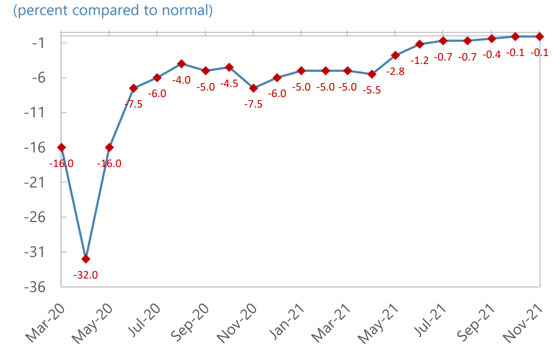
Mobility Around Retail Shops
(Percent deviation from baseline)



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

Economic activity is operating at less than 1 percent below normal, compared to the 36 percent at the height of the first lockdown.

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



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

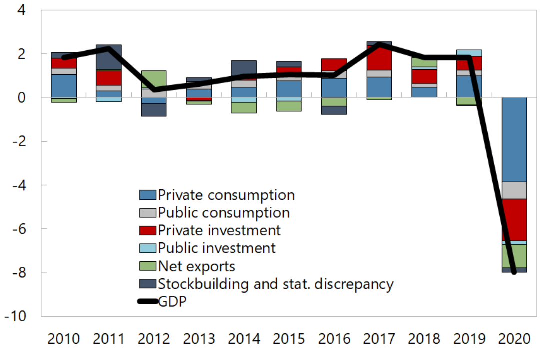
Figure 2. Real Sector Developments

Growth fell by about 8 percent in 2020, with all components adding to the decline…

.. but activity has rebound well over the first half of 2021, with pre-crisis losses nearly regained by the third quarter of 2021.

Contribution to Annual Real GDP Growth

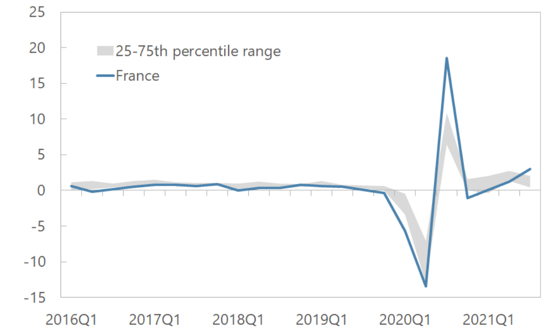
(Percent; Y/Y growth)



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

Real GDP

(Percent, Q-on-Q growth)



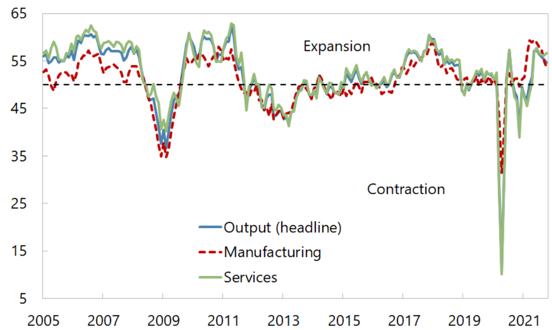
Sources: WEO and IMF staff calculation

PMIs continue to be strong since April and well above 50…

.. with business confidence recovering at a faster rate than the pickup in consumer confidence..

Purchasing Managers' Indices

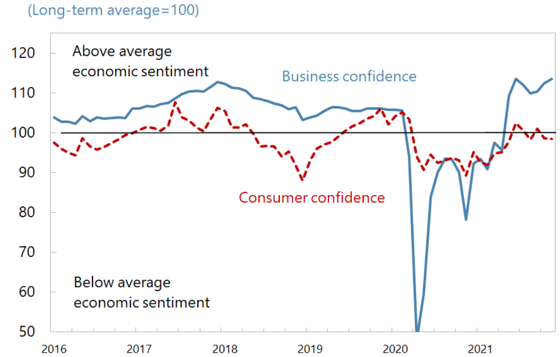
(50+=Expansion)



Source: CDAF/IHS Markit (Haver Analytics).

Business and Household Confidence

(Long-term average=100)



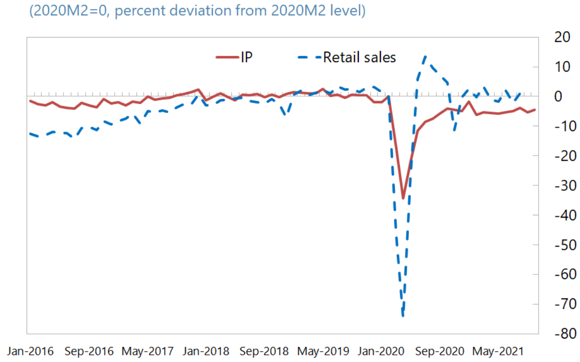
Source: INSEE (Haver Analytics).

Industrial production volumes and retail sales have also almost recovered to their pre-crisis levels….

.. while capacity utilization recovered from its low of 26 percent below average in Q2, with only some slack remaining.

Industrial Production and Retail Sales Volume Indices

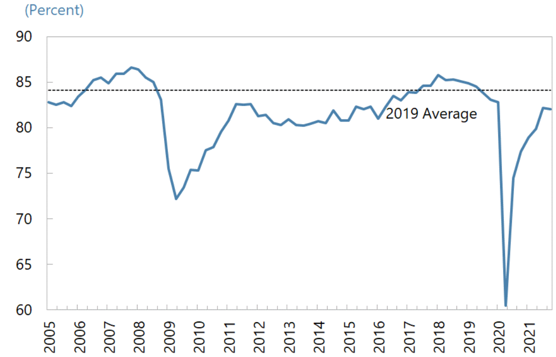
(2020M2=0, percent deviation from 2020M2 level)



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

Capacity Utilization: Industry

(Percent)



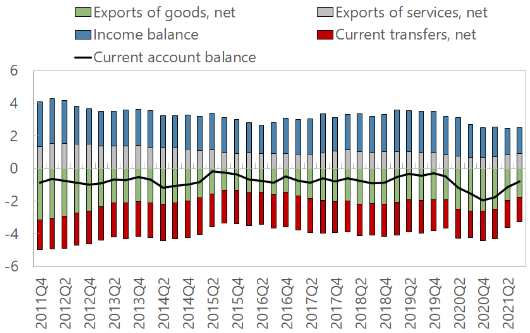
Sources: INSEE (Haver Analytics).

Figure 3. External Sector Developments

Even though the current account deficit widened in 2020, it is gradually normalizing since the beginning of 2021…

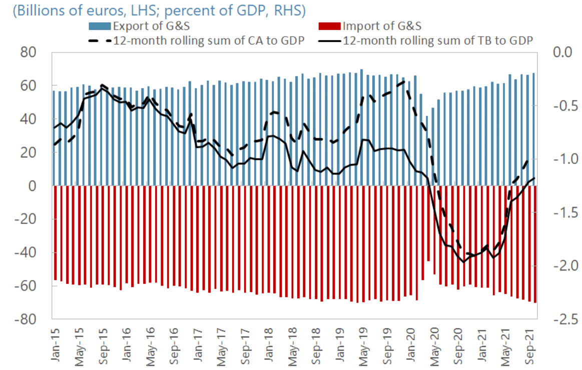
…driven by a higher trade activity in services exports.

Quarterly Current Account
(Moving average percent of GDP)



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

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

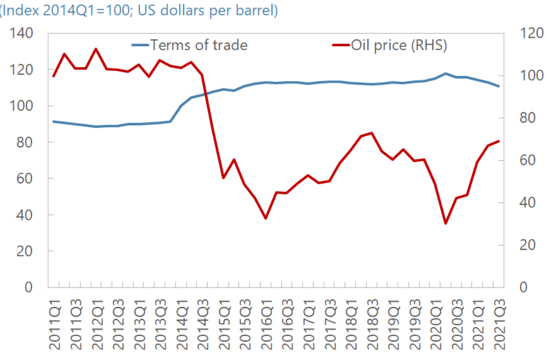


Sources: Haver Analytics

The increase in oil prices is weighing on the oil goods deficit in the first half of the year.

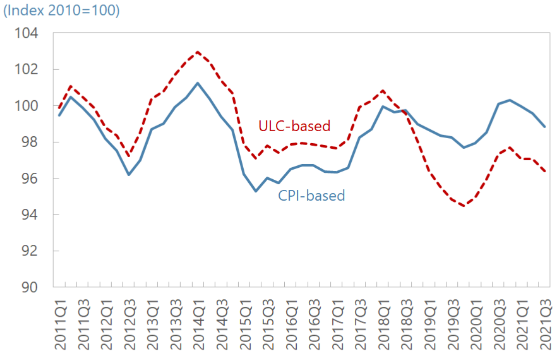
The ULC and CPI-based REER depreciated slightly in 2021, driven by the depreciation of the euro against the dollar.

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



Sources: WEO, Haver Analytics and IMF staff calculation

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

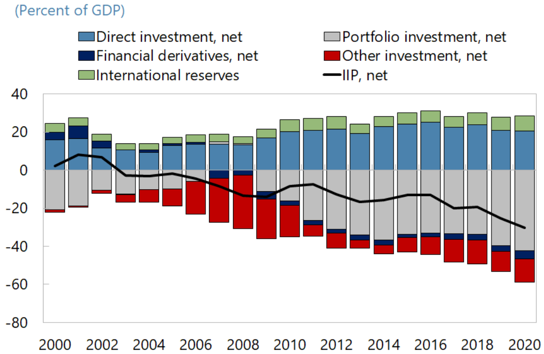


Sources: Eurostat

The Net International Investment Position became more negative…

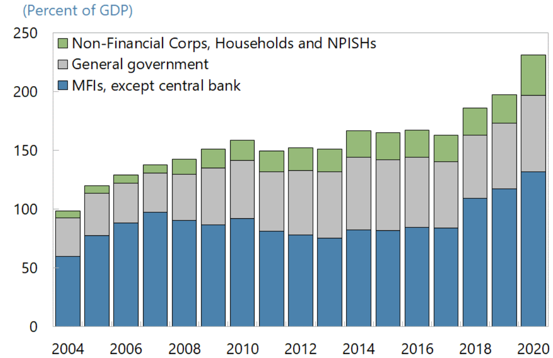
… with an increase in gross liabilities across all sectors of the economy.

Net International Investment Position
(Percent of GDP)



Source: IMF BOP.

External Debt
(Percent of GDP)



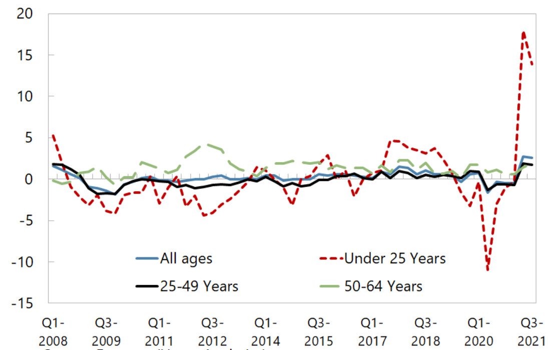
Source: IMF BOP and Eurostat.

Figure 4. Labor Market Developments

Employment growth rebound sharply in the first half of 2021 especially among the youth, who were hit hard during the crisis.

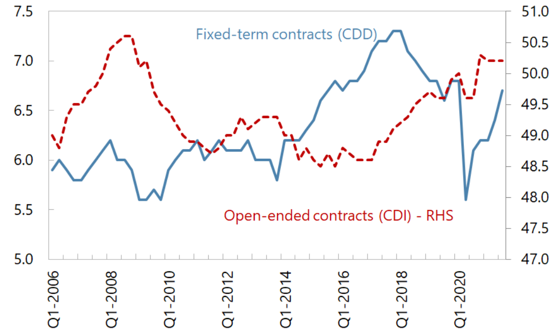
Employment relationships with both fixed-term and open-ended contracts have started to recover.

Employment Growth by Age Groups
(Y-on-Y percent change)



Source: Eurostat (Haver Analytics).

Employment Rate, by Contract Type
(Percent of working age population)

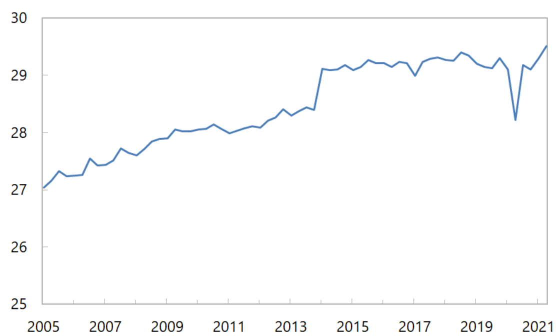


Source: INSEE (Haver Analytics).

The labor force fell as search activity came to a halt in the lockdown, but rebounded in 2020:Q3 and has by now exceeded pre-crisis levels.

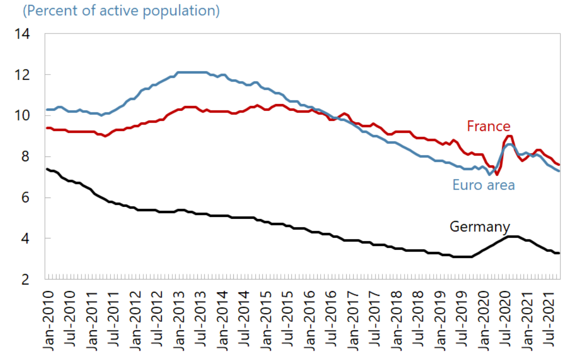
As a result, the unemployment rate in France has remained virtually stable, relative to pre-crisis, at par with that of the Euro area.

Labor Force: 15-64 Years
(Millions)



Source: European Commission (Haver Analytics).

Harmonized Unemployment Rate
(Percent of active population)

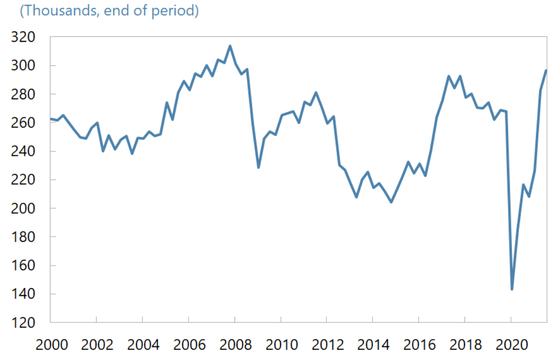


Source: Eurostat (Haver Analytics).

The number of job vacancies is accelerating, having exceeded pre-crisis levels after the steep decline during the first lock-down.

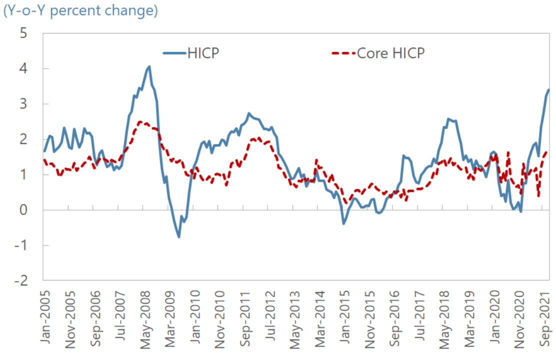
Inflation increased, driven by an increase in energy and food prices.

Job Vacancies
(Thousands, end of period)



Source: INSEE (Haver Analytics).

Inflation Growth
(Y-o-Y percent change)

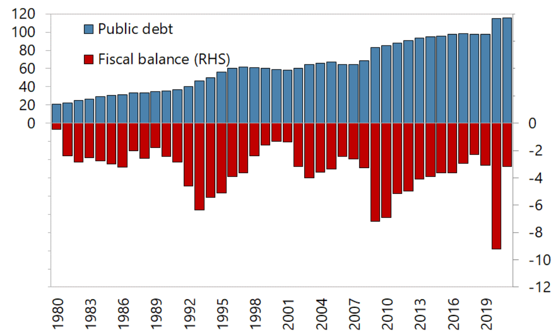


Sources: Haver Analytics

Figure 5. Fiscal Sector Developments

Following decades with sizable deficits, France's debt has been steadily increasing since the early 1980s …

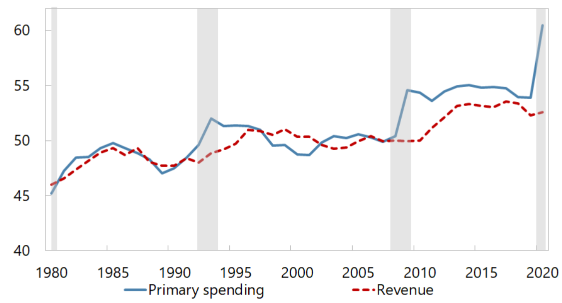
Public Debt and Fiscal Balance
(Percent of GDP)



Sources: INSEE; and IMF staff calculations.

… as efforts to redress public finances after episodes of a steep increase in spending during recessions tended to be insufficient.

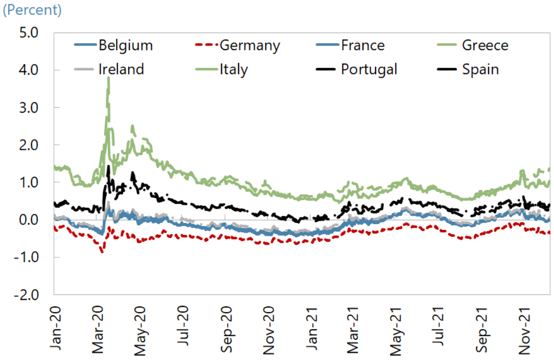
General Government Revenue and Spending
(Percent of GDP)



Sources: IMF WEO Database; Association Francaise de Science Economique; and IMF staff calculations.
Note: Shaded bars denote recessions periods (years with at least 1 quarter of recession).

While low funding costs provide fiscal space to maintain support in the near term…

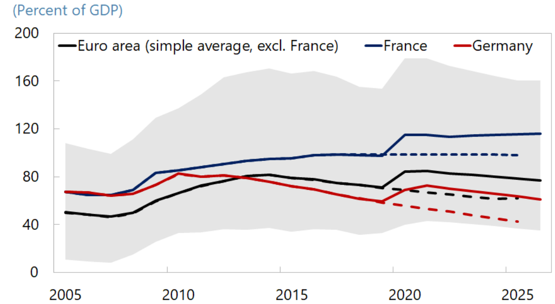
10Y Bond Yield
(Percent)



Sources: Bloomberg

…fiscal restrain will be needed over the medium term to revert a widening gap between public finances in France and European peers.

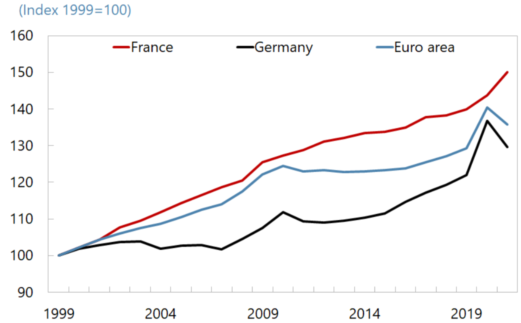
Public Debt
(Percent of GDP)



Sources: Haver Analytics; and IMF staff calculations.
Note: Dashed line dennotes pre-crisis projections (January 2020 WEO Update), and solid line represents the current projections for France and for peers is from October 2021 WEO Update. Shaded area denotes interdecile range across Euro Area countries.

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

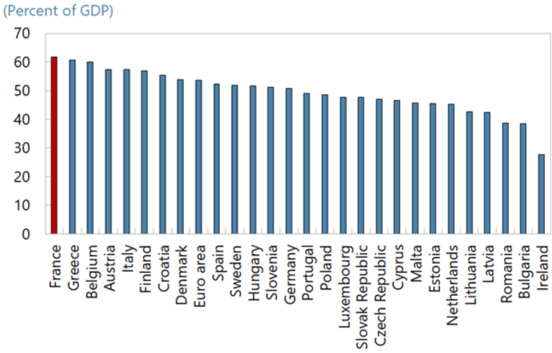
Real General Government Spending
(Index 1999=100)



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

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

General Government Expenditure, 2020
(Percent of GDP)



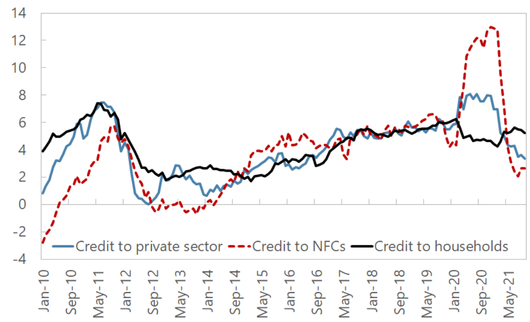
Sources: WEO; and IMF staff calculations.

Figure 6. Financial Sector Developments

Credit to the private sector, which accelerated during the crisis, is now at growth levels observed prior to the pandemic.

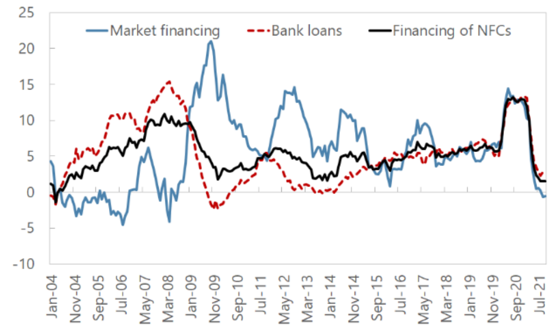
Growth of NFC financing, which exceeded pre-GFC highs in 2020, was supported by bond and loan growth and is gradually normalizing.

Non-Financial Private Sector Credit
(Percent, Y-on-Y)



Sources: Haver Analytics

Annual Growth Rate, by Type of Financing
(Percent)

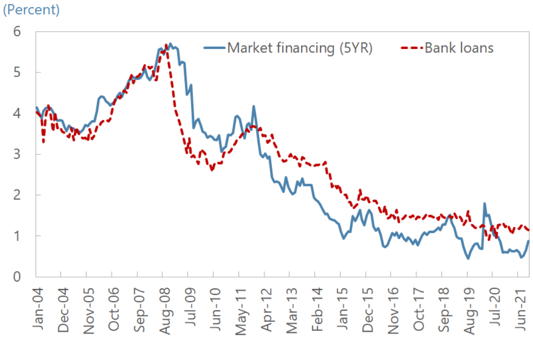


Sources: Banque de France

Interest rates on loans, as well as on market debt are at historically low levels.

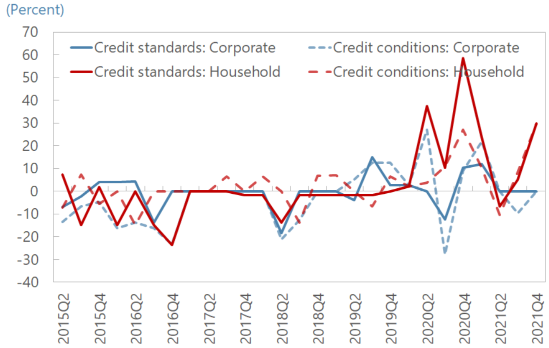
Credit standards and conditions started to tighten in the third quarter of 2021, mostly for housing loans.

Average Cost of Financing
(Percent)



Sources: Banque de France

Bank Lending Survey: Credit Supply Indicators
(Percent)

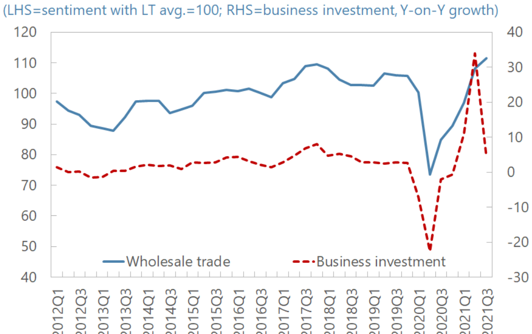


Sources: BLS

Business investment and wholesale trade show a sharp recovery during the first half of 2021.

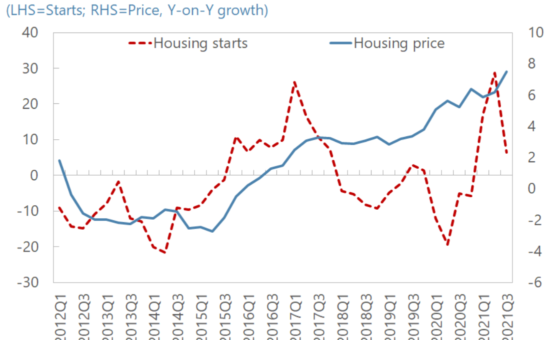
Meanwhile, house prices accelerated amidst some rebound in housing-related construction activity.

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



Sources: Haver Analytics

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



Sources: Haver Analytics

Table 1. France: Selected Economic and Social Indicators, 2018–26

			Est.	Projections					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Real economy (change in percent)									
Real GDP	1.8	1.8	-8.0	6.7	3.7	1.7	1.6	1.5	1.4
Domestic demand	1.4	2.1	-6.8	6.1	3.0	1.8	1.7	1.5	1.4
Private consumption	0.8	1.9	-7.2	4.6	5.3	2.4	2.0	1.8	1.6
Public consumption 1/	0.8	1.0	-3.2	5.7	-0.6	0.9	1.0	0.9	1.1
Gross fixed investment	3.3	4.1	-8.9	11.8	1.5	1.2	1.8	1.4	1.4
Foreign balance (contr. to GDP growth)	0.4	-0.3	-1.1	0.4	0.6	-0.1	-0.2	0.0	-0.1
Exports of goods and services	4.6	1.5	-16.1	8.4	5.2	3.8	3.8	3.8	3.5
Imports of goods and services	3.1	2.4	-12.2	6.3	2.8	3.9	4.1	3.7	3.4
Nominal GDP (billions of euros)	2,363	2,438	2,303	2,463	2,602	2,674	2,755	2,831	2,913
CPI (year average)	2.1	1.3	0.5	2.1	2.4	1.0	1.4	1.3	1.4
GDP deflator	1.0	1.3	2.7	0.2	1.9	1.0	1.4	1.3	1.4
Gross national savings (percent of GDP)	23.0	24.1	21.8	23.8	23.4	23.2	23.2	23.2	23.0
Gross domestic investment (percent of GDP)	23.9	24.4	23.7	25.2	24.8	24.4	24.3	24.1	24.0
Public finance (percent of GDP)									
General government balance	-2.3	-3.1	-9.2	-8.3	-5.1	-3.6	-3.3	-3.3	-3.3
Revenue	53.4	52.3	52.6	52.0	51.2	51.0	51.0	50.7	50.7
Expenditure	55.6	55.4	61.8	60.3	56.3	54.6	54.3	54.0	53.9
Primary balance	-0.7	-1.7	-8.0	-7.1	-4.1	-2.8	-2.6	-2.5	-2.5
Structural balance (percent of pot. GDP)	-1.6	-2.1	-6.0	-6.9	-5.0	-3.5	-3.3	-3.3	-3.3
Nominal expenditure (change in percent)	1.3	2.6	5.4	4.4	-1.4	-0.3	2.5	2.0	2.8
Real expenditure (change in percent)	-0.8	1.3	4.9	2.2	-3.7	-1.3	1.1	0.8	1.3
General government gross debt	98.0	97.6	115.1	114.7	113.3	114.4	114.8	115.3	115.7
Labor market (percent change)									
Employment	0.7	0.8	-0.7	1.2	0.2	0.3	0.2	0.1	0.0
Labor force	0.2	0.2	-1.1	1.2	0.3	0.0	0.1	0.0	0.0
Unemployment rate (percent)	9.0	8.4	8.0	8.0	8.1	7.9	7.8	7.7	7.7
Credit and interest rates (percent)									
Growth of credit to the private non-financial sector	5.5	5.3	8.1	2.5	3.8	2.8	3.1	2.8	2.9
Money market rate (Euro area)	-0.4	-0.4	-0.5	...	...	...	...	...	...
Government bond yield, 10-year	0.8	0.1	-0.1	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account	-0.8	-0.3	-1.9	-1.4	-1.3	-1.2	-1.1	-1.0	-1.0
Trade balance of goods and services	-1.1	-0.9	-1.9	-1.6	-1.3	-1.2	-1.2	-1.2	-1.1
Exports of goods and services	32.8	32.7	28.8	31.5	32.5	32.6	32.9	33.4	33.7
Imports of goods and services	-34.0	-33.7	-30.7	-33.1	-33.9	-33.8	-34.1	-34.5	-34.8
FDI (net)	2.2	0.2	1.6	0.8	0.9	0.9	0.9	0.9	1.0
Official reserves (US$ billion)	66.1	69.7	76.1	...	...	...	...	...	...
Exchange rates									
Euro per U.S. dollar, period average	0.85	0.89	0.88	...	...	...	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	98.2	97.1	97.4	...	...	...	...	...	...
REER, ULC-based (2005=100, +=appreciation)	92.6	90.2	95.8	...	...	...	...	...	...
Potential output and output gap									
Potential output (change in percent)	1.1	1.0	-3.3	3.7	1.8	1.6	1.5	1.4	1.4
Memo: per working age person	1.2	1.2	-3.2	3.8	1.8	1.6	1.5	1.4	1.4
Output gap	-0.8	0.0	-4.8	-2.1	-0.2	-0.1	0.0	0.1	0.1

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

1/ Values reflect lockdown-related losses in value added due to pubic services not provided during the lockdown in 2020.

Table 2. France: General Government Operations, 2018–26

(In percent of GDP unless otherwise indicated)

			Est.	Proj.					
	2018	2019	2020	2021	2022	2023	2024	2025	2026
Revenue	53.4	52.3	52.6	52.0	51.2	51.0	51.0	50.7	50.7
Taxes	30.0	30.2	30.3	29.4	28.9	29.0	29.0	28.9	28.9
Direct taxes	13.2	13.1	13.2	12.4	12.2	12.2	12.2	12.2	12.2
Indirect taxes	16.7	17.1	17.0	17.1	16.7	16.8	16.8	16.7	16.7
Social contributions	18.0	16.7	17.1	16.8	16.8	16.7	16.7	16.6	16.6
Other revenue	5.4	5.4	5.3	5.8	5.5	5.4	5.4	5.2	5.2
Expenditure	55.6	55.4	61.8	60.3	56.3	54.6	54.3	54.0	53.9
Expense	55.4	55.1	61.6	60.1	56.1	54.4	54.1	53.8	53.7
Compensation of employees	12.4	12.2	13.2	12.7	12.3	12.2	12.1	12.0	12.0
Goods and services	4.9	4.9	5.3	5.2	5.0	5.0	5.0	4.9	4.9
Interest	1.7	1.4	1.3	1.3	1.1	0.9	0.9	0.9	0.9
Social benefits	25.4	25.3	28.9	27.5	25.8	25.1	25.0	25.0	25.0
Other expense	10.9	11.3	12.8	13.4	11.9	11.3	11.2	10.9	10.9
Gross public investment	3.4	3.7	3.7	4.1	4.0	3.7	3.7	3.5	3.5
Net acquisition of nonfinancial assets	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net lending / borrowing	-2.3	-3.1	-9.2	-8.3	-5.1	-3.6	-3.3	-3.3	-3.3
Primary balance	-0.7	-1.7	-8.0	-7.1	-4.1	-2.8	-2.6	-2.5	-2.5
Memorandum items:									
Structural balance (percent of potential GDP)	-1.6	-2.1	-6.0	-6.9	-5.0	-3.5	-3.3	-3.3	-3.3
Structural primary balance (percent of potential GDP)	0.0	-0.8	-4.9	-5.7	-4.0	-2.8	-2.6	-2.5	-2.5
Change in structural primary balance	*0.3*	*-0.8*	*-4.1*	*-0.9*	*1.7*	*1.3*	*0.2*	*0.1*	*0.0*
Public gross debt (Maastricht definition)	98.0	97.6	115.1	114.7	113.3	114.4	114.8	115.3	115.7
Nominal GDP (in billion of Euros)	2,363	2,438	2,303	2,463	2,602	2,674	2,755	2,831	2,913
Real GDP growth (in percent)	1.8	1.8	-8.0	6.7	3.7	1.7	1.6	1.5	1.4
Nominal expenditure growth	1.3	2.6	5.4	4.4	-1.4	-0.3	2.5	2.0	2.8
Real expenditure growth (in percent)	-0.8	1.3	4.9	2.2	-3.7	-1.3	1.1	0.8	1.3
of which: primary	-0.8	1.8	5.5	2.1	-3.5	-1.0	1.1	0.7	1.3
of which: structural primary	-0.7	1.9	4.8	2.5	-3.2	-0.9	1.1	0.7	1.3

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

Table 3. France: Balance of Payments, 2015–26
(In percent of GDP)

					Est.		Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Current account	-0.4	-0.5	-0.8	-0.8	-0.3	-1.9	-1.4	-1.3	-1.2	-1.1	-1.0	-1.0
Net exports of goods	-1.3	-1.4	-2.0	-2.2	-1.9	-2.6	-3.0	-3.1	-3.0	-3.1	-3.0	-3.0
Exports of goods	21.4	21.1	21.6	22.0	21.9	19.2	20.8	21.1	21.2	21.4	21.7	21.9
Imports of goods	22.7	22.5	23.6	24.1	23.8	21.8	23.8	24.3	24.2	24.4	24.7	24.9
Net exports of services	0.9	0.9	1.1	1.0	1.0	0.7	1.4	1.8	1.8	1.8	1.9	1.9
Exports of services	10.5	10.5	10.6	10.8	10.9	9.7	10.7	11.4	11.4	11.5	11.7	11.8
Imports of services	9.6	9.6	9.5	9.8	9.9	9.0	9.3	9.6	9.6	9.7	9.8	9.9
Income balance	2.1	2.2	2.1	2.3	2.5	1.9	2.0	1.8	1.8	1.9	2.0	2.0
Current transfers	-2.0	-2.1	-1.9	-2.0	-1.9	-1.9	-1.8	-1.8	-1.8	-1.8	-1.8	-1.9
Capital and financial account												
Capital account	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	0.0	-0.8	-1.4	-1.0	-0.8	-2.3	-1.3	-1.3	-1.2	-1.1	-0.9	-0.9
Direct investment	0.3	1.7	0.4	2.2	0.2	1.6	0.8	0.9	0.9	0.9	0.9	1.0
Portfolio investment	1.8	0.0	1.2	0.7	-2.8	-1.6	2.0	0.9	0.4	0.2	0.2	0.1
Financial derivatives	0.6	-0.7	-0.1	-1.1	0.2	-1.0	-0.6	-0.4	-0.3	-0.3	-0.2	-0.2
Other investments net	-3.0	-1.8	-2.8	-3.2	1.5	-1.4	-4.6	-2.8	-2.3	-2.1	-2.0	-1.9
Reserve assets	0.3	0.1	-0.1	0.4	0.1	0.2	1.1	0.2	0.2	0.2	0.2	0.2
Errors and omissions	0.4	-0.3	-0.6	-0.3	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 4. France: Vulnerability Indicators, 2013–20

(In percent of GDP unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019	2020
External Indicators								
Exports (annual percentage change, in U.S. dollars)	5.6	2.0	-10.4	0.3	6.8	10.0	-2.5	-15.2
Imports (annual percentage change, in U.S. dollars)	3.9	2.7	-11.6	0.8	8.1	10.5	-3.1	-12.1
Terms of trade (annual percentage change)	1.3	1.2	3.2	1.0	-1.3	-1.2	1.0	0.6
Current account balance	-0.5	-1.0	-0.4	-0.5	-0.8	-0.8	-0.3	-1.9
Capital and financial account balance	-0.7	-0.4	-0.1	-0.7	-1.4	-0.9	-0.7	-2.2
Of which								
Inward portfolio investment (debt securities, etc.)	4.9	4.1	0.2	1.6	1.2	0.6	5.4	7.8
Inward foreign direct investment	1.1	0.2	1.8	1.3	1.4	2.8	2.1	0.4
Other investment (net)	3.5	-0.1	-3.0	-1.8	-2.8	-3.2	1.5	-1.4
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	50.8	49.5	55.2	56.1	54.8	66.1	69.7	76.1
Euros per U.S. dollar (period average)	0.8	0.8	0.9	0.9	0.9	0.8	0.9	0.9
Market Indicators								
Financial Markets								
Public sector debt 1/	93.4	94.9	95.6	98.0	98.3	98.0	97.6	115.1
3-month T-bill yield (percentage points)	0.0	0.1	-0.2	-0.6	-0.6	-0.6	-0.6	-0.6
3-month T-bill yield in real terms (percentage points)	-0.7	0.0	-0.4	-1.2	-1.8	-2.2	-2.0	-0.6
US 3 month T-bill	0.1	0.0	0.1	0.3	0.9	1.9	2.1	0.4
Spread with the US T-bill (percentage points)	0.0	0.0	-0.3	-0.9	-1.6	-2.6	-2.6	-0.9
10-year government bond (percentage points)	2.2	1.7	0.8	0.5	0.8	0.8	0.1	-0.1
10-year government bond (United States)	2.4	2.5	2.1	1.8	2.3	2.9	2.1	0.9
Spread with US bond (percentage points)	-0.1	-0.9	-1.3	-1.4	-1.5	-2.1	-2.0	-1.0
Yield curve (10 year - 3 month, percentage points)	2.2	1.6	1.0	1.0	1.5	1.4	0.7	0.4
Stock market index (period average, 1995=100)	211.1	231.7	258.2	236.1	276.7	282.6	279.7	279.1
Real estate prices (index, Q1-10=100, period average)	103.8	101.9	100.0	100.9	104.0	107.2	110.7	116.9
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	0.5	0.5	2.5	4.3	4.6	6.3	5.3	8.5
Bank credit to households	2.7	1.9	3.3	3.3	5.6	5.3	6.0	4.7
Housing Loans	3.8	2.2	4.0	3.5	6.1	5.8	6.8	5.5
Bank credit to nonfinancial enterprises	-0.3	2.6	4.3	4.3	5.8	5.7	4.2	13.0
Sectoral risk indicators								
Household sector								
Household savings ratio	14.2	14.6	14.1	14.0	14.1	14.5	15.1	21.5
Household financial savings ratio	4.7	5.2	4.8	4.5	4.2	4.3	4.6	12.1
Corporate sector								
Gross margin ratio	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Investment ratio	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Savings ratio	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Self-financing ratio	0.9	0.9	1.0	1.0	1.0	0.9	1.0	0.9
Banking sector								
Share of housing loans in bank credit to the private sector	42.6	41.3	41.6	41.8	42.4	42.4	42.7	42.2
Share of nonperforming loans in total loans	4.5	4.2	4.0	3.7	3.1	2.7	2.5	2.7
Ratio of nonperforming loans net of provisions to capital	19.8	19.2	18.0	16.2	15.0	13.6	12.2	11.9
Liquid assets to total short-term liabilities 2/	...	17.8	17.5	20.2	20.7	19.3	20.1	26.0
Return on assets	0.4	0.4	0.6	0.5	0.4	0.4	0.4	...
Return on equity	8.1	6.2	9.2	8.4	6.3	6.7	6.4	...
Regulatory capital to risk-weighted assets	15.4	16.3	17.1	18.3	18.9	18.8	19.6	19.9

Sources: French authorities, INSEE, BdF, ECB, Haver, and IMF International Financial Statistics.
1/ The debt figure does not include guarantees on non-general government debt.
2/ Data is based on new methodology which is not comparable to older figures before 2014.

Table 5. France: Core Financial Soundness Indicators, 2016-20

	2016	2017	2018	2019	2020
Deposit-taking institutions 1/					
Regulatory capital to risk-weighted assets 2/	18.3	18.9	18.8	19.6	19.9
Regulatory Tier I capital to risk-weighted assets 2/	15.1	15.4	15.6	16.0	17.1
Nonperforming loans net of provisions to capital	16.2	15.0	13.6	12.2	11.9
Bank provisions to Nonperforming loans	51.0	50.6	50.4	49.9	48.7
Nonperforming loans to total gross loans	3.7	3.1	2.7	2.5	2.7
Sectoral distribution of loans to total loans, of which					
Deposit-takers	2.2	2.6	2.7	3.1	3.5
Nonfinancial corporation	11.1	14.0	14.0	14.8	16.6
Households (including individual firms)	28.1	25.7	25.5	25.9	24.2
Nonresidents (including financial sectors)	28.0	32.3	33.4	34.2	34.8
ROA (aggregated data on a parent-company basis) 3/ 4/	0.4	0.4	0.4	0.4	0.3
ROA (main groups on a consolidated basis) 2/ 4/	0.5	0.4	0.4	0.4	0.2
ROE (aggregated data on a parent-company basis) 3/ 4/	6.8	6.5	6.4	6.0	4.1
ROE (main groups on a consolidated basis) 2/ 4/	8.4	6.3	6.7	6.4	3.9
Interest margin to gross income	37.8	36.2	36.0	37.1	38.8
Noninterest expenses to gross income	71.5	74.2	76.2	73.3	70.4
Liquid assets to total assets	13.0	13.9	13.7	14.1	18.0
Liquid assets to short-term liabilities	20.2	20.7	19.3	20.1	26.0

Sources: Banque de France, ACPR

1/ These may be grouped in different peer groups based on control, business lines, or group structure.
2/ Consolidated data for the five banking groups (IFRS).
3/ All credit institutions' aggregated data on a parent-company basis.
4/ ROA and ROE ratios are calculated after taxes (same calculation as the ECB consolidated data ratios).

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2020 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Continue to provide fiscal support in the near-term, which should become increasingly targeted as the recovery firms. If downside risks materialize, the policy response should be scaled up through temporary measure.	The authorities refocused the exceptionally generous conditions of the SWTS and access to other support measures to the sectors most affected by lockdowns. The availability of emergency measures was extended beyond initial expiry dates as needed amidst recurrent waves of new covid cases.
Permanent tax cuts should be accompanied by offsetting measures (scheduled to enter into effect only when the recovery is firm), to avoid aggravating future fiscal consolidation needs. Develop a credible expenditure-based consolidation plan to put debt on a firm downward path over the medium term.	In the context of the 2022 budget, the authorities presented projections with debt on a declining trajectory by 2027 based on an objective to limit real expenditure growth to 0.7 percent. However, no specific structural measures have been defined to bring about the planned consolidation.
Structural Reforms	
Policies should aim at boosting employment, particularly among vulnerable groups, by facilitating new work relationships in dynamic sectors.	The authorities supported youth employment by launching temporary hiring subsidies for the youth and apprenticeship programs. The 2022 budget also includes additional measures to tackle skills shortages in certain activities and to aid labor market integration of youth that are neither working nor studying. The authorities further plan to kick-start a new five-year investment plan (*France 2030*), worth 1.2 percent of GDP.
Implement additional green policies consistent with Paris Climate Agreement commitments and European initiatives to reduce emissions, including by pricing carbon adequately across sectors of the economy. This should be accompanied by mitigating measures for low-income households to ensure their social acceptance.	Policy proposals have been announced in the context of the "Fit For 55" initiative at the EU level, including a new ETS for transport and buildings and harmonization and better alignment of energy taxation with carbon context. In response to the recent increase in energy prices, the government announced a €100 one-off grant increase for each of the 5.8 million households which are already eligible for the *chèques énergie* to cushion the impact on low-income households.

Financial Sector	
Refocus corporate support measures away from government loan guarantees by scaling up equity-like financing targeted at crisis-affected viable enterprises to spur investment and business dynamism, while reducing risk from excessive leverage.	PGE availability is slated to end by June 2022, but firms were granted another year of grace period if needed. The authorities finalized a quasi-equity support scheme (*prets particpatifs*). Take-up rates have been behind expectations.
Prioritize frequent and close monitoring of intragroup transactions within conglomerates to limit the amplification of corporate risks.	The authorities consider intragroup transactions are sufficiently well monitored and noted that reporting will be enhanced in the near future.
Maintain borrower-based measures in the mortgage market and limits for large exposures to high debt corporates to mitigate risks from household and corporate indebtedness	The HCSF on June 30, 2021, decided to maintain limits on banks' exposure to the most heavily indebted companies and on September 14, 2021 decided to make legally binding as of January y 1, 2022 thresholds on DSTI and maturity of mortgage loans, with a flexibility margin of 20 percent of banks' exposure to deviate.
Guidance by the supervisory authorities to limit dividend payouts should continue until the shock is weathered	The supervisor followed the ECB in its July 23, 2021 decision not to extend beyond September 2021 its recommendation that all banks limit dividends.

Annex II. 2019 Key FSAP Recommendations—Implementation Status

Recommendations	Agency	Timing*	Implementation Status
Preemptive Management of Systemic Vulnerabilities			
Engage with ECB and other EU agencies on use of Pillar II measures to address bank-specific residual risk from concentration of exposures to large indebted corporates.	ACPR	I	After having implemented a so-called "pragmatic" (i.e. simplified) SREP process (which notably assesses the concentration risk of significant Institutions) for the 2020 exercise, in 2021, the ECB has conducted a full SREP process with a special focus on the assessment of credit risk (which has covered, amongst other items, the assessment of concentration risk). This regular SREP process should lead to maintain P2 requirements levels broadly in line with previous years, with a marginal increase largely driven by Non Performing Exposure provisioning shortfall add-ons.
Develop analytical framework for borrower-based measures for corporates. Consider a sectoral Systemic Risk Buffer (SRB) if risks intensify.	HCSF	NT	A SyRB analytical assessment has been carried out. It was concluded that application of Art. 458 fits risks in the corporate sector better and is more effective..
Evaluate options to further incentivize corporates to finance through equity rather than debt.	MoF	NT	Several measures in the Recovery plan aim at incentivizing equity financing, including the Label Relance, the Fonds France Relance Etat-Régions and the participatory loans.
Ensuring Adequate Liquidity Management and Buffers			
Develop with the ECB options to manage any disruptions in wholesale funding markets. Consider, as appropriate, liquidity buffers to cover at least 50 percent of wholesale funding outflows over/up to five days horizon for all major currencies.	ACPR, ECB	NT	ECB and ACPR, in line with BCBS and EBA statements, have reminded banks and markets that liquidity buffers have been built to be used in case of a liquidity stress situation. However, banks currently prefer to maintain a significant liquidity buffer, above the 100% usual threshold. Therefore, at the current juncture of the COVID-19 crisis, there is no need to add or change liquidity buffer requirements. Moreover, within the framework of the SREP analysis, the ECB has judged that liquidity risks were not particularly high for the time being. In addition, the entry into force of the NSFR new prudential requirement in June 2021 has added liquidity constraints on wholesale funding resources.
Actively engage with the ESRB and others for a speedy development of liquidity and leverage related tools for insurers and investment funds.	BdF, HCSF, ACPR, AMF	NT	Concerning investment funds, BdF contributed to the "low interest expert group report" in which the questions of leverage and liquidity are extensively discussed. BdF is also taking an active part in the design of the ESRB recommendation on money market funds that is in preparation. Concerning insurers, the review of Directive 2009/138/EC aims notably at enhancing liquidity monitoring and supervising by introducing a liquidity risk management plan and new powers for the supervisor, such as requiring insurers to implement measures to strengthen their liquidity or even temporarily stopping redemption of contracts.
Further Integration of Financial Conglomerate Oversight			
Report intragroup exposures and transactions within conglomerates on a flow and stock basis at quarterly or regular frequency. Develop guidance to address direct and indirect, and common exposures of entities in the conglomerate.	ACPR, AMF	NT	As of this date, French conglomerates report intragroup exposures and transactions within conglomerates on a flow and stock basis at regular frequency (reporting CONGLOMER). An enhanced reporting is currently being reviewed by the Commission and should be implemented in 2023.
Develop with the ECB and other EU agencies liquidity risk management requirements and stress testing at the conglomerate level.	ACPR, AMF	NT	No liquidity risk management requirement has been considered at this stage because the current supervisory framework coinciding with the prudential consolidation perimeter is deemed satisfactory. Within the framework of the SREP analysis, the ECB has judged that liquidity risks were not particularly high for the time being. Along with market-wide stress test that typically encompasses conglomerates and allows distinguishing their performance compared with other financial groups, ACPR is carrying out ad hoc research projects on liquidity analysis and the conduct of stress testing at the conglomerate level.
Strengthen conglomerate oversight and work with the Joint Committee of the ESAs to finalize common reporting templates, and with the ECB on common supervisory guidance for conglomerates.	ACPR, AMF	NT	The ACPR maintained a high level of engagement in both arenas in order to strengthen conglomerate supervision. ACPR's deputy Secretary General chairs the works of the JC of the ESAs on common reporting templates. ACPR actively participates in ESA's work to answer The Commission's call for advice on digital finance includes questions on a potential review of FICOD to supervise mixed-activity groups. ACPR teams actively engaged with ECB staff members to develop the common supervisory guidance and remain involved in current initiatives to enhance the supervisory manual.
Enhancing Governance, Financial Policies and Financial Integrity			
The ACPR and AMF should have autonomy to determine their resource levels based on a forward-looking review of supervisory and monitoring needs.	ACPR, AMF, MoF	I	The NSAs are free to allocate resources towards the most needed fields, but it is not constitutionally possible to let them determine their global resource level as these resources are fiscal by nature thus requiring a parliamentary decision. Note that the parliamentary decision is informed by an independent report from the NSA. The current arrangement with a vote on a resource threshold is guaranteeing a stable funding of the NSAs.
To avoid any perception of a potential conflict of interest and facilitate operationally independent functioning, the government should recuse itself from all supervisory decision-making committees at the ACPR and the AMF.	MoF	I	The presence of the MoF as an observer at the NSAs' board does not prevent the decisions to be taken independently. On the contrary, the cross participation of the NSA and the attendance of a MoF representative on a non-voting basis give a robust legal framework for sharing information between the NSAs and with the MoF both on policy (where the MoF has regulatory responsibilities) and oversight issues (as it contribute to informative feedbacks) .
Reduce further the spread between market interest rates and the return on regulated savings products. Ensure timely and effective implementation of CDC governance reform under the Loi PACTE and undertake a full review of regulated savings framework at the appropriate time.	MoF	NT	The implementation of CDC governance reform under the Loi PACTE is finished. Furthermore, the rate for the Livret A has been reduced from 0.75% to 0.5% in February 2021.
Enhance AML/CFT supervision of smaller banks rated as high-risk. Explore ways to provide systematic guidance on detection of potential terrorist financing activities.	ACPR, Tracfin	I	Elaborating on its AML-CFT risk assessment methodology, the ACPR devised in late 2019 an AML-CFT supervisory approach (SABRE) that links the expected supervisory intensity to the banks' individual risk assessment (as well as other supervised entities, such as insurance companies and payment services and electronic money providers). The AML-CFT supervisory approach provides for different supervisory tools with different levels of intrusiveness, from the annual return and meetings to onsite visits and onsite inspections. Following the pandemic situation and the related lockdown, onsite visits and inspections have now fully resumed, including for the smaller institutions. As regards guidance on detection of terrorist financing activities, the ACPR/TRACFIN joint Guidelines list a number of criteria, including weak signals, that obliged entities have to take into account. In addition, the new Sectoral Risk Assessment published by ACPR describes the risks of each category of institutions and gives a focus on CFT for each activity.

Recommendations	Agency	Timing*	Implementation Status
Reinforcing Crisis Management, Safety Nets, Resolution Arrangement			
Work toward an enhanced resolution framework for insurers by including wider powers to restructure liabilities (bail-in), and enhanced safeguards and funding.	ACPR	MT	The French authorities recognize that the resolution framework would benefit from additional tools, especially bail-in powers and adequate resolution funding arrangements. In September 2021, the European Commission published a proposal of directive for a harmonized regime in recovery and resolution in the European Union within its Solvency II package review. This proposal foresees the inclusion of a write-down or conversion tool, in addition to a solvent run-off tool, an asset and liability separation tool, a sale of business tool and a bridge undertaking tool. However, no funding arrangements nor any harmonization of national Insurance Guarantee Schemes are foreseen in the first version of this proposal. The authorities consider an EU Directive as essential to further advance the recovery and resolution framework in the context of a level playing field for insurers in the European Union.
The eligibility of the FGDR's Supervisory Board membership, which is formed by bank executives in activity, should be changed to independent members only.	FGDR	MT	
Develop modalities for providing ELA in currencies other than euros and establish general rules that may assist banks in identifying assets, which might be proposed as ELA collateral and buttress their operational readiness to pledge them.	BdF, ACPR	MT	The ELA framework is decided by the Governing council of the ECB. Regarding the provision of foreign currency, the ECB maintained its TAF facility in some currencies. An internal TF contemplated last year all the possibilities of sourcing foreign currency for ELA purposes. Regarding the collateral and other operational issues, Banque de France recently revised its internal procedures. On top of that, an internal framework is in place to determine in general terms what type of assets can be pledged.

** I= immediate (within one year), NT= near term (1–3 years), MT= medium term (3–5 years); these ratings reflect the authorities' own assessment of implementation status.*

Annex III. External Sector Assessment

(Preliminary Estimates)

<table>
<tr><td colspan="8">Overall Assessment: On a preliminary basis, and adjusting for transitory factors, recent developments suggest that the external position in 2021 is broadly in line with the level implied by medium-term fundamentals and desirable policies. However, this assessment is preliminary pending revisions and full-year data for 2021. A complete analysis will be provided in the 2022 External Sector Report.

Potential Policy Responses: In response to the COVID-19 pandemic, France deployed significant fiscal resources to bolster the health care system and provide targeted support to affected firms and individuals. Uncertainty surrounding the medium-term outlook is unusually large. If imbalances emerge, policies will need to continue focusing on further improving competitiveness by reinvigorating structural reforms and on rebuilding fiscal space once the recovery is secured.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. The NIIP stood at −32 percent of GDP in the second quarter of 2021, below the range observed during 2014–19 (between −16 and −23 percent of GDP). The NIIP fell by about 2 percent of GDP since the end of 2020, largely driven by an increase in banks’ and public sector gross debt (about 7 and 7 percent of GDP, respectively). While the net position is moderately negative, gross positions are large. Gross assets stood at 321 percent of GDP in the second quarter of 2021, of which banks’ non-FDI-related assets accounted for about 41 percent, reflecting their global activities. Gross liabilities reached 353.6 percent of GDP in the second quarter of 2021, of which external debt was about 227 percent of GDP (54 percent accounted for by banks and 25 percent by the public sector). About three-quarters of France’s external debt liabilities are denominated in domestic currency. The average TARGET2 balance in 2021 (end-Sept) was about €12.8 billion.

Assessment. The NIIP is negative, but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities coming from large public external debt (58 percent of GDP in the second quarter of 2021) and banks’ gross financing needs—the stock of banks’ short-term debt securities was €112 billion in the fourth quarter of 2020 (4.3 percent of GDP), and financial derivatives stood at about 39 percent of GDP.</td></tr>
<tr><td>2021Q2 (% GDP)</td><td colspan="2">NIIP: −32.4</td><td>Gross Assets: 321.2</td><td>Debt Assets: 181.7</td><td>Gross Liab.: 353.6</td><td colspan="2">Debt Liab.: 226.6</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The CA deficit narrowed to 1.4 percent of GDP (from 1.9 percent in 2020), driven by an uptick in services exports. One-off factors continue to weigh-in on the current account deficit (for example, imports of health-care-sector equipment) together with temporary factors that are expected to gradually normalize (for example, services balance, including business and tourism travel). Over the medium term, the IMF staff projects the CA deficit will narrow to about 1 percent of GDP by 2026 as temporary factors dissipate and selected reforms to improve France’s competitiveness start to pay off.

Assessment. The 2021 cyclically adjusted CA deficit is estimated at −1.7 percent of GDP compared with an EBA-estimated norm of a 0.1 percent deficit. The model residual accounts for about a third of the estimated gap. The IMF staff estimates CA net adjustments related to COVID-19 at 1 percent of GDP, driven by travel-services-related transitory factors (0.25 percent of GDP), exports of aeronautics (0.4 percent of GDP),[1] exports of medical goods (0.25 percent) and shift in household consumption composition to durable goods (0.1 percent of GDP). On this basis, the IMF staff assesses that the CA gap in 2021 is between −1.2 and −0.0 percent of GDP (compared with −2.7 to −1.7 percent of GDP in 2020), with a midpoint of −0.6. The CA gap is expected to narrow over the medium term as the effect of the crisis fades.</td></tr>
<tr><td>2021 (% GDP)</td><td>CA: −1.4</td><td>Cycl. Adj. CA: −1.7</td><td>EBA Norm: -0.1</td><td>EBA CA Gap: −1.6</td><td>COVID-19 Adj.: 1</td><td>Other Adj.: 0.0</td><td>Staff CA Gap: −0.6</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. Following an appreciation of the ULC-based REER and the CPI-based REER of 4.7 and 1.0 percent, respectively, in 2020 both REER measures depreciated in 2021 as of end-September. The ULC-based REER depreciated by 2.1 percent with respect to the 2020 average, while the CPI-based REER depreciated by 1.1 percent. From a longer-term perspective, although both REER measures depreciated by about 7-9 percent between 2008 and 2020, France has not managed to regain the loss of about one-third of its export market share registered in the early 2000s (while the export market share of the euro area remained broadly stable between 2000 and 2020).

Assessment. The IMF staff CA gap implies a REER gap of 2.2 percent in 2021 (applying an estimated elasticity of 0.27).[1] The EBA REER index model points to a REER gap of −1.7 percent, while the EBA REER level model points to a REER gap of 2.8 percent. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be overvalued in the range of -0.1 to 4.4 percent, with a midpoint of 2.2 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. The CA deficit in 2021 was financed mostly by net portfolio debt inflows, other investment flows, and financial derivative flows. Inward foreign direct investment normalized in 2021 after decreasing significantly between 2019 and 2020, by 1.7 percent of GDP. The capital account is open.

Assessment. France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sectors.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="7">Background. The euro has the status of a global reserve currency.

Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</td></tr>
<tr><td colspan="8">[1] The adjustor is derived by estimating the loss for aeronautics net exports in value added terms during 2021 (i.e., the difference between domestic value-added of exports and non-reexported imports using data on global value chains). The final adjustor reflects only the temporary component of the total loss and deducts the extent of loss that is expected to persist through the medium-term (i.e., the level of scarring in this sector per staff judgment).</td></tr>
</table>

Annex IV. Risk Assessment Matrix

Risks	Likelihood of Risk[1]	Expected Impact of Risk	Policy Response
Global resurgence of the Covid-19 pandemic. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	Medium	**Medium:** While the link between economic activity and health restrictions is weakening, the outbreak of a vaccine-resistant variant could negatively impact economic recovery through stricter nationwide lockdowns and renewed uncertainty.	Ensure hospitals are adequately resourced. Plan ahead for vaccine or booster procurement and ramp-up the testing capacity to facilitate early detection of cases. Provide fiscal support in a targeted manner for affected firms and households.
Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.	Medium	**High:** Higher input cost for firms and further supply-chain disruptions leading to production losses and pass-through effects on consumer prices. Rising commodity prices could also increase the current account deficit. Trade partner growth could also be affected, further weakening the external position.	Provide financial support to vulnerable households and firms impacted by high energy prices. If inflation became substantially higher and/or more protracted, the policy mix may need to be rebalanced.
***Domestic Risk:* Increased consumer confidence leading to a faster and expanded run-down of excess savings.** Optimism around the path of the pandemic and/or demand-side stimulus aimed at consumers in the run up to elections could boost consumer confidence.	Medium	**High:** Higher household consumption & investment growth in the near term, with reduced scarring in the medium term. Temporary rise in inflation if all excess savings are directed towards consumption. Increase in government borrowing costs from higher fiscal spending. Acceleration in asset price growth.	Calibrate policies to ensure economy is not overly heated and use the opportunity to undertake needed structural reforms, such as the unemployment and pension reforms to raise potential growth.
Intensified geopolitical tensions and security risks. Geopolitical tensions in selected countries/regions cause economic/political disruption, disorderly migration, higher volatility in commodity prices (if supply is disrupted), and lower confidence, with spillovers to other countries.	High	**Medium:** Changing geopolitical alliances could undercut France's already decreasing trade market share. Conflicts in the middle east also risk further migration pressures.	Diversify product markets and undertake competitiveness enhancing reforms.
Disorderly transformations. Covid-19 triggers structural transformations, but the reallocation of resources is impeded by labor market rigidities, debt overhangs, and inadequate bankruptcy resolution frameworks. This, coupled with a withdrawal of Covid-19-related policy support, undermines growth prospects and increases unemployment, with adverse social/political consequences. Adjustments in global value chains and reshoring (partly driven by geostrategic and national security concerns) shift production activities across countries.	Medium	**Medium:** Larger economic scarring and increase in unemployment, wiping out previous gains. Lower firm productivity from dynamic misallocation of capital.	Providing training, hiring subsidies to address skill and regional mismatches. Support innovation and provide solvency support for viable firms that continue to be affected by the crisis.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions and accelerate emigration from these economies. A sequence of severe events in large economies reduces global GDP and prompts a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility.	Medium	**Medium:/Low** Localized climate shocks can affect French agricultural production and tourism. Shocks to trade partners could lower trade demand further weakening the external position.	Invest in climate mitigation and climate adaptation strategies, including early warning systems for disasters. Undertake competitiveness boosting reforms to mitigate the negative impact on trade.

[1] The Risk Assessment Matrix shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of the staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. ("Low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more.)

Annex VI. Debt Sustainability Analysis

A. Public Debt Sustainability Analysis

France's public debt sustainability risks increased considerably during the COVID-19 pandemic, which led to a sizable increase in the level of debt that is expected to persist. While debt sustainability risks receded slightly over the past year, largely due to better-than-expected growth outcome in 2020-21 and somewhat lower medium-term output losses, they remain sizable. Debt-to-GDP ratio is projected to reach about 115 percent of GDP in 2021 and to increase by another one percent of GDP over the medium-term under staff's baseline, while the materialization of some adverse scenarios could add almost another 10 percent of GDP to public debt. Low funding costs from accommodative monetary policy and the long average maturity of France's sovereign debt constitute important mitigating factors.

1. Background. Before the pandemic, the debt-to-GDP ratio oscillated around 98 percent of GDP over 2017–19, after increasing by around 33 percent of GDP between 2007 and 2016. Interest payments had nonetheless been on a steady declining path, reaching 1.4 percent of GDP in 2019—a level not seen since the early 1980s—on the back of record low yields at issuance. In 2020, the debt ratio increased steeply to 115 percent of GDP as a result of the economic contraction during the COVID-19 pandemic, with output contracting by 8 percent, and the strong fiscal policy response, with the deficit reaching more than 9 percent of GDP. Interest rates and spreads with respect to German bonds increased somewhat at the onset of the crisis but only for a short period, and the average yield of 10-year sovereign bonds in along 2020 was negative, at -0.15 percent.

2. Baseline assumptions. The baseline fiscal scenario is based on the initial 2021 budget law, the amendment voted in July 2021, and the draft 2022 budget. No offsetting measures or consolidation effort is assumed in the baseline. The economy is expected to keep recovering and growing above potential during the forecast horizon, with the growth rate of real GDP gradually declining from 3.7 percent in 2022 to 1.4 percent over the medium term, but to remain about 1.2 percent below the level projected before the onset of the pandemic. While long-term interest rates (benchmark 10-year sovereign bond yield) are projected to gradually increase over the projection horizon from current historical low levels, the effective interest rate is projected to decline further as maturing debt would still be refinanced at lower rates.

3. Baseline projections.

- **Fiscal deficit.** Staff projects the primary fiscal deficit to reach 7.1 percent of GDP in 2021 and to decline to 4.1 percent of GDP in 2022. The improvement largely reflects a reduction of about 2½ percent of GDP in funding needs for emergency support schemes (notably, the short-time work scheme and grants to offset revenue losses of firms affected by containment measures) as well as the expansion in output. The primary deficit is projected to continue declining until reaching about 2½ percent of GDP over the medium run—compared to a projection of around 1.6 percent of GDP before the pandemic and a debt-stabilizing level of 2 percent of GDP. The effective interest rate is expected to remain contained at around 0.9 percent on average over

2022-26 on the back of exceptionally accommodative monetary policy and given the long maturity of French debt.

- **Debt and gross financing needs.** Despite still-large primary deficits, the debt level is projected to decline from 115.1 percent of GDP in 2020 to 113.3 in 2022 due to a very favorable interest-growth differential and other stock/flow adjustments (notably, the withdrawal of treasury deposits built in 2020). Over 2023-26, however, the primary deficit contribution would more than offset the favorable interest-growth dynamics and debt would increase to about 115.7 percent of GDP by 2026. Under the baseline, the gross financing needs of the government would gradually decline from more than 27 percent of GDP in 2021 to about 22 percent of GDP in 2026.

4. Realism of Projections. The median forecast error for real GDP growth during 2011–19 was -0.3 percent, suggesting an upward bias in staff projections during that period. This is associated with a median forecast error of -0.2 percent for the primary balance and a -0.3 percent median forecast bias for inflation. Cross-country experience suggests that the projected adjustment and level of the cyclically-adjusted primary balance (CAPB) are below the thresholds that would cast doubt on the feasibility of the adjustment, based on high-debt country experience. While at about 3.3 percent of GDP, the largest projected adjustment over any three years during the projection is slightly above the threshold of 3 percent of GDP, the rather larger near-term adjustment in the CAPB mostly reflects the unwinding of sizeable but temporary fiscal measures adopted in response to the pandemic during 2020-21. In turn, the maximum average level of the cyclically-adjusted primary deficit for any consecutive 3-year period during the projection horizon reaches -2½ percent of GDP, well below the threshold of 3.5 percent of GDP.

5. Heat map and fan chart. Risks from the debt level and gross financing needs are deemed high, given that France is above the pre-COVID thresholds of 85 and 20 percent of GDP, respectively, under the baseline and all stress scenarios. The share of public debt held by non-residents was 50 percent in 2020, above the relevant threshold of 45 percent—although it declined significantly from the peak of 71 percent reached in early 2010. The high share of public and private (mainly banks) debt held by non-residents also results in high external financing requirements. Risks related to the sharp increase in contingent liabilities during the pandemic from state guarantees on bank loans are also important. The fan chart analysis with no restriction on the distribution of shocks indicates a 50 percent probability of debt reaching between 108 and 120 percent of GDP by 2026. When upside risks are constrained, the analysis indicates a 50 percent probability of debt being between 113 and 122 percent of GDP by 2026.

6. Shocks and Stress Tests. France's debt dynamics would worsen significantly more than under the baseline in a scenario in which the economy is hit by a combination of a negative shock to growth, public finances, and interest rates, which is the most pertinent scenario for France at the current juncture, with debt reaching about 124 percent of GDP in 2026 (compared to 115.7 percent under the baseline). A standalone shock to interest rates would lead to a backloaded deterioration in the debt path (given its maturity profile) which would reach about 119 percent of GDP by 2026. While bankruptcies have remained contained so far, the increase in contingent liabilities related to fiscal measures in response to the COVID-19 pandemic has increased the overall risks to the path of public debt.[1] A scenario in which contingent liabilities materialize would also lead to sizable deterioration in debt dynamics, with debt reaching close to 121 percent of GDP by 2026.

- **Growth shocks.** Under this scenario, real output growth rates in 2022-23 are assumed to be lower than in the baseline by one standard deviation (computed over 2010-19, that is, excluding the exceptional outcome of 2020, implying a shock to growth of 0.7 percentage points). The decline in growth is assumed to lead to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth) and to an increase in the interest rate, by 25 basis points for every 1 percent of GDP worsening of primary balance. Public debt would increase to about 119 percent of GDP by 2026 under this scenario. Gross financing needs over 2022-26 would be ¾ percent of GDP higher, on average, than under the baseline.
- **Primary balance shock.** This scenario examines the implications of a shock to non-interest spending, such that only half of the annual improvement in the primary balance over 2022-26 under the baseline materializes (implying, for instance, that the deficit is 1.5 percent of GDP higher in 2022). The scenario also assumes that the interest rate is commensurately higher (25 basis points for each percent of GDP that the deficit worsens). Public debt would follow a similar path than under the growth shock scenario, reaching about 118 percent of GDP in 2026.
- **Interest rate shock.** This scenario assumes an increase in projected interest rates by of 270 basis points from 2022 onward.[2] The deterioration of public debt and gross financing needs are back-loaded, as old debt gradually matures and new debt is contracted at higher interest rates.[3] The debt ratio under this scenario would reach about 118 percent of GDP by 2026. Gross financing needs would be 2.1 percent of GDP higher than under the baseline scenario by 2026.
- **Real exchange rate shock.** This scenario assumes a 13 percent devaluation of the real exchange rate in 2022. The debt and gross financing needs would be very similar to those under the baseline scenario.
- **Combined macro-fiscal shock.** This scenario combines shocks to real growth, the interest rate, the exchange rate, and the primary balance. Under this scenario, debt would reach about 124 percent of GDP in 2026, with average gross financing needs over 2022-26 about 2.4 percent of GDP higher than under the baseline.
- **Contingent liability shock.** This scenario assumes that about 3 percent of GDP in COVID guarantees (representing approximately about 50 percent of bank loans guarantees claimed to date) are called. In this scenario, real GDP growth in 2022-23 is also assumed to be 0.7 percent lower than in the baseline. Under this scenario, debt increases to around 121 percent of GDP by 2026.

[1] At the onset of the pandemic, the authorities approved an envelope of public guarantees of about 14.2 percent of GDP in response to the crisis, mostly for bank loans (€300 billion out of a total envelope of about €330 billion). The total use of guarantees has however been much smaller, with around €140 billion loan guarantees claimed by October 2021.

[2] The increase in interest rates under this scenario is calibrated by the difference between the average effective real interest rate observed 2011-20 and the average over the projection period.

[3] As of July-2021, the average maturity of medium- and long-term outstanding debt was around 9 years.

7. Overall risk assessment and mitigating factors. The path of public debt and gross financing needs under the baseline is subject to risks. France has committed a significant envelope of public guarantees in the context of the pandemic. The guarantees for bank loans (PGE program), with an envelope of €300 billion (out of a total of €334 billion in guarantees made available during the pandemic), has been extended until June 2022—although take-up has stabilized at a much lower level, less than ½ of the total envelope, and losses from guarantees being called remain contained.[4] A tightening financial cycle (triggered, for instance, by earlier normalization of monetary conditions) presents an additional source of risks with problems in balance sheets of the private sector potentially migrating to the public sector (e.g., by triggering contingent liabilities or requiring bailouts). However, risks from higher funding costs would remain contained over the medium term given the maturity profile of French debt (see stress test below) and, to the extent that to the extent that the higher yields reflect a better-than-expected recovery, including in France, the primary balance would be higher than projected under the baseline, improving debt dynamics. Moreover, there are important mitigating factors to debt risks, notably the long average maturity, home bias, and large institutional investor base of French sovereign debt, the low share that is issued in foreign currency, and financing from the Next Generation EU Recovery Fund.

B. External Debt Sustainability Analysis

8. The external DSA provides a framework to examine a country's external debt sustainability that complements the External Sector Assessment (Annex I). Under the baseline scenario, external debt is projected to decrease from 228 percent of GDP in 2020 to 218 percent of GDP in 2021 and then decline gradually thereafter to a level slightly above the pre-COVID ratio, helped mainly by favorable growth interest rate differentials. France has a high level of external debt, but some mitigating factors include the current low cost of debt, the high amount of foreign assets, the limited share of debt in foreign currency, and a positive non-interest current account.

- **Background.** External debt increased by about 30 percent point of GDP in 2020 following the large contraction in GDP from COVID-19 and associated financing needs. Globally active banks account for about half of the external debt (104 percent of GDP), while the government accounts for another quarter (54 percent of GDP). Intercompany loans account for about 10 percent of GDP in external debt. France also holds a substantial stock of foreign assets.
- **Assessment.** France's external debt, while high, is sustainable over the medium term. Under the baseline scenario, external debt is projected to decline from 218 percent of GDP in 2021 to 214 percent of GDP in 2026 but remain close to pre-COVID levels. This gradual decline is helped by the projected non-interest current account surpluses in the medium term, and favorable growth interest rate differentials. Some mitigating factors include the current low cost of debt, the high amount of foreign assets, the limited share of debt in foreign currency, and a positive non-interest current account. The path of external debt is robust to standard stress test scenarios. Under the historical scenario, in which macroeconomic variables are set equal to their

[4] Based on estimates from Banque de France, the government projects less than ¼ percent of GDP in net losses from PGE.

current negative growth averages, the external debt would not decline over the medium term. Under this scenario, external debt would steadily increase from 218 percent of GDP in 2021 to about 261 percent of GDP in 2026. External debt is more vulnerable to a real depreciation and to some extent the growth shock, while the effect of an interest shock as well as a non-interest current account shock would be small. Under the real depreciation scenario, with a one-time depreciation of 30 percent in 2022, external debt would rise to 245 percent of GDP and reach 249 percent of GDP by 2026.

Figure VI.1. France Public DSA Risk Assessment

Heat Map

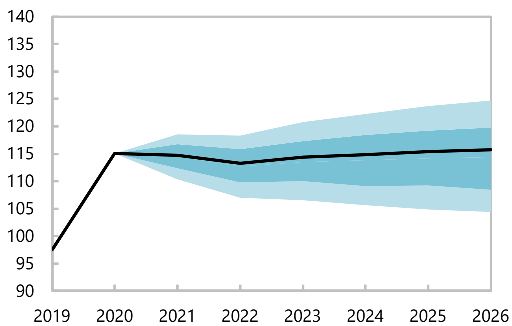
Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

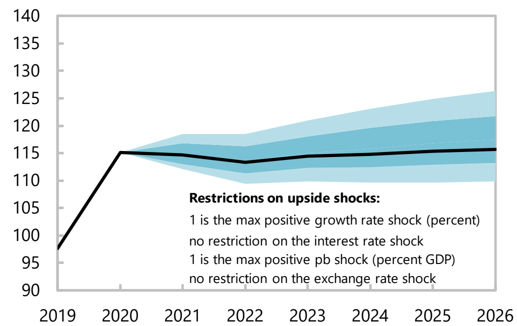
(in percent of GDP)

Baseline Percentiles: 10th-25th 25th-75th 75th-90th

Symmetric Distribution



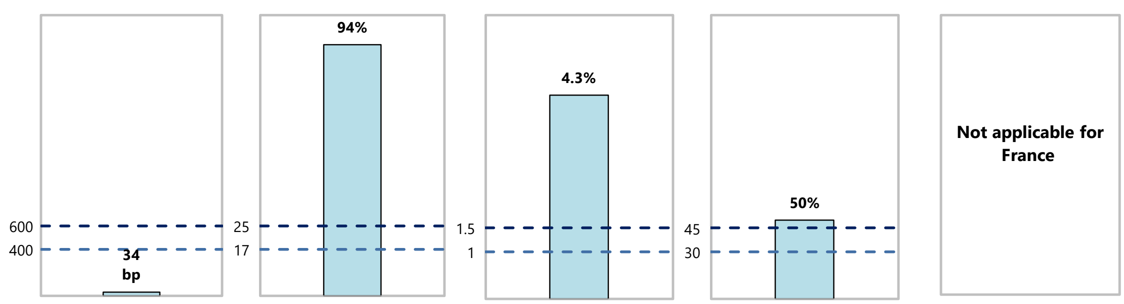
Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)

France Lower early warning Upper early warning



Bond spread	External Financing Requirement	Annual Change in Short-Term Public Debt	Public Debt Held by Non-Residents	Public Debt in Foreign Currency
(in basis points) 4/	(in percent of GDP) 5/	(in percent of total)	(in percent of total)	(in percent of total)

Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

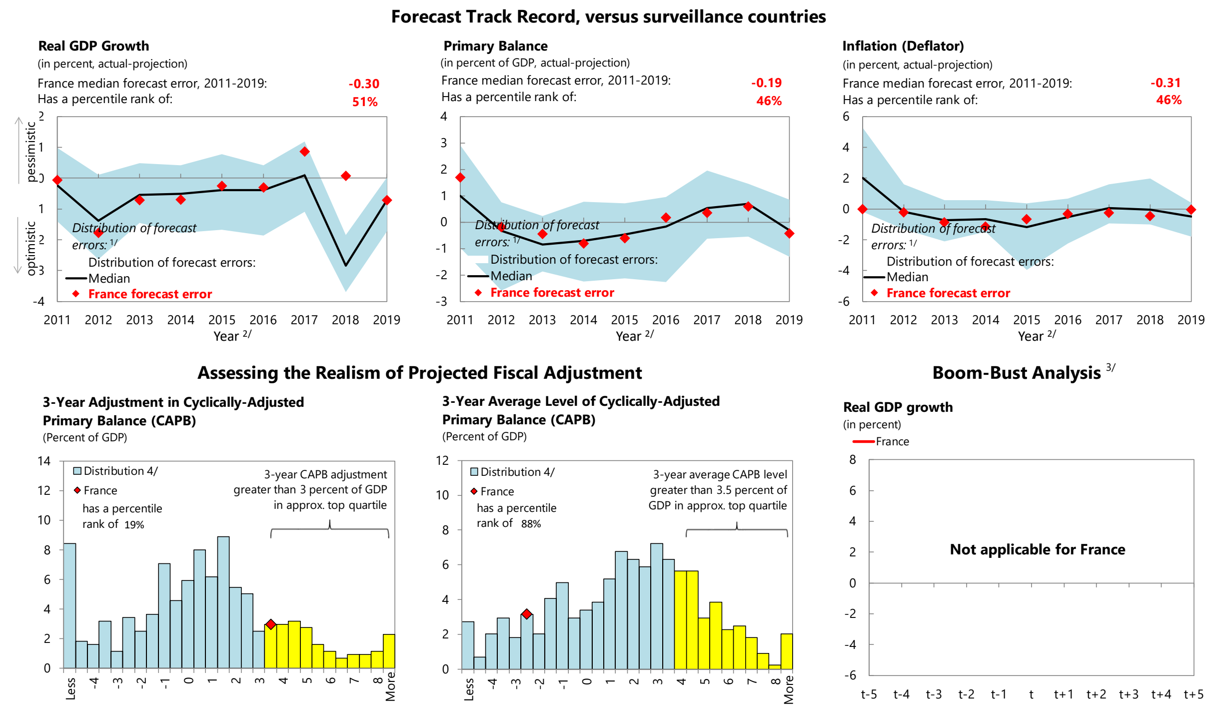
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

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

4/ Long-term bond spread over German bonds, an average over the last 3 months, 14-Aug-21 through 12-Nov-21.

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

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



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for France, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

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

(in percent of GDP unless otherwise indicated)

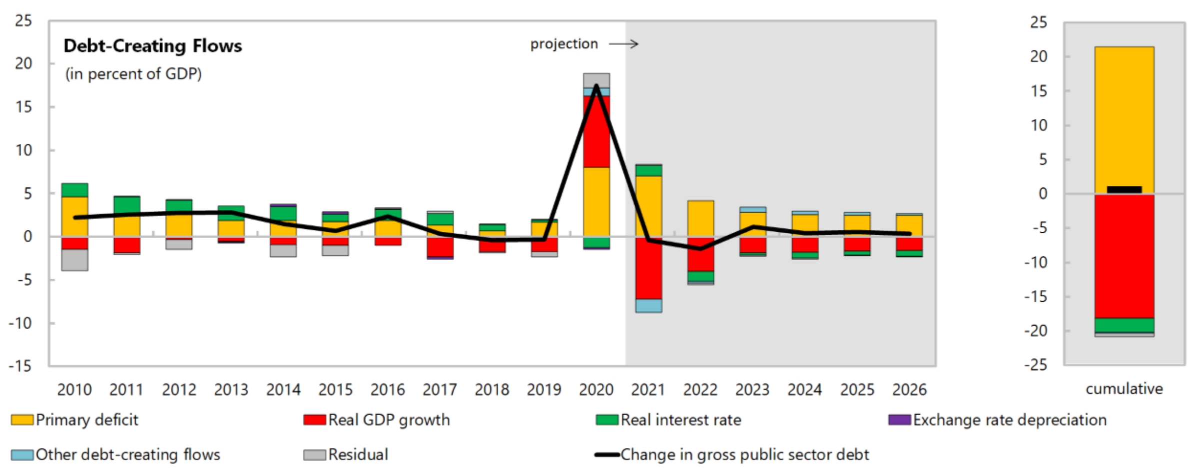
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	93.5	97.6	115.1	114.7	113.3	114.4	114.8	115.3	115.7
Public gross financing needs	20.4	15.7	23.0	27.3	23.7	22.9	22.1	21.7	21.8
Real GDP growth (in percent)	1.4	1.8	-8.0	6.7	3.7	1.7	1.6	1.5	1.4
Inflation (GDP deflator, in percent)	0.9	1.3	2.7	0.2	1.9	1.0	1.4	1.3	1.4
Nominal GDP growth (in percent)	2.2	3.1	-5.5	6.9	5.6	2.8	3.1	2.8	2.9
Effective interest rate (in percent) [4/]	2.5	1.5	1.2	1.3	0.9	0.8	0.8	0.9	0.9

As of December 02, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		35
5Y CDS (bp)		22
Ratings	Foreign	Local
Moody's	Aa2	Aa2
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.7	-0.3	17.5	-0.4	-1.4	1.1	0.4	0.6	0.4	0.6	
Identified debt-creating flows	2.4	0.2	15.8	-0.5	-1.2	1.3	0.5	0.7	0.5	1.2	
Primary deficit	2.1	1.7	8.0	7.1	4.1	2.8	2.6	2.5	2.5	21.5	-2.0
Primary (noninterest) revenue and grants	52.4	52.2	52.5	51.9	51.1	51.0	50.9	50.6	50.6	306.1	
Primary (noninterest) expenditure	54.5	53.9	60.5	59.0	55.2	53.8	53.5	53.1	53.0	327.6	
Automatic debt dynamics [5/]	0.2	-1.5	6.8	-6.1	-5.2	-2.1	-2.5	-2.1	-2.2	-20.2	
Interest rate/growth differential [6/]	0.2	-1.5	7.0	-6.1	-5.2	-2.1	-2.5	-2.1	-2.2	-20.2	
Of which: real interest rate	1.4	0.2	-1.3	1.2	-1.1	-0.3	-0.7	-0.5	-0.7	-2.1	
Of which: real GDP growth	-1.2	-1.7	8.3	-7.2	-4.0	-1.9	-1.8	-1.6	-1.6	-18.1	
Exchange rate depreciation [7/]	0.0	0.0	-0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	1.0	-1.5	-0.2	0.6	0.4	0.3	0.3	-0.1	
Direct equity support to strategic firms (negative)	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other stock/flow adjustments	0.0	0.0	1.0	-1.8	-0.5	0.6	0.4	0.3	0.3	-0.8	
Residual, including asset changes [8/]	-0.7	-0.6	1.7	0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.5	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

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

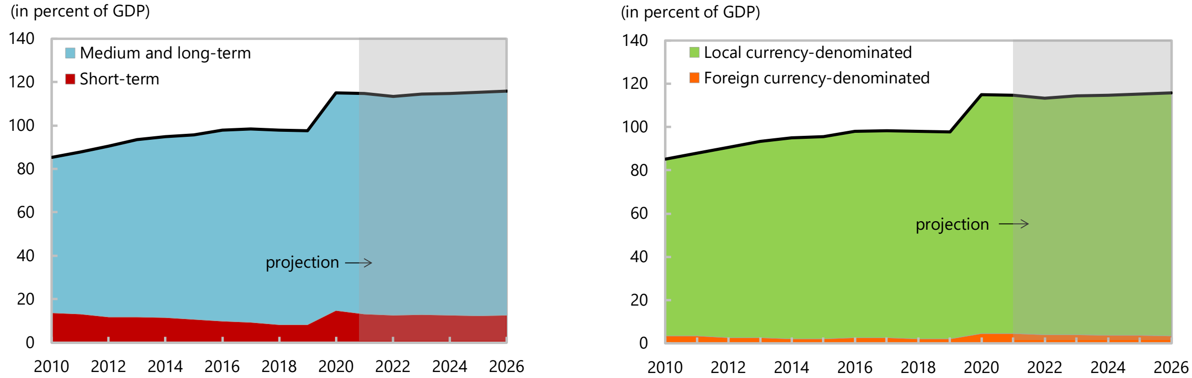
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

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

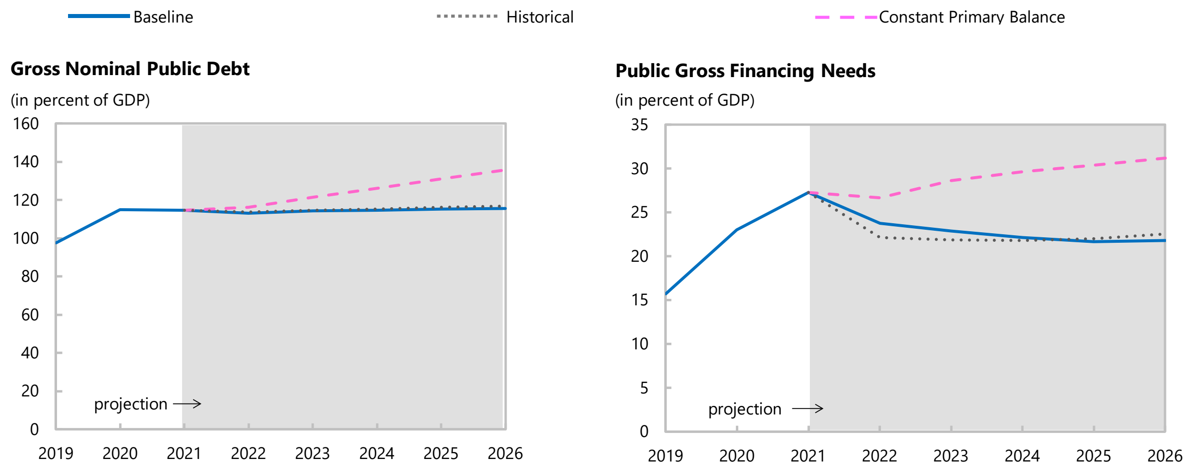
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

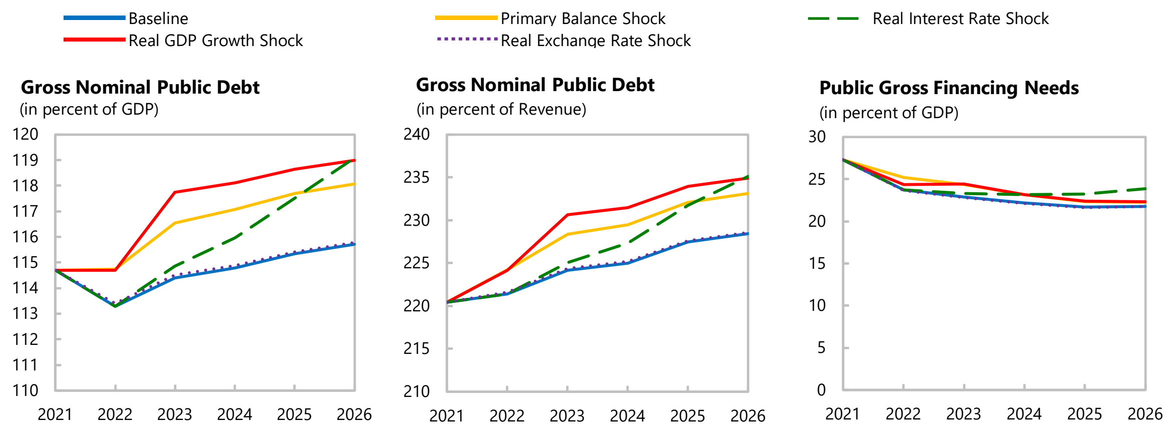
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.7	3.7	1.7	1.6	1.5	1.4
Inflation	0.2	1.9	1.0	1.4	1.3	1.4
Primary Balance	-7.1	-4.1	-2.8	-2.6	-2.5	-2.5
Effective interest rate	1.3	0.9	0.8	0.8	0.9	0.9
Constant Primary Balance Scenario						
Real GDP growth	6.7	3.7	1.7	1.6	1.5	1.4
Inflation	0.2	1.9	1.0	1.4	1.3	1.4
Primary Balance	-7.1	-7.1	-7.1	-7.1	-7.1	-7.1
Effective interest rate	1.3	0.9	0.8	0.8	0.8	0.8

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.7	1.4	1.4	1.4	1.4	1.4
Inflation	0.2	1.9	1.0	1.4	1.3	1.4
Primary Balance	-7.1	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	1.3	0.9	1.1	1.3	1.4	1.6

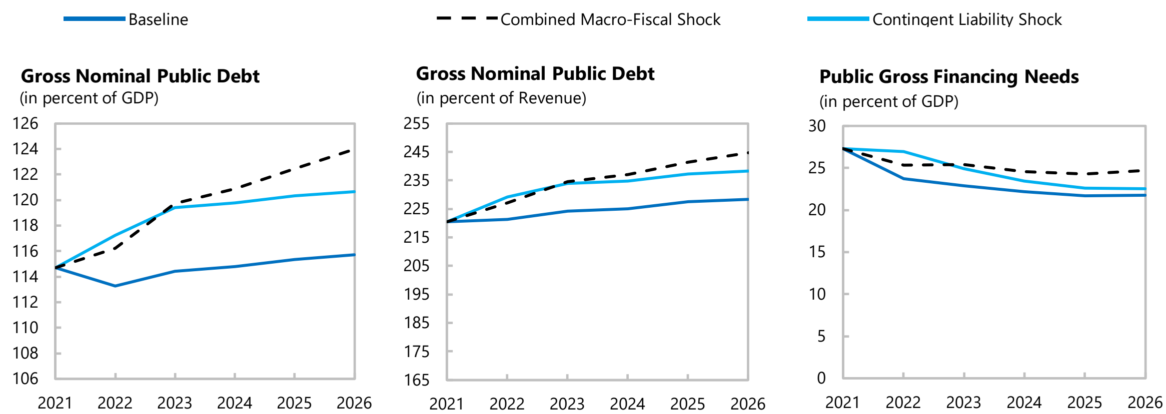
Source: IMF staff.

Figure VI.5. France Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	6.7	3.7	1.7	1.6	1.5	1.4
Inflation	0.2	1.9	1.0	1.4	1.3	1.4
Primary balance	-7.1	-5.6	-3.5	-2.7	-2.5	-2.5
Effective interest rate	1.3	0.9	0.9	0.9	0.9	0.9
Real Interest Rate Shock						
Real GDP growth	6.7	3.7	1.7	1.6	1.5	1.4
Inflation	0.2	1.9	1.0	1.4	1.3	1.4
Primary balance	-7.1	-4.1	-2.8	-2.6	-2.5	-2.5
Effective interest rate	1.3	0.9	1.2	1.5	1.7	2.0
Combined Shock						
Real GDP growth	6.7	3.0	1.0	1.6	1.5	1.4
Inflation	0.2	1.7	0.9	1.4	1.3	1.4
Primary balance	-7.1	-5.6	-3.8	-2.7	-2.5	-2.5
Effective interest rate	1.3	0.9	1.2	1.5	1.8	2.0

Real GDP Growth Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	6.7	3.0	1.0	1.6	1.5	1.4
Inflation	0.2	1.7	0.9	1.4	1.3	1.4
Primary balance	-7.1	-4.6	-3.8	-2.6	-2.5	-2.5
Effective interest rate	1.3	0.9	0.8	0.9	0.9	0.9
Real Exchange Rate Shock						
Real GDP growth	6.7	3.7	1.7	1.6	1.5	1.4
Inflation	0.2	2.3	1.0	1.4	1.3	1.4
Primary balance	-7.1	-4.1	-2.8	-2.6	-2.5	-2.5
Effective interest rate	1.3	0.9	0.8	0.8	0.9	0.9
Contingent Liability Shock						
Real GDP growth	6.7	3.0	1.0	1.6	1.5	1.4
Inflation	0.2	1.7	0.9	1.4	1.3	1.4
Primary balance	-7.1	-7.1	-2.8	-2.6	-2.5	-2.5
Effective interest rate	1.3	0.9	0.9	0.9	0.9	0.9

Source: IMF staff.

Table VI.1. France External Debt Sustainability Framework, 2016–26

(in percent of GDP unless otherwise indicated)

	Actual							Projections					
	2016	2017	2018	2019	2020			2021	2022	2023	2024	2025	2026
1 **Baseline: External debt**	201.2	200.2	200.2	198.1	227.6			**217.9**	**214.0**	**214.2**	**213.9**	**213.9**	**213.8**
2 Change in external debt	14.6	-1.0	0.0	-2.1	29.6			-9.8	-3.9	0.2	-0.3	0.0	0.0
3 Identified external debt-creating flows (4+8+9)	-3.5	-7.6	-9.8	-3.6	9.1			-12.9	-7.1	-3.1	-3.1	-3.2	-3.0
4 Current account deficit, excluding interest payments	-3.2	-2.1	-1.7	-2.3	-1.2			-1.6	-1.2	-0.7	-0.8	-1.0	-0.9
5 Deficit in balance of goods and services	0.5	0.9	1.1	0.9	1.9			1.6	1.3	1.2	1.2	1.2	1.1
6 Exports	31.6	32.1	32.8	32.7	28.8			31.5	32.5	32.6	32.9	33.4	33.7
7 Imports	32.1	33.1	34.0	33.7	30.7			33.1	33.9	33.8	34.1	34.5	34.8
8 Net non-debt creating capital inflows (negative)	-1.1	-1.8	-2.6	-0.8	-3.4			-0.5	-0.7	-0.8	-0.9	-1.1	-1.1
9 Automatic debt dynamics 1/	0.9	-3.7	-5.6	-0.6	13.6			-10.8	-5.2	-1.6	-1.4	-1.1	-1.0
10 Contribution from nominal interest rate	3.7	2.9	2.5	2.6	3.1			3.0	2.5	1.9	1.9	1.9	2.0
11 Contribution from real GDP growth	-1.9	-4.7	-3.4	-3.8	16.4			-13.8	-7.7	-3.5	-3.3	-3.0	-2.9
12 Contribution from price and exchange rate changes 2/	-1.0	-1.9	-4.6	0.6	-5.9			...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3) 3/	18.1	6.5	9.9	1.5	20.5			3.1	3.2	3.3	2.8	3.2	3.0
External debt-to-exports ratio (in percent)	637.4	622.9	609.6	604.8	789.5			692.7	657.6	657.8	650.7	641.0	635.0
Gross external financing need (in billions of US dollars) 4/	1904.0	2069.6	2133.3	2238.7	2434.1			2848.9	3009.7	3097.4	3230.8	3352.7	3478.9
in percent of GDP	77.0	79.9	76.5	82.0	92.7	10-Year	10-Year	97.6	98.6	97.2	97.3	97.4	97.4
Scenario with key variables at their historical averages 5/								**218.9**	**223.7**	**233.1**	**242.2**	**251.4**	**260.9**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Real GDP growth (in percent)	1.0	2.4	1.8	1.8	-8.0	0.4	3.0	6.7	3.7	1.7	1.6	1.5	1.4
GDP deflator in US dollars (change in percent)	0.3	2.3	5.8	-3.9	4.5	-0.2	6.7	4.3	0.8	2.7	2.6	2.2	2.2
Nominal external interest rate (in percent)	2.0	1.5	1.3	1.3	1.5	1.7	0.3	1.5	1.2	0.9	0.9	0.9	0.9
Growth of exports (US dollar terms, in percent)	0.3	6.6	10.1	-2.5	-15.3	0.9	9.3	21.4	8.1	4.5	5.2	5.3	4.6
Growth of imports (US dollar terms, in percent)	0.8	7.9	10.6	-3.0	-12.3	1.1	9.5	19.9	7.0	4.1	5.2	5.0	4.4
Current account balance, excluding interest payments	3.2	2.1	1.7	2.3	1.2	2.4	0.7	1.6	1.2	0.7	0.8	1.0	0.9
Net non-debt creating capital inflows	1.1	1.8	2.6	0.8	3.4	1.1	1.5	0.5	0.7	0.8	0.9	1.1	1.1

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

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

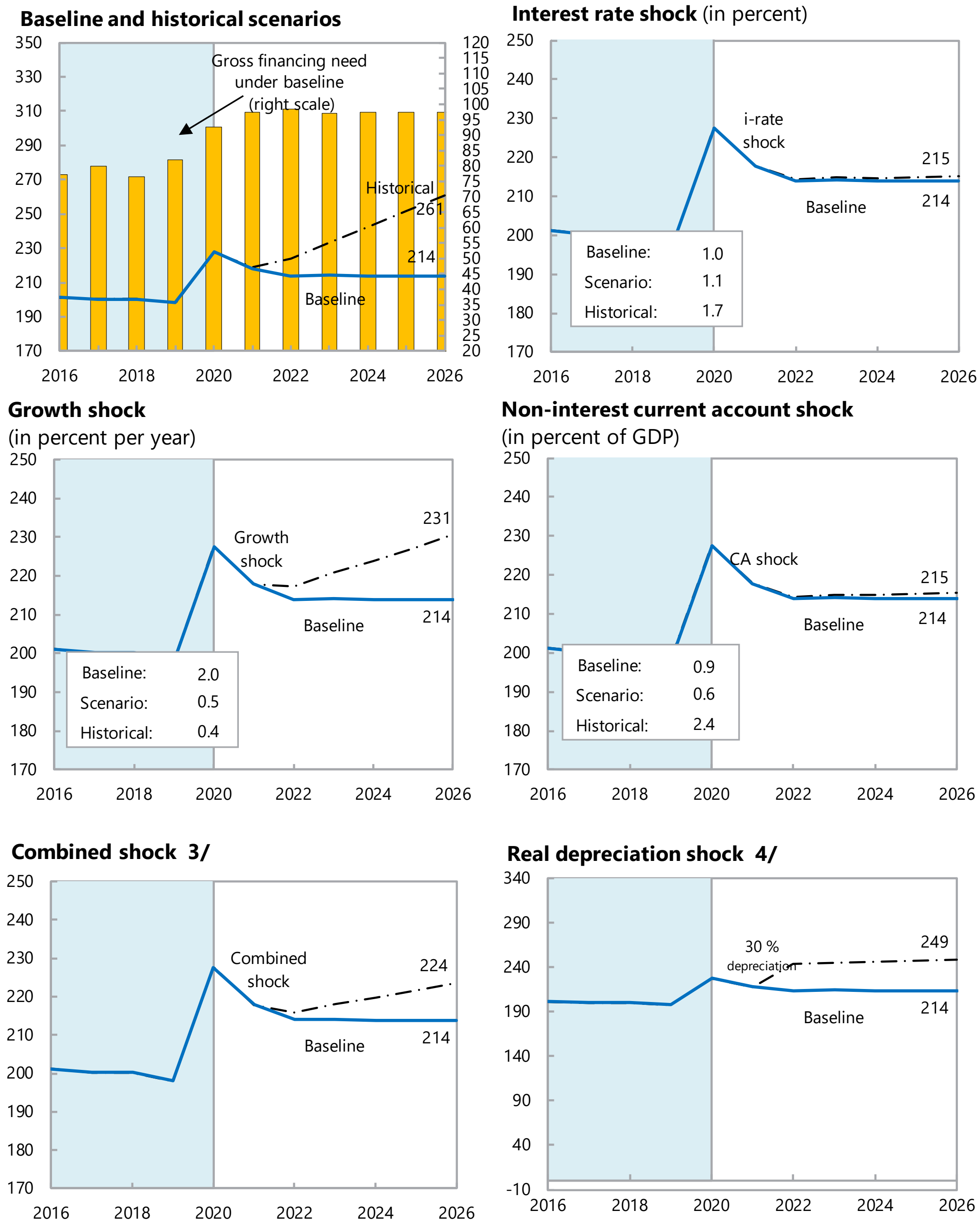
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario bein presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information i used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2022.

INTERNATIONAL MONETARY FUND

FRANCE

December 14, 2021

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By European Department

CONTENTS

FUND RELATIONS

(As of October 31, 2021)

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

General Resources Account	SDR Million	Percent of Quota
Quota	20,155.10	100.00
Fund Holding of Currency (Exchange Rate)	15,151.86	75.18
Reserve Tranche Position	5,003.33	24.82
Lending to the Fund		
New Arrangements to Borrow	223.62	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	29,451.96	100.00
Holdings	27,769.18	94.29

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Sep 19, 1969	Sep 18, 1970	985.00	985.00
Stand-By	Jan 31, 1958	Jan 30, 1959	131.25	131.25
Stand-By	Oct 17, 1956	Oct 16, 1957	262.50	262.5

Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2021	**2022**	**2023**	**2024**	**2025**
Principal					
Charges/Interest	0.24	1.34	1.34	1.34	1.34
Total	**0.24**	**1.34**	**1.34**	**1.34**	**1.34**

Implementation of HIPC Initiative: Not applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not applicable

Implementation of Post-Catastrophe Debt Relief (PCDR): Not applicable

Exchange Arrangements:

- The currency of France is the euro. The exchange rate arrangement of the euro area is free floating. France participates in a currency union (EMU) with 18 other members of the EU and has no separate legal tender. The euro, the common currency floats freely and independently against other currencies.

- France is an Article VIII member and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions imposed solely for the preservation of international peace and security, which have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultation:

The last Article IV consultation was concluded on January 13, 2021. The associated Executive Board assessment is available at https://www.imf.org/en/News/Articles/2021/01/19/pr2014-france-imf-executive-board-concludes-2020-article-iv-consultation and the staff report at https://www.imf.org/en/Publications/CR/Issues/2021/01/15/France-2020-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-50022. France is on the standard 12-month consultation cycle.

FSAP Participation and ROSC:

France–Report on the Observance of Standards and Codes (ROSC): Module I–Fiscal Transparency	October 17, 2000
Fiscal Transparency—Update	IMF Country Report No. 01/196, 11/05/01
Fiscal Transparency—Update	IMF Country Report No. 04/345, 11/03/04

Summary: The report found that France has achieved a high level of fiscal transparency and has introduced a number of improvements in coverage and presentation of fiscal information. Notable areas of progress include the development in the final accounts publication to include more complete information on government assets and liabilities as well as disclosure of contingent liabilities. Accounting standards have been changed to reflect accruals principles in a number of areas, and these standards are clearly explained. The staff suggested that further steps could be taken to identify and report quasi-fiscal activities in the budget presentation, provide a more consolidated picture of fiscal activity outside the appropriation process, and improve the reconciliation of stated policies with outcomes at the general government level.

These issues have been addressed in the *Loi organique aux lois de finance* (LOLF), which has become fully effective on January 1, 2006. In addition to the annual appropriations, the first multi-annual fiscal framework law was adopted in January 2009, and contains fiscal objectives for the period 2009–12. The budget is organized along missions and provides details on the level of appropriations for each mission and performance indicators by which the expected results of the mission will be assessed ex post. The State Audit Office has been given the new assignment of certifying the public accounts, and implementation of accruals basis accounting has been confirmed. Parliamentary oversight powers have been strengthened.

France–Report on the Observance of Standards and Codes (ROSC): Module II–Transparency in Monetary and Financial Policies	October 2000, corrected: 2/15/01
Transparency in Monetary and Financial Policies—Update	IMF Country Report No. 01/197, 11/05/01
Transparency in Monetary and Financial Policies—Update	IMF Country Report No. 02/248, 11/13/02

Summary: The 2000 ROSC noted that transparency of financial policies is accorded a high priority by all financial agencies assessed, and they are in observance of the good practices of the *Code of Good Practices on Transparency in Monetary and Financial Policies*. The major agencies disclose their objectives, their legal and institutional frameworks, and have open processes of policymaking and regulation. The principles of transparency are observed by dissemination of relevant information to the public and in the agencies' arrangements for internal conduct, integrity, and accountability. However, the staff noted that the framework for supervision and regulation applicable to mutual insurance firms is not as well defined and suggested to improve its transparency. The transparency of monetary policy was not assessed by the Fund team as the *Banque de France* is a member of the European System of Central Banks and no longer conducts independent monetary policy.

Subsequently, the framework for supervision and regulation applicable to a specific group of mutual insurance firms was modified in a number of steps. In August 2003, legislation created a single supervisory body, the *Commission de Contrôle des Assurances, Mutuelles et Institutions de Prévoyance* (CCAMIP) by merging the regular insurance supervisor (CCA) and mutualities' supervisor (CCMIP). Coordination with the banking sector supervisors was strengthened and the powers of the supervisory authorities extended. In 2010, supervision of the banking and insurance sectors was unified under the *Autorité de contrôle prudentiel (ACP)*, which subsequently also was granted resolution powers and was renamed the *Autorité de contrôle prudentiel et de résolution (ACPR)*.

France–Report on the Observance of Standards and Codes (ROSC): Data Module	IMF Country Report No. 03/339, 10/29/03
Data Module—Update	IMF Country Report No. 05/398, 11/07/05

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

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

France participates to the G-20 Data Gaps Initiative, which aims at implementing twenty key recommendations aimed at addressing the data gaps identified after the global financial crisis and promote the regular flow of timely and reliable statistics for policy use. For example, with regard to Recommendation on Sectoral Accounts, all target requirements (dissemination of both annual and quarterly nonfinancial and financial accounts and balance sheets) have been met through the recent transmission of additional data to the OECD.

***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 04/344, 11/03/04
FSAP Assessment and Reports on ROSCs	IMF Country Report No. 04/345, 11/03/04
FSAP Assessment	IMF Country Report No. 05/185, 06/08/05
Publication of FSAP—Detailed Assessment of Observance of Standards and Codes	IMF Country Report No. 05/186, 06/08/05
***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 12/341, 12/07/12

France: Financial Sector Assessment Program—Detailed Assessment of Observance of Standards and Codes	
Basel Core Principles for Effective Banking Supervision	*IMF Country Report No. 13/180, June 2013*
Insurance Core Principles	*IMF Country Report No. 13/181, June 2013*
IOSCO Objectives and Principles of Securities Regulation	*IMF Country Report No. 13/182, June 2013*
Securities Settlement Systems and for Central Counterparties	*IMF Country Report No. 13/183, June 2013*
Financial Sector Assessment Program—Technical Notes	
Housing Prices and Financial Stability	*IMF Country Report No. 13/184, June 2013*
Stress Testing the Banking Sector	*IMF Country Report No. 13/185, June 2013*
***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 19/241, 07/24/19
France: Financial Sector Assessment Program—Technical Notes	
Anti-Money Laundering and Combating the Financing of Terrorism Regime in France	*IMF Country Report No. 19/326, Oct 2019*
Balance Sheet Risks and Financial Stability	*IMF Country Report No. 19/324, Oct 2019*
Issues in Insurance Supervision and Regulation	*IMF Country Report No. 19/323, Oct 2019*
Key Attributes of Effective Resolution Regimes for Insurance Companies	*IMF Country Report No. 19/328, Oct 2019*
Macroprudential Policy Framework and Tools	*IMF Country Report No. 19/327, Oct 2019*
Nonfinancial Corporations and Households Vulnerabilities	*IMF Country Report No. 19/321, Oct 2019*

Risk Analysis of Banking and Insurance Sector — *IMF Country Report No. 19/322, Oct 2019*

Select Topics in Financial Supervision and Oversight — *IMF Country Report No. 19/325, Oct 2019*

Summary: The 2004 report concluded that France's financial sector is strong and well supervised. No weaknesses that could cause systemic risks were identified. The strength of the system is supported by the financial soundness indicators and the strong conformity to the supervisory and regulatory standards approved by the Basel Committee, IAIS, IOSCO, FATF, and CPSS. The degree of observance of the transparency code is high in all relevant areas. The French banking sector has been modernized and restructured over the past two decades and is well capitalized. Systemic vulnerabilities in the important insurance sector are well contained. Securities markets are large and sophisticated.

The FSAP Update undertaken in January and June 2012 confirmed the resilience of France's financial system to severe market pressures but also identified challenges faced by the system. While its structure has contributed to solid profit generation, the crisis exposed the risks posed by the banks' size, complexity, and dependence on wholesale funding. The larger banks have been actively restructuring their balance sheets—moving to more stable sources of funding; reducing their cross-border presence; and building up capital. They remain, however, vulnerable to sustained disruptions in funding markets and reduced profitability, which would cause delays in meeting capital-raising plans.
The 2012 report confirmed that the regulatory and supervisory regime for banks, insurance, and securities market was of a very high standard. Areas for improvement that emerged from the FSAP Update included greater de jure independence of supervisory authorities; disclosure of the capital treatment and related financial interactions within complex banking groups; a move toward a more economic risk-focused approach to insurance regulation and supervision; and enhanced supervision of investment service providers and financial advisors.

The 2012 report also found disclosure-related shortcomings. French banks and listed companies, more generally, make extensive public financial disclosures under IFRS, and as a result of bank regulations (Pillar III of Basel II). Nonetheless, disclosure of financial sector data falls short of international best practice and enhancements would be highly desirable. Market discipline would benefit from the publication of regular and comparable data on an institution-by-institution basis, as well as detailed official analyses of financial sector developments in France.

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

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

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

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: The economic database is comprehensive and of high quality, and data provision to the Fund is adequate for surveillance. The authorities regularly publish a full range of economic and financial data, and calendar dates of main statistical releases are also provided. France subscribes to the Fund's Special Data Dissemination Standard (SDDS) Plus and has transmitted data to international agencies in electronic format using the Statistical Data and Metadata exchange (SDMX) standard.
National Accounts: France adopted the *European System of Accounts 2010* (*ESA 2010*) in May 2014. The transition from the *ESA 1995* (*ESA95*) entailed a revision of national accounts data. New data sources have been incorporated in the revised estimates. Historical data series are available from 1949.
Government Finance Statistics: Starting from September 2014, government finance statistics (GFS) data have been compiled and reported based on *ESA 2010* methodology. Revised time series for general government deficit and debt levels from 1995 onwards, based on the new methodology, were reported shortly thereafter. Although the source data are collected by the Ministry of Economy and Finance, INSEE is principally responsible for the compilation and dissemination of fiscal data in a framework that is consistent with ESA. **Monetary and Financial Statistics:** Monetary data reported for *International Financial Statistics* are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data. Statistics for *International Financial Statistics* on banking institutions and monetary aggregates are prepared on a monthly basis and are timely. Monetary data are also disseminated in the quarterly *IFS Supplement* on monetary and financial statistics. **Financial Sector Surveillance:** France provides financial soundness indicators (FSIs), both the core and some of the encouraged indicators, on a timely basis. **External Sector:** Starting in June 2014, monthly balance-of-payments statistics are published using the guidelines set out in the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*). Back casting of previous periods started with the publication of the Annual report of the balance of payments and the international investment position end June 2014. Currently, a consistent set of quarterly balance of payments and IIP data in *BPM6* format covering the period 1999:Q1 to date are published.

Table 1. France: Table of Common Indicators Required for Surveillance
(As of December 2021)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	11/21	11/21	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/21	11/21	Monthly	Monthly	Monthly
International Investment Position	Q2:2021	Q4:2021	Quarterly	Quarterly	Quarterly
Reserve/Base Money	10/21	11/21	Monthly	Monthly	Monthly
Broad Money	09/21	11/21	Monthly	Monthly	Monthly
Central Bank Balance Sheet	09/21	11/21	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	09/21	11/21	Monthly	Monthly	Monthly
Interest Rates[2]	10/21	11/21	Daily	Daily	Daily
Consumer Price Index	10/21	11/21	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2020	11/21	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	09/2021	11/21	Monthly	Monthly	Monthly
Stock of Central Government Debt	09/21	11/21	Monthly	Monthly	Monthly
External Current Account Balance	09/21	11/21	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	09/21	11/21	Monthly	Monthly	Monthly
GDP/GNP	Q3:2021	Q4:2021	Quarterly	Quarterly	Quarterly
Gross External Debt	Q2:2021	Q4:2021	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] This information is provided on a budget-accounting basis (not on a national accounts basis).

INTERNATIONAL MONETARY FUND

FRANCE

January 13, 2022

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By | European Department

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

1. **The latest high frequency indicators point to the continued resilience of the French economy**. The Banque de France's business confidence survey carried out between December 20th and January 6th suggests that economic activity is holding up well overall, with GDP estimated to be slightly above the pre-crisis level in December. While recruitment difficulties are still significant, there is some easing of supply difficulties experienced by firms. In December, the harmonized index of consumer prices rose by 3.4 percent year on year, similar to the previous month, suggesting that inflation may be close to its peak with transitory factors likely dissipating during the course of 2022, as expected by staff.

2. **The incidence of Covid-19 infections escalated substantially in France due to the rapid spread of the Omicron variant**. France recorded more than 300,000 daily new infections since end-December—the highest reported in the country since the pandemic began. As of January 10, the rolling 7 day infection rate reached 4,000 per million, double the EU average; the positivity rate has also steadily increased, from about 5 percent in mid-December to 18 percent. Hospital admissions have been rising in all regions, but intensive care admissions remain stable so far.

3. **In response to the surge in infections, selective containment measures have been put in place.** These include compulsory teleworking for a minimum of three days per week, limitations on public gatherings, extended closures of nightclubs, international travel restrictions, and mandatory mask wearing in outdoor and indoor venues. The health pass—widely used for entry in several private and public establishments—has also been amended to require proof of vaccination and not just a negative test. Staff expects the infection spread and associated restrictions to have a negative impact on economic activity, with affected sectors (such as accommodation, catering) experiencing a likely decline in activity during the first quarter of 2022. This

would result in lower growth for 2022, by about 0.2 percentage point, compared to staff's previous projections (see updated selected economic indicators Table 1).

4. The authorities also announced targeted additional support to offset the economic impact of containment measures to affected sectors largely. The eligibility criteria and the generosity of some pre-existing emergency programs were expanded again to selected activities most affected by the new restrictions. For instance, the replacement rate of the short-time work scheme (*activité partielle*) for firms affect by containment measures was increased to 100 percent (without the need to justify a turnover loss of 65 percent). Access to a transfer program to cover fixed costs (*dispositif de prise en charge des coûts fixes*) for firms in selected activities (e.g., events) was extended to the entire tourism sector, and the turnover loss threshold was reduced from 65 percent to 50 percent. The cost of these extensions is expected to remain limited and to be covered within already approved envelopes for these programs. New measures to support industrial firms suffering from supply difficulties have also been announced; these measures include long-term lending for firms to bolster their working capital through the state investment bank Bpifrance.

5. A new organic law on public finances, adopted on December 28, 2021, introduced welcome improvements to France's fiscal framework. The organic law enhanced the scope of what should be included in the programming bills, in which medium-term objectives for public finances are set. Notably, the programming bills will include, for each year within the multi-year programming horizon, a target for real expenditure of the general government, as well as for each sublevel, and the corresponding projection in nominal terms. The organic law also requires the government to present, at each budgetary cycle, a report on public debt (including a debt sustainability analysis) and on deviations of nominal spending of public administrations between projections in the programming bill and actual outturns reported in the budget laws. The competencies of the existing Fiscal Council (HCFP) have been expanded to provide assessments of these additional dimensions, including on corrective actions envisaged by the government in the case of important deviations with respect to the multi-year targets.

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

			Projections	
	2019	2020	2021	2022
Real economy (change in percent)				
Real GDP	1.8	-8.0	6.7	3.5
Domestic demand	2.1	-6.8	6.1	2.5
Foreign balance (contr. to GDP growth)	-0.3	-1.1	0.4	0.9
CPI (year average)	1.3	0.5	2.1	2.4
GDP deflator	1.3	2.7	0.2	2.0
Public finance (percent of GDP)				
General government balance	-3.1	-9.2	-8.3	-5.2
Revenue	52.3	52.6	52.0	51.2
Expenditure	55.4	61.8	60.3	56.4
Primary balance	-1.7	-8.0	-7.1	-4.2
Structural balance (percent of pot. GDP)	-2.1	-6.0	-7.0	-5.0
General government gross debt	97.5	115.0	114.6	113.5
Labor market (percent change)				
Employment	0.8	-0.7	1.2	0.2
Labor force	0.2	-1.1	1.2	0.3
Unemployment rate (percent)	8.4	8.0	8.0	8.1
Credit and interest rates (percent)				
Growth of credit to the private non-financial sector	5.3	8.1	2.5	3.8
Money market rate (Euro area)	-0.4	...	...	...
Government bond yield, 10-year	0.1	...	...	...
Balance of payments (percent of GDP)				
Current account	-0.3	-1.9	-1.4	-1.4
Trade balance of goods and services	-0.9	-1.9	-1.6	-1.4
Exports of goods and services	32.7	28.8	31.7	33.8
Imports of goods and services	-33.7	-30.7	-33.3	-35.2
FDI (net)	0.2	1.6	0.8	0.9
Official reserves (US$ billion)	69.7	...	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.89	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	97.1	...	...	...
REER, ULC-based (2005=100, +=appreciation)	90.2	...	...	...
Potential output and output gap				
Potential output (change in percent)	1.0	-3.3	3.7	1.7
Memo: per working age person	1.2	-3.2	3.8	1.7
Output gap	0.0	-4.8	-2.1	-0.4

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

Statement by Mr. Buissé, Mr. Roman and Mr. Grossmann-Wirth on France
Executive Board Meeting
January 19, 2022

On behalf of the French authorities, we would like to express our appreciation for the work conducted by staff for this Article IV consultation. It was made under unusual circumstances, and our authorities welcomed that discussions took place both virtually and in person. They strongly valued this opportunity to exchange directly with the team on the diagnosis, risks and policy priorities, at a time where a strong economic recovery is under way despite a still very volatile situation. The article IV report and the two selected issues papers – on fiscal buffers and the interactions between the climate transition and the French labor market - are in our view a valuable contribution to the policy debate in France, and more generally in Europe and other advanced economies.

Recent developments, outlook and risks

On the health front, strong measures were taken to address the pandemic, including through an unprecedented vaccination campaign: as of January 9, 77 % of the total population - and 91 % of the adult population - has been fully vaccinated. All children between 5 and 11 years can receive a vaccine since December 28. As of December 28, the vaccine booster can be given to all adults as soon as 3 months after the last vaccine injection (Pfizer-BioNTech, Moderna or AstraZeneca) and 4 weeks after the single Janssen injection. As of January 9, 53% of the adult population has received a booster shot. As mentioned by staff, government measures such as the requirement to use a vaccine- or test-linked health pass at various venues (via QR code) and mandatory vaccination for certain occupations (such as people working in the health sector) had an important incentive effect and proved to be very effective in increasing the vaccination rate. A law to transform this health pass into a vaccine pass is currently in Parliament: it would require a full vaccination, including a booster shot, to access certain daily life activities (it would no longer be possible to show only a negative Covid test). The worldwide emergence of the highly transmissible Omicron variant, at a time when the fifth wave linked to the Delta variant is still active, implied to reinstate targeted restriction measures such as mandatory use of masks outdoor in some cities, limitation of attendance for indoor and outdoor events or mandatory teleworking, at least three days a week, for jobs that can be done remotely. Since the virus knows no borders, France has made vaccine donations one of its priorities, to support vulnerable countries which have been shaken by the pandemic and help increase vaccine cover on a global scale. France committed to donate 120 million doses by the end of first-half 2022, and a total of 28.9 million doses have been delivered to countries, as of December 10th (the list of countries and the dates of deliveries are publicly disclosed).

On the economic front, the response has moved from broad emergency support measures towards more targeted support and the continued implementation of the recovery plan focused on the environment, competitiveness, and social and territorial cohesion. French authorities have constantly adapted their support measures to the evolving health situation. Emergency support measures included short-time work schemes, a solidarity fund or social contribution deferrals and exemptions, as well as a state guarantee scheme for bank loans (*prêt garanti par l'État, PGE*). Those made a significant contribution to protecting the incomes of households and businesses in 2020, as more than 85% of the loss of national income was absorbed by the general government. The withdrawal of the various emergency measures has been differentiated across sectors and territories and progressive in time, in line with the gradual lifting of health restrictions and actual recovery conditions. With the recent deterioration of the health situation, new targeted restrictions on businesses have been announced and emergency support measures have been temporarily extended for the sectors most directly exposed. The €100bn "France Relance" recovery plan, of which 40% is financed by the European Union under the NextGeneration EU initiative, has progressively taken over from the emergency measures. By end-December 2021, €72bn out of the envelope had already been committed. In addition, a new investment plan, "France 2030", was presented on October 12, 2021. With €30bn over 5 years, it aims to strengthen the position of French industry in cutting-edge fields by 2030, particularly by supporting the development and early-stage industrialization of technologies needed to accelerate the ecological and digital transitions (for example digital technologies, green energy, low-carbon industry and biotechnology).

As noted by staff, this strategy enabled a particularly strong rebound in economic activity in 2021 and a quick improvement in the labor market. The latest French government official GDP growth forecast was 6 ¼ percent for 2021 in the revised budget bill for 2022 and the draft budgetary plan submitted to the European Commission in October, before the release of the Q3 2021 national accounts first estimate (which was higher than expected and points to a higher 2021 growth figure). While this follows a sharp contraction in output in 2020 (8.0%), the French economy regained its pre-crisis level by the summer 2021, faster than the euro area average. As noted by staff, the rebound was particularly pronounced for investment, which exceeded its pre-crisis level by Q1 2021 for businesses; while initially slower, the rebound in household consumption gained steam in Q3 2021, supported by the consumption of services, linked to the reopening of restaurants and shops at the end of the second quarter. At the same time, the labor market has improved markedly, even more than expected, with salaried employment exceeding its pre-crisis level by +1.0% in Q3 2021. The employment rate in Q3 2021 (67.5%) and the labor force participation rate (73.5 %) also improved compared to their pre-crisis levels, reaching historical highs. The improvement is particularly marked for young people – their employment rate in Q3 2021 is 2.9 pp higher than before the crisis (+0.7 pp for those aged between 15-64) and their labor force participation rate increased by 3.2 pp compared to the end of 2019 (+0.7 pp for those aged between 15-64). The unemployment rate decreased and stood at 8.1% in Q3 2021, similar to its end-2019 level, stabilizing over the last quarter due to a sharp increase in the labor force. The unemployment halo[1] is also in sharp decline (4.4% in Q3 2021, or -0.3 point compared to its pre-crisis level). While short-term policy support was key, past structural reforms also helped generate the strong employment recovery in 2021. Authorities share the view that GDP growth should remain strong in 2022, supported notably by a continued rebound in consumer spending.

Inflation has risen markedly since the beginning of 2021, although significantly less than in the EU and euro area. In line with staff views, our authorities foresee that the increase is mainly temporary, and inflation will gradually normalize. Inflation rose from +0.0% year-on-year in December 2020 to +1.5% in June 2021, +1.9% in August and +2.8% in November and December (first estimate for the latter) according to the National Institute of Statistics and Economic Studies (INSEE). Inflation is currently supported by base effects and higher energy prices (particularly petroleum products and gas). The delayed effects of the rise in the prices of raw materials, other inputs and freight, should continue to support inflation for some time, as these are passed on to the prices of certain food and manufactured products. The peak of inflation is likely to be at the end 2021 or beginning of 2022. While more persistent than initially anticipated, inflation should fall back below 2 % by end 2022. Confronted with this sharp increase in prices, particularly in the energy sector, the government has adopted several measures to swiftly protect vulnerable households, which are discussed in more details below.

As for the risks surrounding the outlook, they appeared more balanced in our view at the time of the mission but the sharp rise in Omicron cases illustrates the prevailing very high level of uncertainty. As recalled by staff, a high vaccination rate and measures such as the health pass have weakened the negative impact of the pandemic on economic activity, as well as saved lives. This will help in dealing with the fifth wave of the pandemic and possible other variants. Our authorities remain fully determined to take the necessary steps in responding to the impact of the health situation and associated restrictions. Supply-chain disruptions are also carefully monitored but should gradually dissipate over the course of the year. The recovery of net exports could be more dynamic than expected by staff in view of the rebound already observed, and the temporary nature of the difficulties in the aeronautics sector. A faster than expected rundown of accumulated savings by the private sector could also raise growth in the near term.

Fiscal policies

Our authorities welcome staff views that the moderately expansionary fiscal stance in the 2022 budget is appropriate. While broad based pandemic related support measures have been phased out months ago, the recent fifth wave of Covid linked to the Omicron variant shows the need to remain flexible. In this regard, targeted temporary measures were announced by Minister Le Maire on January 3rd to support businesses impacted by the new health restrictions. The short-time work scheme (*dispositif d'activité partielle*) fully covered by the State has been extended until the end of January for firms incurring large losses in sectors directly impacted by the epidemic, a new financial aid has been created for companies closed to the public, coverage of fixed costs has been extended and simplified, and conditions for reimbursement of State-guaranteed loans have been relaxed for very small enterprises with liquidity difficulties. This is in our view highly consistent with staff advice to remain flexible throughout the year and provide targeted and temporary additional relief support if downside risks materialize.

The French authorities took concrete and fast measures to respond to rising energy prices and protect the most vulnerable households. Energy vouchers were increased by 100 € - they are used by low-income households, mostly to pay energy bills. Gas prices will be frozen from October 2021 until the end of 2022, the increase in regulated electricity tariffs will be limited to +4% in February 2022, and a one-off "inflation allowance" of €100 was granted to people earning below 2000 € in monthly net income. These measures were effective in limiting the impact of energy prices on low-income households. The design of the measures prioritized the provision of swift and timely support to vulnerable households, which necessarily entails a practical trade-off between quick implementation and refining the targeting of the measures. Our authorities are of course highly vigilant about providing appropriate price signals and staying consistent with the greening objectives of the French economy. These measures are therefore temporary. Furthermore, since more than 90% of France's electricity production stems from low carbon sources (renewables and nuclear energy), not discouraging electric consumption compared to other energy sources is actually coherent with climate objectives. Also, considering that gas prices had already increased by roughly 50% before the temporary freeze was in place, one could argue that the price signal is moderated, but not distorted.

In the medium term, the Government is strongly committed to maintaining the sustainability of public finances. Our authorities share staff's views that the multiyear fiscal consolidation should strike the right balance between rebuilding buffers, supporting the recovery and boosting potential growth. So as not to damage growth, the fiscal trajectory considered by the authorities is based on containing real government expenditure growth at 0.7% per year. The impact on debt levels is quite similar, as the authorities aim at stabilizing public debt and get it on a declining path by 2026, by boosting potential growth factors, improving spending efficiency and controlling government expenditure. In line with the government strategy to reduce the tax burden, the government shares staff view that further adjustment should stem from expenditures; areas identified by staff in this regard appear broadly relevant.

Since the staff report was finalized, France has taken new, concrete steps towards a strong fiscal expenditure rule and enhanced prerogatives of the High Council of Public Finance (HCFP), largely consistent with staff advice. The organic law modernizing the governance of public finances, which was under parliamentary consideration at the time of the staff report, has now been approved by Parliament and published in the Official gazette on December 29th (*loi organique du 28 décembre 2021 relative à la modernisation de la gestion des finances publiques*). Twenty years after the landmark "LOLF" (*loi organique du 1er août 2001 relative aux lois de finances*), this reform of France's fiscal framework will improve the budgetary procedure, starting this year for the 2023 budget process. It comprises three main pillars: (i) it will reinforce the multi-year budget framework, with an expenditure rule set in volume and derived in value (in billion euros) and an obligation for the Government to justify potential deviations in a public report; (ii) it will strengthen the competencies of the fiscal council, which will provide its views on the realism of public finances forecasts and detect potential biases, and give its opinion on the compatibility of sectoral programming laws with the programming finance law; (iii) it will strengthen the role of Parliament in the whole budget process, including with enhanced reporting and Parliamentary debate on the public debt, its trajectory, its financing conditions and sustainability.

Financial Sector

We share staff assessment on both the robustness of the French financial sector and the warranted continued vigilance regarding financial vulnerabilities. As mentioned by staff, banks entered the crisis with comfortable capital and liquid buffers, and these buffers have actually improved through mid-2021. The increase in NPL has been contained overall in France, and the moderate increase in the stock of assets classified as stage 2 under IFRS reflects a cautious assessment of the evolution of the economic conditions of their counterparties, as well as rescheduling in the acute phase of the crisis. In terms of debt vulnerabilities and macroprudential policies, assessed risks related to household debt and drift in credit conditions led the High Council for Financial Stability (*Haut Conseil de stabilité financière*, HCSF) to take measures to regulate the conditions for granting home loans in France. The measure made binding in September 2021 provides that the effort rate of borrowers should not exceed 35% of their income and the maturity of loans should not exceed 25 years (except in special cases). It is also worth mentioning that the vast majority of real estate related loans in the French market are on a long-term fixed rate. The measures taken by the HCSF have made it possible to halt the drift in lending conditions, without slowing down the real estate market or limiting the distribution of credit to French households. In fact, the proportion of loans with a high effort rate or high maturity has fallen and is now very close to the planned flexibility margin. It can also be noted that housing price growth stayed moderate in France since early 2020, below the euro area average, while the market has been buoyant in many countries. Regarding the countercyclical buffer, the HCSF considered in December 2021 that the economic and financial situation justifies an imminent normalization of the countercyclical buffer and plans a normalization to its pre-crisis level at its next meeting, provided that the economic and financial cycle confirms the capacity of the banking system to support growth. Lastly, on AML/CFT issues, the FATF's fourth mutual evaluation of France and the measures implemented to combat money laundering and terrorist financing is currently in progress. The final report will be adopted at the plenary session on March 3, 2022.

Structural reforms

Past structural reforms implemented since 2017 played a key role in the strong employment recovery in 2021; this effort is being continued. The labor market had been made more dynamic, thanks to a simpler labor code, the additional reduction in the cost of labor following the conversion of the competitiveness and employment tax credit (CICE) into permanent cuts in employer contributions, that included the strengthening of the broad-based contribution relief as of Oct. 1, 2019, as well as strong investments in trainings, skills and career transitions. A significant reform of the unemployment benefit system strengthening work incentives was completed in late 2021, after a temporary delay due to the crisis. Important measures have been taken in the field of education, to enhance equal opportunities. Following a major reform of vocational training and an exceptional support, the number of apprenticeship contracts signed in 2020 was up by more than 40% over the previous year, to more than 525,000 contracts.

Fighting climate change and biodiversity loss is a top priority for our authorities. France's total greenhouse gas emissions in 2019 represented a 17.7% percent decline from 1990 levels. According to the OECD, the average effective carbon rate in France amounted to 93.1 EUR/tCO2 in 2021, ranking third across G20 economies. Carbon neutrality should be achieved by 2050. The "France Relance" plan was conceived from the onset to accompany the transformation of the economy towards a cleaner model. It devotes €30 billion over 3 years to the climate transition through support for green investments, decarbonization and R&D. The Climate and Resilience Act adopted in August 2021 provided tools to support structural changes in consumer behavior and to mobilize stakeholders around the goal of greening the economy. These national initiatives are consistent with the legislative proposals of the Fit for 55 package presented by the European Commission in July 2021, which aims to translate the EU's net emissions reduction target of at least 55% by 2030 compared to 1990 levels. Discussions are underway at the European level and will feed into the revision of the national low-carbon strategy and France's multi-year energy plan, scheduled for 2023. Finally, the development of numerous initiatives on sustainable finance at the national and European level (taxonomy, extra-financial reporting, ecolabelling) will help to direct financial flows towards the significant investments needed in low-carbon activities.

The "France 2030" plan aims at boosting critical investments and innovation, with a very strong focus on the green transition. It complements the *France Relance* plan, with a longer-term horizon and a more targeted focus. The plan, with €30 billion in budget funds and €4 billion in equity investments over 5 years, aims to develop industrial competitiveness and innovation. €8 billion will be devoted to clean energy (develop small scale nuclear reactors, green hydrogen, decarbonize France's industry), €4 billion for future transport (electric and hybrid vehicles, low-carbon aircraft), €2 billion for the food sector, €3 billion for the health sector, €2 billion for space and seabed. Additional investments in skills are also foreseen.