IMF Country Report No. 15/178

FRANCE

July 2015

2015 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 2015 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 July 8, 2015 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 July 8, 2015, following discussions that ended on May 20, 2015 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 June 23, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF.
- A **Staff Statement** 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.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 15/328
FOR IMMEDIATE RELEASE
July 10, 2015

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

IMF Executive Board Concludes 2015 Article IV Consultation with France

On July 8, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

A solid recovery is underway. The economy is expected to expand by 1.2 percent this year, supported by an accommodative external environment. Sharply lower oil prices, a depreciated euro, low interest rates on account of quantitative easing (QE), and the recovery in other euro area countries should underpin household consumption, lift export growth, and eventually foster a rebound in investment. Combined with a slowdown in fiscal consolidation, this should allow the output gap to narrow gradually, although unemployment is projected to decline only slowly. After falling to near zero, inflation is set to accelerate this year as euro depreciation and QE feed more fully into prices, and the effect of the oil price decline wears off. Short-term risks are evenly balanced, depending in part on the strength of the euro area recovery.

Structural rigidities continue to weigh on medium-term prospects. Potential output growth is fundamentally weaker than before the crisis, reflecting lower productivity growth and crisis legacies. Rising government spending has pushed up public debt and the tax burden. An extended period of solid wage growth despite declining productivity growth has eroded competitiveness, shrunk profit margins, and reduced firms' capacity to invest and innovate. Labor market rigidities are hampering job creation and feeding high structural unemployment. Longstanding bottlenecks, including extensive regulation and barriers to competition in services, are hindering innovation, investment, and productivity growth. These rigidities could come to undermine medium-term growth, especially if reform implementation falters or external shocks materialize, such as lower growth in advanced countries or financial market volatility.

To address these medium-term challenges, the authorities have embarked on a range of reforms to raise economic growth, reduce unemployment, and consolidate the fiscal position. The *Pacte de Responsabilité et de Solidarité* and the *CICE* tax credit have reduced the labor tax wedge

[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.

substantially. The *Macron* and *Rebsamen* laws are intended to liberalize services and improve the functioning of the labor market. The fiscal strategy, set out in the current multi-year budget law and the 2015 Stability Program, aims to bring the headline deficit below 3 percent of GDP by 2017, with a gradual adjustment based exclusively on spending containment.

Executive Board Assessment[2]

Executive Directors welcomed France's recovery which, supported by an improved external environment, appears to be gathering momentum. Directors noted, however, that the need for further fiscal adjustment calls for a delicate balancing act in the period ahead and entrenched structural rigidities in the labor and product markets continue to restrain medium-term prospects. Accordingly, they encouraged the authorities to persevere with their efforts to rein in public spending, revive job creation, and remove bottlenecks to growth.

Directors commended the authorities for switching the focus of fiscal consolidation to expenditure measures. They considered that the pace of fiscal adjustment should be ambitious enough to safely achieve the medium-term fiscal targets, including a firmly declining path for the debt ratio, without unduly detracting from the recovery. Directors recommended that the adjustment be underpinned by structural measures, identified through comprehensive expenditure reviews at all levels of government.

Directors underscored the need for broad-based labor market reforms to return to pre-crisis rates of job creation. They welcomed progress in narrowing the labor tax wedge, recent measures to reduce legal uncertainty concerning dismissals, and plans to improve the social dialogue. To reduce unemployment more rapidly, Directors recommended allowing more flexibility in firm level agreements on hours and wages, reforming the minimum wage, and strengthening job search incentives for those receiving unemployment or welfare benefits.

Directors encouraged the authorities to maintain the momentum on product market reform. In particular, they agreed that further liberalizing regulated professions, dismantling bureaucratic hurdles to small enterprises, and removing barriers to competition in services will raise productivity and boost potential growth.

Directors noted that, while France's banks are reasonably well placed to adapt to the Banking Union, the low interest rate environment may put pressure on margins for both banks and insurance companies. They stressed the need for close monitoring of financial risks and continued strengthening of bank capital and liquidity buffers in line with evolving regulatory

[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.

requirements. They also recommended reviewing guaranteed interest rates under the regulated savings schemes and tax incentives on financial savings products.

France: Selected Economic Indicators 2013–16

	2013	2014	2015 (Proj.)	2016 (Proj.)
Real economy (change in percent)				
Real GDP	0.7	0.2	1.2	1.5
Domestic demand	0.7	0.6	1.1	1.4
Foreign balance (contr. to GDP growth)	0.0	-0.5	0.1	0.0
Nominal GDP (billions of euros)	2117	2132	2174	2224
CPI (year average)	1.0	0.6	0.1	1.0
Core CPI (year average)	0.7	1.0	0.6	0.8
GDP deflator	0.8	0.6	0.8	0.8
Gross national savings (percent of GDP)	20.9	21.2	21.3	21.1
Gross domestic investment (percent of GDP)	22.3	22.2	21.7	21.6
Public finance (percent of GDP)				
General government balance	-4.1	-4.0	-3.8	-3.4
Structural balance (percent of potential GDP)	-2.9	-2.4	-2.2	-2.0
Primary balance	-1.9	-1.9	-1.9	-1.6
General government gross debt	92.3	95.6	97.3	98.2
Labor market (change in percent)				
Employment	-0.2	0.2	0.5	0.7
Unemployment rate (in percent)	10.3	10.3	10.2	9.9
Money and interest rates (in percent)				
Money market rate (Euro area)	0.0	0.1	...	...
Government bond yield, 10-year	2.2	1.7	...	...
Balance of payments (in percent of GDP)				
Exports of goods	20.7	20.6	23.8	24.5
Imports of goods	-22.7	-22.2	-25.0	-25.9
Trade balance	-2.0	-1.7	-1.2	-1.3
Current account	-1.4	-1.0	-0.4	-0.6
FDI (net)	-0.2	1.1	1.3	1.5
Official reserves (US$ billion)	50.8	49.5	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.75	0.75	...	...
Nominal effective rate, ULC-styled (2000=100)	102.1	101.9	...	...
Real effective exchange rate, ULC-based (2000=100)	109.1	111.4	...	...

Sources: French authorities; IMF staff estimates and projections.

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

June 23, 2015

KEY ISSUES

Context. After several years of near-stagnation, France's economy is recovering, supported by an accommodative external environment, in particular lower oil prices, a depreciated euro, and low interest rates. However, structural rigidities continue to weigh on France's medium-term growth potential, estimated to average just 1.2 percent, despite steady labor force growth.

Policies. The fiscal strategy has rightly shifted to expenditure-based consolidation, but nominal spending containment has not yielded the intended savings in a low growth and inflation environment. Important progress has recently been made on structural reforms, notably by reducing the labor tax wedge and advancing on supply-side reforms. Further efforts are needed to address high unemployment, growth bottlenecks, and record-high public spending.

Spending-based fiscal consolidation. To ensure that medium-term fiscal objectives are met, general government primary spending should be kept flat in real terms, starting in 2016. This would deliver structural adjustment of ½ percent of GDP per year, and place public debt on a downward trajectory by 2017. Spending containment should shift to higher quality structural measures based on broad-based expenditure reviews at all levels of government—notably staffing reform, institutional streamlining and tighter budget constraints for local governments, better targeting of social benefits, and a further increase in the effective retirement age.

Combating unemployment. Building on recent reforms, broad-based efforts are needed to reduce the high level of structural unemployment and accelerate job creation. Flexibility for social partners to agree at firm level on hours and wages should be expanded. Annual increases in the minimum wage should be limited to inflation as long as unemployment remains high. Job search incentives should be strengthened for recipients of unemployment and welfare benefits. Education and training resources should be better targeted to the youth and the unemployed.

Removing growth bottlenecks. The recent momentum on product market reforms should be maintained. Further removing barriers to competition in services would help provide better incentives for innovation and productivity growth. Disincentives for firms to grow beyond certain employee thresholds should be reduced and the process for cutting red tape be made more effective. Further efforts are also needed to alleviate constraints on the supply of affordable housing.

Financial sector. The financial sector should continue to adapt to a changing macroeconomic and regulatory environment. The guaranteed interest rates on regulated savings deposits should be reduced, and tax incentives for savings and insurance products reviewed.

Approved By
Jörg Decressin and Vikram Haksar

Discussions took place in Paris from May 4–20, 2015. The staff team comprised Messrs. C. Mumssen (mission head), Eugster, Hallaert, Oman, and Ms. Kongsamut (all EUR), and Mses. Pérez Ruiz, Valladares, and Messrs. Mason and Gorbanyov (from HQ). Mr. Decressin (EUR) joined at the end of the mission. Mr. de Villeroché and Mr. Guyon (OED) participated in the discussions. Staff met with Ministers Sapin (Finance), Macron (Economy), Eckert (Budget), Pinel (Housing), Bank of France Governor Mr. Noyer, other senior officials, and representatives from the financial and private sectors, parliament, and labor. A press conference was held at the end of the mission.

CONTENTS

TABLES

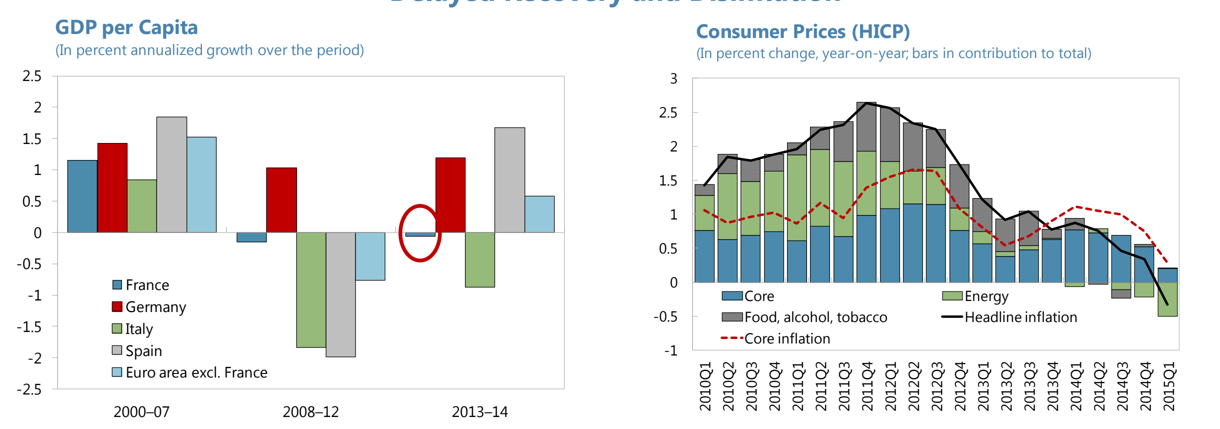
APPENDICES

CONTEXT–LATE RECOVERY AND FISCAL SLIPPAGES

1. **Reform efforts.** France has struggled to bring its fiscal deficit in line with the targets under the Stability and Growth Pact and accelerate structural reforms. The government has recently pushed ahead with a number of supply-side reform initiatives against some resistance in parliament. In April 2015, it presented a multi-year economic strategy in the Stability Program and National Reform Program, which centers on gradual fiscal adjustment and broad-based economic reforms. Notwithstanding political and economic setbacks, the government has vowed to continue its economic reform course.

2. **Late recovery.** While the French economy showed some resilience during the crisis years, the recovery lagged behind other euro area economies, with only 0.2 percent growth in 2014 (Figures 1 and 2). Investment and net exports both declined in real terms while high levels of unemployment and inactivity remained a drag on consumer demand. Consumption and export growth began accelerating in late 2014 and early 2015, but corporate investment remained weak and residential construction depressed. Unemployment continued to climb, reaching 10.5 percent in April 2015.

Delayed Recovery and Disinflation



Sources: OECD, Haver Analytics, and IMF Staff calculations.

3. **Disinflation.** Inflation slowed sharply in 2014 and early 2015 on flagging core inflation (0.6 percent year-on-year in April), energy deflation, and slower food price growth. Unused production capacities, high unemployment, and the pass through of lower import prices all restrained inflationary pressures.

4. **Weak competitiveness and external imbalances.** France's share in world export markets has declined substantially over the past decade (Figure 3), while robust domestic demand throughout the crisis has sustained import growth. The current account deficit declined modestly in 2014, but remained one to three percent of GDP weaker than its cyclically-adjusted norm, and the real exchange rate was five to ten percent overvalued according to staff estimates (Appendix V). Competitiveness has been impaired by a prolonged period during which real wage growth remained

solid despite declining productivity growth. This has squeezed profit margins and reduced firms' capacity to invest and innovate, with regulatory disincentives for SME growth and a rising tax burden adding to the competitiveness gap. While the recent euro depreciation and fall in oil prices are expected to narrow the current account deficit (Figure 4), some of the underlying causes of the external imbalance remain, in particular elevated unit labor costs and a sizeable fiscal deficit.

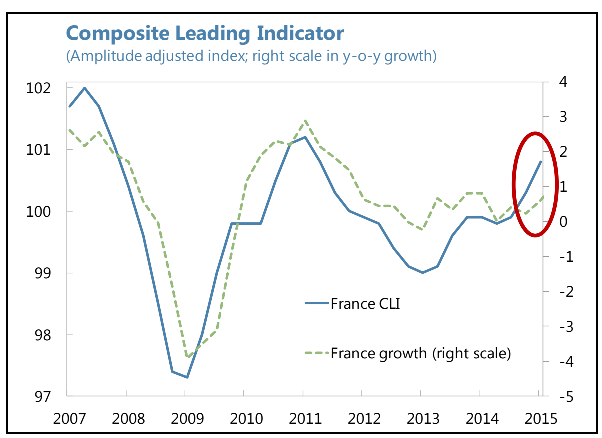
5. **Fiscal slippages.** In early 2012, the authorities set out to bring the structural deficit to balance by 2016, with adjustment equally divided between revenue and expenditure measures. Tax increases were frontloaded and expenditure containment began in 2013. The structural deficit was reduced by about two percentage points of GDP in 2012–13. But the strategy ran into difficulties in 2014 when nominal spending containment efforts did not yield the envisaged savings in the context of low growth and inflation. As a result, fiscal consolidation fell short of the authorities' target, with the headline deficit broadly unchanged at 4 percent of GDP and expenditure and debt ratios continuing to climb.

6. **Financial sector stable.** The banking system's capital and liquidity ratios have been strengthened, and the maturity structure of funding has been lengthened, although banks remain dependent on wholesale funding (Figure 5). The largest four banks have raised Core Equity Tier 1 (CET1) ratios to above 10 percent (fully loaded Basel III basis) and all meet the 100 percent Liquidity Coverage Ratio. The NPL ratio has declined to 4 percent. The ECB's 2014 Comprehensive Assessment did not result in any banks needing to raise additional capital. In the asset quality review, valuation adjustments to risk-weighted assets were less than 0.5 percent, the second lowest among euro area countries, and the stress test reduced the CET1 ratio by around 3 percentage points, less than for most other countries. However, leverage ratios remain comparatively low in some banks. Risks to private balance sheets appear limited, with corporate indebtedness at 66 percent of GDP, adjusted for intercompany loans, and household debt at 55 percent of GDP.

OUTLOOK AND RISKS

A. Brighter Short-Term Prospects

7. **Solid short-term recovery ahead.** We project real GDP growth at 1.2 percent in 2015 and 1.5 percent in 2016, supported by improved consumer confidence and a highly accommodative external environment. Sharply lower oil prices will underpin households' consumption while a depreciated euro and the euro area recovery should lift export growth. Very low interest rates on account of Quantitative Easing (QE) are projected to filter gradually into higher investment (Appendix I quantifies these shocks). Credit growth is expected to pick up alongside rising demand.



Yet headwinds remain. Unemployment is still high and rising, notwithstanding recent cuts in the labor tax wedge under the *CICE* and Responsibility Pact.[1] Residential construction remains depressed, and fiscal consolidation, while slower, will continue to dampen near-term growth.

8. **Inflation to pick up this year**. Lower energy prices and slowing wage growth (including a below average increase in the minimum wage) are projected to reduce annual average inflation to 0.1 percent in 2015, and core inflation to 0.5 percent. Inflation is set to accelerate this year, and rise to 1.0 percent in 2016 as the output gap starts to narrow, the impact of the oil price decline on headline inflation wanes, and the price effects from euro depreciation and QE are felt more fully.

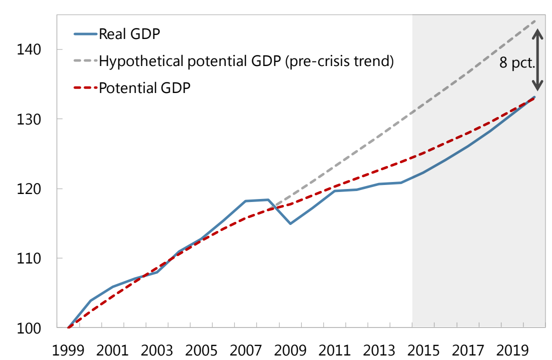
9. **Output gap to narrow gradually.** The more accommodative macroeconomic policy mix on account of QE, a depreciated euro, and slower fiscal consolidation is projected to support aggregate demand over the coming years. Together with recent and planned structural reforms,[2] this more favorable environment should improve economic confidence and filter into a solid rebound in corporate investment, a stabilization and eventual recovery of the housing sector, and further strengthening of private consumption. Export growth is expected to be more dynamic alongside rising global demand and the recovery in the euro area. Under baseline assumptions, this should allow for a gradual narrowing of the output gap and a return of inflation to more normal rates.

10. **Short-term risks evenly balanced.** Growth may turn out stronger than projected in the short term, in particular if QE and improved confidence in the euro area were to filter more quickly into investment and export gains. However, the recovery could be adversely affected by potential confidence losses (e.g., in the event of adverse geopolitical or Greece-related developments), a rebound in energy prices, or a surge in financial volatility.

B. Structural Rigidities Weighing on Medium-Term Prospects

11. **Growth potential fundamentally weaker than before crisis.** Potential output growth has declined sharply, from an average of 2.2 percent in 1981–99, to 1.8 percent in 2000–08, to around 1.1 percent now (Box 1). While some of the decline may reflect lower total factor productivity (TFP) growth from information technology, crisis legacies and structural rigidities appear to have left their mark. Rising government spending has pushed up public debt. Labor market rigidities are hampering job creation, with unemployment projected to

Loss in Potential Output Since the Crisis
(In index number, 1999 = 100)



[1] The *Crédit d'Impôt pour la Compétitivité et l'Emploi* (*CICE*) is a corporate tax credit applying to six percent of the wage bill of employees earning up to 2½ times minimum wage. The Responsibility Pact (*Pacte de Responsabilité et de Solidarité*) reduces employer's social security contributions for wages up to 3.5 times to the minimum wage.

[2] These reforms are estimated to raise real GDP growth by an average of ½ percent over the next five years (Table 7).

remain high throughout the forecast period. Heavy regulation, barriers to competition in services, wage inertia, and a rising tax burden have squeezed profit margins, thereby inhibiting innovation, weakening competitiveness, and aggravating the impact of the prolonged pause of investment growth during the crisis. Looking ahead, potential output in 2020 is projected to be eight percent lower than on pre-crisis trends (chart). In short, France's traditional growth model—with domestic demand supported by government spending, robust real wage dynamics, and a steady labor force growth—appears at risk.

12. **Significant downside risks over the medium term.** While accommodative external conditions and robust domestic demand are projected to underpin growth under baseline assumptions, there is a risk that the recovery may eventually fizzle out, and that France may face a protracted period of sluggish growth, low inflation, and persistently high unemployment. Such a scenario would significantly affect public debt dynamics, which are particularly vulnerable to growth shocks (Debt Sustainability Analysis, Appendix III). Key risk factors include (Appendix IV):

- *Less accommodative external environment.* A protracted period of stagnation in advanced countries would have a significant impact on exports and may spill over into investment dynamics. A sustained increase in commodity prices could further dampen domestic demand.

- *Insufficient reform progress.* If political resolve for structural reform implementation were to wane, growth could suffer as structural rigidities would constrain both supply and demand.

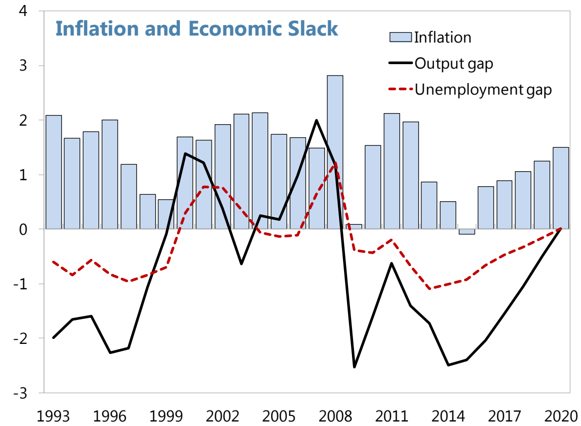
- *Financial volatility.* A protracted period of financial volatility—e.g., from, reassessment of global risk, market uncertainty around unconventional monetary policies, or renewed bond market stress in the euro area—would likely have only limited direct impact on France. However, France's banks remain vulnerable to a globally systemic closure in funding markets, given their reliance on wholesale funding. The low interest rate environment could lead to a gradual build-up of financial sector risks as a result of weakening profitability of banks and insurers or increased risk-taking in the search-for-yield.

13. **Spillovers.** The above risks can in turn create outward spillovers. A protracted period of economic stagnation in France could have an adverse effect on euro area partners, both directly on aggregate demand and indirectly via confidence effects. Failure to deliver on fiscal consolidation and structural reform commitments could be seen as weakening the credibility of EU economic governance. Given their size and interconnectedness, French banks could create adverse effects if forced into further retrenchment from corporate lending and investment banking or from retail operations abroad (e.g., Italy, emerging Europe).

14. **Views of the authorities.** The authorities noted that staff's baseline projections are broadly in line with theirs. They concurred that the recovery was supported by favorable external developments, but also noted that recent reforms have likely played a role in building domestic confidence. They saw the balance of near-term risks as tilted to the upside. The authorities agreed that potential growth and employment creation are still weaker than before the crisis, but considered that their reform program will help in this respect.

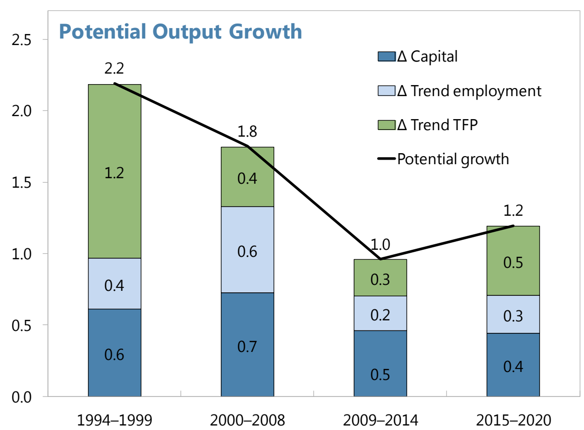
Box 1. Potential Output in France

Estimating potential output is particularly relevant at the current juncture.[1] Potential output plays an important role in assessing fiscal effort and projecting future growth, inflation, unemployment, and debt dynamics. Following significant revisions in recent years, IMF staff has sought to improve the consistency and robustness of its estimates by using a multivariate filter approach that incorporates empirical relationships between actual and potential GDP, unemployment, and inflation. This filter has been applied to assess potential output in the global economy (2015 April WEO) and to estimate potential output separately for four large euro area countries (France, Germany, Italy, Spain).[2]



Potential growth has declined significantly since the early 2000s, driven initially by a sustained decline in TFP and thereafter by crisis legacies. The drop in TFP growth, mirrored in many other advanced countries, may be related to lower growth returns from ICT (Fernald 2014a, 2014b; April 2015 WEO), and, to a lesser extent, the switch from manufacturing to services (van Ark and others, 2007; Dabla-Norris, 2015, Molagoda and Perez, 2011). In France, this decline was initially partly offset by higher potential employment growth related to dynamic labor force growth. During the crisis years, potential growth collapsed to less than 1 percent, reflecting a prolonged slowdown in investment and a rise in structural unemployment.

Looking ahead, France's potential growth appears much weaker than before the crisis. Under current policies, including recent and planned reforms, potential growth should increase over the medium term, but average only about 1.2 percent over 2015–20, despite France's comparatively dynamic demographics. The accumulation of labor and capital is likely to remain broadly stable in the near future, while TFP is projected to rebound somewhat, though not to the exceptional growth rates seen in the 1990s. The Non-Accelerating Inflation Rate of Unemployment (NAIRU) has risen to an estimated 9¼ percent, and is expected to decline only very slowly in the coming years.



1/ Budina N., H. Lin, E. Pérez Ruiz, J. Vandenbussche, and A. Weber, 2015, "Potential growth in France, Germany, Italy, and Spain: A reassessment," Chapter IV, Selected Issues paper for Spain 2015 Article IV.

2/ Potential output is conventionally defined as the level of output—based on full utilization of available labor, capital and technological resources—that is consistent with stable inflation (Okun, 1962). The output gap is the difference between actual and potential GDP. A related concept is the NAIRU, which measures the rate of unemployment consistent with stable inflation.

POLICY DISCUSSIONS

15. **With a recovery finally underway, attention is shifting to the structural rigidities that weigh on medium-term prospects.** The present accommodative macroeconomic environment provides an opportunity to push ahead with the more difficult policies and reforms to address France's more fundamental economic problems. Rising government spending, which had supported aggregate demand before and during the crisis, has pushed up public debt and the tax burden, and makes fiscal adjustment a difficult balancing act. The persistence of high structural unemployment risks creating longer-term social problems while also limiting France's potential growth. A range of long-standing structural bottlenecks, including overregulation and barriers to competition, are hampering innovation, investment, and productivity growth.

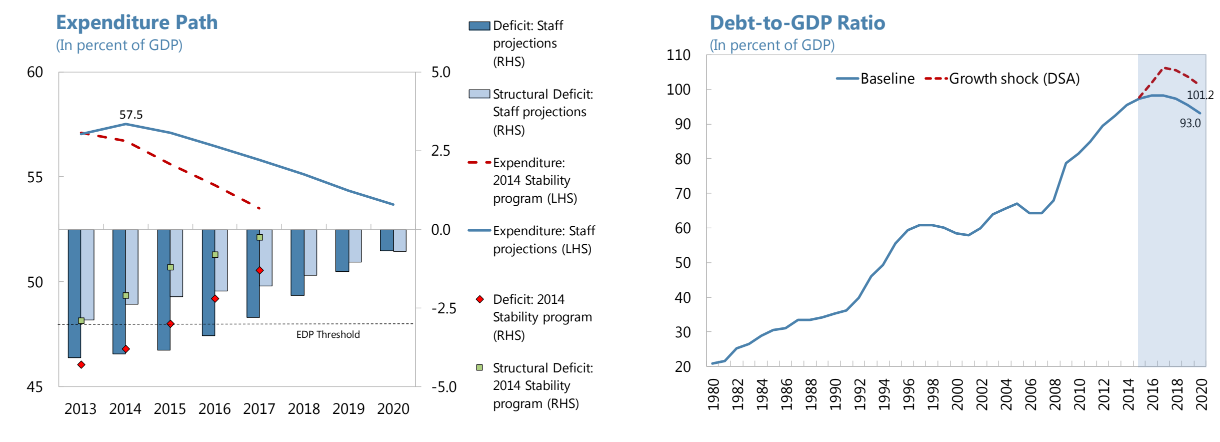
16. **The authorities have embarked on a range of welcome reforms, though further efforts are needed to lay the foundations for sustainable growth (Box 2).** The 2015 National Reform Program and Stability Program set out a broad strategy to raise economic growth, reduce unemployment, and gradually consolidate the fiscal position via spending containment. Following the substantial cuts in the labor tax wedge under the Responsibility Pact and *CICE*, the government is pushing ahead with additional reform initiatives. The *Macron* law—now at a final stage of parliamentary approval following use of a special constitutional procedure to overcome political resistance—contains supply-side reforms to liberalize parts of the economy while also advancing some labor reforms. The draft *Rebsamen* law, expected to be adopted by year end, is intended to improve the social dialogue and ease labor-related regulations that hamper SME growth. While significant, these efforts are likely not enough to lift potential growth closer to pre-crisis levels and ensure that fiscal objectives are achieved with adequate margins. To this end, staff focused its recommendations on the need to underpin fiscal consolidation through deep spending reform, push ahead with broad-based reforms to foster employment creation, while maintaining the recent momentum on product market reforms.

A. Fundamental Spending Reform to Underpin Fiscal Sustainability

17. **High and rising government spending has been at the core of France's fiscal problems** (Selected Issues Chapter I). After more than two decades of steady growth, general government expenditures reached a record high in 2014, at over 57½ percent of GDP—about 12 percentage points above the average of the other euro area countries. This growth was driven primarily by social security and local government spending, which expanded on average one percentage point per year faster than GDP, while the central government spending has been growing on par with GDP. As a result of the persistent spending pressures, revenues had to be raised successively, and France's tax burden is now about ten percentage points of GDP above the euro area average, constraining the growth potential of the private sector (Figure 6). Moreover, with a persistent structural deficit, public debt has ballooned to 95½ percent of GDP in 2014, from 21 percent of GDP in 1980.

18. **The fiscal strategy has rightly shifted to expenditure-based consolidation, but the planned pace of adjustment leaves little room for maneuver.** Reliance on nominal containment measures—such as public service wage-scale freezes and temporary under-indexation of pensions and certain social benefits—did not deliver the adjustment envisaged in last year's Stability Program, as growth and inflation came in below projections.[3] In light of these slippages, the European Council granted France two additional years, until 2017, to bring its headline deficit below the EDP threshold, allowing for a more gradual adjustment path. The fiscal strategy outlined in this year's Stability Program, which includes additional spending reductions of 0.2 percent of GDP for both 2015 and 2016, would bring the headline deficit narrowly below 3 percent of GDP in 2017 under baseline assumptions. While the 2015 deficit objective appears on track to be met, there is a risk that medium-term targets will be missed in the event that growth or inflation fall short, or additional spending needs arise.

Fiscal Adjustment



Sources: France authorities, IMF staff calculations.

19. **Staff recommended keeping spending flat in real terms, starting with the 2016 budget.** A fiscal anchor that ensures that primary general government expenditure grows in line with inflation, supported by a burden sharing mechanism, would deliver structural adjustment of about ½ percent of GDP per year, striking an appropriate balance between anchoring debt sustainability and smoothing the impact on demand. It would provide a safety margin to ensure that the headline deficit is reduced to below 3 percent of GDP by 2017 and debt is placed on a firm downward trajectory. It would also help ensure that structural fiscal balance is achieved within the next five years, which would create fiscal space for tax alleviation in the order of ½ percent of GDP per year starting around 2020. To this end, staff recommended clarifying the structural measures underpinning the already announced spending package and identifying additional savings. In the short term, this could include further tightening the budget constraint for local governments, steps

[3] Nominal spending growth was contained at 1.6 percent in 2014 (almost half of which was due to rising tax credits). With nominal GDP growth coming in at only 0.8 percent, this resulted in a further rise of the spending-GDP ratio. Similarly, with a lower-than-projected nominal GDP path in 2015 and beyond, both spending and headline deficits are projected to exceed the targets set in early 2014 (see text chart).

to reduce staffing at all levels of government, better targeting of family allowances, housing subsidies, and unemployment and welfare benefits, and reforming supplementary pensions. Any windfall gains from potential interest savings or excess revenues should be saved.

Alternative Fiscal Adjustment Path
(In percent of GDP / potential GDP)

	2014	2015	2016	2017	2018	2019	2020
Staff baseline							
Fiscal balance	-4.0	-3.8	-3.4	-2.8	-2.1	-1.3	-0.7
Structural fiscal balance	-2.4	-2.2	-2.0	-1.8	-1.5	-1.1	-0.7
Expenditure	57.5	57.1	56.5	55.8	55.1	54.3	53.7
Gross debt	95.6	97.3	98.2	98.2	97.3	95.5	93.0
Zero real primary spending growth 2016-20							
Fiscal balance	-4.0	-3.8	-3.2	-2.5	-1.7	-0.8	-0.3
Structural fiscal balance	-2.4	-2.2	-1.8	-1.4	-0.8	-0.1	0.0
Expenditure	57.5	57.1	56.3	55.5	54.7	53.8	52.8
Gross debt	95.6	97.3	98.2	98.1	96.9	94.7	91.8
Memorandum items:							
Cumulative nominal spending reduction (in percent of baseline spending)	0.0	0.0	-0.4	-0.8	-1.2	-1.7	-2.2
Cumulative impact on nominal GDP (in percent of baseline GDP)	0.0	0.0	-0.2	-0.3	-0.5	-0.6	-0.5

20. **Fiscal adjustment should rely on deeper reforms that can underpin a lasting reduction in government spending (Selected Issues Chapter I).** Building on recent efforts, regular broad-based expenditure reviews should be employed to assess the efficiency and quality of expenditure at all levels of government and prepare for deeper structural reforms, including:

- Streamlining local government positions and institutions, supported by further cuts in transfers, tighter caps on local borrowing and taxes, and elimination of the universal competency clause that allows local governments to spend in all areas;
- Reversing the growth in public employment based on reviews of staffing at all levels of government;
- Improving the targeting and efficiency of social benefits, including for unemployment, welfare, families, and housing allowances; and
- Reforming pension benefits, by raising the effective retirement age, streamlining special pension regimes, and ensuring the financial sustainability of supplementary pensions.

21. **Views of the authorities.** The authorities confirmed that fiscal consolidation will be fully expenditure-based going forward, and emphasized the spending containment efforts since last year. On the pace of adjustment, they considered that the multi-year strategy outlined in this year's Stability Program provides adequate margins to meet medium-term targets, in particular as

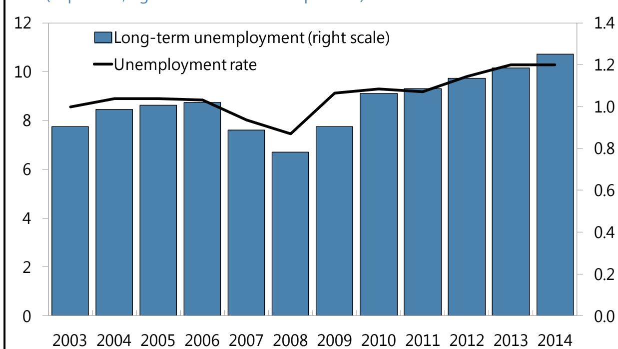
macroeconomic assumptions are prudent. They confirmed that any windfall would be used to reduce debt. The authorities concurred with staff on the need to reduce the expenditure-to-GDP ratio, ultimately bringing it closer to the euro area average. They agreed on the need for structural reforms to contain local spending, control the wage bill, and improve the targeting of social security programs. While horizontal nominal spending measures remain necessary in the near term, the 2016 budget will also include structural measures. The authorities noted that containing spending at the local level is challenging given the constitutionally guaranteed fiscal autonomy of sub-national governments, but progressive cuts in transfers from the state combined with the recent creation of an indicative spending target (*ODEDEL*) should help.

B. Combating Unemployment

22. **High unemployment is becoming entrenched in a segmented labor market.** Sluggish demand during the crisis years, coupled with labor market and wage rigidities, has pushed unemployment to 10.5 percent as of April 2015, from 7.5 percent in 2008 (Figure 7). Despite a relatively robust labor force growth, net job creation has stagnated since 2008. Employment rates remain relatively low, and inactivity rates of the young are now among the highest in Europe. The labor market remains segmented, with 55 percent of young workers below 25 on a fixed-term contract and an unemployment rate among unskilled workers almost three times that of skilled workers. The protracted period of high and rising unemployment has almost doubled the number of long-term unemployed since the onset of the crisis. This is contributing to a rise in structural unemployment, with the NAIRU currently estimated at 9¼ percent.

Unemployment

(In percent; right scale in millions of persons)



Sources: Haver Analytics and IMF Staff calculations.
Note: Long-term unemployment is defined as 1 year or more.

23. **Building on recent efforts, broad-based reforms are needed to return to pre-crisis rates of job creation (Selected Issues Chapter II).** With a steadily rising labor force and moderate medium-term growth prospects, removing barriers to employment growth will be critical to reversing the rise in structural unemployment. Important steps have been taken in recent years, in particular through: the reduction of the tax wedge under the Responsibility Pact and *CICE* tax credit; the 2013 agreements to enhance social partners' flexibility at the enterprise level and ease collective dismissals; the planned reform of the *prud'hommes* system under the *Macron* law to reduce judicial uncertainties on individual dismissals; and the draft *Rebsamen* law would streamline the mandatory discussions between social partners in SMEs. However, given remaining labor market rigidities, the unemployment rate is likely to decline only slowly, and there is a risk that recent labor tax cuts feed

into wages as unemployment declines. Achieving a faster and deeper reduction in unemployment would require a broad-based reform approach that rests on four pillars:[4]

- *Enterprise-level agreements.* The ability of enterprises to adjust hours and wages to changing economic circumstances remains very constrained.[5] Recent reforms were aimed at introducing more flexibility for enterprises in economic difficulties through "job preservation agreements". These agreements have been rarely used, however, in part because of restrictive conditions. Staff recommended enhancing the flexibility of social partners to agree on hours and wages in all enterprises.

- *Minimum wage*. While intended to ensure a basic living wage, France's minimum wage level is one of the highest in the euro area, hampering the employability of the young and of the low-skilled. Moreover, annual minimum wage increases, partially indexed to the average real wage in the economy, set a floor for pay settlements downstream, thus creating a feedback loop that contributes to wage rigidity. To better balance its social role against unemployment effects, staff recommended limiting minimum wage increases to inflation for as long as unemployment remains high.

- *Benefits.* France's benefits system is comparatively generous. Staff recommended harmonizing and strengthening job search incentives of unemployment and social welfare benefit recipients, including through gradual reductions in benefits if reasonable job offers are refused. In addition, job search incentives could be strengthened for unemployment benefits by lengthening the period of work that is required for eligibility, and by introducing degressivity of benefits.

- *Education and training.* Each year, 140,000 young people leave the education system without completing school. Spending on professional training amounts to about 1.4 percent of GDP, but primarily benefits skilled workers and those in large companies. Staff emphasized the need for better targeting resources on quality training for the young, the low-skilled, and unemployed.

24. **Views of the authorities.** Reducing unemployment remains the government's central objective, with structural reform efforts increasingly focusing on the labor market. The authorities estimate that the Responsibility Pact and *CICE* will create around half a million jobs. The authorities noted that the *Macron* law would also facilitate the use of job preservation agreements, and that they have set up a working group to recommend further steps for increasing company-level flexibility. Regarding the minimum wage, they emphasized its social role while noting that recent reductions in the tax wedge have already lowered the effective cost of labor at lower salary ranges.

---

[4] A number of studies point to the need for a multi-pronged strategy, with varying assessments of the importance of individual labor market reforms. Staff estimates that each of the four main reform areas discussed here would reduce the NAIRU by at least ½ percentage point in the long term. A comprehensive package, including further tax wedge cuts once fiscal space allows, could yield a four percentage point reduction of the long-term NAIRU, and raise potential output by five percentage points cumulatively by 2030.

[5] Firm-level labor agreements must improve upon industry-level agreements and labor code. Extension procedures achieve a wide coverage of industry agreements, notwithstanding limited union density.

Regarding benefits, an ongoing review of the unemployment insurance system will inform future reforms to be negotiated by social partners; the employment agency is exploring ways to enforce job search requirements; and the draft *Rebsamen* law would merge the two supplementary income support programs for the working poor. On professional training, the authorities highlighted that the recent introduction of portable training will encourage labor mobility. The government is also exploring options for promoting apprenticeships and better targeting training resources. In early June, the government announced additional measures to promote employment, particularly in SMEs, including by increasing the number of allowed renewals for fixed-term contracts, easing threshold effects for small firms, subsidizing micro enterprises recruiting their first employee, and extending the trial period of apprenticeships.

C. Removing Growth Bottlenecks

25. **Barriers to competition in services and extensive regulation remain important obstacles to growth (Selected Issues Chapter III).** Productivity growth in services has been slow in recent years. As in other European countries, this partly reflects crisis legacies, but also barriers to competition, which limit the development of startups and weaken incentives to innovate and improve quality (Figure 8). This raises the cost of services and filters into the rest of the economy—staff has estimated that a 1 percent productivity gain in regulated services could raise GDP by 0.8 percent after two years. Extensive regulatory requirements on businesses, especially above certain employee thresholds, further limit incentives for investment. Together with a heavy tax burden and labor market rigidities, these factors are a significant drag on France's competitiveness and growth potential.

26. **The recent momentum on product market reform should be maintained.**[6] The *Macron* law contains a number of supply-side reforms, including steps to liberalize opening hours, enhance competition in regulated legal professions, reduce rents received by toll road operators, and open up intercity bus transport. It also expands the competencies of the Competition Authority, notably regarding some barriers to entry affecting retail and regulated legal professions. These reforms complement the ongoing simplification of administrative burden process, with support from the Business Simplification Council. Staff welcomed these steps, while underscoring the significant remaining potential for productivity gains from enhanced competition in services and reduction of red tape (see some specific recommendations in Box 2).

27. **More could be done to alleviate structural rigidities in the housing market.** Residential construction has fallen by 14 percent, and real house prices by 11 percent, since the peak in 2007. While this decline is partly cyclical, a succession of laws introducing regulatory and tax changes may also have contributed. Another long-standing factor affecting the market is the extensive system of housing subsidies, which include rental cash assistance (received by 44 percent of tenants), subsidized mortgage rates for households, and fiscal breaks for providers (including of social

[6] The OECD has estimated that structural reforms undertaken since 2012 (including labor tax cuts and the *Macron* law) would jointly raise GDP growth by 0.3 percent per year. See reference in Selected Issues Chapter III.

housing), together amounting to 1.9 percent of GDP in 2013. While these were aimed at making housing more affordable, studies have found that rental assistance may contribute to rising rents. Staff recommended reviewing the functioning of the housing market, with a view to alleviating constraints on the supply of affordable housing and improving the targeting of benefits.

28. **Views of the authorities.** The authorities were confident that ongoing product market reforms will foster competition and growth. The government recently announced measures to support employment creation in SMEs, including by alleviating administrative and tax requirements, and labor constraints. They also highlighted the recent introduction of temporarily more favorable amortization rules, which should provide a near-term boost to investment. There are plans to reform qualification requirements that act as barriers to entry into certain professions. The authorities also reiterated the importance of seed money from the state to foster innovation and steer the economy toward sectors with growth potential. On housing, they considered that recent measures to increase supply—such as simplifying regulations and increasing availability of land, including in areas with especially high demand—are starting to bear fruit. They also noted that certain rental assistance benefits are under scrutiny as part of efforts to contain expenditure.

D. Adapting the Financial Sector

29. **The low interest rate environment could lead to a gradual build-up of risks in the financial sector (Selected Issues Chapter IV).** While QE is supporting the recovery, a prolonged period of very low interest rates could create vulnerabilities resulting from a narrowing of financial sector profit margins, asset price inflation, and private debt accumulation.

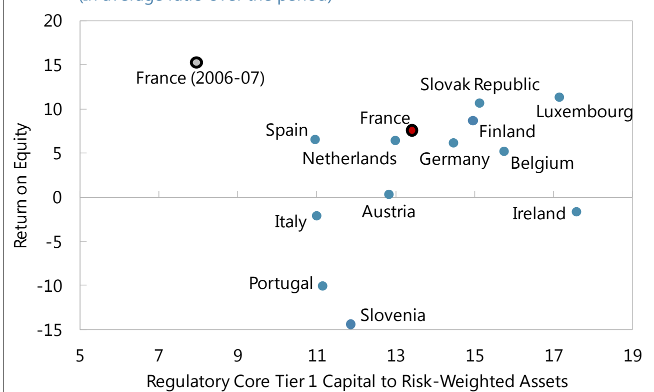
- ***Banks.*** With interest rates at very low levels, banks are facing a squeeze on interest margins, especially due to a sharp increase in mortgage refinancing. An aggravating factor is that interest rates on regulated savings deposits are set well above the ECB's policy rate.[7] At the same time, lending opportunities are increasing as corporate credit demand is picking up, and banks can use the ECB's low-interest Targeted Long-term Refinancing Operations funds to expand credit. Given these offsetting forces, the net impact from QE on banks' profitability is difficult to predict.
- ***Insurers.*** The margin squeeze from the low interest environment will likely be exacerbated by new regulations (Solvency II) requiring significant holdings of safe assets. Low returns may also increase redemption rates, as consumers may shift to alternative investments. However, insurers in France have greater room for maneuver than those in some other countries, as the minimum guaranteed return on life insurances is adjusted every year.
- ***Markets.*** Low interest rates could feed into asset prices as investors shift into equities, higher-yield instruments, and possibly real estate. The main stock market index rose by 12 percent in the year to mid-June. Real estate prices have been on a declining trend, but remain about 10–15 percent overvalued by some metrics, and price pressures could reemerge over the

[7] Around 60 percent of these deposits are centralized at the *Caisse des Dépôts et Consignations* and earmarked mainly for building social housing. Banks are partly remunerated for the centralized deposits, and must pay the full guaranteed return (currently 1 percent for the main savings schemes) for the portion that is not.

medium term. However, the impact of future price adjustments is mitigated by relatively stringent lending standards and manageable levels of household debt.

30. **Banks and supervisors should continue to adapt to a changing regulatory environment.** With banking union taking hold, the SSM has begun supervising France's banks, and the remaining directives on resolution and the deposit guarantees are slated for transposition into French law in the coming months. French banks have strengthened their capital ratios and fared relatively well in the ECB's Comprehensive Assessment. However, challenges remain, including relatively low leverage ratios and risk weights, continued dependence on wholesale funding, and uncertain profitability prospects. Additional capital raising efforts may be needed over the medium term as national regulatory discretion is gradually reduced and practices harmonized, a European leverage ratio is adopted, and new global requirements on "too important to fail" banks are introduced for globally systemic banks. On liquidity, while the big four banks have achieved a 100 percent Liquidity Coverage Ratio, the Net Stable Funding Ratio could be more challenging, given their structural reliance on wholesale funding.[8] These tightening conditions for banks could also push risk outside the banking system.

Regulatory Capital and Profitability, 2013–14
(In average ratio over the period)



Sources: IMF Financial Soundness Indicators, ACPR, and IMF staff calculations.

31. **Views of the authorities.** The authorities acknowledged that the current interest rates on regulated savings deposits, while encouraging a stable pool of savings, may affect the transmission of ECB monetary policy, and took note of staff's recommendation to reduce these rates and review tax advantages for certain savings and insurances products. Regarding insurers, the authorities are carrying out stress tests to identify and address any risks well in advance. More generally, the authorities are closely monitoring the possible side-effects of QE, but have observed very little "search-for-yield" behavior so far. On the housing market, they do not see risks to financial stability at this point, given prudent lending practices based on repayment ability, the predominance of fixed-rate mortgages, and the mortgage insurance scheme. Regarding the changing regulatory landscape, the authorities considered that France's large banks were reasonably well placed to adapt to SSM-related harmonization. However, they recognized that the combination of tougher capital and liquidity requirements and low interest margins could weigh on banks' profitability and limit credit expansion over the medium term. The authorities noted that they are monitoring risks related to "shadow banking", and that the EU directive on alternative investment fund management has brought new investment entities into the regulatory net.

[8] This reflects structural factors that constrain retail deposits, including tax benefits on life insurance and regulated savings (see above footnote).

Box 2. Key Structural Reforms[1]

Government spending	
Key Issues	Spending above 57 percent of GDP. Social spending and wage bill among highest in euro area. Rapid growth in local spending, including on staffing.
Recent reforms	• Wage-scale freeze for all levels of government since 2010 • 2014 pension reform (higher rates and longer contribution period for full pension) • Tightened budgetary target for health spending (*ONDAM*) • Reduced transfers to local governments (phased over 2014−17) • Creation of indicative target for local government spending growth starting 2015 (*ODEDEL*)
Underway	• Targeted expenditure reviews in selected areas, starting in 2015
Additional measures recommended by staff	• Limiting general government spending growth to inflation, with burden sharing mechanism • Institutionalizing broad spending reviews to improve efficiency at all levels of government • Reversing the growth in public employment at all levels of government • Improving targeting of social benefits, including for unemployment, housing, and families • Raising effective retirement age, making complementary pension pillar financially sustainable, and streamlining special pension regimes • Tightening caps on local taxes and borrowing, and eliminate "universal competency" clause
Labor market	
Key issues	High structural unemployment rate, especially among young and low-skilled. Low employment ratio. Duality. Judicial uncertainty around dismissals. High minimum wage. Wage rigidity.
Recent reforms	• Cut in employer's social security contribution (Responsibility Pact) • Tax credit (*CICE*) on firms' payroll on wages below 2.5 * minimum wage • Flexibility on hours and pay for firms in difficulties (*Accords de maintien de l'emploi - AMEs*) • Subsidized jobs for the young and the low-skilled • Introduction of portability of professional training rights across jobs and unemployment
Underway	• Reducing judicial uncertainty around individual dismissals through reform of *prud'hommes* system and ceilings on compensation (*Macron* law) • Simplifying use of *AMEs* (*Macron* law) • Reforming union representation and streamlining mandatory social discussions (*Rebsamen* law)
Additional measures recommended by staff	• Reforming the minimum wage formula • Reforming unemployment benefits and strengthening job search framework • Expanding flexibility for social partners to agree on hours and pay at the enterprise level • Improving the targeting of professional education and training
Product markets, real estate, and financial sector	
Key issues	Low TFP growth. Export market share loss. Barriers to competition in services. Excessive business regulation. Lack of affordable housing. Distortive rates on regulated savings deposit.
Recent reforms	• Liberalization of some regulated professions and the sale of some health products • Creation of Business Simplification Council • Simplification of housing-related regulations
Underway	• Liberalizing legal professions, coach transport, retail trade opening hours, and expanding the competencies of the Competition Authority (*Macron* law) • Easing labor-related regulations for firms above certain employee thresholds (*Rebsamen* law) • Temporary measure to boost investment through favorable amortization rules
Additional measures recommended by staff	• Strengthening the Competition Authority; allowing SMEs to launch class actions in anti-trust cases • Further reducing disincentives for SMEs to grow above certain employee thresholds • Liberalizing regulated professions not covered by the *Macron* law • Enhancing the effectiveness of the Business Simplification process • Alleviating constraints on the supply of affordable housing and improving targeting of benefits • Reducing regulated savings rates and reviewing tax incentives for savings and insurance products

1/ For details, see background in Selected Issues. See Table 7 for estimates of economic impact.

STAFF APPRAISAL

32. **A solid recovery is underway, with short-term risks broadly balanced.** After several years of near-stagnation, growth is expected to pick up, alongside gradually rising inflation. The recovery is supported by an accommodative external environment, in particular sharply lower oil prices, a depreciated euro, and very low interest rates. Growth could turn out stronger in the short term if QE and improved confidence boost investment. On the downside, external risks include potential confidence losses, a sustained increase in energy prices, or a pronounced slowdown in advanced economies. The external position has improved, but remains moderately weaker than that implied by fundamentals.

33. **The general policy direction is appropriate, but further reform efforts are needed to address the structural rigidities that continue to weigh heavily on medium-term prospects.** Supported by a more accommodative macroeconomic policy mix, the output gap should narrow gradually in the coming years. However, potential output growth remains well below pre-crisis rates, structural unemployment high, and competitiveness weak. In addition, France faces a very difficult fiscal adjustment task, with public spending having reached record-high levels and the debt ratio continuing to rise. The authorities are taking significant actions to address these challenges, notably by containing public spending, reducing the labor tax wedge, and advancing supply-side reforms. These important measures should be followed up by additional, bold reforms to ensure lasting results in reining in public spending, reviving job creation, and removing growth bottlenecks.

34. **The switch to expenditure-based fiscal consolidation is welcome.** High and rising government spending is at the heart of France's fiscal challenges—and a decisive break is needed to reverse the growth of public debt and make room for eventually alleviating the heavy tax burden on the economy. While the government's medium-term fiscal framework would reduce the overall deficit narrowly below 3 percent of GDP in 2017 under baseline assumptions, there is a clear risk that medium-term targets may be missed and debt continues to increase in the event that growth or inflation disappoint or new spending pressures arise.

35. **Fiscal adjustment should be underpinned by structural measures to keep real spending flat starting in 2016.** A fiscal anchor of zero real primary spending growth, with appropriate burden sharing across levels of government, would deliver structural adjustment of about ½ percent of GDP per year. While not detracting unduly from demand, it would ensure that medium-term fiscal targets are safely met and debt is placed on a firm downward trajectory by 2017. Spending containment should rely on higher quality structural measures based on regular broad-based expenditure reviews at all levels of government—notably through staffing reform, streamlining of local government institutions, better targeting of social benefits, and a further increase in the effective retirement age.

36. **Building on recent labor market reforms, additional broad-based efforts are needed to return to pre-crisis rates of job creation**. Following the reduction in the tax wedge for lower salary ranges under the Responsibility Pact and *CICE* tax credit, the *Macron* and *Rebsamen* laws will help reduce judicial uncertainty around dismissals and improve the social dialogue.

However, unemployment may still decline only very slowly unless broad-based additional efforts are made. These should include: further expanding the flexibility for social partners to agree at firm level on hours and wages; limiting increases in the minimum wage to inflation as long as unemployment remains high; and strengthening job search incentives for those receiving unemployment or welfare benefits. In addition, education and training resources should be better targeted to the young, the low skilled, and the unemployed.

37. **Recent momentum on product market reforms should be maintained to remove growth bottlenecks**. The *Macron* law is an important step forward, and should be followed by further liberalization of regulated professions. The disincentives for smaller companies to grow should be reduced, including through steps envisaged under the draft *Rebsamen* law and efforts to lighten other regulatory requirements and red tape. Removing barriers to competition in services would help provide better incentives for innovation and productivity growth. Further efforts are also needed to alleviate constraints on the supply of affordable housing and improve the targeting of housing assistance.

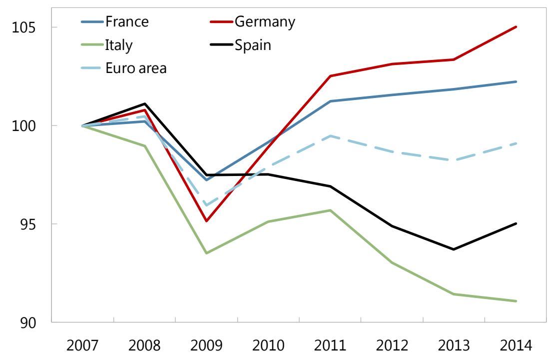
38. **The financial sector has further to go to adapt to a changing economic and regulatory environment.** While France's banks are reasonably well placed to adapt to SSM supervision, the low interest environment is putting pressure on margins for both banks and insurance companies. Risks from this environment, and from banks' reliance on wholesale funding, should remain under close monitoring as banks continue to strengthen capital and liquidity alongside evolving regulatory standards under European and global initiatives. To support the proper transmission of ECB monetary policy, guaranteed interest rates under the regulated savings schemes should be reduced. Tax incentives on financial savings and insurance products should be reviewed.

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

Figure 1. Economic Performance During the Crisis Years

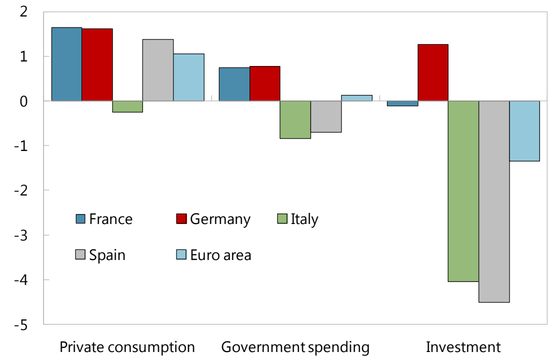
The economy showed resilience during the crisis years.

Real GDP Growth
(In index, 2007 = 100)



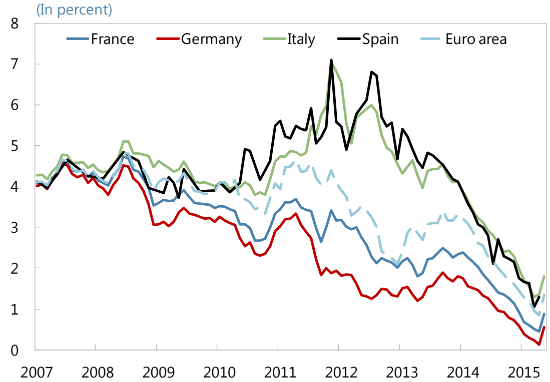
Consumption and government spending remained robust…

Average Growth of GDP Components, 2007–14
(In annual growth)



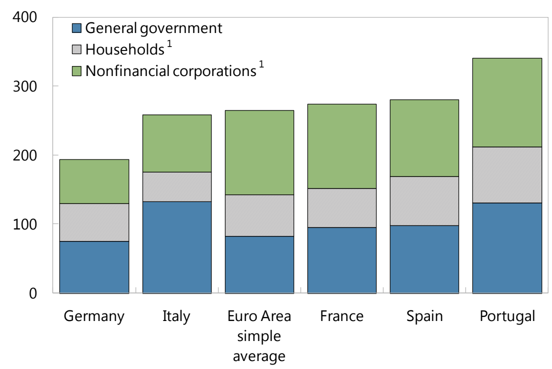
….financing costs continued to trend down…

10 Year Government Bond Yields
(In percent)



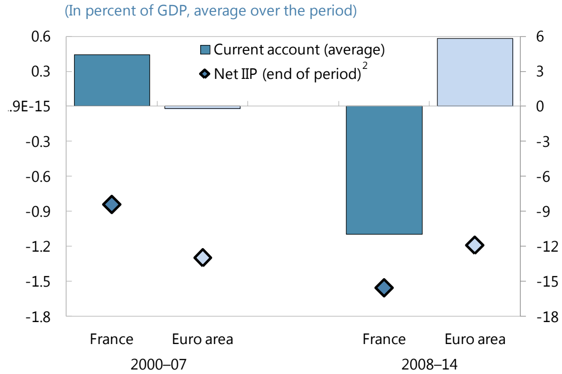
…and indebtedness increased but stayed manageable overall.

Indebtedness by Sector, 2014
(In percent of GDP)



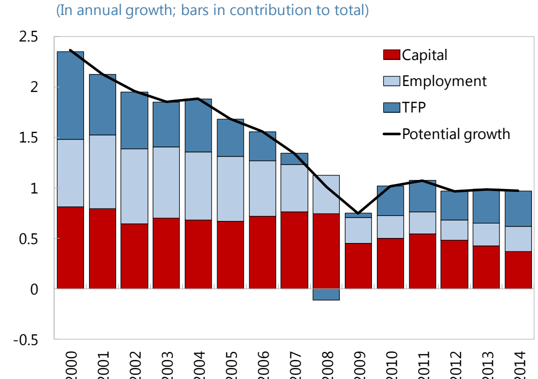
But the external position weakened…

Current Account and Net IIP
(In percent of GDP, average over the period)



…and potential growth slowed down significantly.

Potential GDP Growth
(In annual growth; bars in contribution to total)



Sources: IMF World Economic Outlook, AMECO, ECB, Haver Analytics, and IMF Staff calculations.

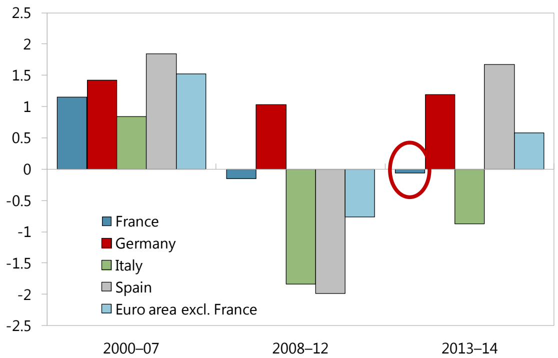
[1] Non-consolidated data.

[2] Euro area net IIP for 2013.

Figure 2. Real Sector and Inflation

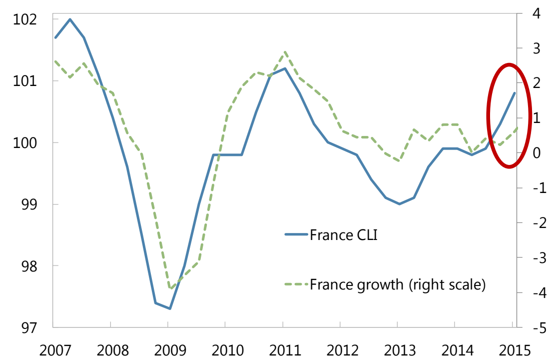
France's recovery has lagged…

GDP per Capita
(In percent annualized growth over the period)



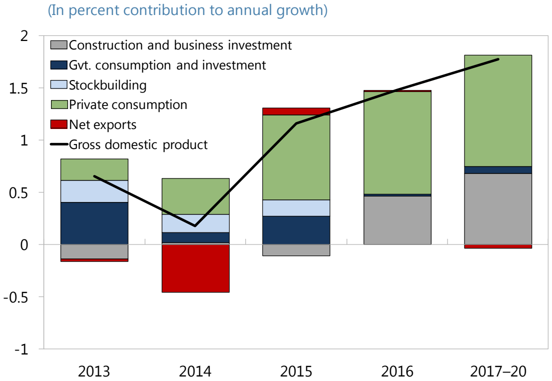
…but growth should accelerate in the near term…

Composite Leading Indicator
(Amplitude adjusted index; right scale in y-o-y growth)



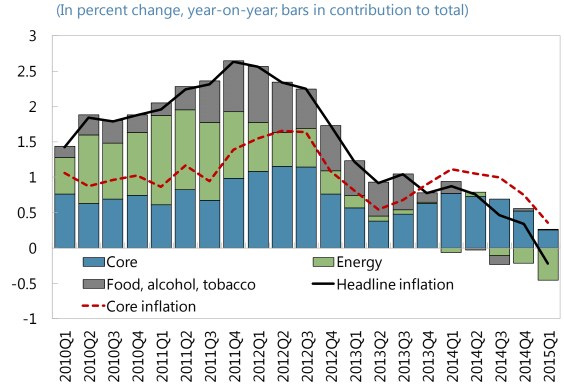
…supported by a rebound in exports and private consumption.

GDP by Demand Components
(In percent contribution to annual growth)



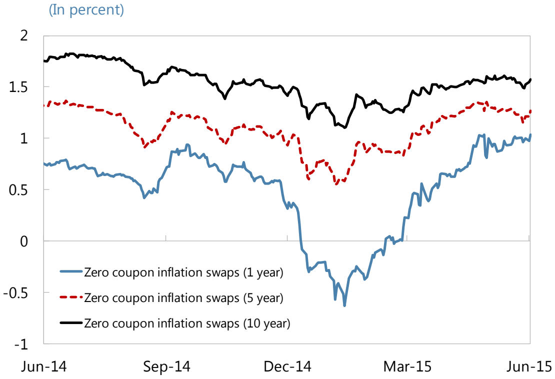
Inflation has slowed sharply…

Consumer Prices (HICP)
(In percent change, year-on-year; bars in contribution to total)



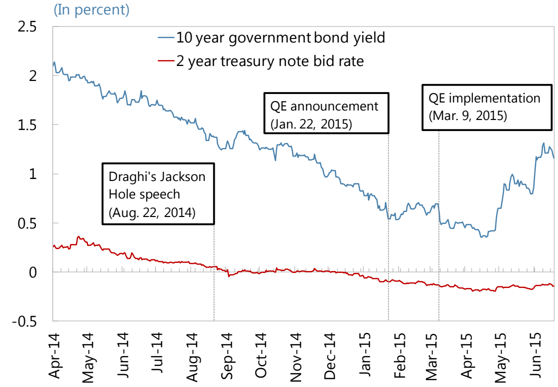
… while inflation expectations rebounded as the ECB moved to QE…

Inflation Expectations
(In percent)



…and financing costs have eased further.

Effect of QE on Financial Markets
(In percent)

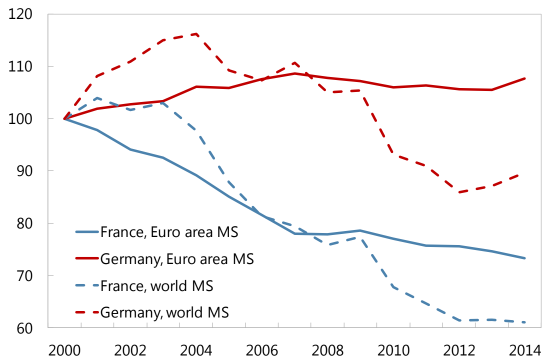


Sources: OECD, Haver Analytics, Bloomberg, and IMF Staff calculations.

Figure 3. Competitiveness

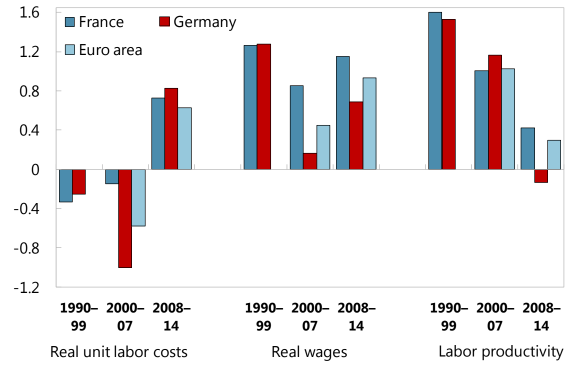
France has lost export market share inside and outside the euro area…

France and Germany: Market Shares
(In index number, 2000 = 100)



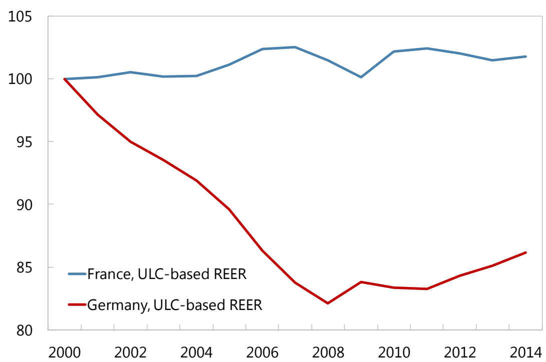
… as real wages grew more strongly than in other euro area countries…

Real Unit Labor Costs and Components
(In annual growth)



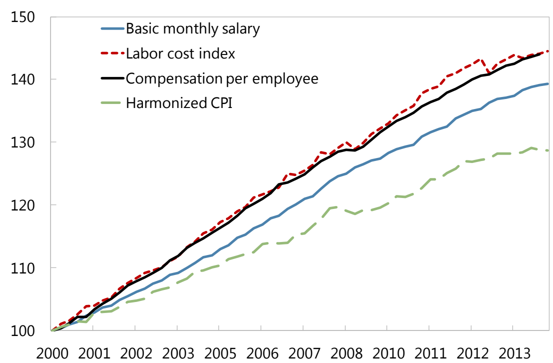
The ULC-based real effective exchange rate has appreciated…

France and Germany: Real Effective Exchange Rates
(In index number, 2005=100)



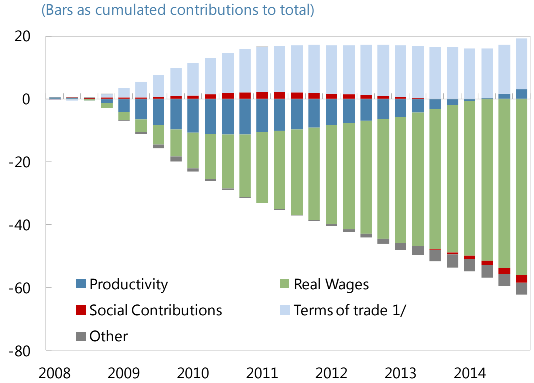
…as wage growth outpaced inflation…

Selected Wage Indicators
(In index, Q1 2000=100)



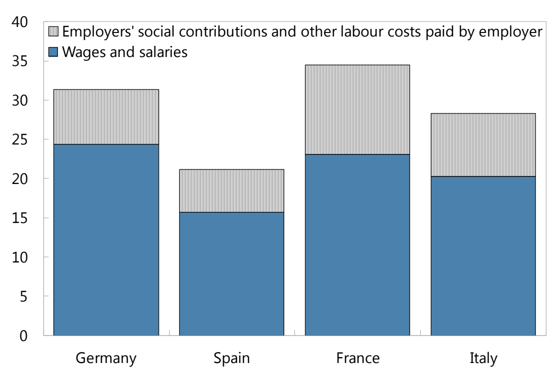
… while profit margins were squeezed.

Contributions to Profit Margins
(Bars as cumulated contributions to total)



Labor cost per hour continues to be high despite recent reduction in the tax wedge.

Labor Costs per Hour by Components, 2014
(In euros)

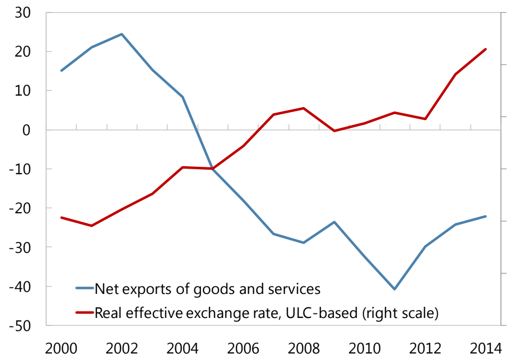


Sources: SNL Financial, ECB, BIS, Haver Analytics, and IMF Staff calculations.
1/ Ratio of price of value added and consumption.

Figure 4. External Sector

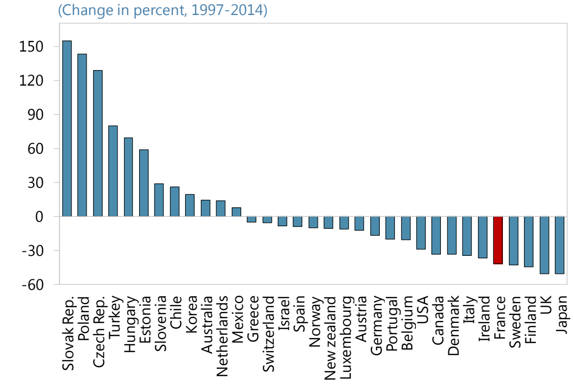
France's net exports have declined since the early 2000s, alongside REER appreciation…

Net Exports of Goods and Services
(In billions of euros; right scale in index, 2005 = 100)



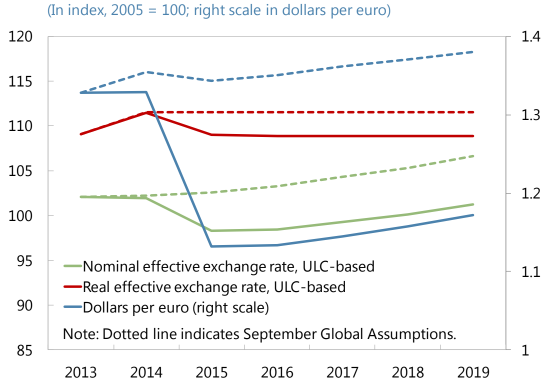
…leading to a loss of market shares in global trade.

Share in World Merchandise Exports
(Change in percent, 1997-2014)



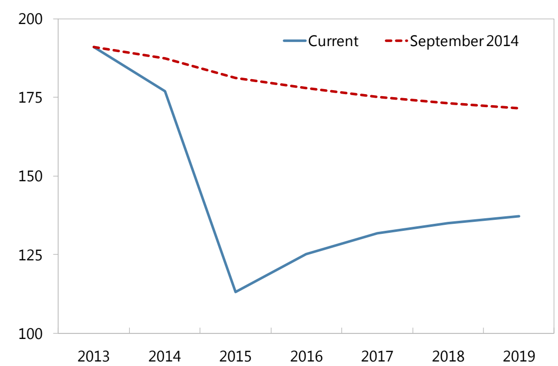
The recent euro depreciation…

Exchange Rates
(In index, 2005 = 100; right scale in dollars per euro)



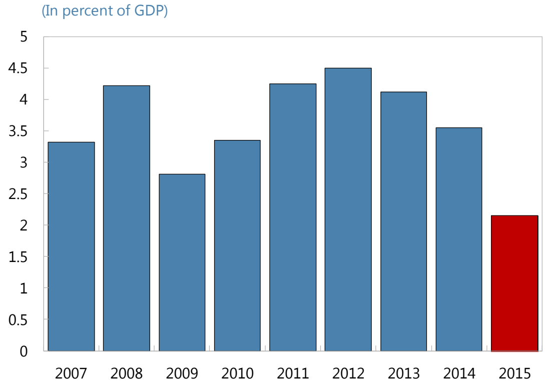
…and oil price declines…

Commodity Fuel Index
(In index, 2005 = 100)



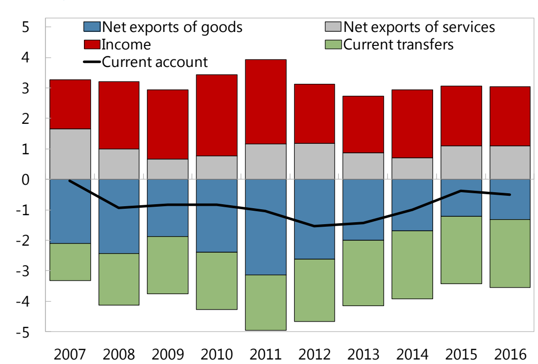
… will lead to significant savings…

Energy Imports
(In percent of GDP)



…and help reduce the current account deficit.

Current Account by Components
(In percent of GDP)

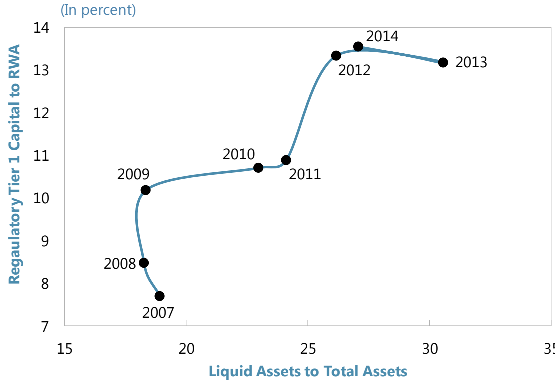


Sources: IMF *Department of Trade Statistics*, IMF *World Economic Outlook*, Haver Analytics, and IMF Staff calculations.

Figure 5. Banking Sector and Credit

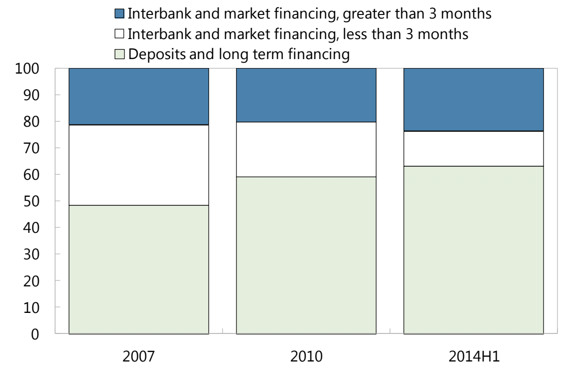
System capital and liquidity have been strengthened since the crisis …

Capital and Liquidity
(In percent)



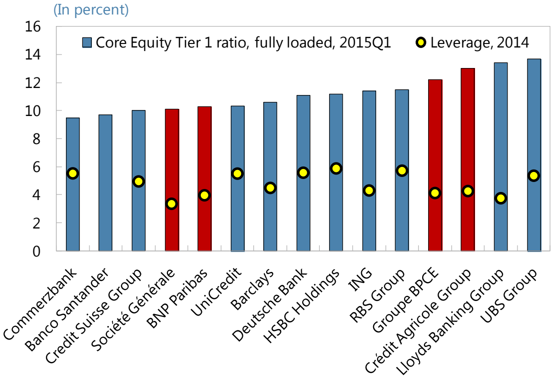
… and the maturity structure of liabilities has also improved.

Financing Structure of the Largest 5 Banking Groups
(In percent of total liabilities)



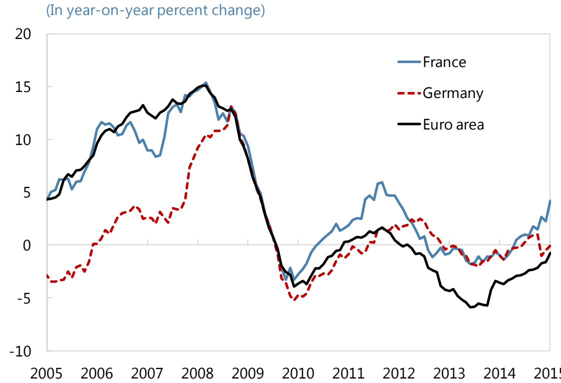
CET1 capital levels at French banks exceed 10 percent, but leverage ratios look low relative to peers.

Bank Capital and Leverage Ratios
(In percent)



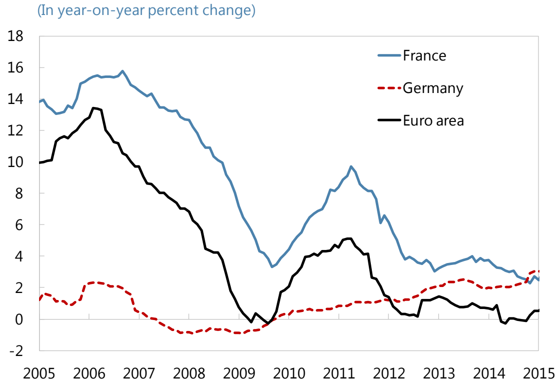
Credit growth to nonfinancial corporations has picked up recently, and remains above that for the euro area…

Corporate Loans
(In year-on-year percent change)



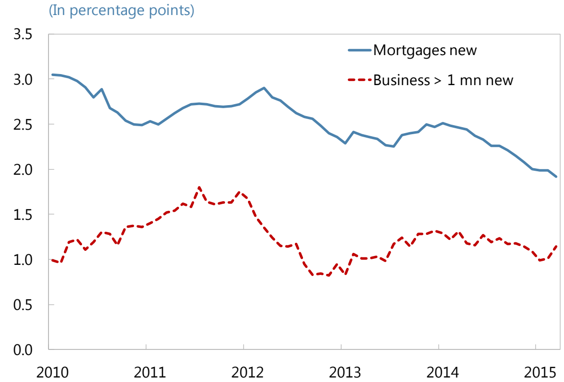
… while that for housing slowed somewhat in 2014.

Housing Loans
(In year-on-year percent change)



Lending rate spreads for mortgages have declined while those for business loans have been broadly stable.

Lending Rate Spreads Over Average Deposit Rates
(In percentage points)

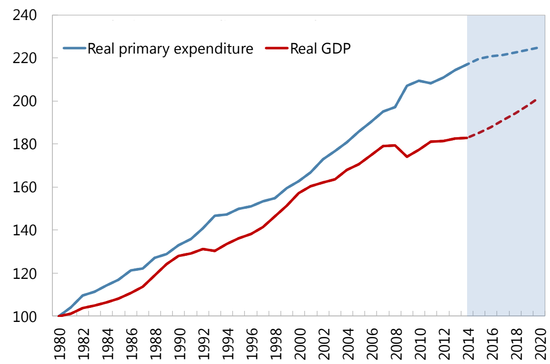


Sources: SNL Financial, ECB, BIS, Haver Analytics, and IMF Staff calculations.

Figure 6. Fiscal Sector

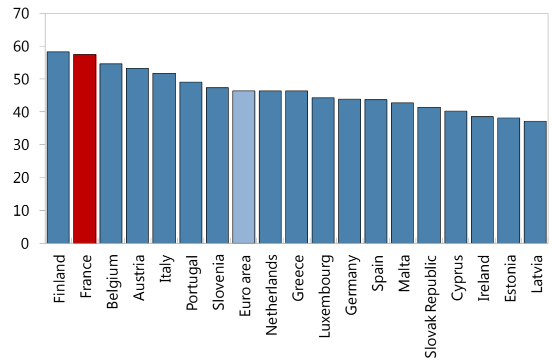
Spending has outpaced GDP...

Real Primary Expenditure and Real GDP
(In index number, 1980=100)



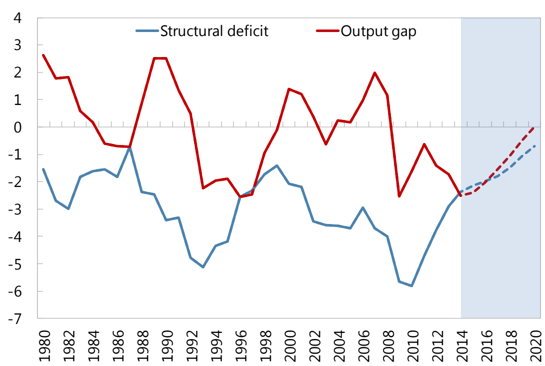
leading in a high expenditure-to-GDP ratio ...

General Government Expenditure
(In percent of GDP)



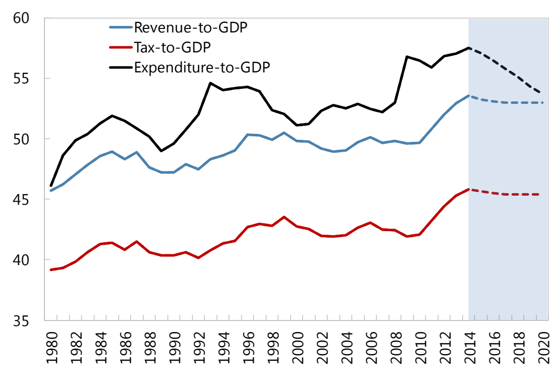
and making it difficult to close the structural deficit even in good times...

Structural Deficit and Output Gap
(In percent of potential GDP)



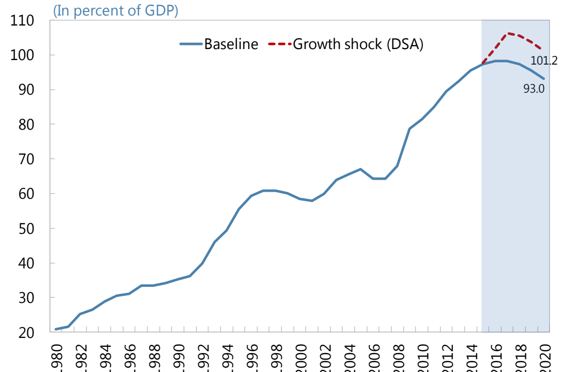
...despite a ratcheting up of taxes.

Fiscal Ratios
(In percent of GDP)



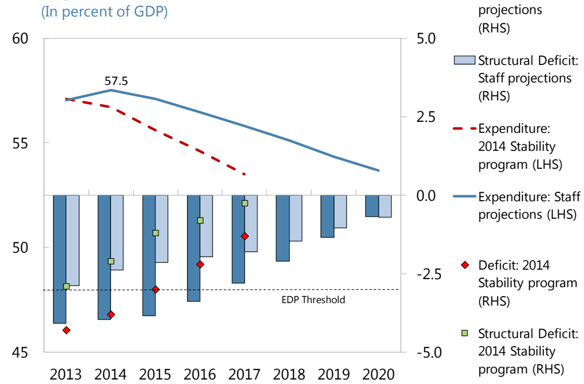
Fiscal buffers have eroded over time.

Debt-to-GDP Ratio
(In percent of GDP)



The fiscal consolidation strategy has run into difficulties, and structural balance is some way off.

Expenditure Path
(In percent of GDP)

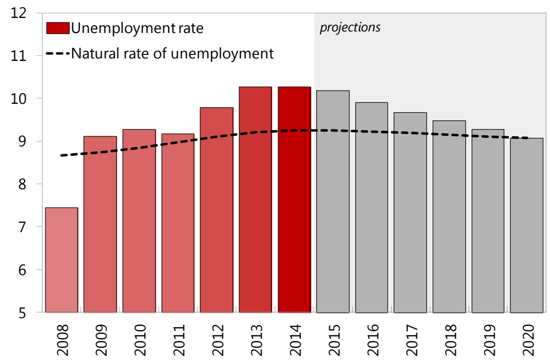


Sources: France Authorities, IMF *World Economic Outlook*, and IMF Staff calculations.

Figure 7. Labor Market

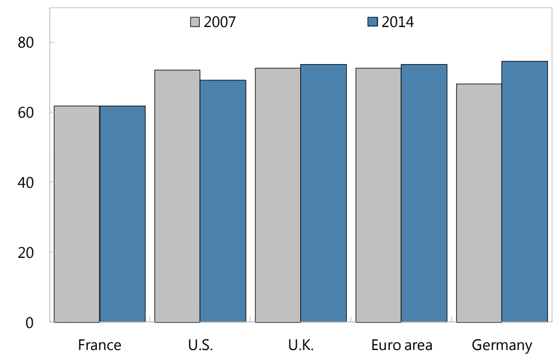
Unemployment remains a problem.

Unemployment
(In percent; right scale in thousands of people)



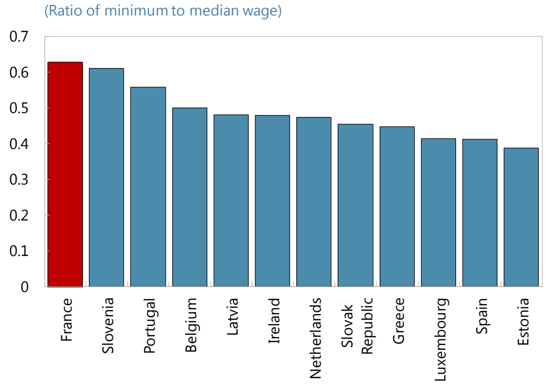
Employment rates are relatively low.

Employment Rate
(In percent)



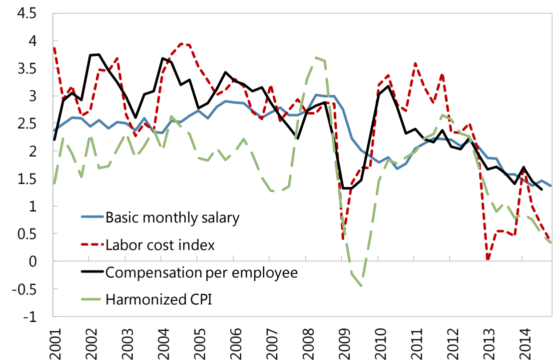
The minimum wage is high relative to the median wage.

Minimum Wages, 2013
(Ratio of minimum to median wage)



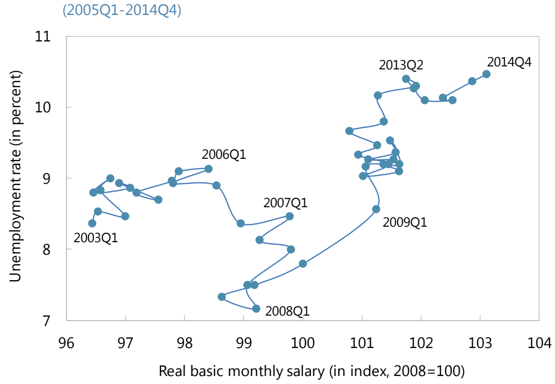
Real wages have continued to increase during the crisis…

Selected Wage Indicators
(In y-o-y percent change)



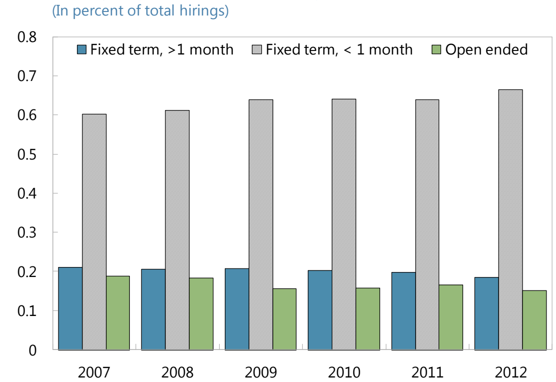
…despite the rise in the unemployment rate.

Basic Monthly Salary and Unemployment Rate
(2005Q1-2014Q4)



Labor market duality is on the rise.

Hirings by Contract Modality
(In percent of total hirings)

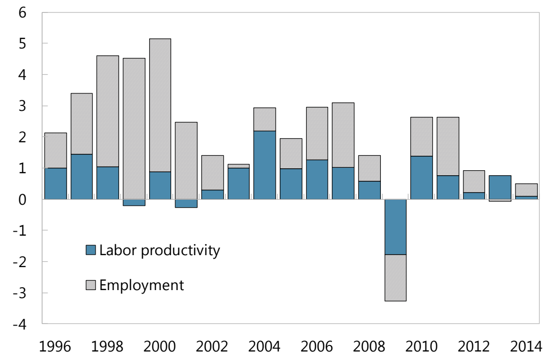


Sources: OECD, Haver Analytics, and IMF Staff calculations.

Figure 8. Product Market

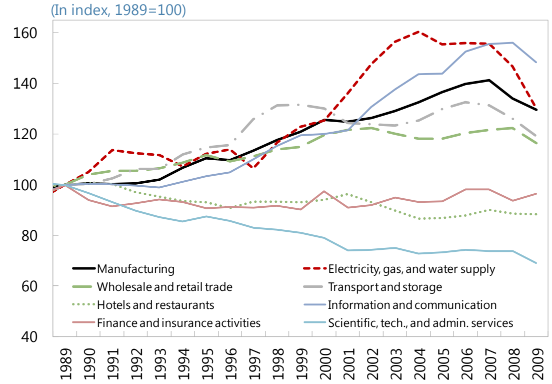
Productivity growth in services is relatively low…

Productivity and Employment in Market Services
(In annual growth)



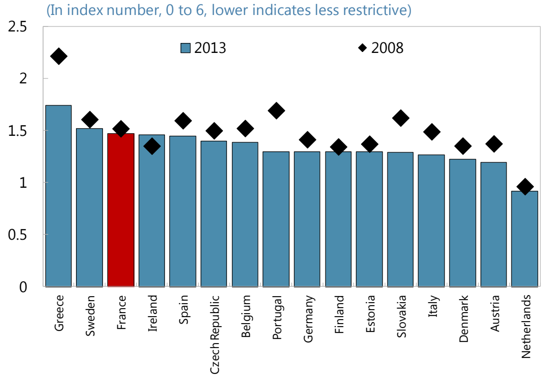
… but there is significant differences across types of services.

Total Factor Productivity by Industry
(In index, 1989=100)



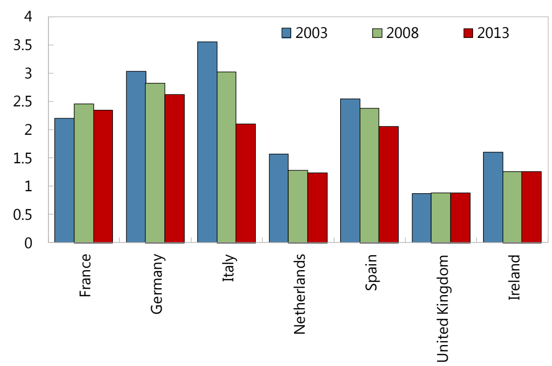
France is one of the more regulated economies in the OECD…

Overall PMR Indicator by Country
(In index number, 0 to 6, lower indicates less restrictive)



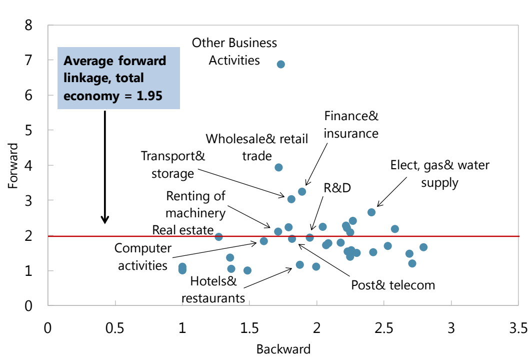
…and regulation in professional services has become more stringent over the past decade.

Professional Services Regulation
(In index value)



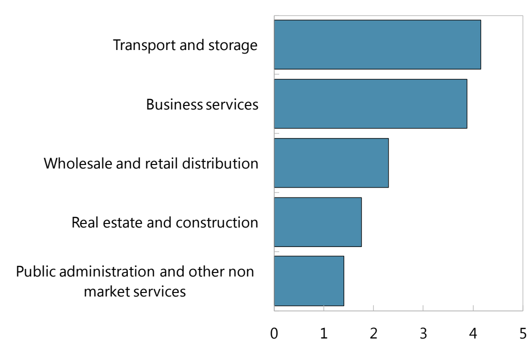
Services have strong forward linkages to the rest of the economy…

France: Services Forward and Backward Linkages, 2009[1]



…and their liberalization can therefore unleash significant output gains.

Productivity Multipliers[2/]



Sources: OECD, IMF *World Economic Outlook*, Haver Analytics, EU KLEMS, Fernandez and Perez Ruiz (2014), and IMF Staff calculations

[1/] Chart shows output rise in sector i due to unit increase in final demand of all other sectors (forward linkages) and output rises in all sectors due to a unit increase in j's final demand (backward linkages).

[2/] Chart shows output response to a 1 percent increase in sector-specific TFP divided by sector's weight in value added.

Table 1. France. Selected Economic and Social Indicators, 2010–20

	2010	2011	2012	2013	2014	Projections 2015	2016	2017	2018	2019	2020
Real economy (change in percent)											
Real GDP	2.0	2.1	0.2	0.7	0.2	1.2	1.5	1.7	1.8	1.9	1.9
Domestic demand	2.1	2.0	-0.3	0.7	0.6	1.1	1.4	1.7	1.8	1.9	1.9
Private consumption	1.8	0.5	-0.2	0.4	0.6	1.5	1.8	1.8	1.9	2.0	2.0
Public consumption	1.3	1.0	1.6	1.7	1.5	1.3	0.6	0.3	0.3	0.3	0.3
Gross fixed investment	2.1	2.1	0.2	-0.6	-1.2	-0.7	1.6	2.8	3.1	3.3	3.2
Foreign balance (contr. to GDP growth)	-0.1	0.0	0.5	0.0	-0.5	0.1	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	9.0	6.9	2.5	1.7	2.4	5.5	4.9	4.8	4.8	4.8	4.8
Imports of goods and services	8.9	6.3	0.7	1.7	3.8	5.0	4.6	4.7	4.7	4.7	4.7
Nominal GDP (billions of euros)	1998	2059	2087	2117	2132	2174	2224	2285	2356	2434	2517
CPI (year average)	1.7	2.3	2.2	1.0	0.6	0.1	1.0	1.1	1.2	1.5	1.7
GDP deflator	1.1	0.9	1.2	0.8	0.6	0.8	0.8	1.1	1.3	1.4	1.5
Gross national savings (percent of GDP)	21.1	22.2	21.1	20.9	21.2	21.3	21.1	21.3	21.5	21.7	21.9
Gross domestic investment (percent of GDP	21.9	23.2	22.6	22.3	22.2	21.7	21.6	21.8	22.0	22.3	22.4
Public finance (percent of GDP)											
General government balance	-6.8	-5.1	-4.8	-4.1	-4.0	-3.8	-3.4	-2.8	-2.1	-1.3	-0.7
Revenue	49.6	50.8	52.0	52.9	53.5	53.2	53.1	53.0	53.0	53.0	53.0
Expenditure	56.4	55.9	56.8	57.0	57.5	57.1	56.5	55.8	55.1	54.3	53.7
Structural balance (percent of pot. GDP)	-5.8	-4.7	-3.8	-2.9	-2.4	-2.2	-2.0	-1.8	-1.5	-1.1	-0.7
Primary balance	-4.5	-2.6	-2.4	-1.9	-1.9	-1.9	-1.6	-1.0	-0.3	0.4	1.0
General government gross debt	81.5	85.0	89.4	92.3	95.6	97.3	98.2	98.2	97.3	95.5	93.0
Labor market (percent change)											
Employment	0.0	0.4	0.0	-0.2	0.2	0.5	0.7	0.7	0.7	0.7	0.7
Labor force	0.1	0.3	0.7	0.3	0.2	0.5	0.4	0.4	0.5	0.4	0.4
Unemployment rate (percent)	9.3	9.2	9.8	10.3	10.3	10.2	9.9	9.7	9.5	9.3	9.1
Total compensation per employee	2.7	2.4	2.2	1.5	1.4	…	…	…	…	…	…
Money and interest rates (percent)											
Money market rate (Euro area)	0.5	0.8	0.1	0.0	0.1	…	…	…	…	…	…
Government bond yield, 10-year	3.1	3.3	2.5	2.2	1.7	…	…	…	…	…	…
Balance of payments (percent of GDP)											
Exports of goods	19.2	20.5	20.9	20.7	20.6	24.1	24.6	25.0	25.3	25.5	25.6
Imports of goods	-21.6	-23.6	-23.5	-22.7	-22.2	-25.3	-26.0	-26.4	-26.7	-26.9	-26.9
Trade balance	-2.4	-3.1	-2.6	-2.0	-1.7	-1.2	-1.3	-1.4	-1.4	-1.4	-1.3
Current account	-0.8	-1.0	-1.5	-1.4	-1.0	-0.4	-0.5	-0.5	-0.6	-0.5	-0.5
FDI (net)	1.3	0.7	0.7	-0.2	1.1	1.3	1.5	1.6	1.8	1.9	2.0
Official reserves (US$ billion)	55.8	48.6	54.2	50.8	49.5	…	…	…	…	…	…
Exchange rates											
Euro per U.S. dollar, period average	0.75	0.72	0.78	0.75	0.75	…	…	…	…	…	…
NEER, ULC-styled (2000=100)	102.4	102.4	100.1	102.1	101.9	…	…	…	…	…	…
REER, ULC-based (2000=100)	104.3	105.4	104.8	109.1	111.4	…	…	…	…	…	…
Potential output and output gap											
Potential output (change in percent)	1.0	1.1	1.0	1.0	1.0	1.1	1.1	1.1	1.2	1.3	1.3
Memo: per working age person	0.7	0.7	0.6	0.6	0.6	0.7	0.7	0.6	0.8	0.9	0.9
Output gap	-1.6	-0.6	-1.4	-1.7	-2.5	-2.4	-2.0	-1.5	-1.0	-0.5	0.0

Sources: French authorities; IMF staff estimates and projections.

Table 2. France: General Government Accounts, 2009–20
(In percent of GDP unless otherwise indicated)

						Projections					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
General government											
Revenue	49.6	50.8	52.0	52.9	53.5	53.2	53.1	53.0	53.0	53.0	53.0
Tax revenue	42.1	43.2	44.4	45.3	45.8	45.6	45.5	45.4	45.4	45.4	45.4
Nontax revenue	7.6	7.6	7.6	7.7	7.7	7.6	7.6	7.6	7.6	7.6	7.6
Expenditures	56.4	55.9	56.8	57.0	57.5	57.1	56.5	55.8	55.1	54.3	53.7
Primary exp.	54.1	53.3	54.3	54.8	55.4	55.0	54.6	53.9	53.2	52.5	51.8
Debt service	2.4	2.6	2.6	2.3	2.2	2.0	1.9	1.9	1.9	1.9	1.9
Balance 1/	-6.8	-5.1	-4.8	-4.1	-4.0	-3.8	-3.4	-2.8	-2.1	-1.3	-0.7
Primary balance	-4.5	-2.6	-2.4	-1.9	-1.9	-1.9	-1.6	-1.0	-0.3	0.4	1.0
Structural balance 2/	-5.8	-4.7	-3.8	-2.9	-2.4	-2.2	-2.0	-1.8	-1.5	-1.1	-0.7
Central government balance 1/	-6.1	-4.4	-3.9	-3.3	-3.5	-3.4	-3.2	-2.8	-2.2	-1.6	-1.1
Social security balance 1/	-1.2	-0.6	-0.6	-0.4	-0.4	-0.3	0.0	0.0	0.1	0.2	0.3
Local government balance 1/	-0.1	0.0	-0.2	-0.4	-0.2	-0.2	-0.2	-0.1	-0.1	0.0	0.0
ODAC balance 1/	0.5	0.0	-0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Gross debt 3/	81.5	85.0	89.4	92.3	95.6	97.3	98.2	98.2	97.3	95.5	93.0
Memorandum items:											
Nominal GDP (in billion of Euros)	1,998	2,059	2,087	2,117	2,132	2,174	2,224	2,285	2,356	2,434	2,517
Potential nominal GDP (in billion of Euros)	2,031	2,072	2,117	2,154	2,187	2,227	2,270	2,321	2,380	2,446	2,517
Real GDP growth (in percent)	2.0	2.1	0.2	0.7	0.2	1.2	1.5	1.7	1.8	1.9	1.9
Nominal expenditure growth	2.5	2.1	3.0	1.8	1.6	1.2	1.2	1.5	1.8	1.9	2.2
Real expenditure growth (in percent)	1.0	0.0	1.1	1.1	1.0	1.1	0.2	0.4	0.5	0.5	0.5
of which: primary	1.0	-0.5	1.2	1.7	1.2	1.3	0.4	0.4	0.5	0.5	0.5
of which: structural primary	1.0	-0.4	0.8	1.7	1.3	0.9	0.6	0.6	0.6	0.5	0.6

1/ Maastricht definition.
2/ In percent of potential GDP.
3/ The debt figure, based on Maastricht definition, does not include guarantees on nongeneral government debt.

Table 3. France: Balance of Payments, 2009–20
(In percent of GDP)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projections						
Current account	-0.8	-1.0	-1.5	-1.4	-1.0	-0.4	-0.5	-0.5	-0.6	-0.5	-0.5
Net exports of goods	-2.4	-3.1	-2.6	-2.0	-1.7	-1.2	-1.3	-1.4	-1.4	-1.4	-1.3
Exports of goods	19.2	20.5	20.9	20.7	20.6	24.1	24.6	25.0	25.3	25.5	25.6
Imports of goods	21.6	23.6	23.5	22.7	22.2	25.3	26.0	26.4	26.7	26.9	26.9
Net exports of services	0.8	1.2	1.2	0.9	0.7	1.1	1.1	1.1	1.1	1.1	1.1
Exports of services	7.6	8.3	8.8	9.1	9.4	11.0	11.2	11.4	11.5	11.6	11.7
Imports of services	6.9	7.1	7.6	8.2	8.7	9.9	10.1	10.3	10.4	10.5	10.5
Income balance	2.7	2.8	1.9	1.9	2.2	2.0	2.0	2.0	2.0	2.0	2.0
Current transfers	-1.9	-1.8	-2.0	-2.1	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2	-2.2
Capital and financial account											
Capital account	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	0.1	-2.5	-1.0	-0.7	-1.6	-0.3	-0.4	-0.4	-0.5	-0.4	-0.4
Direct investment	1.3	0.7	0.7	-0.2	1.1	1.3	1.5	1.6	1.8	1.9	2.0
Portfolio investment	-5.8	-11.7	-1.3	-3.3	-0.5	-0.8	-2.4	-3.8	-5.2	-6.6	-7.9
Financial derivatives	-0.2	-0.7	-0.7	-0.8	-2.2	-0.9	0.4	1.7	3.0	4.2	5.5
Other investments net	4.5	9.4	0.1	3.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets	0.3	-0.3	0.2	-0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions	0.9	-1.5	0.5	0.7	-0.7	0.0	0.0	0.0	0.0	0.0	0.0

Source: IMF, Balance of Payments Statistics; and Direction Générale des Douanes et Droits Indirects for goods exports and imports.

Table 4. France: Vulnerability Indicators, 2007–14
(In percent of GDP unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	Est. 2014
External Indicators								
Exports (annual percentage change, in U.S. dollars)	14.0	5.2	-19.6	7.0	15.8	-3.2	4.9	1.6
Imports (annual percentage change, in U.S. dollars)	15.7	6.7	-20.4	8.3	18.0	-5.1	2.9	0.6
Terms of trade (annual percentage change)	1.2	-0.6	2.6	-1.4	-2.4	-0.3	1.0	1.5
Current account balance	-0.1	-0.9	-0.8	-0.8	-1.0	-1.5	-1.4	-1.0
Capital and financial account balance	-1.5	-1.5	-1.7	0.1	-2.5	-1.0	-0.6	-1.5
Of which								
Inward portfolio investment (debt securities, etc.)	4.4	6.2	16.2	4.3	3.0	1.6	7.1	…
Inward foreign direct investment	3.6	2.2	0.9	1.3	1.3	0.9	0.2	…
Other investment (net)	8.2	3.2	-7.6	-4.5	-8.7	1.6	-5.0	…
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	45.7	33.6	46.6	55.8	48.6	54.2	50.8	49.5
Euros per U.S. dollar (period average)	0.7	0.7	0.7	0.8	0.7	0.8	0.8	0.8
Market Indicators								
Financial Markets								
Public sector debt 1/	64.2	67.9	78.8	81.5	85.0	89.4	92.3	95.6
3-month T-bill yield (percentage points, eop)	3.8	1.9	0.4	0.5	0.1	0.1	0.1	-0.03
3-month T-bill yield in real terms (percentage points, eop)	1.3	0.9	-0.5	-1.2	-2.3	-1.3	-0.5	-0.10
US 3 month T-bill	3.1	0.0	0.1	0.2	0.0	0.1	0.1	0.04
Spread with the US T-bill (percentage points, eop)	0.7	1.9	0.3	0.3	0.1	0.0	0.1	-0.07
5- to 8-year government bond (percentage points, eop)	4.4	3.5	3.5	3.3	3.2	2.0	2.3	0.9
10-year government bond (United States)	4.1	2.4	3.6	3.3	2.0	1.7	2.9	2.2
Spread with US bond (percentage points, eop)	0.3	1.1	-0.1	0.1	1.2	0.3	-0.6	-1.3
Yield curve (10 year - 3 month, percentage points, eop)	0.5	1.6	3.1	2.8	3.0	1.9	2.2	0.9
Stock market index (period average, 1995=100)	306.2	232.0	178.6	200.3	192.1	179.0	211.1	213.4
Real estate prices (index, Q1-10=100, period average)	105.1	106.0	98.5	103.5	109.7	109.1	106.7	104.9
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	13.4	6.2	-0.7	5.6	4.4	2.0	0.5	0.5
Bank credit to households	10.7	5.7	2.9	6.0	5.8	2.1	2.4	-1.9
Housing Loans	12.8	7.5	3.7	8.2	6.2	3.0	4.0	-2.7
Bank credit to nonfinancial enterprises	14.1	10.6	-2.1	1.4	4.7	-0.2	-1.1	2.7
Sectoral risk indicators								
Household sector								
Household savings ratio	15.1	15.0	16.2	15.8	15.6	15.2	15.1	…
Household financial savings ratio	4.4	4.2	7.1	6.5	6.1	5.6	5.8	…
Real estate household solvency ratio (index, 2001=100) 2/	97	101	102.0	99.4	100.9	98.2	98.5	98.5
Corporate sector								
Profitability of business sector (financial margin)	40.0	39.5	37.3	37.9	37.4	36.8	36.0	…
Investment ratio	20.9	21.6	20.0	20.4	21.0	21.0	20.9	…
Savings ratio	19.4	16.8	16.7	18.9	18.2	17.3	17.0	…
Self-financing ratio	85.8	72.1	77.7	85.6	80.3	76.3	75.5	…
Banking sector								
Share of housing loans in bank credit to the private sector	37.1	37.6	39.2	40.2	40.8	41.2	42.6	41.3
Share of nonperforming loans in total loans	2.7	2.8	3.6	3.5	3.5	4.0	4.5	4.0
Ratio of nonperforming loans net of provisions to capital	6.6	8.2	10.8	10.0	9.2	10.7	11.4	9.6
Liquid assets to total short-term liabilities	150.3	139.6	150.1	144.4	136.3	164.0	165.2	178.5
Return on assets	0.4	0.1	0.3	0.6	0.4	0.3	0.4	0.4
Return on equity	13.3	3.8	6.4	11.8	8.2	6.6	8.1	6.2
Regulatory capital to risk-weighted assets	10.2	10.5	12.4	12.5	12.2	14.0	15.1	15.3

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

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

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

Table 5. France: Core Financial Soundness Indicators, 2007–14

	2007	2008	2009	2010	2011	2012	2013	2014 Estimate
Deposit-taking institutions 1/								
Regulatory capital to risk-weighted assets 2/	10.2	10.5	12.4	12.5	12.2	14.0	15.1	15.3
Regulatory Tier I capital to risk-weighted assets 2/	7.7	8.5	10.2	10.7	10.9	13.3	13.2	13.6
Nonperforming loans net of provisions to capital 3/	6.6	8.2	10.8	10.0	9.2	10.7	11.4	9.6
Bank provisions to nonperforming loans 3/	158.3	131.0	109.5	112.0	115.3	106.7	104.7	103.8
Nonperforming loans to total gross loans 3/	2.7	2.8	3.6	3.5	3.5	4.0	4.5	4.0
Sectoral distribution of loans to total loans, *of which*								
Deposit-takers 3/	32.2	33.6	5.0	36.5	40.2	40.7	39.2	39.1
Nonfinancial corporation 3/	18.1	18.3	17.5	20.5	19.2	18.8	19.0	19.5
Households (including individual firms) 3/	24.8	24.1	24.5	30.5	28.7	28.9	30.3	29.8
Nonresidents (including financial sectors) 3/	4.7	4.7	4.6	6.1	5.9	5.6	5.4	5.5
ROA (aggregated data on a parent-company basis) 3/	0.4	0.0	0.4	0.3	0.0	0.2	0.4	0.2
ROA (main groups on a consolidated basis) 2/	0.35	0.1	0.3	0.6	0.4	0.3	0.4	0.4
ROE (aggregated data on a parent-company basis) 3/	9.8	-1.0	8.2	7.9	1.2	5.5	10.1	4.4
ROE (main groups on a consolidated basis) 2/	13.3	3.8	6.4	11.8	8.2	6.6	8.1	6.2
Interest margin to gross income 3/	25.3	40.4	34.9	49.4	51.5	41.4	43.7	44.1
Noninterest expenses to gross income 3/	68.4	84.2	63.1	65.7	67.4	63.2	66.5	67.8
Liquid assets to total assets 3/	18.9	18.3	18.3	23.0	24.1	26.2	30.6	27.1
Liquid assets to short-term liabilities 3/	150.3	139.6	150.1	144.4	136.3	164.0	165.2	178.5

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 seven main banking groups (2005, IFRS).
3/ All credit institutions' aggregated data on a parent-company basis.

Table 6. France: Encouraged Financial Soundness Indicators, 2007–14

(In percent unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013	2014 Estimate
Corporate sector								
Total debt to equity	55.2	86.1	83.9	79.0	86.1	93.5	90.5	96.3
Return on equity	8.2	11.2	8.0	7.9	8.1	8.1	7.0	7.0
Interest paid to financial firms 1/	…	…	…	…	…	…	…	…
Corporate net foreign exchange exposure to equity	…	…	…	…	…	…	…	…
Number of enterprise bankruptcies (thousands)	…	…	…	…	…	…	…	…
Number of enterprise creations (thousands)	…	…	…	…	…	…	…	…
Deposit-taking institutions								
Capital (net worth) to assets	4.1	4.2	4.5	4.6	5.5	4.8	5.5	5.8
International consolidated claims of French banks, *of which* (BIS data, as percent of total international claims)								
Advanced countries	84.0	84.2	83.3	79.8	79.4	78.0	78.6	77.6
Developing Europe	4.0	4.3	4.6	5.7	6.0	7.1	6.8	6.7
Latin America and Caribbean	1.0	1.1	1.2	1.4	1.4	1.5	1.4	1.5
Africa and Middle East	2.6	3.1	3.5	4.4	5.1	5.2	4.2	4.3
Asia and Pacific Area	2.9	2.6	2.9	4.0	3.6	4.1	4.8	5.6
Offshore Financial Centers	5.5	4.7	4.4	4.7	4.6	4.1	4.2	4.4
Gross asset position in financial derivatives to capital	235.0	633.2	362.7	286.2	388.8	346.2	205.8	238.2
Gross liability position in financial derivatives to capital	227.0	616.3	361.9	286.7	388.0	346.0	206.8	238.7
Large exposures to capital	4.7	3.1	4.1	14.1	26.9	7.6	5.4	5.5
Trading income to total income	16.8	-63.9	16.4	10.3	-13.2	6.4	10.6	-0.1
Personnel expenses to noninterest expenses	53.3	51.6	61.1	44.9	42.1	36.0	32.7	35.1
Spread between reference lending and deposit rates	231.5	218.3	236.4	244.4	224.7	217.2	217.7	229.9
Spread between highest and lowest interbank rate	…	…	…	…	…	…	…	…
Customer deposits to total (noninterbank) loans	77.4	78.0	85.3	79.5	78.4	67.9	70.1	82.6
FX loans to total loans 2/	11.3	10.5	10.4	9.8	8.9	8.4	7.6	8.0
FX liabilities to total liabilities	18.1	16.8	15.3	16.4	15.4	13.9	14.3	16.2
Net open position in equities to capital	…	…	…	…	…	…	…	…
Market liquidity								
Average bid-ask spread in the securities market 3/	…	…	…	…	…	…	…	…
Average daily turnover ratio in the securities market	7.7	5.4	3.4	4.3	…	…	…	…
Other financial corporations								
Assets to total financial system assets	20.1	19.1	20.0	19.8	18.3	18.9	19.0	19.2
Assets to GDP	210.1	182.6	203.8	205.8	191.5	202.4	207.1	216.1
Households								
Household debt to GDP	45.6	47.7	51.7	52.9	54.0	54.4	54.8	55.1
Household debt service and principal payments to income	12.1	11.7	12.3	13.2	13.1	12.5	12.8	12.0
Real estate markets								
Real estate prices (in percent change)	5.7	-3.8	-4.1	7.6	3.7	-2.1	-1.8	-2.4

Sources: Banque de France ; ACPR ; BIS ; Ministère des Finances.

1/ In percent of financial firms' gross operating surplus.
2/ Data cover interbank and customer lending to residents and nonresidents on a metropolitan basis.
3/ Or in other markets that are most relevant to bank liquidity, such as foreign exchange markets.

Table 7. Major Structural Reform Implemented and Announced
(Effects in level of GDP, percent)

	as of 2020		Long-term Effects	
Territorial Reform				
Done	A)		A)	
- Reform of governance of large metropolitan areas	0.3		1.0	
- Consolidation of regions from 22 to 13				
- Incentivize fusion of communes				
To Come				
- Improved distribution of competences between governmental levels				
Product Market Reforms				
Done	B)		B)	
- Administrative simplification measures \1	0.2		0.3	
- Measures to promote market efficiency (e.g. internet sales)		0.4		0.8
To Come				
- Continued administrative simplification \2				
- Stimulation of competition and liberalization of protected professions \3				
Investment and Innovation Policy				
Done	C)		by 2030 C)	
- Creation of *Public Investment Banque (BPI)*	0.5		0.2	
- Strategic investment plan including streamlined financing (*PIA2)*				
To Come				
- Extension of BPI loans to 2015-17 horizon				
- *Over-amortization* of 40 percent for 2015-16 productive investments				
Energy Transition				
To Come		D)		
- *Energy Transition and Green Growth* law		0.8	NA	
Labor Costs				
Done	B)		B)	
- Tax credit for payroll up to 2.5 x SMIC (*Crédit d'impôt compétitivité emploi)*	1.3		1.7	
- Reduction of SSC and family contribution (*Pacte de responsabilité - Part 1)*		1.7		2.8
To Come				
- Reduction of corporate taxes by 2017 (*Pacte de responsabilité - Part 2)*				
Labor Market and Social Dialogue				
Done	E)		E)	
- Measures for procedural improvements (e.g. on collective dismissal)	0.1		0.1	
- *Unemployment convention* 2014, strengthening re-entry incentives				
To Come		0.2		0.2
- Partial liberalization and simplification of labor market \4				
- Bill on the *Modernisation of Social Dialogue*				
- *Unemployment convention* 2016				
Labor Market Support for Most Disadvantaged				
Done	A)		A)	
- Subsidized employment of disadvantaged youth (E*mplois d'avenir*)	0.1		NA	
- Extension of support to young disadvantaged after pilot phase \5				
To Come		0.15		NA
- Extension of *Emplois d'avenir* (65'000 additional jobs)				
- Improved targeting of public employment services to most disadvantaged				
- Further extension of support to young disadvantaged				
Education				
Done	E)		E)	
- Increase of means allocated to education	0.1		0.6	
- Plan for gender equality in education				
To Come				
- Education reform at various levels of schooling		0.1		1.0
- Reform of professional training / apprenticeship system				
- Plan to avoid dropouts and promote re-entry				
- Plan for a digitalization of education				

\1 Measures include (non-exhaustive): i) generalization of principle of *silence vaut accord* ii) fixed date publication of fiscal instruction iii) simplification of headquarter relocation iv) simplification of construction norms \2 Measures include (non-exhaustive): i) facilitation of professional training ii) facilitated access to public offering for SMEs iii) digitalization of administrative procedures iv) principle of "tell it once" v) consolidation of environmental authorization into one permit \3 Loi pour la croissance, l'activité et l'égalité des chances économique, includes (non-exhaustive): i) liberalization of legal professions ii) ... and of coach transportation iii) strengthening of the power of the Competition authority on commercial urban planning \4 Loi pour la croissance, l'activité et l'égalité des chances économiques; includes (non-exhaustive): i) reform of prud'homme ii) relaxation of Sunday opening hours iii) simplification of collective dismissal \5 The support scheme Garantie

Source: *Programme Nationale de Reforme* 2015, Estimates from: A) OECD B) Trésor-Insee Mésange C) Trésor-Insee Mésange and various, see PNR 2015 D) Specific Impact Study linked to bill proposal E) Government calculation

Appendix I. Estimating the Impact of External Shocks

Prepared by Esther Perez Ruiz

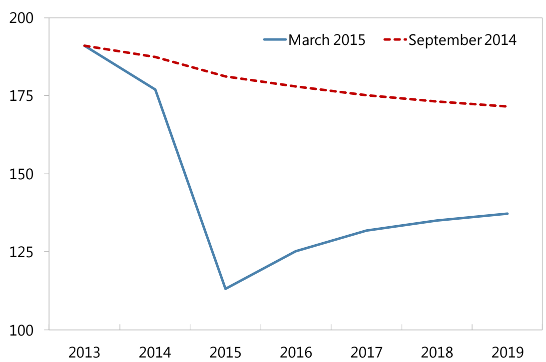
The combined effect of major external shocks affecting the French economy since the summer of 2014 is estimated at +0.8 percentage points of additional growth, cumulatively over 2015–16.

Shocks. Like other euro area economies, France has been affected by four external shocks since the summer (Figure I.1): the slowdown in demand from trading partners, the euro depreciation, the decline in oil prices, and the interest rate effects of QE. The simulation below quantifies the impact of these shocks on France's real GDP growth over 2015–16.

Recent External Shocks Affecting the Outlook

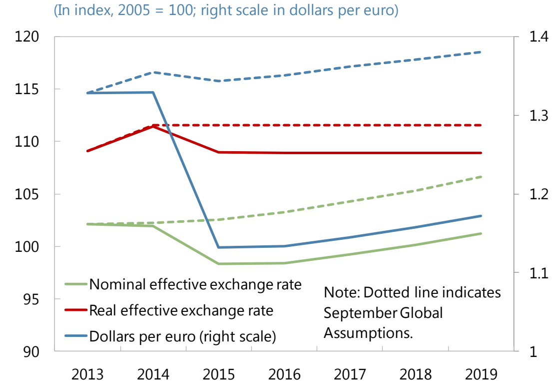
Energy prices have plunged,...

Commodity Fuel Index
(In index, 2005 = 100)



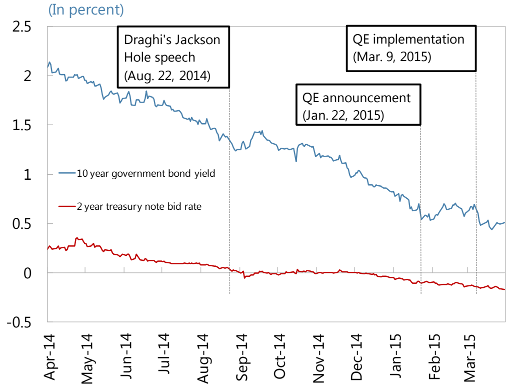
...the exchange rate has depreciated,...

Exchange Rates
(In index, 2005 = 100; right scale in dollars per euro)



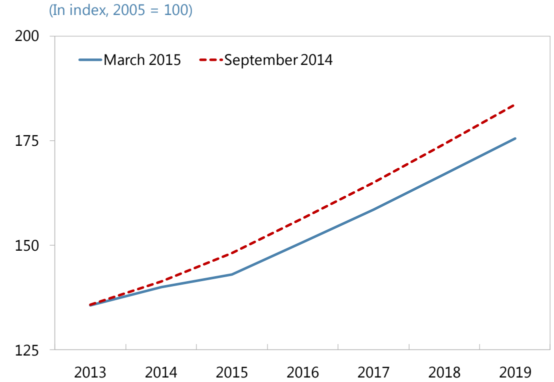
...and financing costs have eased further,...

Effect of QE on Financial Markets
(In percent)



....yet the slowdown in global demand weighs on growth.

Global Demand Adressed to France
(In index, 2005 = 100)



Sources: IMF Global Assumptions data, Bloomberg, and IMF Staff calculations.

Channels. Simulations focus on the most significant channels that affect real GDP growth and its components: (i) impact of the energy price windfall on private consumption and business investment, and imports; (ii) impact of the slowdown in demand from trading partners on exports; (iii) impact of the euro depreciation on exports; (iv) impact of the QE-induced reduction in the cost of capital on investment.

Methodology. Simulations are conducted *ex ante,* relative to a (free-of-shocks) macroeconomic baseline from the October 2014 WEO. The size of each shock is quantified by comparing the September 2014 and March 2015 global WEO assumptions. The shocks are then fed into demand equations (based on error correction model regressions) estimated for France by Lebrun and Pérez Ruiz (2014). Simulations are conducted one by one, all other things being equal.

Assumptions. Several assumptions underlie the simulations: (i) Lower energy prices are fully passed onto consumers. (ii) As per WEO assumptions, the ULC-based REER is projected to depreciate by 2.2 percent in 2015 and to remain broadly stable through 2016. (iii) As per WEO assumptions, export demand addressed to France in 2015 and 2016 is 2.7 and 0.4 percent lower than projected in September 2014. (iv) The QE-related term premium reduction (difference between 10-year and 2-year yields) between September 2014 and March 2015 lowers the real cost of capital via lending rates and equities.

Results

- *Oil price decline*. The gross impact of lower energy prices on consumption and investment is +0.4 percent of GDP cumulatively over 2015–16, which is partly offset by feeding into higher imports (about -0.2 percent of GDP impact). The relatively muted net impact on real GDP growth is in line with past patterns, where some of windfall gains are, at least initially, saved.

- *Euro depreciation*. The cumulative impact of the euro depreciation over 2015–16 is estimated at +0.5 percentage points of additional real GDP growth, based on a 2 percent impact on exports, which are projected to grow by 5.5 and 4.9 percent in real terms in 2015 and 2016 respectively. The growth impact of the euro depreciation is muted by France's relatively low export-to-GDP ratio, its high share of exports to countries in the euro area, and the very limited depreciation in real ULC terms in the case of France.

- *Demand from trading partners*. The cumulative impact of the slowdown in global demand for French exports over 2015–16 is estimated at -0.3 percentage points of reduced real GDP growth.

- *QE-related term premium reduction*. The cumulative impact of lower borrowing costs on investment is estimated at +0.4 percentage points of additional real GDP growth over 2015–16, offset by higher investment-related imports of about 0.3 percent of GDP. The impact of QE is subject to high uncertainty. The scenario is based on the historical link between interest rates and investment, and does not model the expectations channel or the effects of protracted low growth on investment and credit demand.

Net impact. While the joint impact of positive shocks is estimated at 1.4 percent of GDP over 2015–16, this is partly offset by the import response and lower partner country demand. Moreover, the simulations do not capture all developments that feed into staff's evolving GDP projections such as near-term forecast errors, base effects from data revisions, changes in the timing of impact of policies and reforms, and other domestic and external factors affecting near-term growth.

France. Simulated Growth Impact of Shocks
(percentage points deviations from October 2014 WEO)

Type of shock	*Transmission channel*	*Demand impact 1/*	*GDP impact1/*
		Cum. impact 2015-16	Cum. impact 2015-16
Oil: Energy prices decline by 32.6% in 2015 and raise by 12.4% in 2016	Private consumption	0.7	0.4
	Business investment	0.3	0.1
	Imports	-0.8	-0.2
	Total		0.2
Euro depreciates against dollar by 14 % in 2015 and 0.3% in 2016. As a result, the ULC-based REER depreciates by 2.2 percent in 2015 and 0.1 percent in 2016	Exports	2.0	0.5
Slowdown in global demand addressed to France: reduced by 2.7 ppts in 2015 and 0.4 ppts in 2016	Exports	-1.1	-0.3
QE: Term premium reduced by 63 bps since end-September	Business investment	2.6	0.4
	Imports	-1.0	-0.3
	Total		0.1
Overall impact			0.5

Source: Staff.
1/ Simulated impact from applying the elasticities estimated by Lebrun and Perez Ruiz (2014) for French private consumption, business investment, exports, and imports.

References

Lebrun, I., and E. Pérez Ruiz, 2014, "Demand Patterns in France, Germany, and Belgium: Can We Explain the Differences? " IMF Working Papers No. 14/165, Washington DC: International Monetary Fund.

International Monetary Fund, 2015, *World Economic Outlook, April 1995: A Survey by the Staff of the International Monetary Fund,* World Economic and Financial Surveys (Washington).

Appendix II. Main Recommendations of the 2014 Article IV Consultation and Authorities' Actions

Fund Recommendations	Policy Actions
Fiscal Policy	
Back the strategy of steady and moderate fiscal consolidation by comprehensive upfront measures in the fall budget.	Wage-scale freezes and under-indexation of certain social benefits did not deliver the expected savings in the context of low growth and inflation. As a result, the pace of fiscal consolidation through 2017 is now slower than envisaged in last year's Stability Program.
Rely on structural measures to ensure a permanent slowdown in spending growth.	Targeted expenditure reviews were introduced in specific areas this year and should lead to durable savings in the 2016 budget law. The multi-year budget law adopted late 2014 also creates an indicative target for local governments' spending growth (*ODEDEL*) aimed at emulating the *ONDAM* cap for health spending growth.
Financial Sector Policy	
Level the playing field in the taxation of financial instruments	No reform of tax incentives is planned at this stage.
Structural Reforms	
Open protected sectors to greater competition	The *Macron* law, expected to be adopted soon, liberalizes legal professions, intercity transport, and retail opening hours, while broadening the mandate of the Competition Authority
Enhance the scope for enterprise-level negotiation based on a more cooperative social dialogue	The draft *Rebsamen* law, expected to be adopted by year end, would reform the legal framework for social dialogue in SMEs. The *Macron* law provides firms in severe economic difficulty greater flexibility in applying "job preservation agreements".
Set the minimum wage with a view to increasing job opportunities for the low skilled.	No changes are currently envisaged.

Source: IMF Staff.

Appendix III. Debt Sustainability Analysis[9]

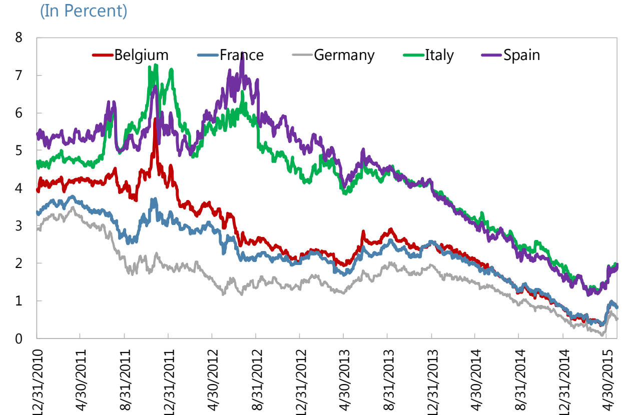
Under the baseline scenario, the debt-to-GDP ratio is projected to peak at 98.2 percent in 2016 and to decline to 93 percent by 2020 as economic recovery gains traction and the primary balance shifts to a surplus starting in 2019. Due to the maturity structure of the French debt, gross financing needs would increase substantially in 2016, to 10.2 percent of GDP, but decline thereafter. The debt-to-GDP ratio is projected to be higher than was forecast previously due to an upward revision in historical debt data, weaker nominal GDP growth, and slower pace of adjustment. Accordingly, public debt is expected to remain above 93 percent of GDP throughout the projection period and presents vulnerabilities as illustrated by the stress scenarios. The debt ratio would be bumped up significantly in the event of protracted stagnation. The impact of lower fiscal consolidation and higher interest rate remains comparatively more limited.

Background. The combined effect of low growth over several years and the persistence of high fiscal deficits, augmented by the fiscal stimulus of 2009, have increased the debt-to-GDP ratio by 31½ percentage points in seven years, to 95.6 percent in 2014. Despite ongoing fiscal consolidation, the debt ratio is projected to continue to increase in the short term, peaking at 98.2 percent of GDP in 2016, and decline thereafter.

Yields on French debt are at historically low levels. The flattening of the yield curve that occurred in 2014 has been supported by QE. The benchmark yield (10 years) has declined from 4.7 percent in June 2008 to about 0.9 percent end-May 2015. The spreads over German Bunds, which had increased to almost 190 basis points in November 2011, were at about 40 basis points in mid-June 2015.

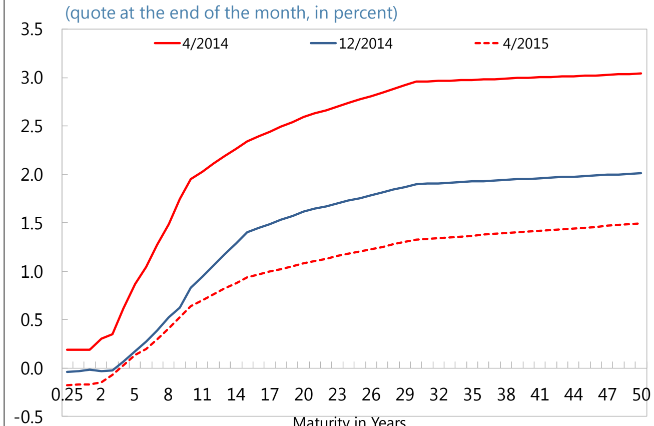
Owing to the sharp decline in interest rates, the rising debt has had a limited impact on the debt service. Interest payments were at the historically low level of 2.2 percent of GDP in 2014[10] and are projected to continue

10 Year Sovereign Yields
(In Percent)



Source: Thomson Financial/Datastream.

French Government Yield Curve
(quote at the end of the month, in percent)



Sources: French Authorities and Bloomberg.

[9] Prepared by Jean-Jacques Hallaert (EUR).

[10] This is the lowest level since 1983 when the debt-to-GDP ratio was at 26.6 percent.

to decline over the projection period. Given this low level, the recent drop in interest rate and in inflation[11] has little impact on fiscal balance.[12]

Baseline. Staff projects that the debt-to-GDP ratio will peak at 98.2 percent in 2016 and then decline to 93 percent in 2020. Interest payments would remain low averaging 1.9 of GDP over 2015-20 because: (i) fiscal consolidation leads to a primary surplus starting in 2019 and (ii) interest rates are expected to remain low, increasing only slightly during the projection period.

- **Macroeconomic assumptions.** Recent growth performance has been affected by the weak external environment and the drag caused by large structural fiscal adjustment in 2011–14. After several years of near-stagnation, the economy is projected to grow by 1.2 percent in 2015, and then rise steadily to 1.9 percent by the end of the projection period, with the output gap closed in 2020.

- **Fiscal outlook.** The pace of structural adjustment has slowed. Reaching 1 percentage point per year in 2011–13, it has slowed to 0.5 percentage point in 2014 and is expected, in the baseline, to average 0.3 percentage point per year during 2015–20. Primary balance would shift to a surplus in 2019 and would be above its debt-stabilizing level starting in 2017.

- **Debt levels and gross financing needs.** The gross financing need, despite the expected increase in 2016 remains below the threshold. Part of the increase in the debt ratio reflects financial support to other Euro area countries which grew from 0.2 percent of GDP in 2010 to 3.2 percent of GDP in 2014.[13] This support is expected to decline starting in 2015.

Realism of Projections. The median forecast error for real GDP growth during 2006–14 is -0.52 percent suggesting there is a modest upward bias in the staff projections. The median forecast bias for inflation stands at -0.21 percent suggesting again a slight upward bias in the staff projections. At -0.76 percent, the median forecast error for primary balance suggests that staff projections have proved relatively optimistic.

Since the publication of the staff report for the 2014 Article IV Consultation, historical debt data have been revised leading to an increase in the debt-to-GDP ratio level of 0.5 percentage point in 2013 and, as a result, during the projection period. Beyond this statistical impact, the debt ratio is projected to increase faster in the short term (by 1.7 percentage point of GDP in 2015 vs. 0.8 percentage point) and to start declining one year later (2017 instead of 2016). As a result, the debt ratio is projected to be in 2019 only 0.1 percentage point lower than in 2014. This is much less than the 5.2 percentage point reduction envisaged previously. About half of the difference in the

[11] The drop in inflation reduces the debt service as 11 percent of French debt is indexed on inflation.

[12] In 2014, implicit interest rate were lower by 0.15 percentage point than projected in the Staff report for the 2014 Article IV Consultation and inflation by 0.4 percentage point. The fiscal impact was limited as the reduction in the debt service was less than 0.1 percent of GDP

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

change in the debt ratio over 2014–19 can be explained by slower nominal GDP growth and the remainder by other factors notably slower fiscal consolidation.[14]

The projected fiscal adjustment appears feasible. The reduction in the cyclically-adjusted primary balance would average 0.3 percent per year during 2015−20. This is slightly less than the reduction achieved during 2013–14. Cross-country experience also suggests that fiscal adjustment projections are realistic. The projected adjustment and level of the CAPB are below the thresholds that would cast doubt on the feasibility of the adjustment, based on high debt country experience.[15]

Heat map. Risks levels from the debt level are deemed high given that the relevant threshold to which France's values are compared is 85 percent and this threshold is breached under baseline and all stress test scenarios. In contrast, France's gross financing needs remain below the benchmark of 20 percent of GDP in the baseline and all stress test scenarios. The debt profile remains below relevant thresholds except for the share of public debt held by foreigners. As of end-2014, foreigners held 64.3 percent of French debt, a level substantially lower than the peak of 70.6 percent reached in mid-2010.

Shocks and Stress Tests. The DSA framework suggests that France's government debt-to-GDP ratio remains below 107 percent and its gross financing needs would not exceed 12¼ percent of GDP under different macroeconomic and fiscal shocks.

- **Growth shock.** Under this scenario, real output growth rates are lower by one standard deviation over 2015–2016, i.e. 1.6 percentage points relative to the baseline scenario. The assumed decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth) and the interest rate is assumed to increase 25 basis points for every 1 percent of GDP worsening of primary balance. Under this scenario, the debt-to-GDP ratio would increases to 106.3 percent of GDP in 2017 and declines thereafter.
- **Primary balance shock.** This scenario examines the implications of a dual shock of lower revenues and rise in interest rate, leading to a cumulative 1.5 percent deterioration in the primary balance over 2016–2020. Under this scenario, the debt-to-GDP ratio would increase to almost 100.7 percent of GDP in 2017 and declines thereafter.
- **Interest rate shock.** This scenario assumes an increase of 246 basis points increase in the cost of debt throughout the projection period. The deterioration of public debt and gross financing needs are back-loaded as old debt gradually matures[16] and new higher interest rate debt is

[14] Average nominal GDP growth over 2014-19 is projected to be 0.68 percentage point lower on account of lower inflation (0.43) and lower real growth (0.25). In addition, in nominal terms, the improvement in the primary balance is expected be 42 percent smaller.

[15] More specifically, at 1.3 percent of GDP, the largest projected adjustment over any three years during the projection is below the threshold of 3 percent of GDP. In addition, the maximum average level of the cyclically-adjusted primary deficit for any consecutive 3-year period during the projection horizon reaches is 0.75 percent of GDP, well below than the threshold of 3.5 percent of GDP.

[16] As of end April 2015, the average maturity of debt is 7 years and 7days.

contracted. In 2020, the impact on the gross financing needs is less than 1 percent of GDP and about 2½ percentage points for the debt-to-GDP ratio.

- **Real exchange rate shock.** This scenario assumes 13 percent devaluation of the real exchange rate in 2016 and examines the impact on debt through the inflation channel. Under this scenario, the debt-to-GDP ratio would be marginally larger (0.5 percentage point at most) than in the baseline.
- **Combined macro-fiscal shock.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance while taking care not to double-count the effects of individual shocks. Under this scenario, debt would reach 106.5 percent of GDP in 2017 and decline to 103 percent of GDP in 2020. The gross financing needs would peak at 12.1 percent of GDP in 2017, which remains below the 20 percent benchmark considered by the heat map.

Views of the authorities. The authorities project a debt profile similar to staff's with the debt ratio also starting to decline in 2017. However, they expect the debt-to-GDP ratio to be slightly lower and to decline faster than staff on account of faster nominal growth and fiscal consolidation notably in the second half of the projection period.

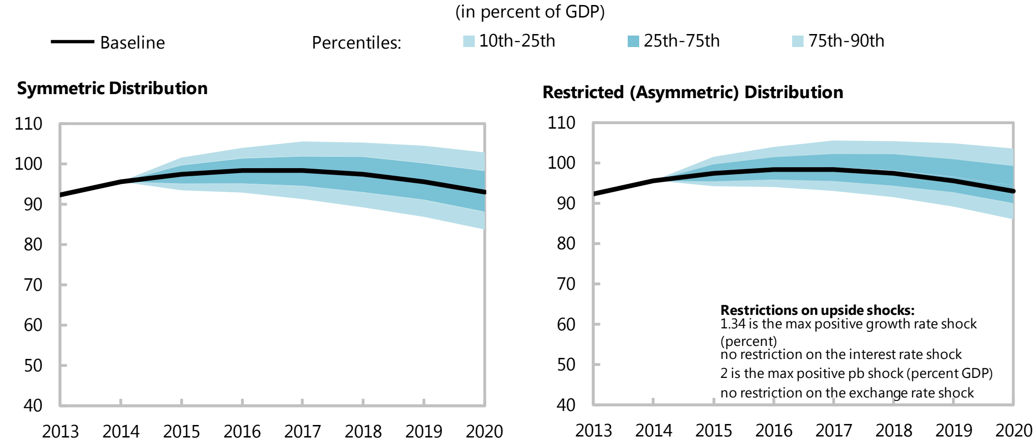
France: Public DSA Risk Assessment

Heat Map

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

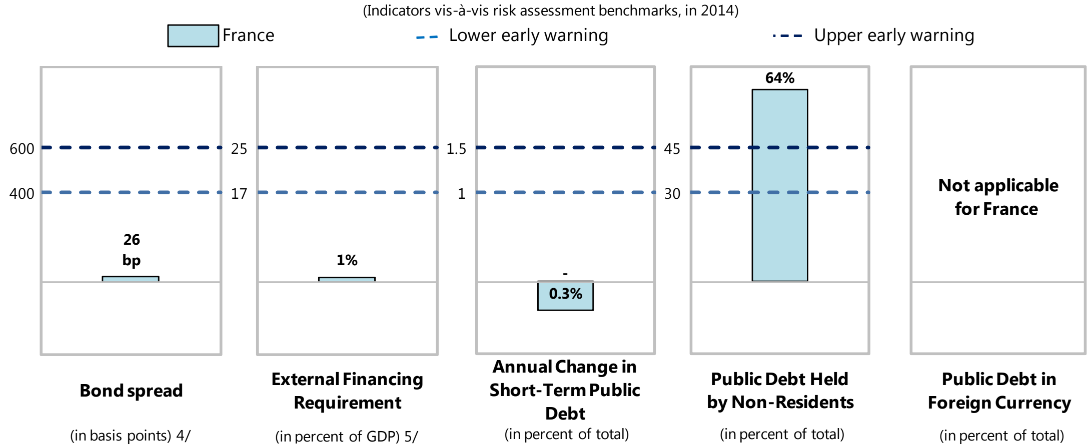
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



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.

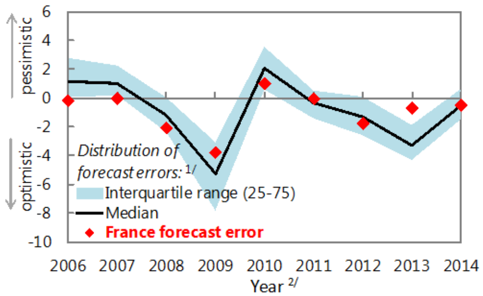
4/ Long-term bond spread over German bonds, an average over the last 3 months, 25-Feb-15 through 26-May-15.

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.

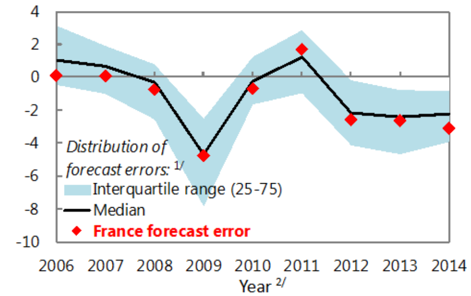
France: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

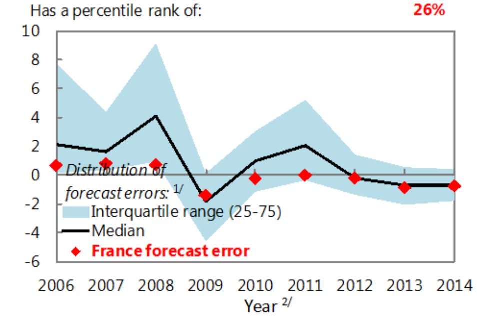
Real GDP Growth
(in percent, actual-projection)
France median forecast error, 2006-2014: -0.52
Has a percentile rank of: 40%



Primary Balance
(in percent of GDP, actual-projection)
France median forecast error, 2006-2014: -0.76
Has a percentile rank of: 63%

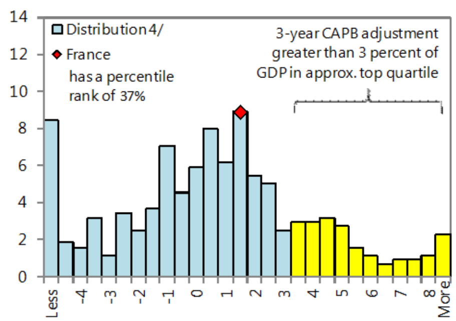


Inflation (Deflator)
(in percent, actual-projection)
France median forecast error, 2006-2014: -0.21
Has a percentile rank of: 26%

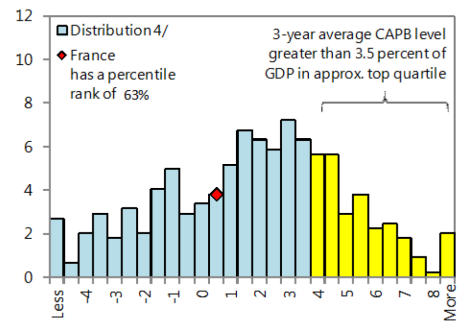


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

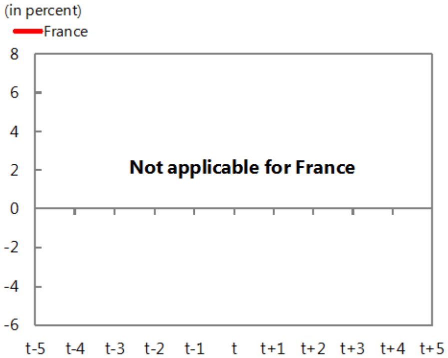


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



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.

France: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

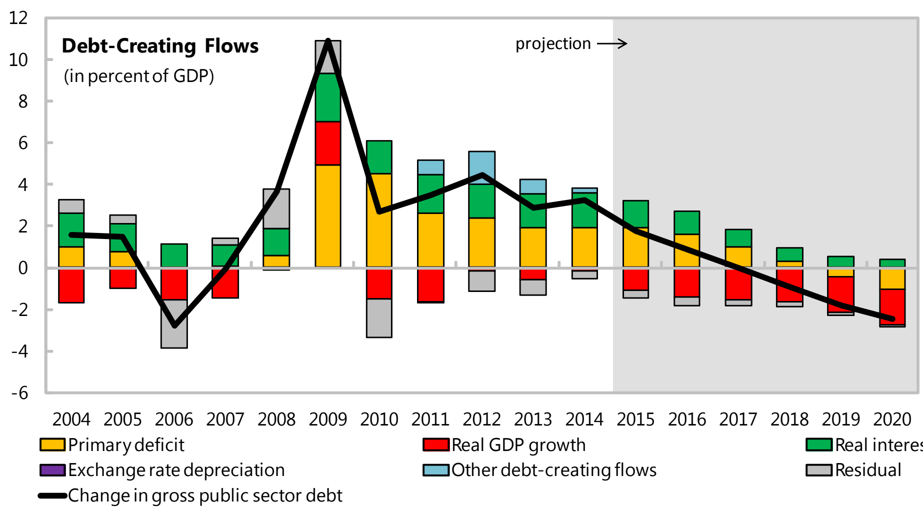
Debt, Economic and Market Indicators [1/]

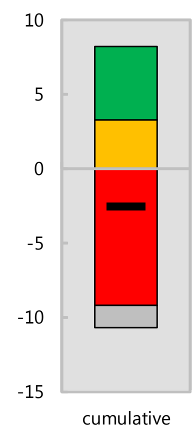
	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	73.7	92.3	95.6	97.3	98.2	98.2	97.3	95.5	93.0
Public gross financing needs	8.5	8.3	8.8	9.2	10.2	9.0	6.9	6.8	4.5
Real GDP growth (in percent)	1.2	0.7	0.2	1.2	1.5	1.7	1.8	1.9	1.9
Inflation (GDP deflator, in percent)	1.6	0.8	0.6	0.8	0.8	1.1	1.3	1.4	1.5
Nominal GDP growth (in percent)	2.8	1.4	0.8	2.0	2.3	2.8	3.1	3.3	3.4
Effective interest rate (in percent) [4/]	3.8	2.6	2.4	2.2	2.0	2.0	2.0	2.0	2.0

As of May 26, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		31
5Y CDS (bp)		31
Ratings	Foreign	Local
Moody's	Aa1	Aa1
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing
Change in gross public sector debt	2.8	2.9	3.3	1.7	0.9	0.0	-0.9	-1.8	-2.5	-2.5	primary
Identified debt-creating flows	2.9	3.6	3.6	2.1	1.3	0.3	-0.7	-1.7	-2.4	-1.0	balance [9/]
Primary deficit	1.9	1.9	1.9	1.9	1.6	1.0	0.3	-0.4	-1.0	3.3	-1.3
Primary (noninterest) revenue and gra	49.9	52.8	53.4	53.1	53.0	52.9	52.9	52.9	52.9	317.7	
Primary (noninterest) expenditure	51.8	54.8	55.4	55.0	54.6	53.9	53.2	52.5	51.8	320.9	
Automatic debt dynamics [5/]	0.7	1.0	1.5	0.2	-0.3	-0.7	-1.0	-1.2	-1.3	-4.3	
Interest rate/growth differential [6/]	0.7	1.0	1.5	0.2	-0.3	-0.7	-1.0	-1.2	-1.3	-4.3	
Of which: real interest rate	1.5	1.6	1.6	1.3	1.2	0.9	0.7	0.5	0.4	4.9	
Of which: real GDP growth	-0.8	-0.6	-0.2	-1.1	-1.4	-1.6	-1.7	-1.8	-1.7	-9.2	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euro	0.3	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.0	-0.7	-0.4	-0.4	-0.4	-0.3	-0.2	-0.1	-0.1	-1.5	





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 - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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 - π (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).

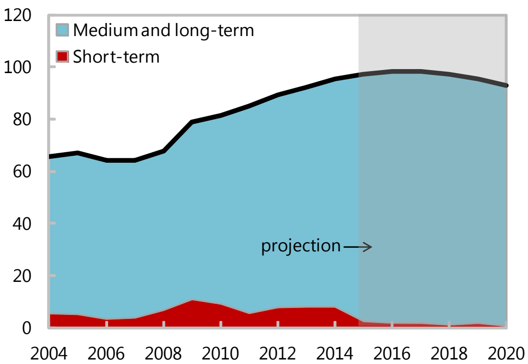
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

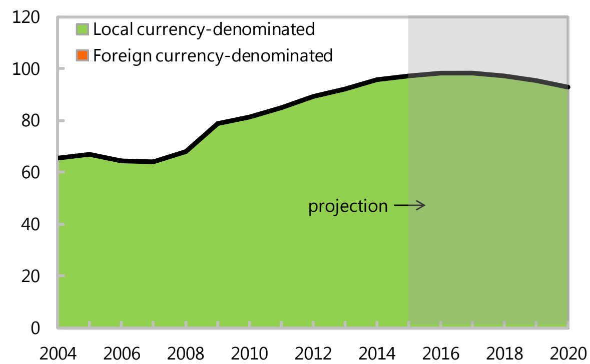
France: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



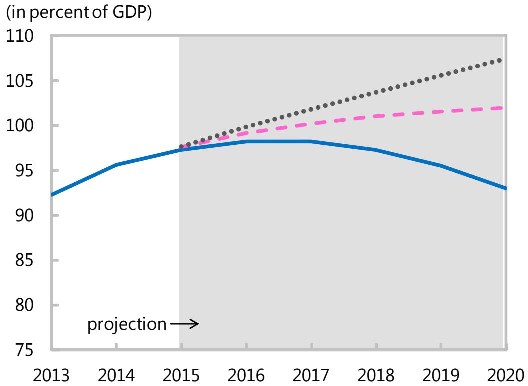
By Currency
(in percent of GDP)



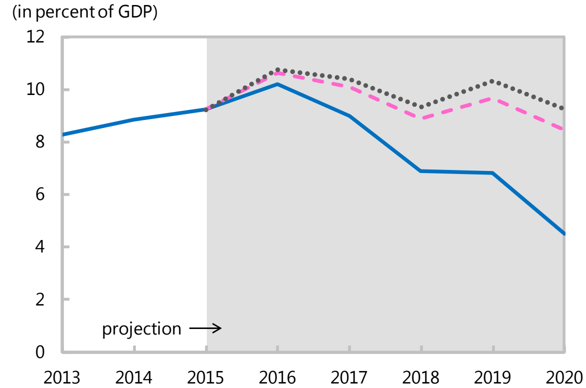
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

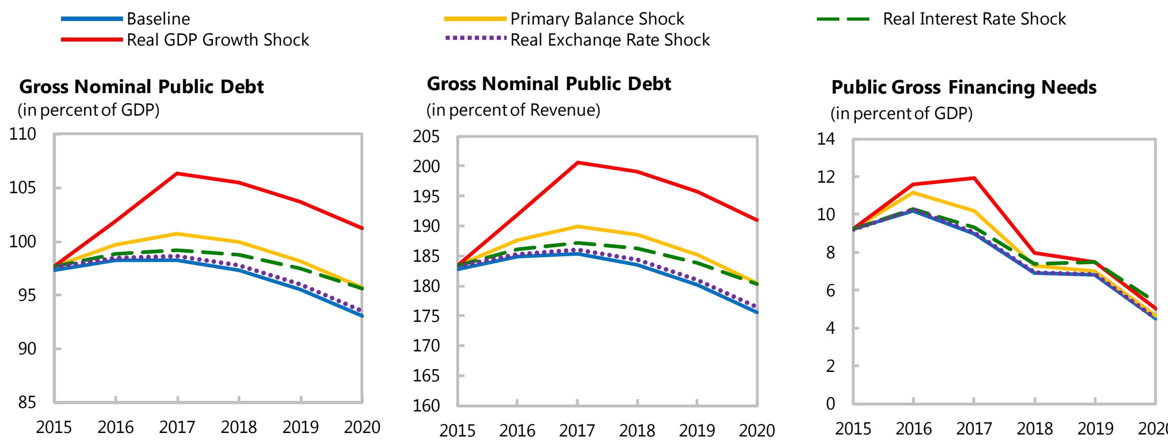
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.2	1.5	1.7	1.8	1.9	1.9
Inflation	0.8	0.8	1.1	1.3	1.4	1.5
Primary Balance	-1.9	-1.6	-1.0	-0.3	0.4	1.0
Effective interest rate	2.2	2.0	2.0	2.0	2.0	2.0
Constant Primary Balance Scenario						
Real GDP growth	1.2	1.5	1.7	1.8	1.9	1.9
Inflation	0.8	0.8	1.1	1.3	1.4	1.5
Primary Balance	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Effective interest rate	2.2	2.0	2.0	2.0	2.0	2.0

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.2	0.9	0.9	0.9	0.9	0.9
Inflation	0.8	0.8	1.1	1.3	1.4	1.5
Primary Balance	-1.9	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	2.2	2.0	2.1	2.2	2.3	2.4

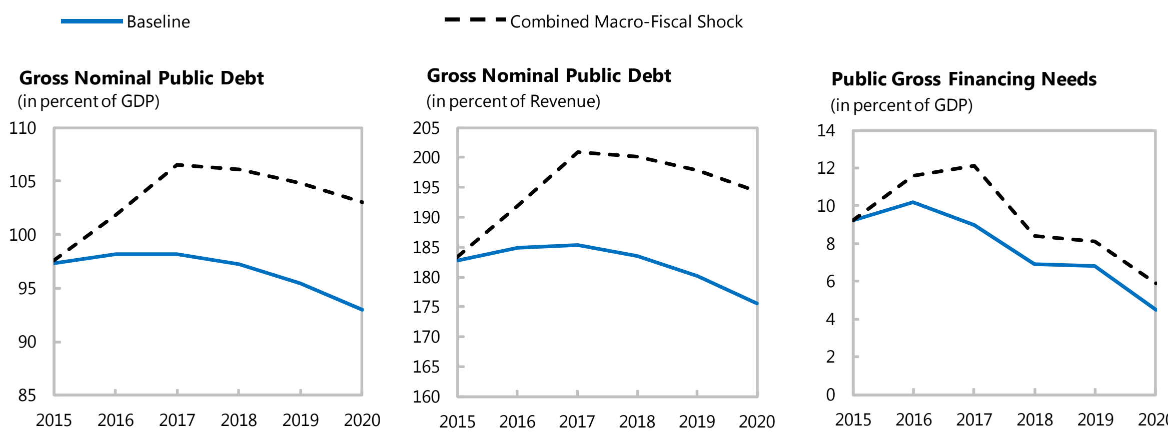
Source: IMF staff.

France: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.2	1.5	1.7	1.8	1.9	1.9
Inflation	0.8	0.8	1.1	1.3	1.4	1.5
Primary balance	-1.9	-2.4	-1.8	-0.3	0.4	1.0
Effective interest rate	2.2	2.0	2.1	2.1	2.1	2.1
Real Interest Rate Shock						
Real GDP growth	1.2	1.5	1.7	1.8	1.9	1.9
Inflation	0.8	0.8	1.1	1.3	1.4	1.5
Primary balance	-1.9	-1.6	-1.0	-0.3	0.4	1.0
Effective interest rate	2.2	2.0	2.3	2.4	2.6	2.7
Combined Shock						
Real GDP growth	1.2	-0.1	0.0	1.8	1.9	1.9
Inflation	0.8	0.4	0.7	1.3	1.4	1.5
Primary balance	-1.9	-2.7	-3.2	-0.3	0.4	1.0
Effective interest rate	2.2	2.0	2.3	2.5	2.6	2.8

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.2	-0.1	0.0	1.8	1.9	1.9
Inflation	0.8	0.4	0.7	1.3	1.4	1.5
Primary balance	-1.9	-2.7	-3.2	-0.3	0.4	1.0
Effective interest rate	2.2	2.0	2.1	2.1	2.1	2.1
Real Exchange Rate Shock						
Real GDP growth	1.2	1.5	1.7	1.8	1.9	1.9
Inflation	0.8	1.2	1.1	1.3	1.4	1.5
Primary balance	-1.9	-1.6	-1.0	-0.3	0.4	1.0
Effective interest rate	2.2	2.0	2.0	2.0	2.0	2.0

Source: IMF staff.

Appendix IV. France: Risk Assessment Matrix[17]

Source of Risks	Relative Likelihood	Impact on France if Realized	Policy response
A surge in financial volatility	**High** Investors reassess underlying risk and move to safe haven assets	**Medium** French banks are vulnerable to a globally systemic closure in funding markets. But inward spillovers from global financial market volatility have been limited in recent years	Ensure that banks reduce reliance on wholesale funding
Protracted period of slower growth in key advanced and emerging economies	**High** Weak advanced economy demand and persistently low inflation could take a toll through trade and investment links.	**Medium** Automatic stabilizers mitigate short run impact. But entrenched unemployment and limited fiscal space would make it difficult to exit low growth trap	Continue with and deepen structural reforms to lift output growth and reduce structural unemployment
Sustained rise in higher oil prices	**High** Could impact still-nascent confidence and further delay investment recovery	**Low** France's reliance on nuclear energy provides some cushion to oil price developments	
Financial imbalances from protracted period of low interest rates	**Medium** Corporate borrowers may become excessively leveraged, while margins of life insurers and mortgage lenders get squeezed. Search for yield results in asset price bubbles.	**Medium (over medium term)** Large refinancing of mortgages poses medium-term risk for bank profitability, while impact on life insurers may build over time (mitigated by annual adjustment of guaranteed rates of return).	Monitor lending standards and risks Monitor life insurance sector and take policy action as needed
Weak implementation of fiscal and structural policy commitments.	**Medium** Political resolve for reform may wane in the face of protracted low growth and popular discontent.	**Medium** Reversal of commitments could undermine investment and growth, adversely impact public debt dynamics, and eventually trigger adverse market reactions.	
Changes in forthcoming regulatory landscape larger than expected (medium-term)	**Medium** Risks from regulatory uncertainty (e.g. on risk weighted assets, leverage ratio, loss absorption capacity for globally systemic banks)	**Medium** Banks could be required to raise more capital, reducing their profitability and ability to provide credit to the economy over the medium-term	Promote continued restructuring and cost cutting efforts by banks
Bond market stress from a reassessment in sovereign risk	**Medium** Sovereign stress re-emerges due to policy uncertainty, faltering reforms, political and social upheaval, or adverse developments in Greece	**Low/Medium** The direct impact would be low, as trade and financial linkages are limited. Indirect confidence effects could be larger	

[17] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF 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). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Appendix V. External Sector Report

	France	Overall Assessment
Foreign asset and liability position and trajectory	**Background**. After averaging near balance in the four years before the global crisis, the net international investment position (NIIP) deteriorated, to around -15 percent of GDP in 2013, reflecting current account deficits and valuation losses. Gross asset and liability positions grew steadily in the pre-crisis period, in parallel with the expansion of French banks' balance sheets. Since the crisis, the gross asset position has declined moderately and stood at 271 percent of GDP in 2013, with large exposures to Italy and Spain. Public external debt accounts for about 20 percent of the gross liability position, which came to about 286 percent of GDP in 2013. Stability of the French public debt market is an important element of euro-zone financial stability. Current projections assume a small surplus current account surplus and a stabilization of the NIIP to GDP ratio over the medium term. **Assessment**. The net external position is negative but its size and trajectory do not raise sustainability concerns. However, there are vulnerabilities due to large exposures to Italy and Spain on the asset side, and to the external public debt on the liability side.	**Overall Assessment**: *The external position in 2014 was weaker than the level consistent with medium-term fundamentals and desirable policy settings*. Developments as of May 2015, including the depreciation of the euro and lower oil prices, suggest some strengthening of the external position. However, it is still moderately weaker than implied by fundamentals, given high unit labor costs and fiscal deficits. To improve cost competitiveness durably, the labor tax wedge cuts undertaken since 2013 (equivalent to 3 percent of total labor costs, spanning 2014-17) should be backed by wage moderation. Measures taken in 2013 to improve non-cost competitiveness (labor market reforms, regulatory simplification, and support to SMEs) reinforced by a comprehensive reform package ("Macron Law") this year. **Potential policy responses**: Wage moderation (especially of the minimum wage), continued reform of the labor market, and productivity-enhancing reforms (increasing competition in product markets and further regulatory simplification) would help restore competitiveness. Along with the planned gradual elimination of the fiscal deficit over the medium term, these measures should help correct the external imbalance (as well as promote growth).
Current account	**Background**. Over the past decade, the current account has deteriorated from a surplus of 2.3 percent of GDP in 2002 to a deficit of 1 percent in 2014, mostly due to structural factors (the cyclically-adjusted deficit is estimated at -1.5 percent of GDP). The deterioration originates from a worsening net saving position of the private sector and higher government deficits in equal proportions. The current account is set to improve significantly in 2015, to -0.4 percent of GDP, up from 1 percent in 2014, reflecting in part lower oil prices (the energy trade deficit amounted to 3 percent in 2014; savings from lower energy prices this year are estimated at 0.9 percent of GDP) and the depreciation of the euro. **Assessment**. The staff assesses the 2014 current account to be 1 to 3 percent of GDP below its cyclically-adjusted norm. This is consistent with the EBA model estimate that the cyclically-adjusted current account is 2 percent weaker than the value consistent with medium-term fundamentals and desirable policy settings. Recent developments, including the depreciation of the euro and lower oil prices, suggest some strengthening of the external position. Over the medium term, the current account deficit is projected to stabilize at about 0.6 percent of GDP as imports pick up in line with domestic demand. The gradual elimination of the fiscal deficit will help narrow the EBA-estimated gap.	
Real exchange rate	**Background**. The trend deterioration in unit labor costs (11.3 percent cumulative appreciation of the ULC-based real effective exchange over the last 10 years) points to a loss of competitiveness consistent with the assessment of an imbalance in the current account. However, such loss of competitiveness is less evident based on relative price indicators, such as CPI-based real effective exchange rate (REER), as firms appear to have squeezed profit margins to retain price competitiveness. The EBA REER regression model estimates a 10 percent overvaluation (as informed by the REER regression in levels), close to the overvaluation underlying the EBA CA regression estimate of about 7 percent. 1\ The recent euro/dollar exchange rate realignment implies a 5 percent depreciation in the CPI-based REER relative to the 2014 average (in turn ½ percent below the 2013 average). **Assessment**. Staff assesses the real exchange rate to be 5 to 10 percent overvalued, as the recent depreciation of the euro is modest in ULC-based REER terms and will not fully correct past competitiveness losses.	
Capital and financial accounts: flows and policy measures	**Background**. The current account deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Flows in financial derivatives have grown sizably on both the asset and liability side since 2008. The capital account is open. **Assessment**. France remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities.	
FX intervention and reserves level	**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.	
Technical background notes	1/ The EBA Level REER model estimates a gap of some +10 percent, while the gap estimated by the EBA Index REER model is about -1 percent. Considering in addition the ULC based REER, which provides an additional perspective on the loss of competitiveness, the staff's assessment is that the real exchange rate is above the level consistent with fundamentals and desirable policy settings by 5-10 percent.	

INTERNATIONAL MONETARY FUND

FRANCE

June 23, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The European Department

CONTENTS

FUND RELATIONS

(As of May 31, 2015)

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

General Resources Account:	SDR Million	Percent of Quota
Quota	10,738.50	100.00
Fund Holding of Currency (Exchange Rate)	9,287.37	86.49
Reserve Tranche Position	1,451.22	13.51
Lending to the Fund		
New Arrangements to Borrow	1,890.09	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	9,329.16	92.06

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				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.20	0.58	0.58	0.58	0.58
Total	0.20	0.58	0.58	0.58	0.58

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 Rate Arrangements:

- France's currency is the euro, which floats freely and independently against other currencies.
- France maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions imposed solely for the preservation of international security. These restrictions involving certain individuals and entities and which target specified countries have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). In accordance with the relevant EU regulations and UNSC resolutions, certain restrictions are maintained on the making of payments and transfers for certain transactions with respect to Belarus, the Democratic Republic of Congo, the former Government of Côte d'Ivoire, the Islamic Republic of Iran, the former government of Iraq, the Democratic People's Republic of Korea, Guinea (republic of), Guinea Bissao, the former Government of Liberia, the former Government of Libya, Myanmar, the former Government of Tunisia, Transnistria, Eritrea, the former Government of Egypt, Somalia, Sudan and South Sudan, Syria, certain individuals associated with the murder of former Lebanese Prime Minister Rafiq Hariri, and, Central African Republic, Ukraine, Russia, Yemen, Zimbabwe.
- Measures have been taken to freeze accounts of listed persons and entities linked to terrorists pursuant to the relevant EU regulations (n°881/2002, n°2580/2001 and n°753/2011) and UN Security Council resolutions (resolutions 1267 and 1373 and subsequent resolutions).

Article IV Consultation:

The last Article IV consultation was concluded on July 1, 2014. The associated Executive Board assessment is available at http://www.imf.org/external/np/sec/pr/2014/pr14326.htm and the staff report at http://www.imf.org/external/pubs/ft/scr/2014/cr14182.pdf. 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, 10/2903
Data Module—Update	IMF Country Report No. 04/345, 11/03/04
Data Module—Update	IMF Country Report No. 05/398, 11/07/05

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

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

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

***France–Financial System Stability Assessment* (FSSA)**	IMF Country Report No. 04/344, 11/03/04
FSAP Assessment and Reports on ROSCs	IMF Country Report No. 04/345, 11/03/04
FSAP Assessment	IMF Country Report No. 05/185, 06/08/05

Publication of FSAP—Detailed Assessment of Observance of Standards and Codes	IMF Country Report No. 05/186, 06/08/05
***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*

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.

STATISTICAL ISSUES

The economic database is comprehensive and of high quality, and data provision to the Fund is adequate for surveillance. The authorities regularly publish a full range of economic and financial data, and calendar dates of main statistical releases are also provided. France subscribes to the Fund's Special Data Dissemination Standard. Country is currently working on implementing the transmission of data in electronic format using the Statistical Data and Metadata A data ROSC mission conducted an assessment of the statistical system in March 2003, and the report was published in October 2003. A factual update to the main report was published in November 2004.

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 new estimates. As a result of these changes, the GDP level in 2010 has been revised 3.2 percent upward. Historical data series are available from 1949.

Government Finance Statistics: Starting from September 2014, government finance statistics (GFS) data will be based on *ESA 2010* methodology which is likely to include revisions of the general government deficit and debt levels from 1995 onwards. Revised data series were published in October 2014. 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.

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. It is expected that greater international consistency will be achieved once all EU members adopt the BPM6.

France: Table of Common Indicators Required for Surveillance
(As of June 2015)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	05/15	05/15	Monthly	Monthly	Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	05/15	05/15	Monthly	Monthly	Monthly
International Investment Position	2014	Q1:2015	Annual	Annual	Annual
Reserve/Base Money	04/15	05/15	Monthly	Monthly	Monthly
Broad Money	04/15	05/15	Monthly	Monthly	Monthly
Central Bank Balance Sheet	04/15	05/15	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	04/15	05/15	Monthly	Monthly	Monthly
Interest Rates[2]	04/15	05/15	Monthly	Monthly	Monthly
Consumer Price Index	04/15	05/15	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2015	05/15	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	03/15	05/15	Monthly	Monthly	Monthly
Stock of Central Government Debt	04/15	05/15	Monthly	Monthly	Monthly
External Current Account Balance	03/15	05/15	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	03/15	05/15	Monthly	Monthly	Monthly
GDP/GNP	Q1:2015	05/15	Quarterly	Quarterly	Quarterly
Gross External Debt	Q4:2014	05/15	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] This information is provided on a budget-accounting basis (not on a national accounts basis).

Statement by the Staff Representative on France
Executive Board Meeting
July 8, 2015

This statement provides information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

There is substantial uncertainty in the euro area following recent events in Greece, including the expiration of the European program last week and Sunday's referendum. The broader market reaction has been generally contained, with the euro exchange rate remaining stable against the U.S. dollar, sovereign spreads widening moderately for a number of countries, and equity prices declining throughout the euro area. For France, sovereign yields have remained broadly stable since the issuance of the staff report, while stock prices have declined alongside other euro area markets, with contagion effects particularly noticeable for bank equities. Heightened uncertainty may continue to weigh on markets and sentiment.

As noted in the staff report, direct trade and financial linkages between France and Greece are limited, but adverse developments in Greece could weigh on confidence in the region and indirectly affect France's economic prospects. Overall, staff continues to see risks to France's short-term growth outlook as broadly balanced at this stage, with heightened uncertainty around Greece weighing on the downside.

The recent events highlight the importance of timely and effective policy actions to manage potential spillovers, especially at the euro area level. Beyond the near term, there should be a concerted effort to accelerate deeper integration within the euro area and strengthen firewalls. The upcoming euro area Article IV report will elaborate on these policy challenges.

Statement by Mr. de Villeroché, Executive Director for France
July 8, 2015

We thank staff for the rich discussions during the 2015 Article IV Consultations with France as well as for the well-written report.

French economic recovery is well underway. The authorities have been pursuing a comprehensive reform agenda over the past three years, to reduce the fiscal deficit, address excessive unemployment and improve competitiveness. This strategy is starting to bear fruits.

While we broadly concur with the staff appraisal, which validates the agenda that is being implemented since 2012, we think that the report could have put a stronger emphasis on the impact of recent or on-going reforms. Since the beginning of the crisis, the French economy demonstrated its resilience. In the long term, a strong birth rate, rising innovation efforts by French corporates, a highly qualified and productive workforce, excellent infrastructure and a stable investment rate during the crisis are factors bound to support France's growth prospects.

1. Economic outlook

In the short run, an improvement of the economic situation is on-going, structural reforms are starting to pay off and external factors, such as the decrease in oil prices and a moderate depreciation of the effective exchange rate, are supporting aggregate demand. GDP rose by a robust 0.6 percent (quarter-on-quarter) in Q1 2015.

Staff growth projections of 1.2 percent in 2015 and 1.5 percent in 2016 appear slightly above the government's own and voluntarily cautious scenario (1.0 percent in 2015 and 1.5 percent in 2016). Staff projections are also in the lower range of the available forecasts: the latest *Consensus Forecasts* stands at 1.2 percent in 2015 and 1.6 percent in 2016, and the OECD and the European Commission both expect 1.1 percent in 2015 and 1.7 percent in 2016.

In the medium term, growth should gradually improve on the back of internal drivers that are expected to gather strength and gradually replace the role of external factors. Investment is expected to strengthen in line with more robust activity levels. In the Stability Programme, growth is forecast to reach 1.5 percent in 2017 and 1.8 percent in 2018, broadly in line with staff projections.

2. Public finances

2014 execution

French public deficit stands at 4.0 percent of GDP in 2014 which is significantly lower than the objective set in the last multiyear budget law for 2014-2019 passed in December 2014 (4.4 percent of GDP). This performance resulted from the strict containment of public spending. Indeed, nominal public spending excluding tax credits has increased by only 0.9 percent in 2014, significantly below the target set in the 2014 Stability Programme (1.4 percent) and the lowest in decades.

Fiscal medium-term consolidation path

France targets a 0.5 point of GDP structural adjustment of public balance in 2015, 2016 and 2017, which will allow under a prudent growth scenario to bring back the headline deficit below 3 percent in 2017 with a safety margin, a trajectory which is compliant with our European commitments. This pace of consolidation, fully based on expenditure containment, strikes the right balance between the need to secure public finances sustainability in the medium term and avoid a drag on growth in the short term. We do not find that the alternative fiscal adjustment path presented by staff makes a compelling argument for a faster consolidation.

To reach these targets, the government has committed itself to implement a EUR 50 billion savings plan over 2015-2017. This commitment has been enacted in the multiyear budget law of December 2014. To offset the negative impact of low inflation, the French authorities committed to undertake additional expenditure-based savings measures, representing EUR 4 billion in 2015 and EUR 5 billion in 2016.

Long term sustainability

Strong demographics, the improvement in its older workers participation rate and the phasing-in of recent pension reforms, have placed France in a better position to deal with its ageing population than most of its OECD partners. The latest pension reform adopted in 2014 will raise the number of years of service required to obtain a full pension, up to 43 years in 2035. Negotiations between social partners for a new agreement to be signed in 2015 on the financing of the supplementary retirement scheme are currently underway. According to the latest long term projections of the European Ageing Report 2015, public pension spending is expected to decrease by 2.8 percent of GDP between 2013 and 2060. The financial equilibrium of France's pension system is no longer a major issue for the long-term sustainability of public finances.

3. Structural reforms

France is fully committed to reforming its economy in order to reduce unemployment, continue to improve competitiveness and enhance its potential growth.

Improving cost competitiveness

Labor cost and tax reductions (*Crédit d'Impôt Compétitivité Emploi* and the *Responsibility and Solidarity Pact)* represent a positive supply shock of almost EUR 40 billion (close to 2 percent of GDP) which has already led to concrete results: the average unit labor cost in the manufacturing sector is inferior to German unit labor costs and profit margins have been recovering since the beginning of 2015 (and reached their highest level since early 2011).

Empirical studies, including previous staff working papers, concur to find a very positive impact of labor tax cuts on employment and growth.

Little is said in the report on the on-going external rebalancing. Over the pre-crisis decade, real wages have been in line with productivity in France. It is only in the aftermath of the crisis that real wages have slowed down less markedly than productivity, due in particular to negative inflation surprises. However, it is worth noting that unit labor costs in France have been less dynamic than in Germany since mid 2012, which is a positive development not only from a domestic perspective but also for demand rebalancing within the euro area.

Cutting red tape and improving public administration efficiency

The intensification of the "simplification shock" will help improving the non-cost competitiveness of our economy. The measures already implemented enabled EUR 3.3 billion savings since 2013, and a permanent council of companies' executives and public administration representatives will propose and assess new measures every six months.

In parallel, the government has also launched several institutional reforms that will significantly improve the functioning of the public administration and will improve the long term efficiency of local governments. The number of regions will be halved by merging administrative structures, a major reform since the administrative map will be completely revamped. The repartition of competencies among the different levels of local government will be further simplified and clarified.

Improving the functioning of product markets

The *Macron Law* on growth, economic activity, and equal economic opportunities aims to enhance competition across the economy.

The law which will be definitively adopted by summer 2015 will improve the functioning of transportation services, of retail distribution (with more power given to the French competition authority), will open up regulated professions and link their tariffs to costs, as well as release the conditions governing Sunday and evening working. The law will also provide a reform of commercial courts to enable a comprehensive, more efficient processing of the most important cases.

Improving the functioning of the labor market

The *Rebsamen Law* on social dialogue modernization will increase the effectiveness of social dialogue at firm level by rationalizing the rules, adapting them to the size of the companies, and giving companies greater leeway with regard to collective agreements. Social dialogue will become simpler and of higher quality, with a reduction of the effect of thresholds related to the number of employees.

After the staff visit, the Government also announced in early June a Small Businesses Act in order to boost employment and activity, with measures to improve flexibility and security (job retention agreements), to enhance job creation (strong financial incentives for first job creation), to allow renewal of fixed-term contracts two times instead of one and to cut legal uncertainty on individual dismissals costs *(prud'hommes).*

Overall impact of structural reforms

Reforms are starting to yield positive results, and have an impact on growth potential. The Government estimates that the reforms implemented since 2012 and to be adopted by the end of the year will have a positive impact of about 4 points of GDP by 2020, with significant impact starting in 2015 and 2016. Consistently, the OECD estimated the impact of several reforms decided between 2012 and 2014 to have a positive impact of 3 points of GDP at a 10-year horizon.

4. Financial sector

Staff's report rightly highlights the potential build-up of risks in the financial sector due to the low interest rate environment. However, while these risks exist and should be closely monitored, they are not specific to the French financial sector. Regarding insurers, French average guaranteed rates are relatively low, in most cases based on an annual revisable commitment, and the total duration gap is not of significant size compared to peers.

French banks have achieved strong progress towards meeting Basel III requirements, as underlined in the report. Regarding risk weights, it should be noted that the *in depth assessment* of the AQR has not lead to significant revision, suggesting that current RWA calculation is well grounded and prudent. French banks have reduced their dependence to short term wholesale funding: their loan–to-deposit ratio has decreased, in particular thanks to an increase in deposits, since 2008, following an adjustment of their funding model.

Regulated savings deposits and accounts play a key role in encouraging a stable pool of savings. Regarding their returns, the French authorities acknowledge the importance of having regulated interest rates consistent with an efficient transmission of ECB monetary policy. In this respect, the guaranteed interest rate on the housing savings plan (*Plan Epargne Logement)* was recently cut.