IMF Country Report No. 23/56

FRANCE

January 2023

2022 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 2022 Article IV consultation with France, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 25, 2023, consideration of the staff report that concluded the Article IV consultation with France.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 25, 2023, following discussions that ended on November 18, 2022, 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 January 4, 2022.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for France.

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

Selected Issues

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

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Washington, D.C.

PRESS RELEASE

PR23/21

IMF Executive Board Concludes 2022 Article IV Consultation with France

FOR IMMEDIATE RELEASE

WASHINGTON, DC – January 30, 2022: On January 25, 2023, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

France saw a robust recovery from the Covid-19 shock but is now facing the repercussions of Russia's war in Ukraine. In 2021, output rebounded by 6.8 percent and recovered to pre-crisis levels. The recovery was broad-based and faster than in most other European countries. While France is less directly exposed to the energy shock, the war in Ukraine is dampening the recovery by denting confidence and exacerbating supply-side difficulties. Staff expect growth of 2.6 percent for 2022. Inflation has surged over the past year, driven by supply chain bottlenecks and the energy price shock, but remains well-below peers thanks to energy price controls and subsidies. These and other measures to support purchasing power keep the fiscal deficit elevated despite the unwinding of Covid-19 support. While capacity utilization remains below pre-crisis levels, labor market conditions have further tightened. The banking sector has weathered the crisis soundly, though financial stability risks are increasing.

The large fiscal response to the energy price shock has cushioned the economic impact but has been costly, poorly targeted, and distortionary. Support totaling 2 percent of GDP in 2021-22 has been centered on households and largely channeled through untargeted, and thus costly, energy price measures and cash transfers. For 2023, the price cap is raised by 15 percent—with poorer households compensated upfront through cash transfers—while a more targeted fuel voucher ("chèque carburant") for households earning up to median income replaces the fuel subsidy ("remise carburant"). In parallel, energy bill support to firms will be scaled up, funded from a new infra-marginal rent tax and solidary contribution from energy producers. France's fiscal response to successive shocks over 2020-22 has been swift and effective but costly, narrowing its fiscal space and widening the public debt gap relative to Euro Area peers.

Staff projects growth at 0.7 percent in 2023, while inflation will remain persistent over the next two years as price controls ease. Near-term risks are titled to the downside stemming from a prolonged war and an escalation of sanctions and a further spike in gas and electricity prices, faster-than-expect monetary policy adjustments in Europe or elsewhere, and a deeper

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

slowdown in the US or China. Over the medium-term, output will grow near potential but scarring from the pandemic and the energy shock will leave output some 2 percentage points below the pre-pandemic trend. The government sees unemployment, pension, and vocational training reforms, as well as measures to foster youth employment as key levers to raise labor supply and potential growth. The energy crisis also presents opportunities to accelerate the green transition.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They noted that France saw a strong economic recovery from the Covid-19 shock but is now facing strong headwinds. While it has been less affected than most EU countries by the energy crisis due to a lower reliance on Russian gas and a strong policy response, economic activity is slowing sharply and inflation will remain persistent as energy price controls ease. Directors stressed that risks are titled to the downside stemming from possible further impacts of Russia's war in Ukraine, faster-than-expected monetary tightening and a deeper global slowdown.

Directors welcomed the effectiveness of the fiscal response to the energy shock in containing the impact on output and inflation but noted that its largely untargeted nature pushed up costs and reduced incentives to lower energy consumption. While many Directors agreed with the staff's recommendation for a modest fiscal tightening in 2023, including by accelerating the phase-out of energy price controls and better targeting support, a number of Directors saw merit in a more gradual adjustment with the exit from price controls conditional on market developments and the policy response at the regional level. Directors broadly agreed that a sustained expenditure-led fiscal consolidation over the medium term will be critical to rebuild buffers and bring debt on a firmly downward path while leaving space to accelerate green and digital investment. Noting that implementation of the unemployment benefit and pension reform plans could deliver part of the needed adjustment, they emphasized the need for additional reforms, including to rationalize tax expenditures and enhance spending efficiency.

Directors noted that the banking sector has weathered the crisis soundly, but global financial stability risks are increasing, including from the impact of the economic slowdown on corporate balance sheets, increased credit risk from energy intensive and inflation affected sectors, and a possible downturn in the housing market. Directors supported the authorities' decision to raise the counter-cyclical buffer to guard against the buildup of financial stability risks but cautioned that the buffer should be promptly released should there be a sudden deterioration of financial conditions.

Directors urged continued action to reduce labor market frictions and increase labor supply. They welcomed the recently approved unemployment benefits reform and upcoming pension

[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.

reform which will help raise the labor supply. In addition, Directors recommended policies to improve educational outcomes and alleviate skills mismatches.

Directors underscored the urgency of the transition to cleaner and more secure energy sources. They stressed the importance of streamlining regulatory and judicial procedures for renewable energy development and increasing carbon pricing while providing support for vulnerable households as part of a broader package of climate measures.

Directors commended the authorities for France’s leadership in multilateral cooperation and looked forward to their continued leadership in addressing global challenges.

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

Table 1. France: Selected Economic Indicators, 2019-23

				Projections	
	2019	2020	2021	2022	2023
Real economy (change in percent)					
Real GDP	1.9	-7.9	6.8	2.6	0.7
Domestic demand	2.1	-6.7	6.6	3.1	0.5
Foreign balance (contr. to GDP growth)	-0.3	-1.0	0.0	-0.6	0.1
CPI (year average)	1.3	0.5	2.1	5.9	5.0
GDP deflator	1.2	2.9	1.3	2.6	3.5
Public finance (percent of GDP)					
General government balance	-3.1	-9.0	-6.5	-5.0	-5.3
Revenue	52.3	52.5	52.5	53.5	52.8
Expenditure	55.4	61.5	59.1	58.4	58.1
Primary balance	-1.7	-7.8	-5.2	-3.2	-3.7
Structural balance (percent of pot. GDP)	-2.1	-5.8	-5.2	-4.4	-4.5
General government gross debt	97.4	114.7	112.6	111.6	112.0
Labor market (percent change)					
Employment	0.8	-0.3	1.7	0.4	-0.1
Labor force	0.1	-0.7	1.6	0.0	0.0
Unemployment rate (percent)	8.4	8.0	7.9	7.5	7.6
Credit and interest rates (percent)					
Growth of credit to the private non-financial sector	5.3	8.1	2.5	3.8	4.2
Money market rate (Euro area)	-0.4	...	...	...	...
Government bond yield, 10-year	0.1	...	...	...	...
Balance of payments (percent of GDP)					
Current account	0.5	-1.8	0.4	-1.5	-1.6
Trade balance of goods and services	-0.9	-1.8	-1.2	-1.7	-1.5
Exports of goods and services	32.7	28.4	31.2	39.3	40.7
Imports of goods and services	-33.6	-30.2	-32.4	-41.1	-42.2
FDI (net)	1.1	0.2	-0.4	0.4	0.8
Official reserves (US$ billion)	69.7	...	...	...	...
Exchange rates					
Euro per U.S. dollar, period average	0.89	...	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	97.1	...	...	...	...
REER, ULC-based (2005=100, +=appreciation)	90.2	...	...	...	...
Potential output and output gap					
Potential output (change in percent)	1.0	-3.3	3.7	1.5	1.0
Memo: per working age person	1.2	-3.2	4.1	1.5	1.0
Output gap	0.0	-4.7	-1.9	-0.8	-1.1

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

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION

January 4, 2023

KEY ISSUES

Context: France saw a robust recovery from the Covid-19 shock but is now facing the repercussions of Russia's war in Ukraine. In 2021, output rebounded by 6.8 percent and recovered to pre-crisis levels. The recovery was broad-based and faster than in most other European countries. While France is less directly exposed to the energy shock, the war in Ukraine is dampening the recovery by denting confidence and exacerbating supply-side difficulties. Inflation has surged but remains well-below peers thanks to energy price controls and subsidies. These and other measures to support purchasing power keep the fiscal deficit elevated despite the unwinding of Covid-19 support. While capacity utilization remains below pre-crisis levels, labor market conditions have further tightened.

Outlook: Staff estimates growth at 2.6 percent in 2022 and 0.7 percent in 2023, with inflation averaging 5.9 and 5 percent, respectively. Near-term risks to the outlook are tilted to the downside, dominated by possible further impacts of Russia's war against Ukraine. Under current policies, the fiscal deficit is expected to narrow as support is phased out and the economy recovers but will remain elevated at 4 percent of GDP in the medium term.

Policies: Key policy priorities are:

- **Fiscal Policy:** The fiscal stance in 2023 should begin to normalize from its highly stimulative position over the last 3 years, thus supporting monetary policy by easing demand pressures, through a structural effort of ¾ ppt of GDP relative to staff's baseline structural deficit of 4½ percent of GDP. Better targeting energy support and accelerating the phase-out of energy price controls would help underpin this effort. This should be followed by a steady, expenditure-led consolidation until reaching a structural deficit of 0.4 percent of GDP in 2030, consistent with France's previous medium-term objective (MTO). Doing so would require a sustained annual effort averaging 0.7 percent over 2024-30, for a cumulative effort of about 5 percent of GDP relative to staff's baseline. This would bring public debt on a firmly downward path from 2024.

- **Financial policy:** Systemic risks in the financial sector have increased since the onset of the war, despite high profitability. Banking supervision should remain vigilant against possible negative effects of increased credit risk from vulnerable corporates. Staff support the authorities' decision to further tighten the counter-cyclical buffer to a rate above pre-pandemic levels given the buildup of financial stability risks and still low cost of capital for banks.

- **Structural policy:** Labor market policies should ensure smooth transition of apprentices into permanent work while addressing skills shortages and inferior educational outcomes. Continuing structural reforms, particularly in pensions, unemployment, and product and services markets will be essential for future fiscal health as well as better competitiveness and growth. The energy crisis presents an opportunity to accelerate the green transition through energy conservation and a faster switch to renewable energy.

Approved By
Julie Kozack (EUR) and Maria Gonzalez (SPR)

Discussions took place virtually and in Paris from November 7–18, 2022. The staff team comprised J. Franks (mission head), R. Vermeulen, I. Teodoru, M. Patnam, R. Lee (all EUR), and was assisted at headquarters by P. Castillo and K. Cerrato (both EUR). Arnaud Buisse (Executive Director) joined the mission. Staff met with the Central Bank Governor Villeroy de Galhau; senior officials in the president and prime minister's offices, various ministries, and the *Cour des Comptes*; financial sector interlocutors, think tanks, and academics; trade union and employer association representatives; and had a conference call with the SSM. A press conference was held at the end of the mission.

CONTENTS

TABLES

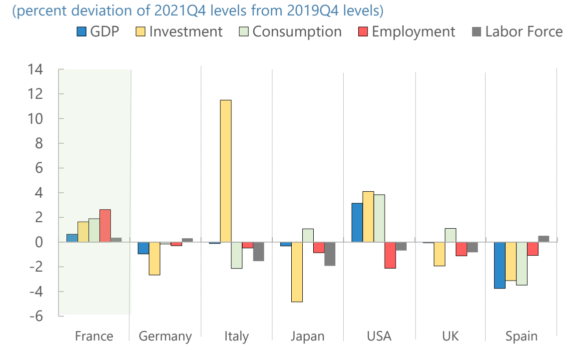
ANNEXES

CONTEXT AND RECENT DEVELOPMENTS

1. After a robust recovery from the economic shock of the COVID pandemic, France is now facing the repercussions of Russia's invasion of Ukraine. In 2021, GDP rebounded by 6.8 percent and by the end of the third quarter, output had recovered to pre-crisis levels. The recovery was broad-based—consumption, investment, employment, and labor force participation all rebounded more quickly than in most other European countries, with public consumption and private investment growth particularly strong. Only manufacturing production remained below pre-crisis levels. The energy crisis is dampening the recovery by reducing consumer purchasing power, denting confidence, and exacerbating supply-side difficulties. Staff expect growth of 2.6 percent for 2022, but high frequency indicators point to stagnating growth in the coming quarters, with businesses expecting weaker services growth, while the composite PMI has fallen into contractionary territory driven by services. In contrast, manufacturing output improved slightly with some easing of supply bottlenecks. Capacity utilization continues to remain below pre-crisis levels.

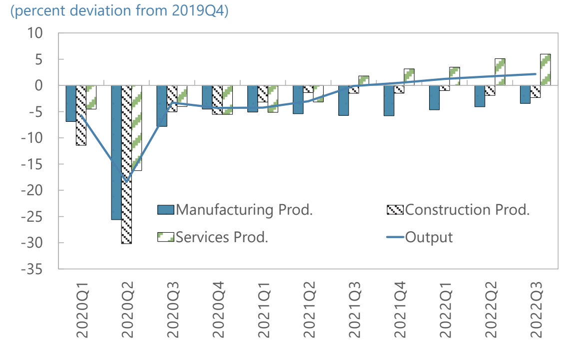
Figure 1. France: Economic Recovery, Confidence, and Supply-Side Difficulties

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



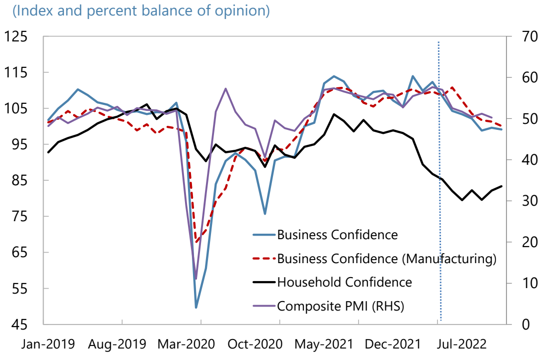
Sources: Haver Analytics; and IMF Staff Estimates
Note: Seasonally adjusted data. For EU countries employment uses national accounts concept while labor force is from the LFS.

Economic Recovery: Output and Components
(percent deviation from 2019Q4)



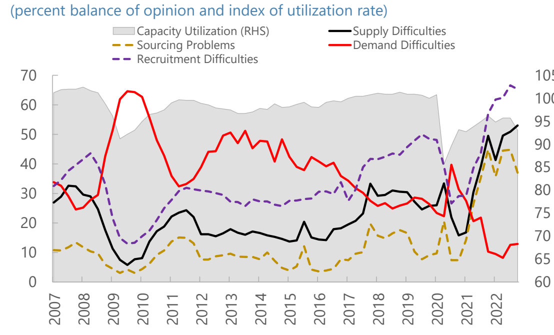
Sources: INSEE.

Household and Business Sentiment
(Index and percent balance of opinion)



Sources: INSEE.

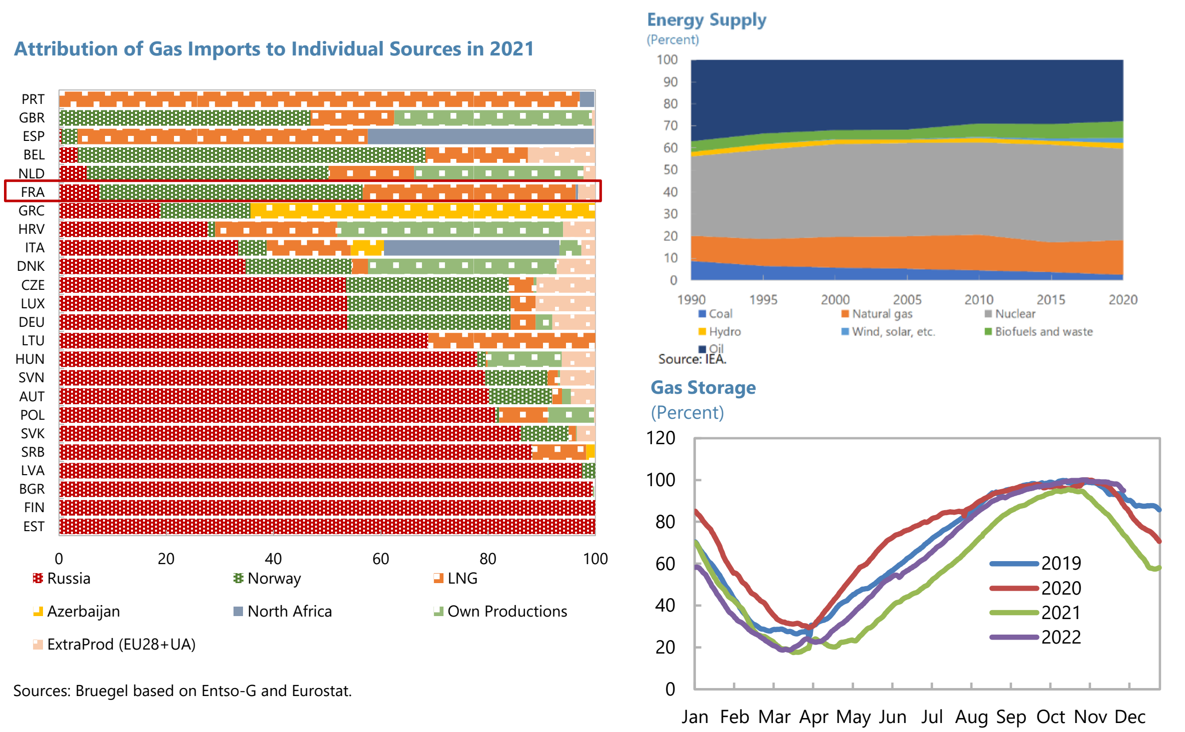
Supply & Demand Difficulties in French Industry
(percent balance of opinion and index of utilization rate)



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

2. France is less directly exposed to the energy shock from the war in Ukraine, but indirect effects are dampening the recovery. Compared to European peers, France is less vulnerable to the direct effects of the war due to its reliance on nuclear energy and low dependence on Russian gas. The share of natural gas in French energy supply is about 16 percent (vs. 24 percent for the EU). Imports from Russia accounted for less than 10 percent of natural gas supply (with most coming from Norway and from LNG imports). Higher LNG imports and non-Russian pipeline flows have kept gas imports largely unchanged and allowed storage levels to increase to normal seasonal levels (95 percent capacity in early December), providing a buffer covering about 30 percent of annual consumption. However, higher gas and electricity prices, supply chain disruptions, and confidence effects are weighing on consumption and investment, and the slowdown in partner countries has weakened external demand.

Figure 2. France: Energy Supply, Gas Imports, and Gas Storage



Sources: Bruegel based on Entso-G and Eurostat.

Source: IEA.

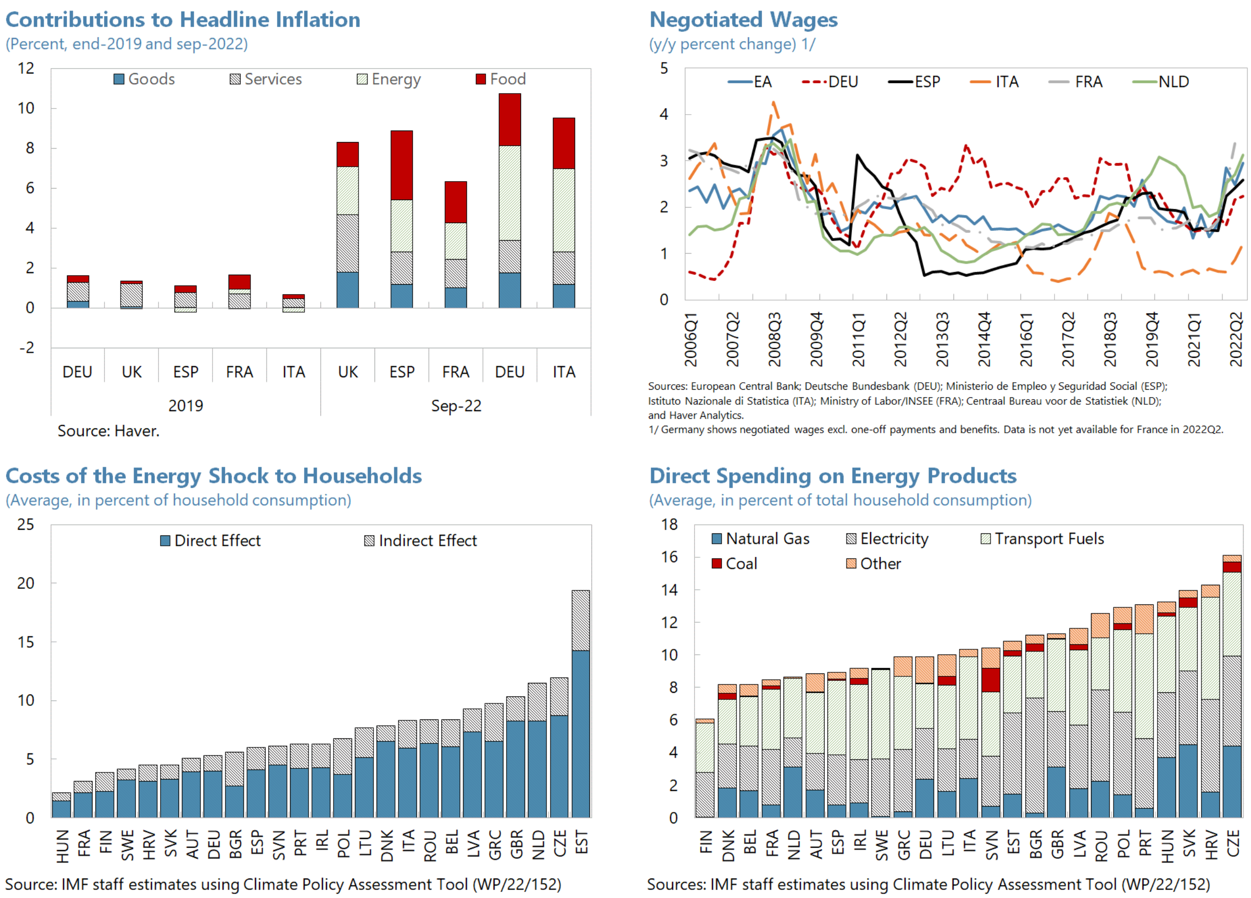
Sources: Gas Infrastructure Europe (GIE) AGSI+ Storage Transparency Platform.

3. Inflation has surged over the past year, driven by supply chain bottlenecks and the energy price shock, and is expected to average 6 percent in 2022. The twelve-month inflation rate of consumer prices (HIPC) reached 7.1 percent in November, driven by food and goods prices, while energy prices have fallen somewhat. Inflation is expected to peak in the coming months, but continues to be well below the EU average, largely due to energy price controls and subsidies, which have kept price increases an estimated 2-3 ppts lower.[1] These controls also lowered the passthrough into food and goods prices. Combined, the average burden of the energy price shock for French

[1] Insee estimates that these measures reduced inflation by 3.1 percent , accounting for both direct and indirect effects through the diffusion of cost-induced increases in prices of non-energy goods/services (1.9 percent and 1.2 percent , respectively, see Insee Analyses no. 75, September 1, 2022).

households was contained at about 3 percent of total household consumption in 2022 (3.3 percent for the first quintile) and about 4 percent in 2023, among the smallest across Europe.[2] While services inflation has risen over the past year, wage increases remain below headline inflation (3 percent) and year-ahead wage expectations (4 percent) were below overall inflation expectations in Q3 2022 (5 percent). However, risks from wage adjustments are already building, as reflected in some recent collective bargaining agreements. In addition, the automatic indexation of the minimum wage—and to a lesser extent pensions and social benefits (and advanced indexation as part of recent purchasing power measures)—could create second-round pressures and a weakening in productivity in 2023. Unit labor costs are also expected to increase over 2022-23, which may exacerbate inflation.

Figure 3. France: Inflation, Wages, and Effect of the Energy Shock on Households Burdens

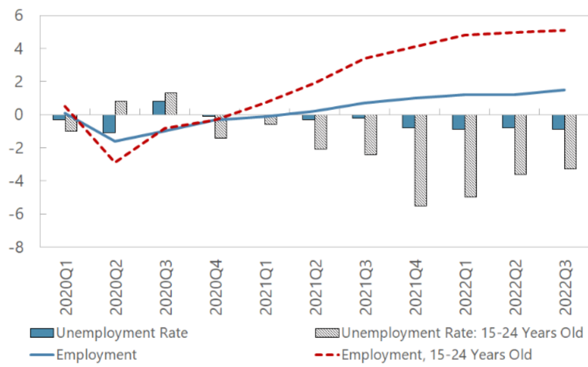


Notes: The price scenario for the direct and indirect effects is based on the projected energy prices for 2022 derived from international fossil fuel futures prices (as of May 2022), compared with a baseline derived from futures prices as of January 2021. The analysis is based on the maximum pass-through (i.e., the ratio of 12-month retail inflation to 12-month wholesale inflation) over the last year (since May 2021). See WP/22/152 for details on the methodology.

[2] The household burden is based on direct effects from the estimated retail price increases and historical spending shares, and indirect effects from the increase in prices of non-energy products. See WP/22/152 for details on the methodology.

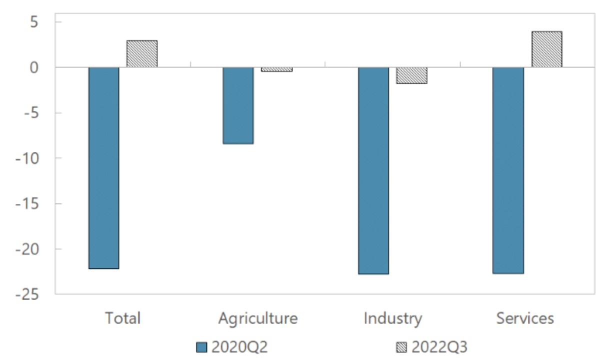
4. The labor market performed strongly in the recovery from the pandemic, with employment, hours worked, and labor force participation all exceeding pre-crisis levels. Headline unemployment has declined from 8.2 percent in 2019:Q4 to 7.3 percent in 2022:Q3, with a substantial contribution from falling youth unemployment. This performance reflects in part earlier labor market reforms and more recent apprenticeship programs for youth.[3] Despite a rise in apprenticeships in 2022, the unemployment rate started rising for people aged 15 to 24, while remaining virtually stable for those aged 25 to 49 and decreasing for those over age 50. Total working hours are also above pre-pandemic levels in 2022:Q3, due to higher employment and the phase-out of the short-time work scheme.

Evolution of Unemployment
(Percent of Working Age Population, change since 2019Q4)



Source: INSEE Labor Force Survey.

Total Hours Worked
(Percent deviation from 2019Q4)

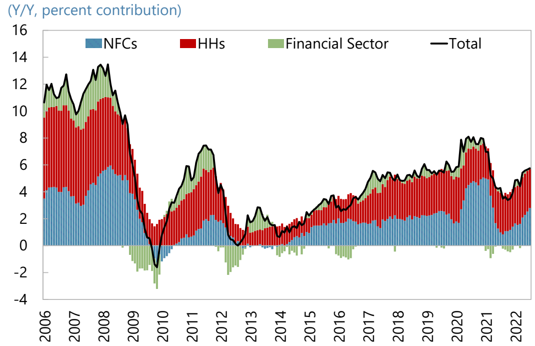


Source: INSEE.

5. Financial conditions have tightened amid increasing funding costs. Both external and domestic financing conditions are tightening under the impact the global increase in interest rates. Corporate bond spreads have risen, and French equities have lost some 12 percent since their peak in early 2022, with the tech and services sector stocks particularly hard-hit. Market financing rates have risen more swiftly than policy rates, reflecting the market's dynamic response to higher inflation. Despite the increase in interest rates, corporate credit growth picked up in the first half of 2022, mainly driven by an increase in cash loans. Household credit growth remained stable but recent months have seen some slowdown in mortgage lending (¶21).

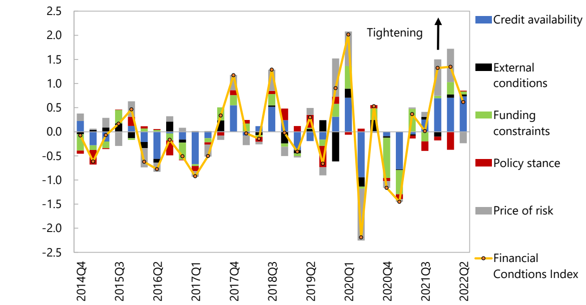
[3] Entries in apprenticeships increased by 42 and 41 percent in 2020 and 2021.

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



Source: Haver Analytics.

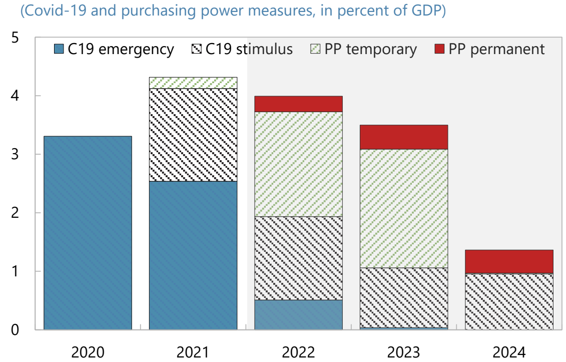
Financial Conditions Index and its Components
(qoq difference in index and contribution)



Sources: IMF Staff Estimates.
Notes: FCI is not scaled. For methodological details see *Financial Conditions in the Euro Area*, (Raphael Espinoza, Vincenzo Guzzo, Romain Lafarguette, Vina Nguyen, Miguel Segoviano, and Philippe Wingender), forthcoming IMF Departmental Paper 2022

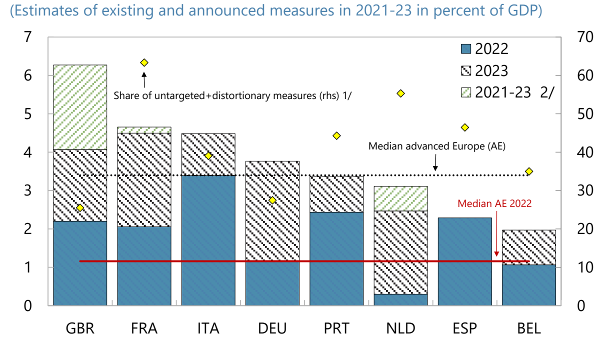
6. **The external position in 2022 is assessed to be moderately weaker than the level implied by medium-term fundamentals and desirable policies (Annex III).** The Current Account (CA) balance moved to a surplus of 0.4 percent of GDP in 2021 (from a deficit of 1.8 percent in 2020), driven by an improvement in the services balance and an exceptional surplus in transport services (i.e. maritime transport). Quarterly trade data point to a deterioration in the CA balance in 2022, with both the oil and non-oil goods deficits increasing sharply, while the services surplus has continued to strengthen, supported by tourism exports in the second and third quarters. Together, the large terms-of-trade shock and lower external demand are expected to produce a CA deficit of about 1.5 percent of GDP in 2022. While there is an important domestic gap from looser fiscal policy of about -1.1 percent of GDP, the overall policy gap is zero, as the gap with the rest of the world is positive.

Fiscal Support
(Covid-19 and purchasing power measures, in percent of GDP)



Source: Authorities and IMF staff calculations.

Fiscal Support in Response to Energy Shock
(Estimates of existing and announced measures in 2021-23 in percent of GDP)



1/ Distortionary: measures distorting energy prices or disincentivizing energy savings.
2/ Either cost in 2021 (FRA) or not separable by year.
Source: IMF European Department desk survey (November 2022).

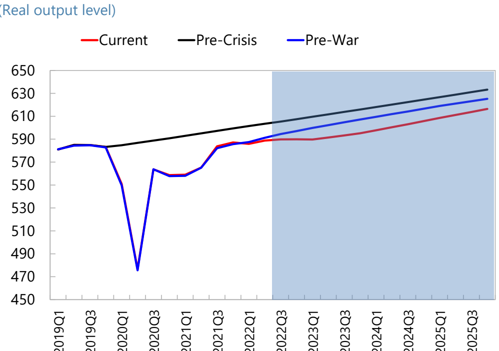
7. **The fiscal deficit remained elevated as purchasing power support replaced expiring Covid-19 support and debt service costs rose.** The deficit narrowed by 2.5 ppts to 6.4 percent of GDP in 2021 due to a strong rebound in revenues and activity that more than offset the increase in recovery and purchasing power measures (1 percent of GDP). Measures in response to rising energy prices announced in 2021 included regulated gas and electricity price freezes, and cash transfers to households, totaling ½ percent of GDP over 2021-22. In 2022, support was scaled up in March,

August, and November, bringing the total to 2.1 percent of GDP, well-above that of peers.[4] They included the extension of energy price controls, a fuel price rebate, grants to energy-intensive firms, targeted sector support, additional targeted cash transfers, tax cuts, and indexation of pensions, social assistance, and public wages. These costs were partially compensated by lower subsidies and windfall revenues from claw-back provisions in contracts with renewable energy producers under the public service energy obligation mechanism (*CSPE*). Despite lower inflation than peers, debt service costs related to inflation-indexed debt increased by ½ percent of GDP on top of a small increase due to higher yields. The deficit is nonetheless expected to decline and meet the 2022 budget target of 5 percent of GDP thanks to sizeable revenue overperformance, on top of windfalls under the CSPE, from stronger-than-expected corporate profits, labor income, and VAT collection.

OUTLOOK AND RISKS

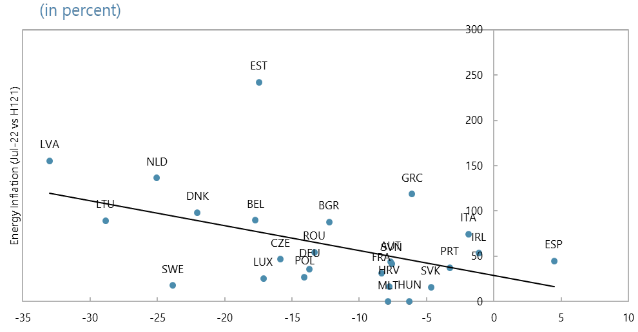
8. The war in Ukraine will weigh on growth in 2023. Average inflation is expected to remain around 5 percent in 2023 as energy prices stabilize and supply bottlenecks ease. Inflationary effects, coupled with weakened confidence, will depress household consumption growth. The savings ratio is expected to remain at about 15.8 percent in 2022-23 (slightly above the 2019 level of 15 percent) as disposable income is supported by fiscal measures and employment growth. Higher interest rates and lower confidence will likely slow investment growth. Staff projects GDP growth at 0.7 percent in 2023, with quarterly growth of near zero in 2022:Q4 and 2023:Q1, but with activity expected to slowly rebound later in the year, driven by resilient consumption and an expected improvement in the external balance driven by rebounds in the key nuclear, aerospace, and automobile industries. Over the medium term, growth is expected to converge towards the potential rate of 1.3 percent, with scarring from the pandemic and the war in Ukraine leaving output some 2 percentage points below the level implied by the pre-pandemic trend. Inflation will remain persistent over the medium term with the gradual lifting of the price caps and only gradually decline to around 2 percent in 2025. The CA deficit is expected to shrink over the medium term as fiscal consolidation and structural reforms to improve competitiveness of the economy are implemented.

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



Sources: IMF Staff Calculations. Shaded area is forecast.

Energy Retail Prices and Gas Consumption
(in percent)



Note: Energy inflation is simple average of retail electricity and gas (as measured by HICP subcomponents).

[4] Data cover the fiscal cost of measures over 2021-23, based on a November 2022 EUR desk survey.

9. Risks to the outlook are high and tilted to the downside. Main downside risks stem from a prolonged war and an escalation of sanctions.[5] Gas and electricity prices could further spike, leading to another surge in inflation. Inflationary pressures and higher wage demands could in turn weigh on the outlook and increase the risk of a wage-price spiral. Faster-than-expected monetary policy adjustments in Europe or elsewhere could further depress output. A deeper slowdown in the US or China could depress external demand. On the upside, swift adjustment to accelerate the green transition could ease energy shock risks and boost investment.

Authorities' Views

10. There was broad agreement on the short-term outlook, while the authorities are more optimistic on medium-term prospects. The government is slightly more optimistic on growth for 2023, expecting a 1 percent increase in GDP, while inflation is expected to be slightly lower at about 4.7 percent (HICP). The authorities shared staff's views on the main downside risks from a prolonged war and additional inflationary pressures, but thought that some risks are symmetric, with both upside and downside risks to gas and electricity prices going forward. They also saw more limited risks of a wage-price spiral. Over the medium-term, the authorities expect faster growth due to less scarring from the Covid and energy crises. They anticipate the savings rate will gradually decrease from its historically high level, which would boost consumption. They also expect a boost in potential growth over the medium term from the effects of labor market and pension reforms.

POLICY DISCUSSIONS

Fiscal policy should start tightening in 2023 after a highly stimulative position over the last 3 years. Steady, expenditure-based consolidation should be the priority for the remainder of the decade. Financial supervision should remain vigilant against possible negative effects from rising interest rates, with tighter macroprudential policy advisable in the baseline scenario. Tighter fiscal and macroprudential policies would also assist ECB monetary policy in easing inflationary pressures. Labor market policies should build on recent successes to ensure smooth transition of apprentices into permanent work while addressing skills shortages and inferior educational outcomes. Continuing structural reforms, particularly in pensions, unemployment, and product and services markets will be essential for future fiscal health as well as better competitiveness and growth. Accelerating the green transition through price and non-price measures and investment in renewable energy would help achieve emission reduction targets.

[5] The list of EU sanctions adopted following Russia's invasion of Ukraine is available here. An analysis of the global spillovers of sanctions can be found here. In line with the recently revised Institutional View on the liberalization and management of capital flows, some of the sanctions imposed on Russia can be capital flow management measures (CFMs) imposed for national and international security reasons.

A. Fiscal Policy: Focusing Crisis Support and Reducing the Deficit

11. The large fiscal response to the energy price shock has cushioned the economic impact but has been costly, poorly targeted, and distortionary.[6] Support totaling 2 percent of GDP in 2021-22 has been centered on households and largely channeled through untargeted, and thus costly, energy price measures and cash transfers (text table). The tariff shield ("*bouclier tarifaire*") capped the increase in regulated electricity tariffs at 4 percent from February 2022 for one year and froze regulated gas tariffs at their October 2021 level until the end of 2022, at a cost of 1 percent of GDP excluding cost incurred by EDF (Box 1). For 2023, the price cap is raised by 15 percent—with poorer households compensated upfront through cash transfers[7]—while a more targeted fuel voucher ("*chèque carburant*") for households earning up to median income replaces the fuel subsidy ("*remise carburant*"). In parallel, energy bill support to firms will be scaled up, funded from a new infra-marginal rent tax[8] and solidary contribution from energy producers.[9] With sizeable fiscal windfalls from renewable energy producers funding about two-thirds of the cost of the tariff shield, the net cost of support is lower than in 2022, but remains substantial at 1 percent of GDP, reflecting the large gap between market and regulated energy prices and modest demand reduction. To reduce fiscal cost and incentivize energy savings, measures should be better targeted by accelerating the phase-out of price controls and increasing support to the most affected. Alternatively, a tiered pricing mechanism could be considered, with the tariff shield only covering basic energy needs as a second-best option to a swift phase-out.

[6] For a discussion on the design of cost-effective and targeted fiscal support that preserve incentives for energy conservation, see Ari et al. (2022).

[7] Through another exceptional energy voucher, like in 2021, but with eligibility widened to cover 12mn instead of 6mn households and amounts increased from €100 to €100-200, varying with income.

[8] This transposes the European Council decision of September 30, 2022, to tax rents of energy producers above €180/MWh, effective from December 2022 (duration and thresholds have been adjusted).

[9] Assistance to firms is compliant with EU state aid rules that have been amended and extended until end-2023 under the Temporary Crisis Framework.

Table 1. France: Purchasing Power Measures [1/]

(Percent of GDP)

	2021	2022	2023
Total (gross)	**0.2**	**2.1**	**2.4**
Households 2/	**0.2**	**2.0**	**2.1**
Energy price measures	0.0	1.3	1.6
Energy price controls (*bouclier tarifaire*)	0.0	1.0	1.6
Fuel subsidy (*remise carburant*)		0.3	0.0
Cash transfers	0.2	0.1	0.1
One-off transfer (*indemnité inflation*)	0.2	0.0	0.0
Additional energy check (*chèque énergie*)	0.0	0.1	0.0
Exceptional back-to-school bonus (*aide exceptionnelle de rentrée*)		0.0	0.0
Heating voucher for poor households using fuel oil		0.0	0.0
Fuel cost voucher (*chèque carburant*)			0.1
Other		0.5	0.4
Advanced indexation (pensions, wages, social assistance)		0.4	0.3
Eliminate state broadcasting fee (*redevance audiovisuelle*)		0.1	0.1
Increase in mileage allowance coefficients (*barème indemnité kilométrique*)		0.0	0.0
Firms		**0.1**	**0.3**
Energy bill support for energy-intensive firms		0.1	0.2
Targeted sector energy relief measures		0.0	0.0
Electricity bill rebate (*amortisseur électricité*)		0.0	0.1
Fiscal windfall from higher energy prices	**-0.1**	**-0.7**	**-1.5**
Renewable energy subsidies	-0.1	-0.3	-0.3
Repayment of renewable energy subsidies and removal of ceiling		-0.4	-0.7
Infra-marginal rent tax energy producers		0.0	-0.4
Temporary solidarity contribution			0.0
Total (net)	**0.1**	**1.4**	**0.9**

Source: 2021-23 budget laws and decrees, IMF staff estimates.

1/ Measures exclude the reintroduction/extension of some Covid measures (i.e., STW scheme, tax deferrals, and PGE loan guarantees) but include those enacted under the purchasing power/supplementary 2022 budget laws (the authorities exclude the indexation of public wages and elimination of broadcasting fees from anti-inflation measures).

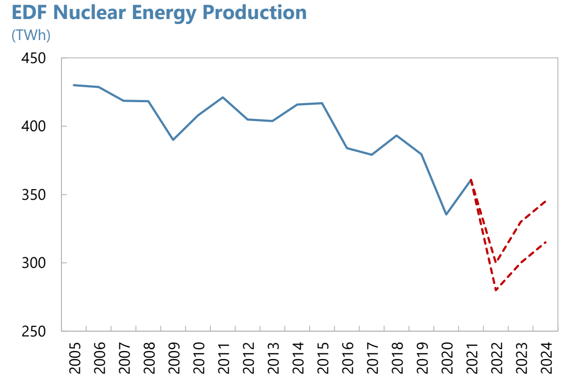
2/ Regulated gas and electricity tariffs under the tariff shield (bouclier tarifaire), and measures to operationalize their price caps such as the temporary cut in electricity excise tax (TICFE) and increase in the supply of nuclear energy (+20TWh) at low cost under the Arenh regime also cover firms--especially micro firms (those with less than 10 employees and turnover below €2mn, and an electricity connection of less than 36kVA benefit from regulated electricity prices).

Box 1. France: EDF's Renationalization

France has a long-standing commitment to nuclear energy, and continued reliance on it is a pillar of the country's strategy to reduce greenhouse gas emissions. In this context, the renationalization of France's nuclear energy producer EDF aims to give the government more control over the country's energy transition but risks exposing it to further losses. EDF has faced operational difficulties in 2022 related to production shortfalls from both planned and unforeseen maintenance and repair of reactors as well as the government's response to the energy crisis to cap regulated electricity tariffs and increase the amount of low-cost electricity that EDF is required to provide under the Arenh regime[1], aggravating pre-existing financial difficulties. Following a capital injection in March of €2.6bn, the government announced in July that it would acquire the remaining 16 percent of capital it doesn't already own, offering €12 per share for a total of €9.7bn. By renationalizing EDF, the government gains full control over the country's nuclear energy production with a view to accelerate France's energy independence, sovereignty, and transition. It enables the government to act more quickly in navigating the energy crisis and transition, with large long-term investment needs to extend and expand France's nuclear and renewable energy capacities (see below and Box 3). While EDF is already majority state-owned and implicitly backed by the state, reflected in its stand-alone credit ratings, the nationalization risks exposing the state to further losses. EDF is expected to continue to be classified as a non-financial public enterprise, but the nationalization entails a risk to the 2023 budget if considered a capital transfer (EC, 2022).

Nuclear reactor outages and measures in response to the energy shock have dented EDF's revenues in 2022. Nuclear power generation has dropped to 280-300 TWh in 2022 and is expected to rebound to 300-330 TWh in 2023 (~30 percent below its 2005 peak). A combination of factors contributed to this underperformance: (i) the *Grand Carénage* focused on safety upgrades and reactor lifetime extensions between 2014-25, with tighter post-Fukushima safety standards increasing inspection time (from 3 to 6 months); (ii) the pandemic created a reactor maintenance backlog; (iii) corrosion led to the temporary shutdown of 12 reactors (a production loss of 60 TWh); and (iv) delays to start operating the Flamanville-3 reactor. As a result, more than half of French nuclear reactors have been unavailable since the beginning of 2022, turning EDF into a net importer of electricity. In addition, as part of the tariff shield, EDF had to sell an extra 20 TWh to its competitors at a below-market price of €46.2/MWh under the Arenh regime. Combined with sizeable investments, EDF will face negative cashflows in 2022 and has issued successive profit warnings. In the latest, it estimated the impact of outages and regulatory measures on its 2022 EBITDA at €32bn and €10bn[2], respectively.

EDF Nuclear Energy Production



Sources: RTE Bilan Électrique 2021, EDF, and IMF staff calculations.

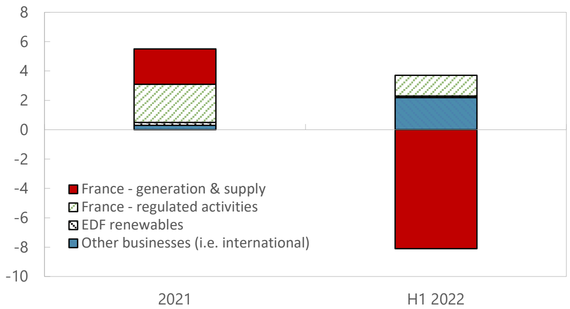
With the nationalization of EDF, the government will have to strike a balance between rehabilitating the company's financials and continuing to shield consumers. Key policy decisions will need to be taken regarding retail price increases, new financing schemes for investments in low carbon energy, and the reorganization of the company. The government plans to build at least three pairs of new nuclear reactors at an estimated cost of €52bn, with possibly an additional eight reactors by 2050. It envisages the first two coming into operation by 2035-37 and has drafted legislation to accelerate administrative procedures. The investment comes on top of an estimated €32bn for lifetime extensions of second-generation reactors under phase two of the *Grand Carénage* (2022-28). The nationalization of EDF could facilitate access to better

Box 1. France: EDF's Renationalization (Concluded)

financing conditions for future investments in low carbon energy and the power grid but given the high debt of the company and the important costs associated with these investments, phasing out the tariff shield and restoring EDF's production capacity would be critical to rehabilitate the company's financials.

EDF Operating Profits, 2021 and H1 2022

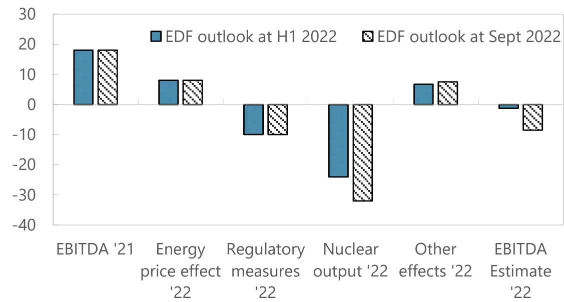
(Bn euros)



Source: EDF Financial Statements, December 2021 and June 2022.

EDF Outlook and EBITDA in 2022

(September vs. H1, Bn euros)



Source: EDF Financial Statements, June and September 2022.

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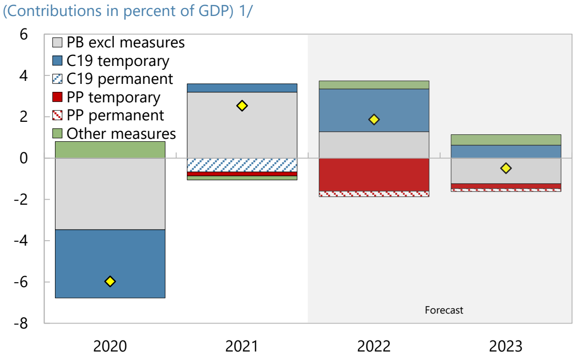
[1] The Arenh regime requires EDF to sell 100 TWh of its annual nuclear output to other energy suppliers at a fixed price set by the Energy Regulatory Commission.

[2] INSEE will decide in March 2023 when the 2022 government accounts will be published whether to record this as government expenditure.

12. **Fiscal policy is expected to remain supportive in 2023.** Beyond extending energy measures, the budget envisages cutting a distortive value-added tax (CVAE, 0.3 percent of GDP) in half, with the remainder to be eliminated in 2024. This follows earlier tax cuts for firms and households that led to a permanent revenue loss of 1½ percent of GDP since Macron's first term and adds to the reversal of temporary revenue windfalls seen in 2022, reflected in a large decline in the revenue ratio. The authorities nonetheless target an unchanged deficit of 5 percent of GDP in 2023. In contrast, staff projects the deficit to widen by ¼ ppts to 5.3 percent of GDP, driven by a less favorable macro forecast.

Change in Primary Balance

(Contributions in percent of GDP) 1/



1/ C19 and PP denote Covid-19 and purchasing power measures.
Source: Insee, authorities, and IMF staff calculations.

13. **Fiscal policy should take advantage of the phase-out of pandemic support to begin reducing the deficit in 2023.** France's fiscal response to successive shocks over 2020-22 has been swift and effective but costly, narrowing its fiscal space. The country's high and rising debt level, widening gap relative to EA peers, and electoral cycle argues for consolidation to start in 2023. While activity is slowing and the output gap widening, historically low unemployment amid a tight labor market and high inflation point to limited slack. Moreover, with monetary policy normalizing to stem inflation, fiscal policy should contribute to easing demand pressures. Staff thus recommends

a fiscal tightening of ¼ ppt of GDP relative to 2022 or 0.7 ppt relative to staff's baseline, equivalent to the savings from expiring temporary Covid-19 support. This could be achieved by better targeting energy support and fully funding it from the savings from higher energy prices (under CSPE). Additional savings could come from postponing production tax cuts until compensatory measures are in place or other measures, such as temporarily indexing higher pensions and income tax brackets below inflation.[10] However, if downside risks materialize, automatic stabilizers should be allowed to work while any discretionary support should be well-targeted and offset by compensatory measures to preserve an appropriately tight policy mix, policy credibility, fiscal sustainability, and consistency with monetary policy. Under an upside scenario, any revenue overperformance should be saved and support be phased out faster to accelerate the deficit reduction.

Options to Achieve Fiscal Adjustment in 2023
(Percent of GDP)

	Cost	Savings
Total	**0.7**	**-0.9**
Energy measures	**0.6**	**-0.6**
Accelerated phase-out energy price controls	1.6	-0.8
Savings from higher energy prices	-1.1	0.0
Targeted cash transfers		0.2
Other	**0.1**	**-0.2**
Offset/postpone production tax cut (CVAE)	0.1	-0.1
Incomplete pension indexation		-0.1

Source: IMF Staff estimates.

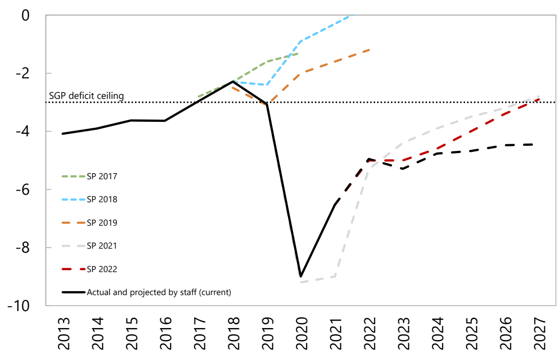
14. The authorities' medium-term fiscal adjustment largely relies on the supply response of reforms that are not yet fully specified. Plans to bring the deficit below the Maastricht ceiling of 3 percent of GDP by 2027 and debt on a downward path from 2026 center on pension and labor market reforms (¶18), rationalizing tax expenditures, improving the efficiency of social security administration while reducing fraud, and tightening health and local government spending control. Savings are reflected in real spending growth targets in the draft medium-term programming bill, but measures largely remain to be specified.[11] The savings would largely cover planned increases in health, education, environment, and security spending, with growth and jobs generated by reforms bringing the deficit to target.[12]

[10] A low incidence of old-age poverty, both relative to peers and to the rest of the population, mitigates concerns regarding the poverty impact of a temporary pension indexation below inflation (as in 2019-20 and foreseen for the complementary regime).

[11] Unemployment benefit and pension reform are underway. The 2021 organic budget law introduced a new fiscal framework requiring medium-term programming bills to set annual real spending targets and corresponding nominal targets for the general government and each sublevel, broadly in line with Staff advice (IMF Country Report No. 22/18).

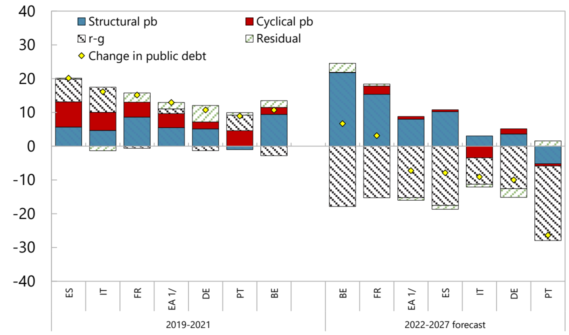
[12] France's fiscal watchdogs, the *Cour des Comptes* (La situation et les perspectives des finances publiques, 2022) and High Council for Public Finances (HCFP Avis 2022-3 PSTAB), criticize optimistic assumptions underpinning the macro baseline that tend to inflate the deficit reduction and undermine the credibility of the adjustment path. The HCFP reiterated this in its assessment of the draft 2023 budget and medium-term programming bills.

Overall Balance Projections in Stability Programs
(Percent of GDP)



Sources: French authorities; and IMF staff calculations.

Change in Public Debt 2019-2027
(Decomposition of the change in the debt ratio, percent of GDP)



1/ Weighted average for the Euro Area (PPP GDP).
Source: WEO and Staff calculations.

15. Further efforts are needed to rebuild buffers over the medium term through a gradual but sustained fiscal consolidation. Under current policies, the fiscal deficit is expected to reach about 4½ percent of GDP by 2027, well-above the 3 percent SGP deficit ceiling and deficit levels of peers.[13] The primary deficit is projected to narrow to 2¼ percent, more than 1½ ppts above its debt-stabilizing level. As a result, debt will remain on an upward path, widening an already sizeable debt differential with European peers. With already elevated debt and gross financing needs (at some 112 and 22 percent of GDP in 2022, respectively) continuing to increase over the projection horizon, risks to debt sustainability have increased (see Annex VI). Risks to the debt outlook include faster monetary tightening or the materialization of contingent liabilities (e.g., loan guarantees under the *PGE/Resilience* schemes, EDF losses, see Box 1)[14], but are mitigated by France's large institutional investor base, home bias, lack of foreign currency debt, and long maturity profile. To reverse the deficit and debt divergence from peers and insure against a faster monetary policy tightening, staff recommend a sustained adjustment to bring the deficit down to 0.4 percent of GDP by 2030—in line with France's pre-crisis medium-term objective (MTO). This is one year later than what staff advised last year, reflecting the need to accommodate the policy response to the energy shock. The adjustment implies a cumulative effort of about 5 ppts of GDP over 7-8 years, for an average annual effort of 0.7 percent. To minimize drag, the consolidation should be gradual and focus on current spending while protecting investment (particularly given large green/digital investment needs, ¶28 and Box 3), underpinned by structural reforms.

[13] Under active policies (based on Stability Programs), France will not reduce its deficit below 3 percent until 2027 while Germany does so in 2023 and other EA countries with a similar starting position in 2025 (i.e., Belgium, Italy, Portugal, and Spain have a deficit around 5 percent of GDP and debt in excess of 100 percent in 2022).

[14] The 2022 Supplementary Budget Act of August 2022 allocated €12.7bn to the State Financial Holding special appropriation account (*CAS FPE*), with a €9.7bn provision for the simplified tender offer for EDF's equity shares. This is recorded as a below-the-line transaction, with a corresponding increase in gross public debt.

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

	2019	2020	2021	2022	2023	2024	2025	2026	2027
Baseline									
Real GDP growth (percent)	1.9	-7.9	6.8	2.6	0.7	1.6	1.8	1.6	1.4
Revenue	52.3	52.5	52.5	53.5	52.8	51.6	51.4	51.2	51.2
Expenditure	55.4	61.5	59.1	58.4	58.1	56.4	56.0	55.7	55.7
Overall balance	-3.1	-9.0	-6.5	-5.0	-5.3	-4.8	-4.7	-4.5	-4.5
Primary balance	-1.7	-7.8	-5.2	-3.2	-3.7	-3.1	-2.9	-2.5	-2.3
Fiscal effort 1/				1.2	-0.3	0.5	-0.1	0.2	0.2
o/w temporary Covid-19 measures				*2.0*	*0.6*	*0.1*	*0.0*	*0.1*	*0.0*
Public debt	97.4	114.7	112.6	111.6	112.0	112.2	113.0	114.2	115.7
Recommended									
Real GDP growth (percent)	1.9	-7.9	6.8	2.6	0.4	1.3	1.6	1.4	1.1
Revenue	52.3	52.5	52.5	53.5	52.8	51.6	51.4	51.2	51.2
Expenditure	55.4	61.5	59.1	58.4	57.5	55.6	54.9	54.1	53.6
Overall balance	-3.1	-9.0	-6.5	-5.0	-4.7	-4.0	-3.5	-2.9	-2.4
Primary balance	-1.7	-7.8	-5.2	-3.2	-3.2	-2.3	-1.8	-1.0	-0.3
Fiscal effort 1/				1.2	0.3	0.9	0.5	0.7	0.8
Cumulative fiscal effort since 2023					*0.3*	*1.2*	*1.7*	*2.4*	*3.2*
o/w temporary Covid-19 measures					*0.6*	*0.7*	*0.8*	*0.8*	*0.8*
Recommended additional fiscal effort 1/					0.7	0.4	0.5	0.5	0.6
Cumulative recommended additional fiscal effort since 2023					*0.7*	*1.1*	*1.6*	*2.1*	*2.7*
Public debt	97.4	114.7	112.6	111.6	111.6	111.1	110.6	110.0	109.3

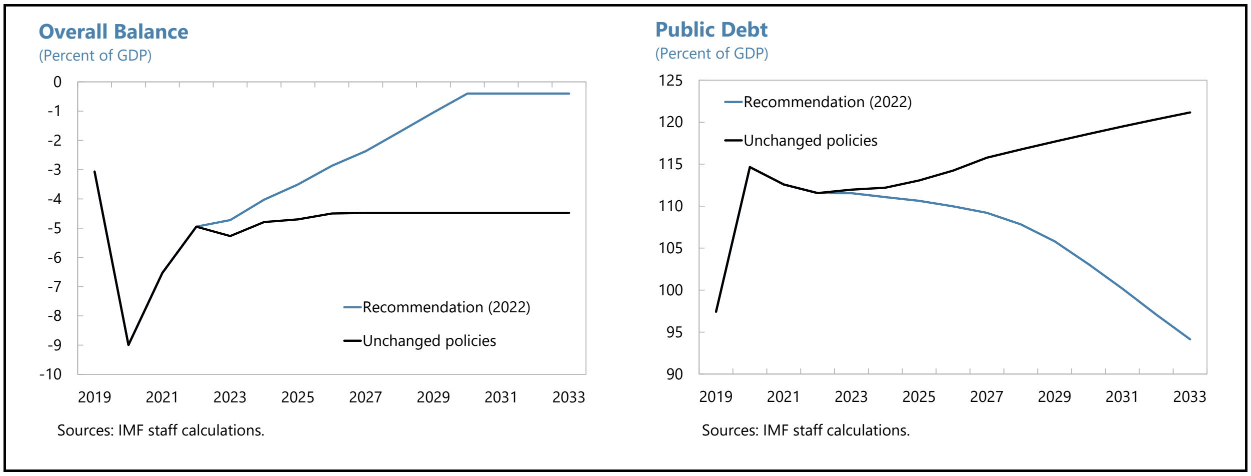
Source: IMF staff calculations.

1/ Computed as the change in the structural primary balance. Recommended additional fiscal effort is relative to the baseline projections.

16. **A credible package of reforms is needed to rationalize spending and narrow the gap with peers.** This could build on earlier proposals and new plans that are yet to be fully specified:

- **Pension reform**: Reform plans—still to be finalized—aim to increase the employment rate of older workers, the effective retirement age, and minimum pensions, and to gradually bring special regimes into the general regime for new participants. While key parameters remain under discussion, raising the minimum retirement age at a rate of 3 months-per year and contribution period for a full pension—with provisions for special circumstances (e.g., long or interrupted careers, arduous jobs, etc.)—should bring the effective retirement age, among the lowest in Europe, closer to peers. Beyond facilitating longer careers, this would strengthen the sustainability of the system and generate significant savings.[15] Introducing automatic adjustment by indexing the retirement age to life expectancy would further enhance sustainability, while unifying the fragmented system—comprising 42 different schemes—would improve equity, lower administrative cost, and facilitate labor mobility.

[15] Earlier staff estimates show that bringing the increase in the effective retirement age to 64 forward from 2040 to 2030 could yield about ½ percent of GDP in savings over the medium-term (IMF Country Reports 22/18; 19/245). The OECD (2021) estimates that increasing it to 64 by 2025 would yield 0.9 percent of 2019 GDP in savings, while increasing GDP per capita by 0.5 percent through employment and productivity gains.



- **Unemployment benefit reform**: The delayed 2019 reform adjusted rules to calculate and cumulate benefits, tightened eligibility and introduced degressivity for higher incomes and a modulation of employers' unemployment contribution rate under a new bonus-malus system to discourage excessive use of short-term contracts. A recently enacted law[16] extends the application of the reform that was due to expire on November 1 until end-2023 and allows the government to expand it by introducing countercyclicality in unemployment benefits. The reform, to be enacted by decree and effective from February, envisages varying benefit duration with labor market conditions, with a 25 percent reduction in the maximum duration when the unemployment rate is below 9 percent and its quarterly rate of increase below 0.8 ppts.[17] It also tightens eligibility for workers who voluntarily resign and workers on fixed-term contracts who repeatedly refuse permanent contracts. After negotiations of social partners on the governance of unemployment insurance, new rules should apply from 2024. While welcoming the reform plans that would strengthen automatic stabilizers and labor market incentives, staff encourage further revisiting eligibility and generosity as the reform firms up that could generate additional savings.

- **Other reforms**: Bringing spending closer to peers could yield substantial savings in several areas, with an over 10 ppt of GDP spending gap driven by social benefits, the wage bill, and subsidies (see heatmap and SIP). Tax expenditures that are not only costly but also distortive, regressive, or relatively ineffective should be rationalized (e.g., fossil fuels and housing) or redesigned (e.g., R&D).[18] Reinvigorating plans from Macron's first term to streamline the public sector workforce would improve its efficiency and lower the public wage bill. Reducing overlap between different levels of government would support this effort while lowering administrative

[16] Law governing emergency measures to improve the functioning of the labor market to attain full employment enacted in December 2022.

[17] Subject to two safeguards: (i) a floor of 6 months minimum duration; and (ii) an extension of the duration in case the labor market deteriorates.

[18] Studies show the positive effect of the R&D tax credit on R&D spending, investment and innovation but with a relatively low additionality ratio (CNEPI 2021, OECD 2021). Introducing a ceiling on the R&D tax credit and reducing overlap between R&D incentives could improve its effectiveness (*Cour des Comptes* 2021, 2022; CPO 2022). The R&D tax credit is the single largest tax expenditure, accounting for ¼ percent of GDP. Fossil fuel and housing-related tax expenditures account for about ½ and ⅓ percent of GDP. Tax breaks on household savings add another ¼ percent of GDP. Rationalizing these tax expenditures could yield some ½-1 percent of GDP.

costs. Simplifying and unifying social minima schemes, while differentiating for special conditions, in line with pre-pandemic plans, could improve their targeting and administration, yielding additional savings. This could build on social security benefit reform plans (*solidarité à la source*) that aim to improve and streamline access through automation, digitalization, and better data exchange. Upcoming spending reviews that will be integrated into the budget process provide an opportunity to identify additional structural measures that can sustainably reduce current spending over the medium term.

Spending Gap Relative to Peers

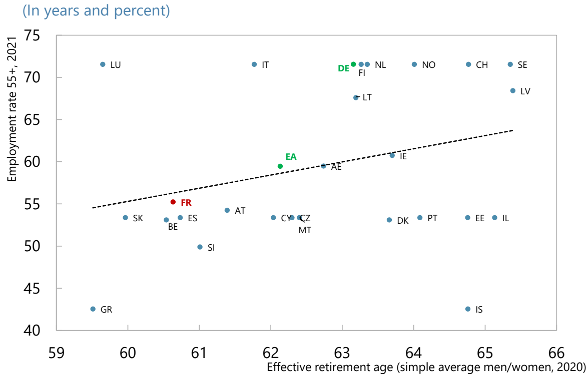
(Difference between France and peers in percent of GDP, 2019)[1/]

		General Public services				Economic affairs					Health							Education				Social protection						
	Total Expenditure	**Total**	Exec.&Legis. Organs, Fiscal, Financial & External affairs	General Services	*Other*	**Total**	General econ., commercial and labour affairs	Energy and Communication	Transportation	*Other*	**Total**	Medical products, appliances and equipment	Outpatient services	Hospital services	Public health services	R&D Health	*Other*	**Total**	Pre-primary and primary education	Secondary education	*Other*	**Total**	Sickness and disability	Pensions	Family and children	Unemployment	Housing	Social exclusion
Total	10.6	-0.2	-0.1	0.5	-0.6	1.6	1.1	0.3	-0.3	0.5	1.4	0.5	1.0	0.1	0.0	-0.1	-0.2	0.2	-0.4	0.5	0.1	5.5	-0.1	3.9	0.2	0.7	0.6	0.4
Social benefits	6.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6	0.6	1.9	-0.8	0.0	0.0	0.0	-0.1	-0.1	0.0	-0.1	4.8	-0.5	3.5	0.2	0.7	0.5	0.5
Subsidies	1.2	0.0	0.0	0.0	0.0	1.4	0.9	0.2	0.2	0.2	-0.2	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Compensation of employees	1.4	0.1	-0.1	0.5	-0.3	-0.1	-0.1	0.0	-0.2	0.1	0.2	0.0	-0.5	0.7	0.0	-0.1	0.0	0.6	-0.1	0.6	0.1	-0.1	-0.1	0.2	-0.1	0.0	0.0	0.0
Investment	1.0	-0.2	-0.1	0.1	-0.2	0.4	0.3	0.1	-0.1	0.2	-0.1	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consumption of goods and services	-1.1	-0.5	-0.2	-0.2	-0.2	-0.2	0.0	0.0	-0.3	0.1	-0.3	0.0	-0.3	0.1	0.0	0.0	-0.1	-0.2	-0.1	0.0	-0.1	-0.1	-0.1	0.1	0.0	0.0	0.0	-0.1
Other spending	1.5	0.4	0.3	0.1	0.1	0.2	0.1	0.0	0.2	0.0	0.2	0.0	-0.1	0.1	0.0	0.1	0.1	-0.1	0.0	-0.1	0.1	1.0	0.7	0.1	0.2	0.0	0.2	0.0

Higher than peers by more than 25 percent
Higher than peers by 5-25 percent
Higher than peers by 0-5 percent
Lower than peers by 0-5 percent
Lower than peers by 5-25 percent
Lower than peers by more than 25 percent

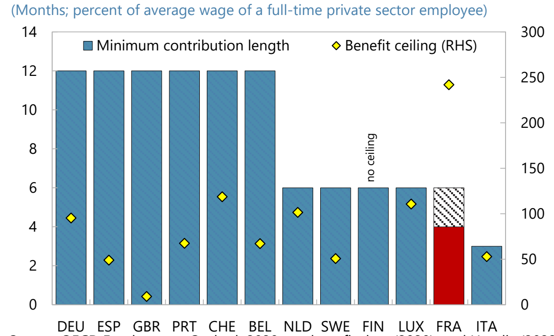
1/ Peers include: Austria, Belgium, Denmark, Finland, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland.
Sources: Eurostat and IMF Staff calculations

Effective Retirement Age and Old-age Employment Rate
(In years and percent)



Source: OECD, Eurostat, and IMF staff calculations.

Features of Unemployment Benefits
(Months; percent of average wage of a full-time private sector employee)



Source: OECD Employment Outlook 2020, tax-benefit data (2020), and Unedic (2022).
Note: The shaded area represents the effect of the delayed 2019 reform.

17. Adoption of the medium-term programming bill is critical to the implementation of new fiscal framework. The December 2021 organic budget law requires programming bills to include annual real spending targets and their corresponding nominal amounts for each level of government over the full 5-year horizon, with deviations to be reported in annual budgets and assessed by the Fiscal Council (HCFP). Notwithstanding the transposition of targets in annual budgets, the adoption of the medium-term programming bill is key for the new fiscal framework to become fully operational.

Authorities' Views

18. The authorities agreed on the need to better target support and rebuild buffers through an expenditure-led fiscal consolidation but are pursuing more gradual adjustment. They argued that the tariff shield has been effective in containing inflation, second-round effects, and indexation, leaving French households better off than those in neighboring countries while offsetting part of its fiscal cost. They agreed that support should be temporary and better targeted, but they noted that the energy shock necessitated a timely response and disproportionally hit middle-income earners, complicating targeting, and that unwinding temporary cash transfers has proved difficult in the past. The authorities plan to gradually ease price controls while protecting the vulnerable but stressed that any exit strategy would depend on energy market developments, including a coordinated response at the European level to reduce wholesale prices. The authorities agreed that rebuilding fiscal buffers should be a key policy priority. They concurred that this should be achieved through an expenditure-led fiscal consolidation while leaving space for investment needs for the green and digital transition (including through *France 2030*). They stressed that the pace and composition of adjustment would need to strike a balance between preserving credibility, growth, and reform momentum, reflected in a gradual adjustment path that relies more on supply side reforms to boost growth and job creation. With significant untapped potential, they see unemployment, pension, and vocational training reforms, as well as measures to foster youth employment as key levers to raise labor supply and potential growth. They agreed with other areas for potential savings outlined by staff, pointing out that spending reviews are underway. While emphasizing that fiscal objectives are reflected in budget laws, they agreed that adoption of the medium-term programming bill is important to fully operationalize the new fiscal framework.

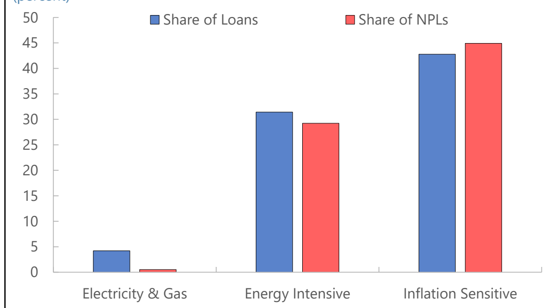
B. Maintaining Financial Sector Stability in Choppy Waters

19. Since the onset of Russia's war against Ukraine, systemic risks in the financial sector have increased. The darkening economic outlook will adversely impact corporate balance sheets, while a sharp reduction in asset prices is also amplifying financial market volatility.[19] This, coupled with a possible downturn in the housing market and increased debt ratios, has increased the credit risk for financial institutions and will weigh in on their profitability. Exposures to the financial sector from possible turbulence in the non-financial sector (both resident and non-resident) under tightening financial conditions and commodity price volatility could also perturb financial stability.

[19] See also the ESRB's general warning on heightened financial stability risks within the European Union.

20. French banks posted higher profits at the beginning of the year but face weaker prospects from the economic slowdown. The five major French banks doubled their annual net profit in 2021, to about 25 percent above pre-crisis levels. This was mainly due to lower loan loss provisioning and higher net income. Despite the increase in profitability, banks' return on assets improved by only 3 basis points compared to 2019, suggesting that balance sheet expansion was the main driver of profitability. Bank solvency and liquidity indicators remained solid – the CET1 ratio increased by 4 percentage points to 15.5 percent at end-2021 while the LCR stood at about 150 percent. The non-performing loan (NPL) ratio fell to 3.4 percent, but there was substantial heterogeneity across sectors, with NPL volumes increasing by 60 percent in pandemic-affected sectors (hospitality and recreation). The overall strong banking performance will, however, likely weaken in the near term with banks expected to incur higher credit risk from energy and inflation-affected sectors (about 75 percent of combined loan exposure).[20] The economic slowdown, amidst heightened uncertainty, will also impact bank revenues from slower lending growth. Some of these effects could be offset by higher net interest margins from the rise in interest rates, but as the net effect will likely depend on bank-specific fundamentals, the authorities should remain vigilant and closely monitor the health of all banks.

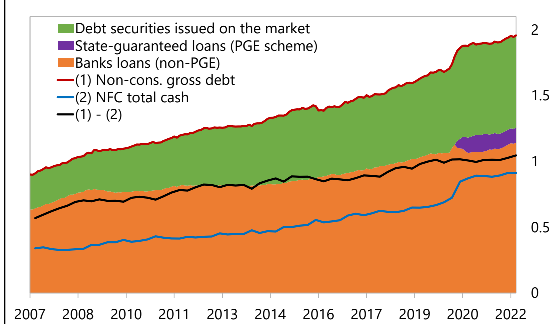
French Banks - Exposure to Vulnerable Sectors
(percent)



Sources: EBA
Notes: Energy Intensive refers to sectors that have a high share of energy input; Inflation Sensitive refers to sectors that have a high sensitivity to price changes and are at the end of the value-added chain.

21. Vulnerabilities in the corporate sector are starting to reemerge, with firms facing liquidity pressures from energy price volatility. Corporate liquidity is starting to weaken, with firms reporting cash outflows in the first half of 2022, partly due to significant redemptions from commodity related money market funds. This has led to a slight increase in corporate net debt, which had previously remained stable despite a rise in gross debt levels. Firm bankruptcies are still below pre-pandemic levels, but are currently trending higher, suggesting pockets of risk among smaller enterprises. Energy sector firms and energy-intensive firms are particularly vulnerable in the context of high price volatility. Liquidity support to affected firms in the form of guaranteed loans (€150bn envelope) and grants to energy-intensive firms (€3bn envelope) mitigate risks, but uptake has been low so far. While the guarantee scheme could cover a portion of energy related losses, staff encourage the authorities to consider more targeted liquidity support options for critically integrated wholesale energy producers to help cover their extraordinarily large

French Non-Financial Corporate debt
(EUR trillion)



Sources: Banque de France

[20] Direct exposures to Russia and Ukraine are low (at about €30 billion), which reduced further after Société Générale sold its Russian subsidiaries in April 2022 without significant hit to its capital.

margin requirements, should energy market volatility escalate.[21] This would help stabilize the energy market as well as safeguard financial stability by minimizing counterparty risk in the case that firms fail to post the large collateral required to hedge against price fluctuations.

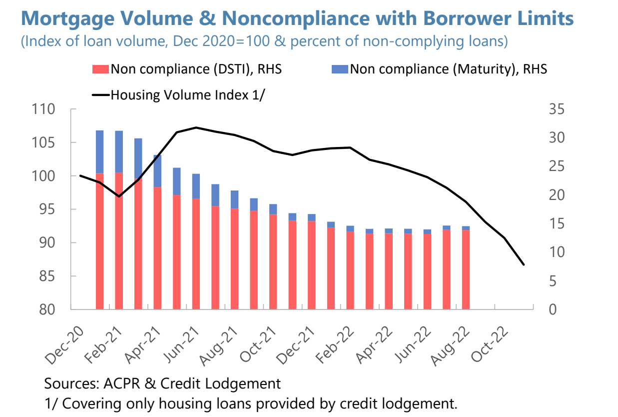
22. The housing market is beginning to cool amid rate rises and tighter prudential standards. Mortgage loan volumes were 9 percent lower through end-August, compared to the same period last year (see also text figure). This partly reflects rate hikes and the tightening of borrower-based limits. While effective interest rates on housing loans have increased by about 50 basis points compared to a year ago, the government-mandated cap on effective rates—the usury rate—has increased by only about 10 basis points in recent months (text figure).[22] The narrowing of the gap between effective interest rates and the legal cap increases constraints on banks to adequately price their lending without resorting to credit rationing within some segments or offering riskier credit instruments, which could have adverse implications for financial stability. Banks also face tighter borrower limits following the decision by the French prudential authority, the HCSF, to make legally binding limits to loan maturity (25 years) and debt-service-to-income ratios (35 percent) effective January 1, 2022. All banks are complying with these limits; the roughly 15 percent of the loans remaining above the limits are well within the exemption margin of 20 percent. While banks are adequately shielded from housing-related losses, due to mortgage insurance and the preponderance of fixed-rate loans, risks from high inflation remain elevated. Staff analysis shows that the percentage of borrowers-at-risk could increase by 5 percentage points from a cost-of-living shock (20 percent increase in food and energy prices). Staff judge that the current borrower-based measures are adequate and will help prevent any possible lowering of credit standards in the wake of rising interest rates. Staff noted the adjustment introduced by the authorities in April 2022 to more dynamically update the usury rate[23] to better reflect changes in market conditions but encouraged them to consider additional modifications as needed to enable a complete pass-through of monetary policy and prevent an undue exclusion of marginal borrowers from access to credit.[24]

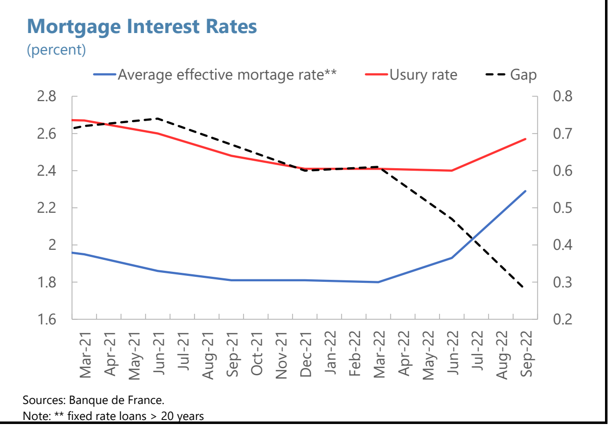
[21] European power producers are estimated to face costs of over €1tn in margin calls (Baringa, Equinor) and several countries have extended enlarged loan guarantees to affected firms to mitigate this (e.g., Germany, Denmark). The French gas producer Engie faced an increased margin requirement of over € 4 billion in recent quarters. This was mitigated to some extent by its reliance on the liquidity swap program and stand-by credit arrangements with core banks, but the risk is passed on to banking partners with possible financial stability implications.

[22] The usury rate is adjusted every three months following a backward-looking formula that calculates the effective interest rates charged by banks over the past quarter and adds one third.

[23] Adjustment measures include: (i) creation of additional duration strata for fixed-rate loans for local authorities (ii) extension of the collection period of the Banque de France in order to reduce the delays in transmitting market conditions to usury rates, iii) reminding credit institutions that the rates are declared at the irrevocable signature of the loan, without waiting for the funds to be made available.

[24] Most European countries have interest caps only on personal loans; very few (e.g., Italy, Belgium) maintain the mortgage interest cap.





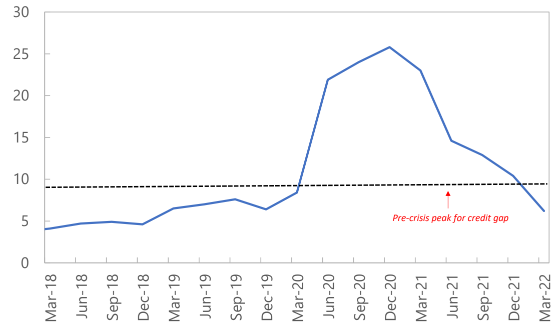
23. Staff support the authorities' plan to tighten the counter-cyclical buffer (CCyB) to a rate above pre-crisis levels, given the buildup of financial stability risks and ample excess capital buffers. Overall credit growth eased in early 2021, reflecting the phase-out of pandemic support loans, which helped reduce the large and positive credit gap to pre-crisis levels. Corporate credit growth also rebounded (see ¶5) and may increase further if liquidity pressures intensify. The countercyclical capital buffer (*CCyB*) rate was returned in March 2022 to its pre-crisis level of 0.5 percent, and the HCSF has recently decided to raise it by a further 0.5 points. Staff support this decision, which is consistent with the monetary stance aimed at curbing inflation[25]. Staff believe that targeting a CCyB rate[26] between 1 to 1.25 percent would be appropriate at this juncture given that: (i) current credit-gap metrics remain around pre-crisis levels and would call for a commensurate increase in the buffer to address pre-existing debt vulnerabilities and to prevent an abrupt reversal of the credit cycle under the worsening outlook[27]; and (ii) constraints on increasing the CCyB is not large at this juncture, given significant excess capital buffers, but could increase if downside risks materialize. Raising the buffer now also leaves banks with ample space should financial stability risks materialize and creates room to promptly lower it later, in response to future downturns. The HCSF should therefore stand ready to release the buffer should there be a sudden deterioration of financial conditions. Given the concentration of debt vulnerabilities in the corporate sector, the authorities could also explore the deployment of a sectoral systemic risk buffer directed at corporate exposures.

[25] Under conditions when stabilizing inflation comes at the cost of lost output, there is a case for macroprudential policy to be used alongside monetary policy so as to limit systemic risk stemming from the expansion in leverage (see IMF Policy Paper, The Interaction of Monetary and Macroprudential Policies).

[26] This could also be consistent with strategy of having a neutral rate in periods when credit supply is not associated with elevated systemic risks has been followed by the UK, Finland and Sweden among others. See also recent communication from the Basel Committee on Banking Supervision that supports a positive cycle-neutral countercyclical capital buffer rate.

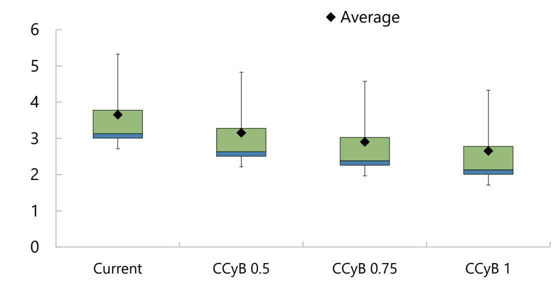
[27] See IMF Financial Sector Assessment for France, 2018 for more details on the strong corporate-bank nexus.

Credit Gap
(percent of GDP)



Sources: BIS

French Banks - Excess Capital buffers
(CET1 capital over and above regulatory requirements in percent of RWA)



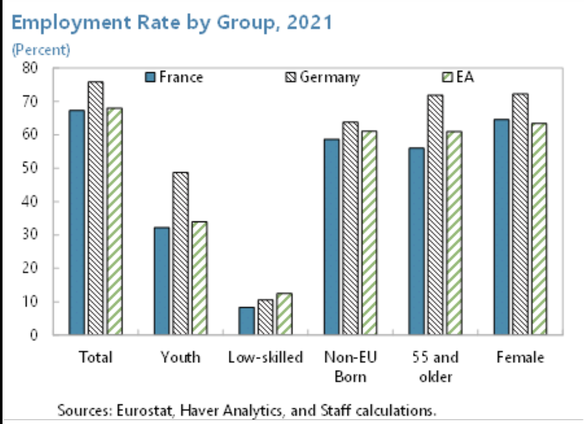
Sources: Fitch , data as of March 2022.
Note: The blue and green boxes show the inter-quartile range with whiskers at 5th/95th percentiles. Charts represent data for 4 major French banks.

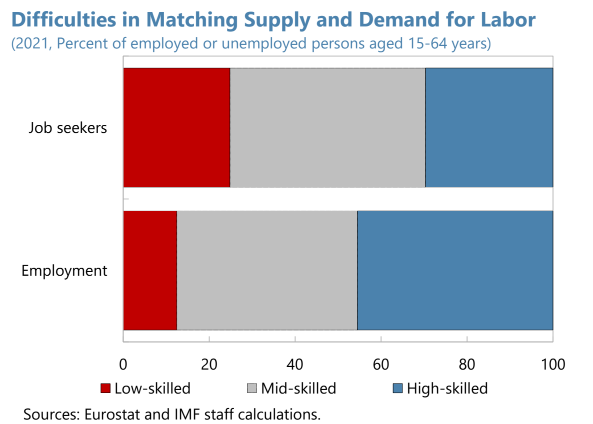
Authorities' Views

24. The authorities broadly shared staff's assessment of the buildup of financial stability risks due to the energy crisis and Russia's war in Ukraine and the need for heightened vigilance of all banks. They reiterated the need to raise the CCyB rate further to guard against the buildup of these risks, taking into account the high and still increasing debt trajectory as well as the low cost of raising capital for banks from increased profitability. The authorities deem the current borrower-based limits sufficient and felt they would help contain credit growth in riskier segments of the mortgage market as rates rise. They disagreed with staff on the need to further adjust the usury rate, noting that this would require parliamentary approval and is politically costly at this stage. They felt that the current adjustments and communication were sufficient to prevent any borrower exclusion.

C. Structural Policies to Increase Potential Growth

25. Further efforts to reduce labor market frictions, increase labor supply, and improve worker training will help raise potential growth. The French labor market has performed very well in recent years, with historically high employment and labor force participation and historically low unemployment. Nevertheless, participation rates remain below many peer countries and there are still challenges, particularly among low-skilled and young workers. Policies should be aimed at alleviating skills shortages, such as combining job-search assistance schemes with training programs and improving the quality of training. In this respect, continued efforts by *France Compétences* to enhance certification of training and professional qualifications will be important, also to contain fiscal cost. The apprenticeship system—which has had significant success in bringing more youth into the workforce—should be monitored to ensure the smooth transition of apprentices into permanent work. Steps to improve job-to-job and geographical mobility could also help reduce structural unemployment. Unemployment benefits and pension reforms (discussed above) will improve labor force participation and enhance growth.





26. Addressing weak educational outcomes and inefficiencies in education spending could help upskilling of the workforce (see Box 2). Educational attainment and student performance in France are relatively low compared to peers while spending is relatively high, suggesting room for efficiency savings. This could include rebalancing excess spending from upper secondary to primary education and rationalizing non-teaching staff spending. Reducing performance gaps in education could further be supported by improving teacher training and aligning compensation with performance, given low teacher salaries relative to peers. Disparities linked to socio-economic status could be reduced by incentivizing teachers to teach in disadvantaged areas, including through teacher pay. Giving more responsibilities and autonomy to school administrations could foster teaching innovations.

27. Improving product and service market efficiency would increase productivity growth and resilience to shocks. Recent laws adopted as part of the National Recovery and Resilience Plan[28] introduced measures to encourage competition in network sectors (i.e., road transport) and ease the administrative burden on firms. France continues to lag peers on regulatory barriers, including entry barriers and competition in regulated professional services (especially accounting and legal services), retail services, and network sectors. Easing these restrictions would help raise potential growth.

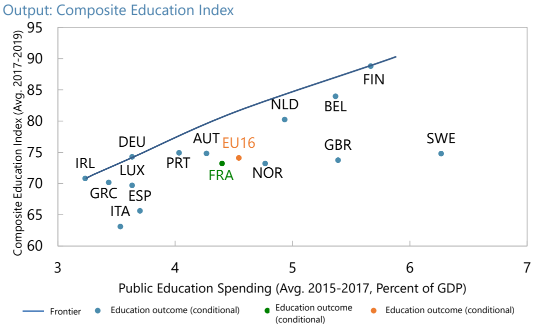
[28] e.g., Mobility Law and Law on accelerating and simplifying public action.

Box 2. France: Spending Efficiency and Educational Attainment

Public education spending is high compared to peers, and mostly geared towards secondary education. At 5.2 percent of GDP in 2019, public education spending is higher than in other advanced European countries. While teachers' salaries are lower than in peers, compensation of non-teaching staff represents a larger share of current expenditure from primary to tertiary education (22 percent in non-tertiary and 38 percent in tertiary education, vs. 12 and 28 percent in peers, respectively). Expenditure per student is 5 percent higher than peers for secondary education and over 30 percent higher for the upper secondary level, while it is 20 percent lower for primary and 8 percent lower in tertiary education. While teacher/pupil ratios at all education levels are lower than peers, they are slightly higher in upper secondary education, which drives costs up. Meanwhile, higher average class sizes can lead to lower educational outcomes. Compared to the rest of advanced Europe, France appears to have scope for efficiency savings from rationalizing education spending.

Efficiency Frontiers: Education

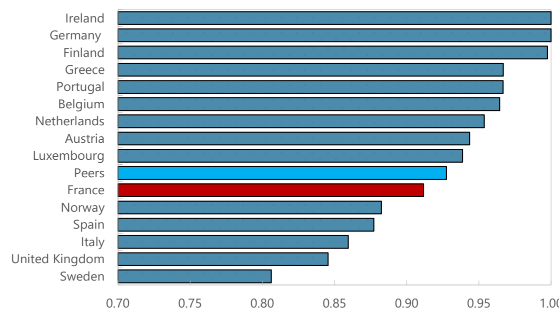
Input: Public Education Spending, GDP, Youth Population, Population Density;
Output: Composite Education Index



Sources: OECD and ESTAT Databases.

Efficiency Score: Education

(Index)

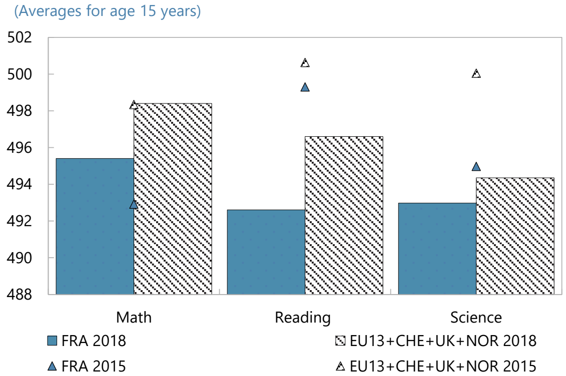


Sources: OECD, Eurostat, and IMF staff calculations.

Student performance, education attainment and skills are relatively lower than peers. PISA test scores in secondary education in France are below Germany, the UK and other advanced economies. France also performs worse than the G5 in terms of test scores in math, science, and reading for grades 4 and 8. Only 30 percent of the population have completed a post-secondary education cycle, versus 35 and 33 percent in the UK and Germany, respectively. Within the post-secondary education, France has one of the lowest shares of students graduating with a master's degree or higher among the G5. Meanwhile, it has one of the highest shares of graduates for upper secondary education.

PISA Test Scores

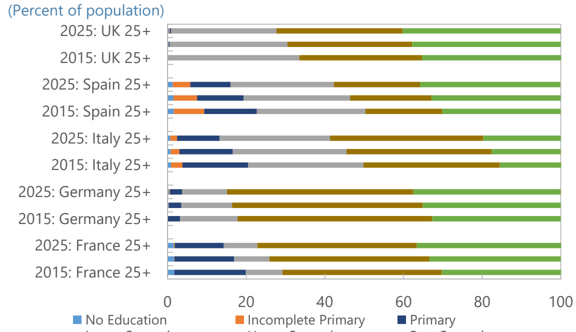
(Averages for age 15 years)



Sources: OECD; and IMF staff calculations.

Education Attainment for Age 25+

(Percent of population)



Source: Wittgenstein Centre for Demography and Global Human Capital.

Notes: For the methodology on the most likely future trajectory in education-specific progressio

Box 2. France: Spending Efficiency and Educational Attainment (Concluded)

There are also important differences in performance and educational attainment linked to socio-economic inequalities. In France, more than 20 percent of math performance was explained by the PISA index of socio-economic status, with a smaller share of top performers in math in the bottom quarter of the PISA index compared to the G5 and other advanced economies. A similar gap for disadvantaged students exists in reading performance. Furthermore, the share of adults completing tertiary education among disadvantaged adults is smaller in France compared to most G5 and the EU14 average, while the likelihood of completing tertiary education among advantaged adults is relatively higher. In addition, students from lower socio-economic backgrounds are more likely to enter upper secondary vocational programs than general ones in France. Students without any tertiary-educated parent represented 84 percent of entrants to upper secondary vocational programs, compared to 50 percent among entrants to general programs.

Equity in Educational Attainment

	Disadvantaged[1] adults who completed tertiary education			Adults who reported higher educational attainment than their parents (upward social mobility)			Increased likelihood of completing tertiary education among advantaged[2] adults, relative to disadvantaged adults
	All (26-65 years old)	Older adults (56-65 years old)	Younger adults (26-35 years old)	All (26-65 years old)	Older adults (56-65 years old)	Younger adults (26-35 years old)	All (26-65 years old)
	%	%	%	%	%	%	Odds ratio
UK	22.9	20.0	23.0	39.0	40.4	33.4	**9.3**
France	16.9	11.3	24.2	45.2	41.2	41.3	**13.6**
Germany	14.9	N/A	N/A	24.4	33.2	20.5	**7.9**
Italy	6.7	4.8	10.2	34.2	22.6	46.1	**24.9**
Spain	24.1	12.6	29.5	39.8	27.4	43.1	**7.6**
EU14+CHE+UK	**20.5**	**15.9**	**26.7**	**40.0**	**39.6**	**34.8**	**8.7**

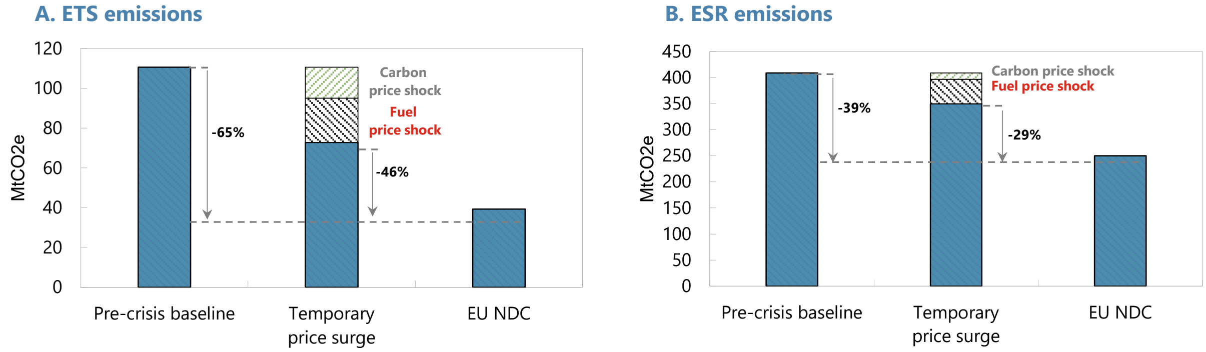
1. Adults with parents who did not complete lower secondary education.

2. Adults with at least one parent who completed tertiary education.

Sources: OECD, PIAAC, and IMF staff calculations.

28. **The energy crisis presents opportunities to accelerate the green transition.** The rise in fossil fuel prices should be used to promote energy conservation and increase the use of renewables, with a positive effect on emission reductions. Investments in low carbon energy, in particular in renewables, should be accelerated in the coming years, to achieve an efficient and low-carbon energy mix over the medium-term. Incentivizing such investments will not only enhance France's energy security but also boost potential output by offsetting the impact of depleted capital stock in fossil fuel assets (see Box 3). In this context, IMF staff supports draft legislation aimed at streamlining regulatory and judicial procedures to accelerate renewable and nuclear energy development. Financial support for capital-intensive conservation measures (e.g. thermal renovation, heat pumps) or renewables investments (e.g. rooftop solar) is also appropriate. In this context, the investments of the France 2030 plan are welcome. Non-pricing instruments, like feebates and regulations, can reinforce incentives for low-carbon investments, especially in the transport and building sectors which are less responsive to emissions pricing. Any future moderation in global energy prices could be used to increase carbon taxation without further hikes in retail energy prices. Scaling up carbon pricing will have to go hand-in-hand with support for vulnerable households. In an illustrative analysis (see details in Ari et al., 2022), the combination of higher projected carbon prices and energy prices would reduce emissions by about a third relative to the pre-crisis baseline in the EU Emissions Trading System (ETS) sectors and about one fourth in the Effort Sharing Regulation (ESR) sectors.

Figure 4. France: Emissions and Targets for ETS and ESR Sectors by 2030



Notes: The ETS/ESR simulations is a hypothetical exercise which compares the effect on carbon emissions of two scenarios: 1) Pre-crisis baseline based on futures prices for 2030 as of January 2021, 2) Price surge scenario which assumes that coal, natural gas, and oil prices follow futures market prices as of early May 2022. In the price surge scenario, the nominal ETS price rises from €87 per ton/CO2 in 2022 to €112 by 2030. See WP/22/152 for details on simulations.

29. **While France has taken significant steps to prevent and deter foreign bribery, challenges exist that undermine enforcement efforts (see Annex V).** France is a voluntary participant in the Fund's assessment of transnational aspects of corruption under the Framework for Enhanced Engagement on Governance. A recent report by the OECD Working Group on Bribery evaluates France's implementation of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The report, published in December 2021, highlights progress by France in combatting foreign bribery, but also identifies critical shortcomings. France has undertaken important legislative and institutional reforms strengthening the criminal justice system. France was also recognized as bolstering its enforcement efforts, with a notable increase in investigations into and prosecutions of foreign bribery, including against legal persons. However, the Working Group considered that enforcement efforts are not yet commensurate with France's risk exposure. Additionally, recent legislative amendments curtailing the length of preliminary investigations are detrimental to complex criminal proceedings. The Working Group therefore recommended that France take all necessary measures to effectively detect, investigate, prosecute, and sanction perpetrators of foreign bribery.

Box 3. France: Investment Needs for the Climate Transition in France

Significant investment into green technologies will be needed to substitute further investment in fossil-fuels and achieve climate neutrality objectives. Various studies have estimated the additional level of investment— both public and private—needed to ensure that the national climate transition objectives are met by 2030. These estimates are based on a sector-wise assessment of investment relative to their climate targets and/or estimating the overall green technology investment needed to reach the sustainable energy mix (see RTE, 2021). The text table provides an illustrative example for France - the net increase in non-fossil fuel energy investment would amount to approximately €200-250 billion over 8 years, including the building of new nuclear reactors and life-cycle extension of existing ones (see Box 1) as well as scaling up of renewable energy. Additional investments in upgrading the transportation and residential infrastructure (e.g., electric vehicles, thermal renovation) would amount to approximately €200-250 billion over the same period. Overall, for France, studies examining the whole economy place net climate investment needs at around €70-90 billion per year (around 2.5 percent of GDP or 10-12 percent in additional gross fixed capital formation).

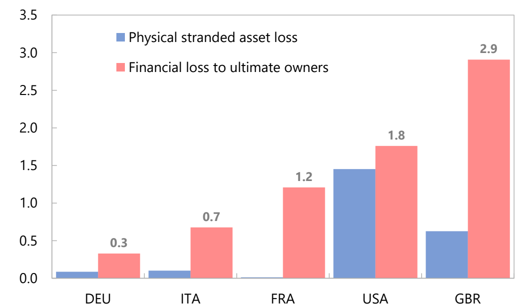
Additional Capital Needs (cumulative, 2023-2030)

	Gross	Net*
	(amount in billion euros)	
Investment in energy:		
Nuclear 1/	85	
Renewable 2/	150-175	
Sub-total 3/	*235-260*	*185-210*
Additional Investment in:		
Transportation 4/		50-94
Buildings (Residential + Tertiary) 4/		250-333
Sub-total		*300-427*
Grand Total (approx.)		**485-640**

* Net of planned investment in fossil-fuel assets (baseline) excl. stranded assets.
1/ Incl. announced pledges on new reactors and existing life-cycle extensions.
2/ Mahfouz and Pisani-Ferry (2022); IRENA ReMap 2050 scenario for EU-28 with French share inferred from French share of renewables.
3/ Difference between gross and net figures approximately derived from I4CE 2022, assuming no further investments in fossil fuel are made (see Pfeiffer et. al, 2016, who show that no new emitting electricity infrastructure can be built after 2017 for the 2°C pathway, to be met.
4/ Rexcode (2022) for upper bound; lower bound deducts some overlaps from energy investments due to boiler renewal or electricity generation needs.

The transition to a low-carbon economy also entails deep structural changes involving a fast phase-out of fossil-fuel production. The collapsing expectations of future profits from invested fossil-fuel capital, as a result of disruptive policy and/or technological change, can lead to a pre-mature stranding of assets. The global estimate for such stranded assets – consistent with achieving a 2°C climate goal – can be large, estimated at around $1.4 trillion. Semieniuk, et. al. (2022), link the (pre-war) stranded fossil-fuel capital and transition risk at the asset level to the financial loss borne by ultimate owners in different countries (text figure). For France, while the physical loss at the oil/gas field are small, the financial losses linked to its companies' and investors' exposure to various physical assets worldwide is large, at around 1.2 percent of GDP. This is attributable to the fact that many major French energy companies have large exposures to oil and gas fields outside of France.

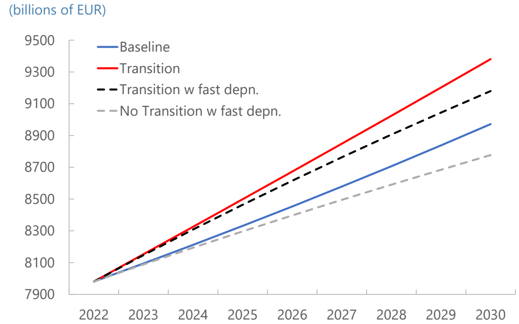
Loss from Stranded Assets
(percent of GDP)



Sources: Semieniuk, G., et. al., *Nat. Clim. Chang.* 12, 532–538 (2022).

The additional investment, considering stranded assets, will likely raise the future capital stock, depending on the scenario considered. Taking the lower bound estimate for additional investment needs, a transition path would increase the level of capital stock in 2030 by about 5 percent, compared to the baseline[1], and its growth rate by 0.5 percentage points if the investment is sustained (text figure). On the other hand, a faster depreciation and/or retirement rate of fossil fuel capital through asset stranding could lower the trajectory, increasing the level of capital stock in 2030 by about 2.5 percent instead. Alternatively, there could be a lower than baseline trajectory of capital stock in the absence of any green investments, which could lead to lower potential output.

Net Capital Stock under Transition Scenarios
(billions of EUR)



Sources: IMF Staff Estimates

[1] Net capital stock (NCS) is given by $NCS_t = [1 - (r_t + d_t)]NCS_{t-1} + GFCF_t$, where r_t and d_t are the retirement and depreciation rates respectively. The baseline is projected using the 5-year average growth rate of GFCF and retirement/depreciation rates backed out from historical data. A doubling of the deprecation rate is assumed for the scenario with faster deprecation for the small share of energy capital stock (to approximate for stranded fossil-fuel assets).

Authorities' Views

30. **The authorities emphasized the strong labor market performance in recent years, which they attributed largely to recently reforms.** They shared staff's concerns on labor market frictions and weak educational outcomes relative to spending. They concurred that alleviating skills mismatches by improving worker training and addressing inefficiencies in education spending remain key for reskilling/upskilling the workforce. They stressed that the upcoming unemployment benefits and pension reforms will help raise the labor supply further. Furthermore, developing competencies and skills for jobs of the future as well as for the youth will help reduce long-term unemployment. There was agreement on the need to ensure the smooth transition of apprentices into permanent work, with some evidence pointing to a relatively high job insertion rate.

31. **On the green transition, the authorities agreed on the need for carbon taxation, but emphasized it should be within a package of measures as part of a medium-term strategy.** While the current context of high energy prices and anticipated declines in prices over the coming years could be an opportunity to incentivize strengthening it, they noted that increases in carbon pricing should be reflected in a planned medium-term strategy of decarbonization and completed with a package of measures. France is implementing a clear strategy of strengthening the carbon price within the "Fit for 55" which is strengthening the existing EU ETS and extending it to the housing and road transport sectors.

STAFF APPRAISAL

32. **After a strong economic recovery from the Covid pandemic, France was hit by an energy shock driven by Russia's invasion of Ukraine.** While it has been less affected than most EU countries due to a lower reliance on Russian gas and a strong (but costly) policy response, France still faces high inflation and a sharp slowdown in economic activity. The energy crisis is dampening the recovery by reducing consumer purchasing power, denting confidence, and exacerbating supply-side difficulties. Inflation has surged over the past year, driven by the energy price shock and an increase in core inflation due to both higher goods and services price rises. However, inflation continues to be well below the EU average, largely due to energy price controls and subsidies. Staff projects growth at 0.7 percent in 2023, while inflation will remain persistent over the next two years as price controls ease. The external position in 2022 is assessed to be moderately weaker than the level implied by medium-term fundamentals and desirable policies. Near-term risks are titled to the downside stemming from a prolonged war and an escalation of sanctions and a further spike in gas and electricity prices, faster-than-expect monetary policy adjustments in Europe or elsewhere, and a deeper slowdown in the US or China. Over the medium-term, output will grow near potential but scarring from the pandemic and the energy shock will leave output some 2 percentage points below the pre-pandemic trend.

33. **Fiscal policy should take advantage of the phase-out of pandemic support to begin reducing the deficit in 2023.** While the large fiscal response to the energy shock has cushioned its impact, two-thirds of the fiscal cost reflect untargeted price and purchasing power measures that

pushed up costs while reducing incentives to lower energy consumption. France's high public deficit and debt levels, divergence from Euro Area peers, and electoral cycle argue for consolidation to start in 2023, which would also support monetary policy efforts to stem inflation. Staff recommends a modest fiscal tightening of ¼ ppt of GDP relative to 2022 which could largely be achieved by a faster phase-out of energy price controls and more targeted support. If, however, downside risks materialize, automatic stabilizers should be allowed to fully operate but any discretionary support should be well-targeted and offset by compensatory measures. Under an upside scenario, any revenue overperformance should be saved and support phased out faster to accelerate the deficit reduction.

34. Further efforts are needed to rebuild buffers over the medium term through a gradual but sustained fiscal consolidation. With elevated debt and gross financing needs, risks to debt sustainability have increased. To put France's debt-to-GDP ratio on a firmly declining path and rebuild fiscal buffers, staff recommends an ambitious adjustment—totaling some 5 ppts of GDP over 7-8 years for an average annual effort of 0.7 percent of GDP—to bring the deficit down to around ½ percent of GDP by 2030. Efforts should focus on rationalizing current spending, underpinned by structural reforms, while leaving space to accelerate green and digital investment. Implementation of the recently approved unemployment benefits reform and the upcoming pension reform could deliver part of the needed adjustment, but additional reforms would be needed to sustainably reduce current spending. Areas for savings could include tax expenditures, social benefits, education, healthcare, and subnational spending. Adoption of—and adherence to—the medium-term programming bill is critical to the implementation of the new fiscal framework that strengthens fiscal governance and the credibility of fiscal targets.

35. The banking sector has weathered the crisis soundly, though financial stability risks are increasing. The five major French banks increased profits in 2021 and bank solvency and liquidity indicators remain solid. However, the overall banking performance could weaken in the near term though increased credit risk from SMEs and energy intensive sectors. Given the buildup of financial stability risks and still low cost of capital for banks, staff support the authorities' plan to tighten the counter-cyclical buffer (CCyB) to a rate above pre-crisis levels by the end of the year. However, this decision should be reconsidered if there is a sudden deterioration of financial conditions in the interim. The housing market has started to cool amidst rate hikes and tighter prudential requirements. Staff judge the borrower-based measures to be sufficient but encourage the authorities to keep adjusting the legal cap on consumer credit to enable a full-pass through of monetary policy and to prevent any borrower exclusion.

36. To boost potential growth, continued action is needed to reduce labor market frictions and increase labor supply as well as to improve product and services market efficiency. Labor force participation rates remain below many peer countries and employment rates for disadvantaged groups, particularly for the youth and the low-skilled, also remain lower. To alleviate skill mismatches, it will be critical to combine training programs with job-search assistance, while the recently approved unemployment benefits reform and upcoming pension reform will help raise the labor supply. In addition, improvements in the quality of education and worker training will help boost productivity and potential growth, including through improved certification of worker training and reorienting educational spending away from non-teaching staff and toward classroom teachers, particularly outside the upper secondary level. Increasing competition in product and services markets will further help raise potential growth.

37. The energy price shock underscores the urgency of the transition to cleaner and more secure energy sources. Allowing fuller passthrough of prices and other incentives will promote energy conservation and increased production of renewable energy, with benefits for climate mitigation. To speed up investments in low carbon energy, in particular in renewables, it would be critical to streamline regulatory and judicial procedures for renewable energy development. The anticipated decline in fossil fuel prices as the current crisis eases may provide an opportunity to scale up carbon pricing while providing support for vulnerable households. Well-designed fiscal incentives, feebates and regulations can accelerate the transition to electric/other zero-emission vehicles and increase building efficiency.

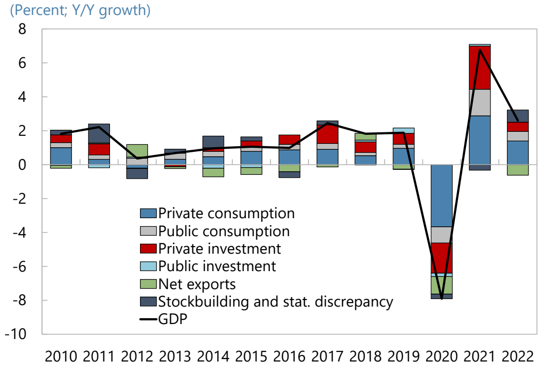
38. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.

Figure 5. France: Real Sector Developments

Output has recovered to pre-crisis levels, and the recovery was relatively broad-based.

Contribution to Annual Real GDP Growth

(Percent; Y/Y growth)

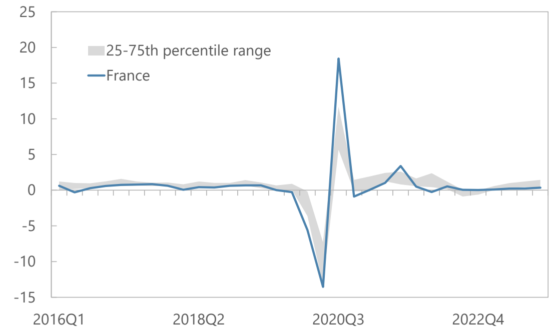


Source: INSEE (Haver Analytics), WEO and IMF staff calculations.

Precrisis losses were regained by the third quarter of 2021.

Real GDP

(Percent, Q-on-Q growth)

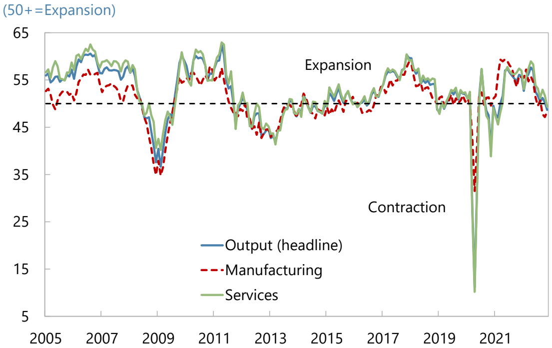


Sources: WEO and IMF staff calculation

PMIs have fallen since the beginning of the war, with both manufacturing and services taking hits into recessionary territory.

Purchasing Managers' Indices

(50+=Expansion)

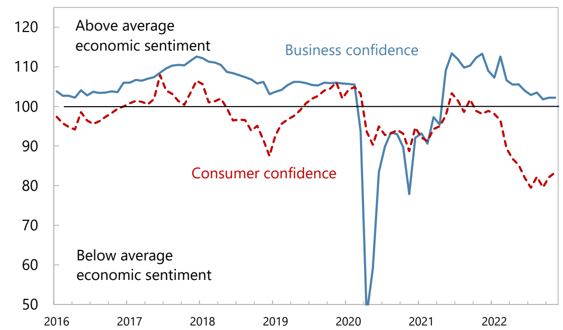


Source: CDAF/IHS Markit (Haver Analytics).

Confidence measures have also fallen, with some rebound more recently.

Business and Household Confidence

(Long-term average=100)

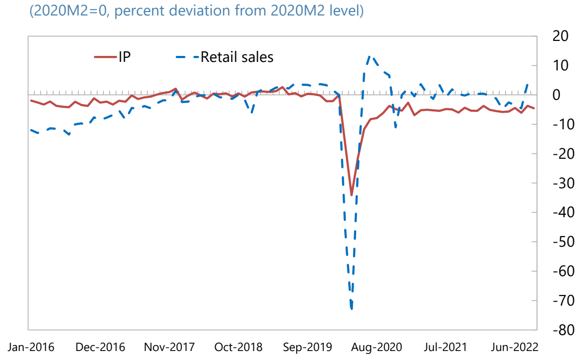


Source: INSEE (Haver Analytics).

Both industrial production and retail sales volumes have been affected by supply side constraints and confidence.

Industrial Production and Retail Sales Volume Indices

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

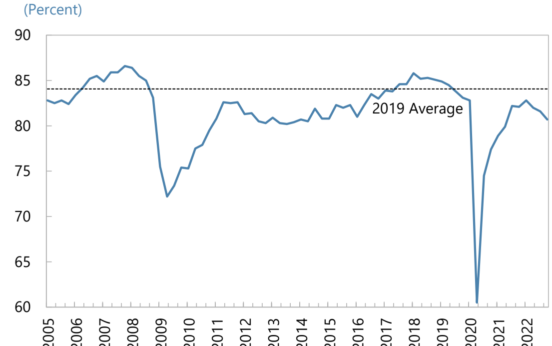


Sources: INSEE (Haver Analytics); and IMF staff calculations.

Capacity utilization remains below pre-crisis levels.

Capacity Utilization: Industry

(Percent)



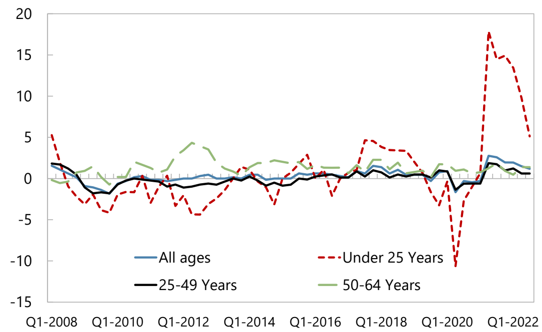
Sources: INSEE (Haver Analytics).

Figure 6. France: Labor Sector Developments

Employment growth rebound sharply in the first half of 2021, especially among the youth, and has moderated since then.

Employment Growth by Age Groups

(Y-on-Y percent change)

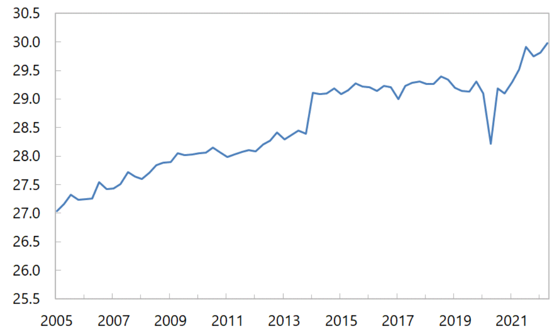


Source: Eurostat (Haver Analytics).

The labor force rebound sharply and has by now exceeded pre-crisis levels.

Labor Force: 15-64 Years

(Millions)

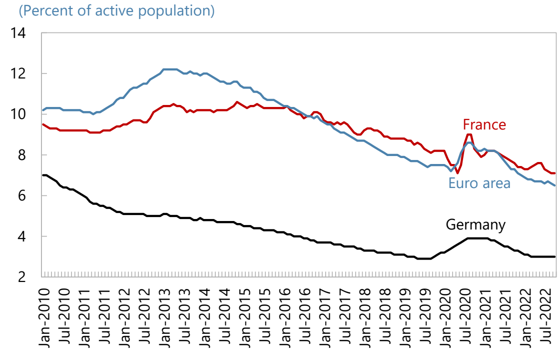


Source: European Commission (Haver Analytics).

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

Harmonized Unemployment Rate

(Percent of active population)

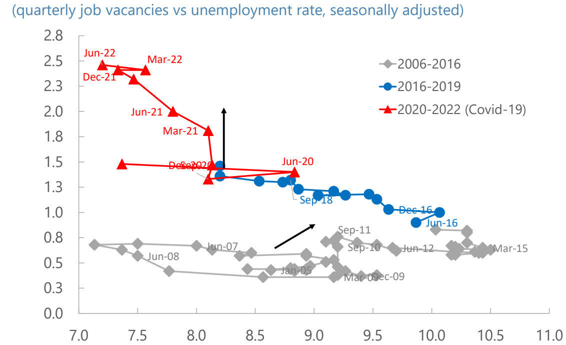


Source: Eurostat (Haver Analytics).

Vacancies are higher for a given level of unemployment and the Beveridge Curve has shifted upward.

Beveridge Curve: Mismatch Unemployment

(quarterly job vacancies vs unemployment rate, seasonally adjusted)

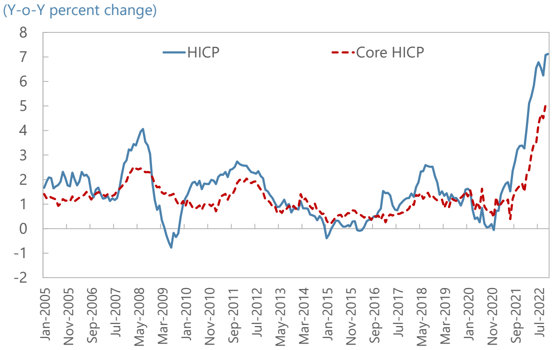


Sources: Eurostat, Ministere du Travail

Inflation has surged driven by supply chain bottlenecks and the energy price shock.

Inflation Growth

(Y-o-Y percent change)

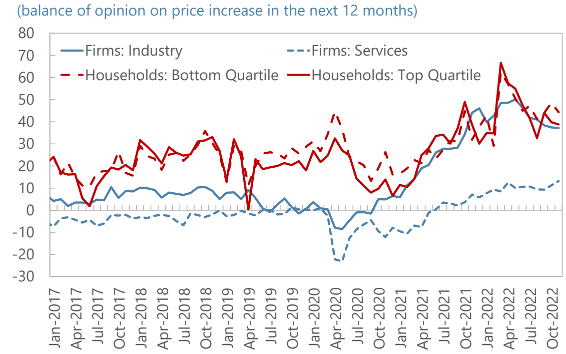


Sources: Haver Analytics

Price expectations of households and firms have been increasing.

Price Expectations: Firms and Households

(balance of opinion on price increase in the next 12 months)

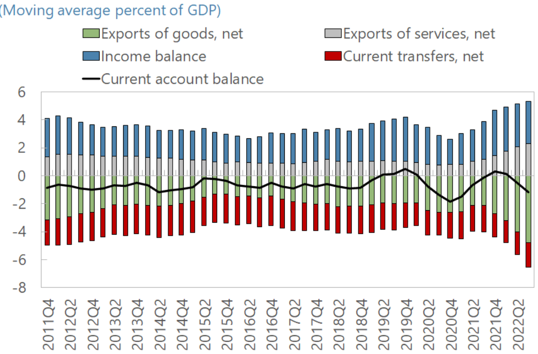


Sources: European Commission

Figure 7. France: External Sector Developments

CA balance moved to a deficit in H1 2022 from a surplus in 2021, driven by the large terms-of-trade shock and lower external demand.

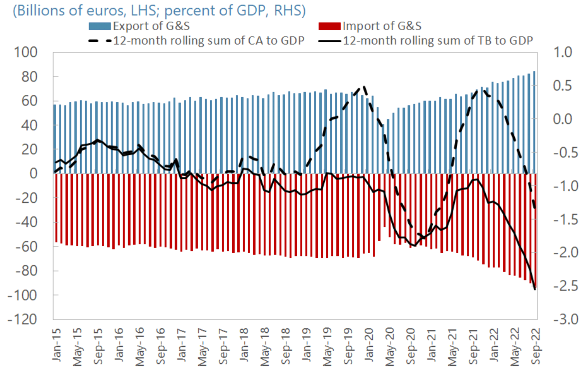
Quarterly Current Account
(Moving average percent of GDP)



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

The trade balance is deteriorating, with both the oil and non-oil goods deficit sharply increasing, while the services surplus has been strengthening.

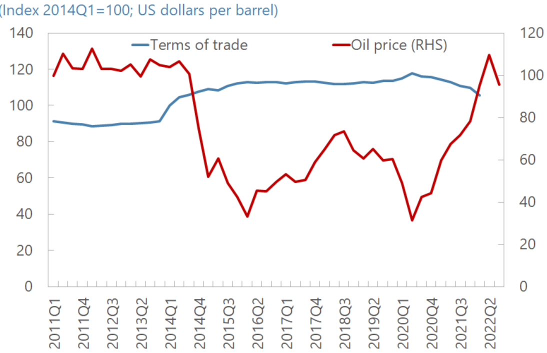
Current Account and Trade Balance
(Billions of euros, LHS; percent of GDP, RHS)



Sources: Haver Analytics

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

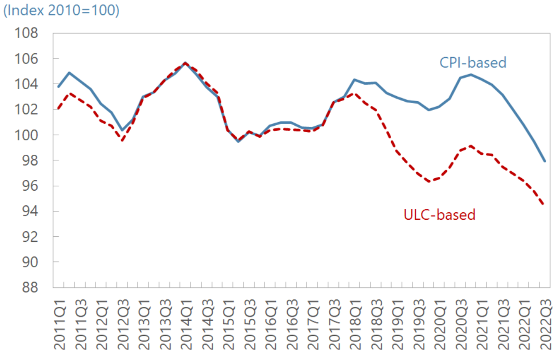
Terms of Trade and Oil Prices
(Index 2014Q1=100; US dollars per barrel)



Sources: WEO, Haver Analytics and IMF staff calculation

The ULC and CPI-based REER continues to depreciate in 2022, driven by the depreciation of the euro against the dollar.

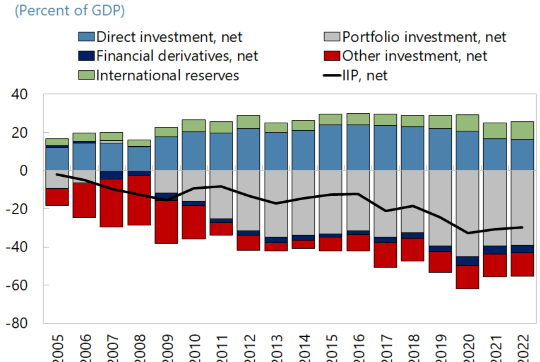
Real Effective Exchange Rate, 37 Trading Partners
(Index 2010=100)



Sources: Eurostat

The Net International Position improved by about 1.4 percent of GDP in 2021 and continues to improve in H1 2022...

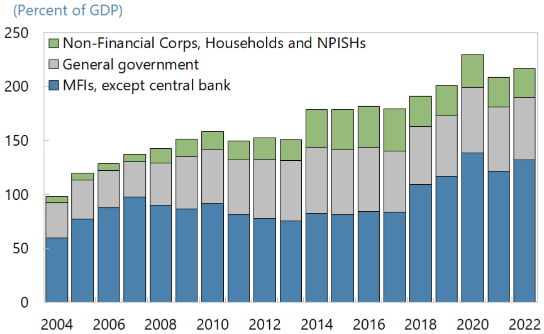
Net International Investment Position
(Percent of GDP)



Source: IMF BOP.

...with a decrease in gross liabilities across all sectors of the economy.

External Debt
(Percent of GDP)



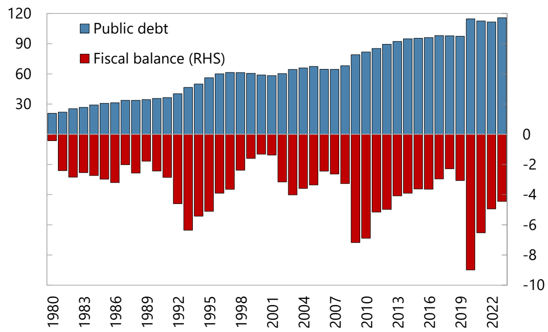
Source: IMF BOP and Eurostat.
Notes: 2022 data is for 2022Q2.

Figure 8. France: Fiscal Sector Developments

Public debt has been trending up in the past four decades as France struggled to contain fiscal deficits…

Public Debt and Fiscal Balance

(Percent of GDP)

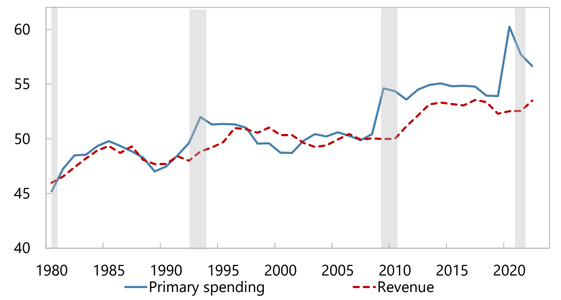


Sources: INSEE; and IMF staff calculations.

… with significant debt rachet effects as fiscal support was not fully unwound following crisis episodes.

General Government Revenue and Spending

(Percent of GDP)

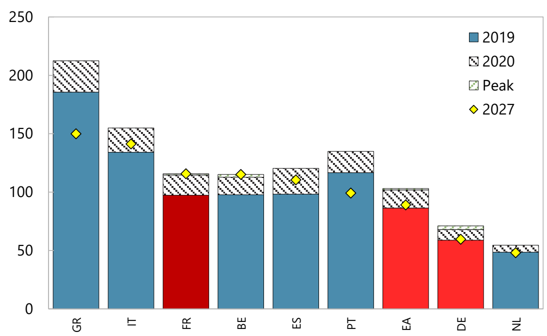


Sources: IMF WEO Database; Association Francaise de Science Economique; and IMF staff calculations.
Note: Shaded bars denote recessions periods (years with at least 1 quarter of recession).

Similarly, debt is not projected to decline or return to pre-crisis levels following the fiscal response in 2020-22, widening the gap with peers.

Public Debt Ratios 2019-27

(Percent of GDP)

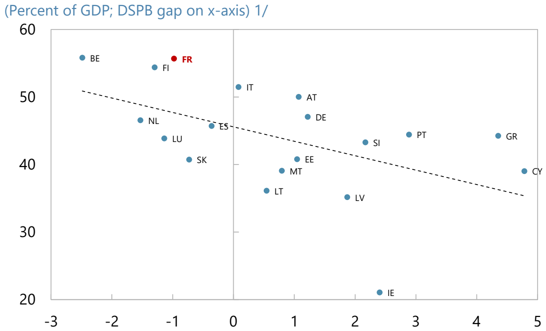


Source: WEO and Staff calculations.

With debt trending up and pre-crisis expenditure the highest in Europe, consolidation will need to focus on containing spending…

Adjustment Needs and 2019 Expenditure Ratio

(Percent of GDP; DSPB gap on x-axis) 1/

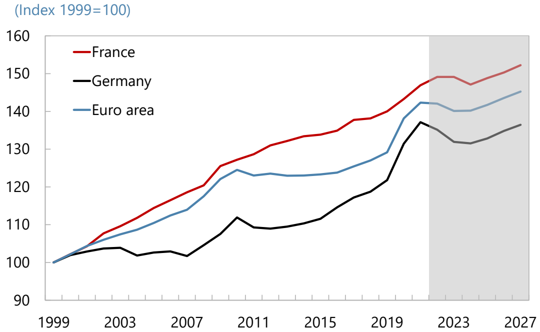


1/ Deviation of primary balance from its debt-stabilizing level in 2027.
Source: IMF WEO and Staff calculations.

… which would require a substantial effort to reverse the trend in real spending growth.

Real General Government Spending

(Index 1999=100)

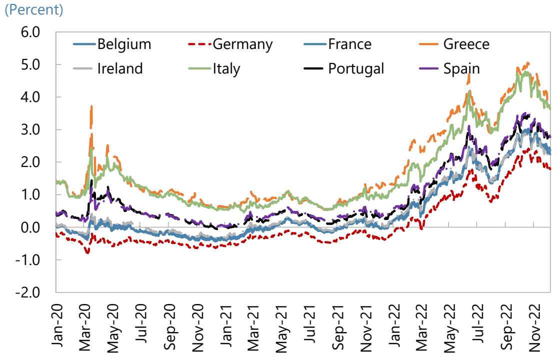


Note: Deflated by GDP deflator.
Sources: WEO (peers' data is from October WEO) and IMF staff calculations.

Following years of low rates, borrowing cost have increased significantly.

10Y Bond Yield

(Percent)

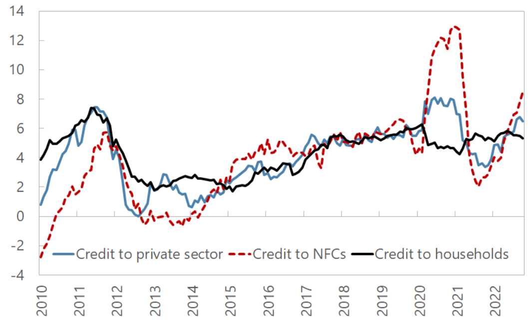


Sources: Bloomberg

Figure 9. France: Financial Sector Developments

Credit to the private sector, which accelerated during the pandemic, is now at pre-pandemic growth levels, but NFC credit remains buyoyant.

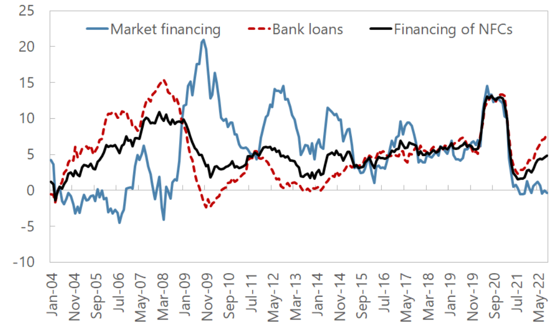
Non-Financial Private Sector Credit
(Percent, Y-on-Y)



Sources: Haver Analytics

Market funding pressures appears to have constrained NFC financing, but banks finance to NFC's is steady.

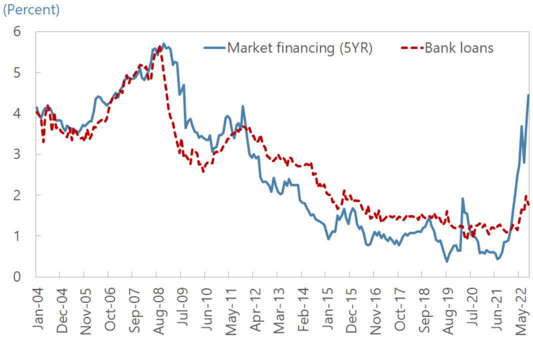
Annual Growth Rate, by Type of Financing
(Percent)



Sources: Banque de France

Interest rates on loans – both bank and market-based - are steeply rising.

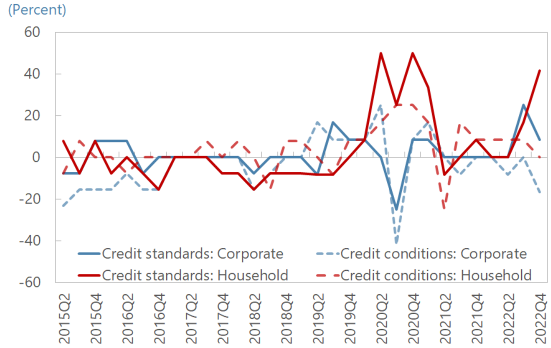
Average Cost of Financing
(Percent)



Sources: Banque de France

Credit standards and conditions started to tighten especially toward 2021Q4.

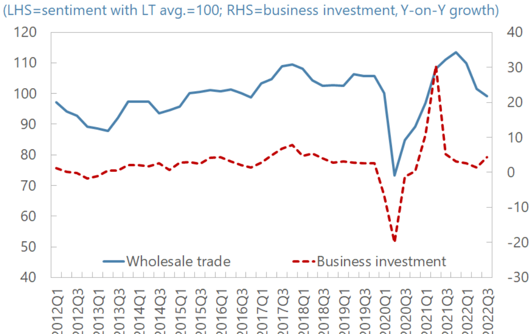
Bank Lending Survey: Credit Supply Indicators
(Percent)



Sources: BLS

Business sentiments and wholesale trade have deteriorated since 2021Q4.

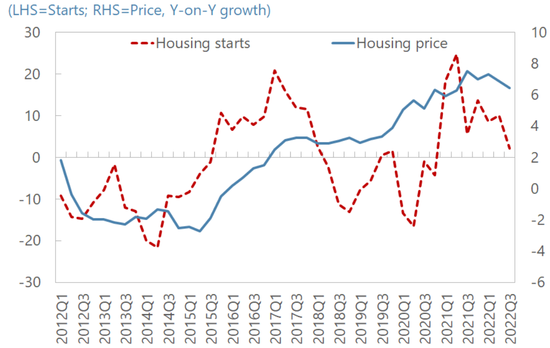
Wholesale Trade Sentiment and Buisness Investment
(LHS=sentiment with LT avg.=100; RHS=business investment, Y-on-Y growth)



Sources: Haver Analytics

Meanwhile, house price acceleration and house sales volume is appearing to slow-down.

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



Sources: Haver Analytics

Table 2. France: Selected Economic Indicators, 2019–27
(In percent of GDP unless otherwise indicated)

				Est.	Projections				
	2019	2020	2021	2022	2023	2024	2025	2026	2027
Real economy (change in percent)									
Real GDP	1.9	-7.9	6.8	2.6	0.7	1.6	1.8	1.6	1.4
Domestic demand	2.1	-6.7	6.6	3.1	0.5	1.3	1.7	1.5	1.4
Private consumption	1.8	-6.8	5.3	2.6	0.5	1.7	2.1	1.6	1.4
Public consumption 1/	1.0	-4.0	6.4	2.3	0.3	0.9	1.1	1.1	1.1
Gross fixed investment	4.2	-8.4	11.3	2.2	0.5	0.9	1.6	1.8	1.7
Foreign balance (contr. to GDP growth)	-0.3	-1.0	0.0	-0.6	0.1	0.3	0.0	0.0	0.0
Exports of goods and services	1.6	-17.0	8.6	7.8	2.8	3.9	4.1	3.9	3.4
Imports of goods and services	2.4	-13.0	7.8	9.0	2.2	2.8	3.8	3.5	3.2
Nominal GDP (billions of euros)	2,438	2,310	2,499	2,631	2,741	2,871	2,984	3,085	3,181
CPI (year average)	1.3	0.5	2.1	5.9	5.0	2.8	2.1	1.6	1.6
GDP deflator	1.2	2.9	1.3	2.6	3.5	3.1	2.1	1.8	1.7
Gross national savings (percent of GDP)	24.9	21.8	24.9	23.5	21.9	22.3	22.4	22.5	22.7
Gross domestic investment (percent of GDP)	24.4	23.6	24.6	25.0	23.5	23.3	23.1	23.0	23.1
Public finance (percent of GDP)									
General government balance	-3.1	-9.0	-6.5	-5.0	-5.3	-4.8	-4.7	-4.5	-4.5
Revenue	52.3	52.5	52.5	53.5	52.8	51.6	51.4	51.2	51.2
Expenditure	55.4	61.5	59.1	58.4	58.1	56.4	56.0	55.7	55.7
Primary balance	-1.7	-7.8	-5.2	-3.2	-3.7	-3.1	-2.9	-2.5	-2.3
Structural balance (percent of pot. GDP)	-2.1	-5.8	-5.2	-4.4	-4.5	-4.2	-4.4	-4.3	-4.4
Nominal expenditure (change in percent)	2.6	5.3	3.9	4.2	3.5	1.7	3.3	2.8	3.0
Real expenditure (change in percent)	1.3	4.7	1.8	-1.7	-1.5	-1.0	1.2	1.1	1.5
General government gross debt	97.4	114.7	112.6	111.6	112.0	112.2	113.0	114.2	115.7
Labor market (percent change)									
Employment	0.8	-0.3	1.7	0.4	-0.1	0.1	0.1	0.1	0.1
Labor force	0.1	-0.7	1.6	0.0	0.0	0.1	0.0	0.0	0.0
Unemployment rate (percent)	8.4	8.0	7.9	7.5	7.6	7.5	7.5	7.4	7.4
Credit and interest rates (percent)									
Growth of credit to the private non-financial sector	5.3	8.1	2.5	3.8	4.2	4.7	3.9	3.4	3.1
Money market rate (Euro area)	-0.4	-0.5	-0.5	...	...	...	...	...	...
Government bond yield, 10-year	0.1	-0.1	0.0	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account	0.5	-1.8	0.4	-1.5	-1.6	-1.0	-0.7	-0.6	-0.4
Trade balance of goods and services	-0.9	-1.8	-1.2	-1.7	-1.5	-0.9	-0.7	-0.5	-0.3
Exports of goods and services	32.7	28.4	31.2	39.3	40.7	41.3	42.7	44.3	46.2
Imports of goods and services	-33.6	-30.2	-32.4	-41.1	-42.2	-42.2	-43.3	-44.8	-46.5
FDI (net)	1.1	0.2	-0.4	0.4	0.8	1.0	1.0	1.1	1.1
Official reserves (US$ billion)	69.7	76.1	101.7	...	...	...	...	...	...
Exchange rates									
Euro per U.S. dollar, period average	0.89	0.88	0.82	...	...	...	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	97.1	97.4	98.4	...	...	...	...	...	...
REER, ULC-based (2005=100, +=appreciation)	90.2	95.8	94.1	...	...	...	...	...	...
Potential output and output gap									
Potential output (change in percent)	1.0	-3.3	3.7	1.5	1.0	1.4	1.3	1.3	1.3
Memo: per working age person	1.2	-3.2	4.1	1.5	1.0	1.4	1.3	1.3	1.3
Output gap	0.0	-4.7	-1.9	-0.8	-1.1	-0.9	-0.5	-0.3	-0.2

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

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

Table 3. France: General Government Operations, 2019–27
(In percent of GDP unless otherwise indicated)

				Est.	Proj.				
	2019	2020	2021	2022	2023	2024	2025	2026	2027
Revenue	52.3	52.5	52.5	53.5	52.8	51.6	51.4	51.2	51.2
Taxes	30.2	30.2	30.0	30.5	30.5	29.5	29.4	29.4	29.4
Direct taxes	13.1	13.2	12.9	13.2	12.8	12.6	12.5	12.5	12.5
Indirect taxes	17.1	17.1	17.1	17.3	17.7	16.9	16.8	16.8	16.8
Social contributions	16.7	17.0	16.8	17.1	16.8	16.7	16.6	16.6	16.5
Other revenue	5.4	5.3	5.8	5.8	5.5	5.5	5.4	5.3	5.3
Expenditure	55.4	61.5	59.1	58.4	58.1	56.4	56.0	55.7	55.7
Expense	55.1	61.3	58.9	58.2	57.8	56.2	55.8	55.5	55.5
Compensation of employees	12.2	13.2	12.5	12.5	12.3	12.2	12.1	12.0	11.9
Goods and services	4.9	5.3	5.1	5.2	5.2	5.2	5.1	5.0	5.0
Interest	1.4	1.3	1.4	1.8	1.6	1.8	1.9	2.0	2.2
Social benefits	25.3	28.8	26.9	25.8	25.6	25.5	25.5	25.4	25.3
Other expense	11.3	12.8	12.9	12.9	13.1	11.5	11.3	11.1	11.0
Gross public investment	3.7	3.7	3.6	3.9	3.7	3.7	3.6	3.4	3.4
Net acquisition of nonfinancial assets	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net lending / borrowing	-3.1	-9.0	-6.5	-5.0	-5.3	-4.8	-4.7	-4.5	-4.5
Primary balance	-1.7	-7.8	-5.2	-3.2	-3.7	-3.1	-2.9	-2.5	-2.3
Memorandum items:									
Structural balance (percent of potential GDP)	-2.1	-5.8	-5.2	-4.4	-4.5	-4.2	-4.4	-4.3	-4.4
Structural primary balance (percent of potential GDP	-0.8	-4.7	-3.9	-2.7	-3.0	-2.5	-2.6	-2.4	-2.2
Change in structural primary balance	*-0.8*	*-3.9*	*0.8*	*1.2*	*-0.3*	*0.5*	*-0.1*	*0.2*	*0.2*
Public gross debt (Maastricht definition)	97.4	114.7	112.6	111.6	112.0	112.2	113.0	114.2	115.7
Nominal GDP (in billion of Euros)	2,438	2,310	2,499	2,631	2,741	2,871	2,984	3,085	3,181
Real GDP growth (in percent)	1.9	-7.9	6.8	2.6	0.7	1.6	1.8	1.6	1.4
Nominal expenditure growth	2.6	5.3	3.9	4.2	3.5	1.7	3.3	2.8	3.0
Real expenditure growth (in percent)	1.3	4.7	1.8	-1.7	-1.5	-1.0	1.2	1.1	1.5
of which: primary	1.8	5.3	1.5	-2.4	-1.2	-1.3	1.0	0.8	1.0
of which: structural primary	1.9	4.6	1.9	-2.3	-1.3	-1.3	1.1	0.8	1.0

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

Table 4. France: Balance of Payments, 2019–27
(In percent of GDP)

	2019	2020	2021	Est. 2022	Projections 2023	2024	2025	2026	2027
Current account	0.5	-1.8	0.4	-1.5	-1.6	-1.0	-0.7	-0.6	-0.4
Net exports of goods	-1.9	-2.6	-2.7	-4.1	-3.9	-3.5	-3.4	-3.4	-3.4
Exports of goods	21.9	19.1	21.0	26.0	27.0	27.3	28.3	29.4	30.6
Imports of goods	23.8	21.7	23.7	30.1	30.9	30.9	31.7	32.8	34.0
Net exports of services	1.1	0.8	1.5	2.4	2.4	2.6	2.8	2.9	3.1
Exports of services	10.8	9.3	10.2	13.3	13.7	13.9	14.4	15.0	15.6
Imports of services	9.8	8.5	8.7	11.0	11.3	11.3	11.6	12.0	12.5
Income balance	3.2	1.8	3.3	1.9	1.7	1.7	1.9	1.9	1.9
Current transfers	-1.8	-1.9	-1.7	-1.7	-1.8	-1.8	-1.9	-2.0	-2.0
Capital and financial account									
Capital account	0.1	0.1	0.5	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	0.0	-2.3	0.1	-1.5	-1.5	-0.9	-0.6	-0.5	-0.3
Direct investment	1.1	0.2	-0.4	0.4	0.8	1.0	1.0	1.1	1.1
Portfolio investment	-2.6	-1.4	-0.2	-1.2	-0.9	-0.2	0.2	0.3	0.5
Financial derivatives	0.2	-1.0	0.7	0.2	0.0	-0.1	-0.2	-0.2	-0.2
Other investments net	1.2	-0.3	-0.9	-1.0	-1.5	-1.7	-1.8	-1.9	-1.9
Reserve assets	0.1	0.2	0.9	0.1	0.1	0.1	0.2	0.2	0.2
Errors and omissions	-0.6	-0.6	-0.7	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 5. France: Vulnerability Indicators, 2014–22

(In percent of GDP unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
External Indicators									
Exports (annual percentage change, in U.S. dollars)	2.0	-10.4	0.3	6.8	10.0	-2.7	-16.0	23.1	17.8
Imports (annual percentage change, in U.S. dollars)	2.7	-11.6	0.8	8.1	10.5	-3.4	-13.2	20.6	18.3
Terms of trade (annual percentage change)	1.3	3.1	1.0	-1.3	-1.2	0.9	0.8	-0.2	-1.1
Current account balance	-1.0	-0.4	-0.5	-0.8	-0.8	0.5	-1.8	0.4	-1.5
Capital and financial account balance	-0.4	-0.1	-0.7	-1.4	-0.9	0.1	-2.3	0.6	-1.4
Of which									
Inward portfolio investment (debt securities, etc.)	4.1	0.2	1.6	1.2	0.6	5.4	7.5	4.2	...
Inward foreign direct investment	0.2	1.8	1.3	1.4	2.8	2.0	0.5	3.0	...
Other investment (net)	-0.1	-3.0	-1.8	-2.8	-3.2	1.2	-0.3	-0.9	-1.0
Total reserves minus gold									
(in billions of U.S. dollars, end-of-period)	49.5	55.2	56.1	54.8	66.1	69.7	76.1	101.7	...
Euros per U.S. dollar (period average)	0.8	0.9	0.9	0.9	0.8	0.9	0.9	0.8	1.0
Market Indicators									
Financial Markets									
Public sector debt 1/	94.8	95.4	96.1	98.1	97.8	97.4	114.7	112.6	111.6
3-month T-bill yield (percentage points)	0.1	-0.2	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	...
3-month T-bill yield in real terms (percentage points)	0.0	-0.4	-1.2	-1.8	-2.2	-2.0	-0.6	-3.4	...
US 3 month T-bill	0.0	0.1	0.3	0.9	1.9	2.1	0.4	0.0	...
Spread with the US T-bill (percentage points)	0.0	-0.3	-0.9	-1.6	-2.6	-2.6	-0.9	-0.7	...
10-year government bond (percentage points)	1.7	0.8	0.5	0.8	0.8	0.1	-0.1	0.0	...
10-year government bond (United States)	2.5	2.1	1.8	2.3	2.9	2.1	0.9	1.4	...
Spread with US bond (percentage points)	-0.9	-1.3	-1.4	-1.5	-2.1	-2.0	-1.0	-1.4	...
Yield curve (10 year - 3 month, percentage points)	1.6	1.0	1.0	1.5	1.4	0.7	0.4	0.7	...
Stock market index (period average, 1995=100)	213.4	216.2	218.6	221.7	224.0	227.3	229.5	230.4	231.7
Real estate prices (index, Q1-10=100, period average)	101.9	100.0	100.9	104.0	107.1	110.7	116.8	124.7	N.A.
Credit markets (end-of-period 12-month growth rates)									
Credit to the private sector	0.5	2.5	4.3	4.6	6.3	5.3	8.5	3.8	5.7
Bank credit to households	1.9	3.3	3.3	5.6	5.3	6.0	4.7	5.3	...
Housing Loans	2.2	4.0	3.5	6.1	5.8	6.8	5.5	6.4	...
Bank credit to nonfinancial enterprises	2.6	4.3	4.3	5.8	5.7	4.2	13.0	3.5	...
Sectoral risk indicators									
Household sector									15.7
Household savings ratio	14.5	14.1	14.0	14.1	14.4	15.0	21.0	18.7	~~16.4~~
Household financial savings ratio	5.2	4.8	4.5	4.2	4.3	4.6	11.6	7.7	...
Corporate sector									
Gross margin ratio	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	...
Investment ratio	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	...
Savings ratio	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	...
Self-financing ratio	0.9	1.0	1.0	1.0	0.9	1.0	0.9	1.1	...
Banking sector									
Share of housing loans in bank credit to the private sector	41.3	41.6	41.8	42.4	42.4	42.7	42.2	43.4	42.8
Share of nonperforming loans in total loans	4.2	4.0	3.7	3.1	2.7	2.5	2.7	2.4	2.3
Ratio of nonperforming loans net of provisions to capital	19.2	18.0	16.2	15.0	13.6	12.2	11.9	10.3	10.4
Liquid assets to total short-term liabilities 2/	17.8	17.5	20.2	20.7	19.3	20.1	26.0	27.0	23.5
Return on assets	0.2	0.6	0.5	0.4	0.4	0.4	...	...	...
Return on equity	4.4	9.2	8.4	6.3	6.7	6.4	...	...	...
Regulatory capital to risk-weighted assets	16.3	17.1	18.3	18.9	18.8	19.6	19.9	20.4	19.7

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

Table 6. France: Core Financial Soundness Indicators, 2016-22

	2016	2017	2018	2019	2020	2021	2022
Deposit-taking institutions 1/							
Regulatory capital to risk-weighted assets 2/	18.3	18.9	18.8	19.6	19.9	20.4	19.7
Regulatory Tier I capital to risk-weighted assets 2/	15.1	15.4	15.6	16.0	17.1	16.9	16.4
Nonperforming loans net of provisions to capital	16.2	15.0	13.6	12.2	11.9	10.3	10.4
Bank provisions to Nonperforming loans	51.0	50.6	50.4	49.9	48.7	49.2	48.4
Nonperforming loans to total gross loans	3.7	3.1	2.7	2.5	2.7	2.4	2.3
Sectoral distribution of loans to total loans, of which							
Deposit-takers	0.0	0.0	0.0	0.0	0.0	3.4	3.5
Nonfinancial corporation	0.0	0.0	0.0	0.0	0.0	20.0	19.7
Households (including individual firms)	28.1	25.7	25.5	25.9	24.2	30.1	29.2
Nonresidents (including financial sectors)	0.0	0.0	0.0	0.0	0.0	38.5	39.9
ROA (aggregated data on a parent-company basis) 3/ 4/	0.4	0.4	0.4	0.4	0.3	0.5	0.4
ROA (main groups on a consolidated basis) 2/ 4/	0.4	0.4	0.4	0.4	0.3	0.5	0.3
ROE (aggregated data on a parent-company basis) 3/ 4/	6.8	6.5	6.4	6.0	4.1	7.1	6.3
ROE (main groups on a consolidated basis) 2/ 4/	6.5	6.4	6.5	6.0	4.1	7.5	6.1
Interest margin to gross income	37.8	36.2	36.0	37.1	38.8	35.6	35.8
Noninterest expenses to gross income	71.5	74.2	76.2	73.3	70.4	67.5	68.1
Liquid assets to total assets	13.0	13.9	13.7	14.1	18.0	18.5	16.9
Liquid assets to short-term liabilities	20.2	20.7	19.3	20.1	26.0	27.0	23.5

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 five banking groups (IFRS).
3/ All credit institutions' aggregated data on a parent-company basis.
4/ ROA and ROE ratios are calculated after taxes (same calculation as the ECB consolidated data ratios).

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2021 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Maintain a supportive fiscal stance in 2022 but target any additional stimulus on supply-side measures to boost potential growth. In response to rising energy prices, provide targeted and temporary support to vulnerable households rather than broad-based transfers and long-lasting price-control measures. If downside risks materialize, additional targeted relief support should be provided.	The authorities provided additional, mostly broad-based support to mitigate the impact of rising energy prices, largely offsetting expiring Covid-19 support. Energy price controls will be extended into 2023, allowing for a 15 percent increase in regulated tariffs coupled with (moderately) targeted cash transfers.
Embark on a gradual but sustained expenditure-based fiscal consolidation over 2023-29 to rebuild buffers and sustainably lower debt.	The authorities are committed to bring the deficit below 3 percent of GDP in 2027 and debt on a declining path from 2026 based on an objective to limit real expenditure growth to 0.6 percent, but key measures are yet to be specified.
Structural Reforms	
Continued action to address labor-market frictions and ensure equitable opportunities for the youth.	The 2022 budget included additional measures to tackle skills shortages in certain activities and to aid labor market integration of youth that are neither working nor studying (*Contrat Engagement Jeune, CEJ*). The CEJ has been launched in March 2022.
Policies to increase product/services market efficiency, raise competitiveness and increase external sector resilience.	The National Recovery and Resilience Plan introduced measures to increase competition in some network sectors and reduce administrative burdens and envisages important investments in innovation and the digital economy.

Implementing additional green policies to reduce emissions and strengthening the existing ones, including adequate carbon pricing with mitigating measures for low-income households.	Policy proposals have been announced in the context of the "Fit For 55" initiative at the EU level, including a new ETS for transport and buildings, as well as harmonization and better alignment of energy taxation with carbon content. The second supplementary budget included additional cash transfers (*chèques énergie*) to compensate households in the bottom two income quintiles (12mn) for the impact of a 15 percent increase in regulated tariffs in 2023.
Financial Sector	
Gradually phase out corporate support measures to spur investment and business dynamism, while reducing risk from excessive leverage.	Covid related corporate support measures have mostly been scaled down but new programs to support firms affected by the war in Ukraine have been launched. PGE availability has also been extended to such firms.
Raise the counter-cyclical capital buffer depending on the recovery.	The HCSF decided in March 2022 to normalize the countercyclical capital buffer rate to 0.5 percent as a preventative measure to guard against persistent vulnerabilities and increased risks.

Annex II. 2019 Key FSAP Recommendations—Implementation Status

Recommendations	Agency	Timing*	Implementation Status D—Done / LD—Largely Done / PD—Partly Done / NA—No Action
			Preemptive Management of Systemic Vulnerabilities
Engage with ECB and other EU agencies on use of Pillar II measures to address bank-specific residual risk from concentration of exposures to large, indebted corporates.	ACPR	I	**D** The ECB has published on its website further explanation with the 'guide on leveraged transactions' dated May 2017. In addition, bank-specific letters were sent to the most exposed banks (of which 4 French groups). Banks were required to provide detailed information on their risk appetite framework and how it is operationalized. The answers to the letters were analyzed by the SSM and fed to the SREP analysis. In France, the macroprudential authority, *Haut Conseil à la Stabilité Financière* (HCSF), issued a decision in 2018 limiting the exposure of systemic banks to highly indebted big French companies to 5% of their eligible funds. A recommendation of reciprocity has been adopted at the European level, which seven countries have applied in the EU. Compliance with this recommendation is closely monitored.
Develop analytical framework for borrower-based measures for corporates. Consider a sectoral Systemic Risk Buffer (SRB) if risks intensify.	HCSF	NT	**PD** These two options were expertized before the HCSF decided to extend Art.458 as a potential alternative. First, BBM measures for NFC cannot be addressed in the only domestic dimension, but European agencies have decided to leave this topic out of their work program. Second, sSyRB analytical assessment has been carried out to substitute the Art.458, but it was concluded that the measure does not fit with the risks and would be less effective than maintaining Art.458.
Evaluate options to further incentivize corporates to finance through equity rather than debt.	MoF	NT	**NA**
			Ensuring Adequate Liquidity Management and Buffers
Develop with the ECB options to manage any disruptions in wholesale funding markets. Consider, as appropriate, liquidity buffers to cover at least 50 percent of wholesale funding outflows over/up to five days horizon for all major currencies.	ACPR, ECB	NT	**PD** Banks currently maintain a significant liquidity buffer, above the 100% usual threshold for LCR and NSFR introduced as a prudential requirement in June 2021. Within the framework of the SREP analysis in 2022, the ECB judged that liquidity risks were not particularly high and liquidity risk management frameworks globally adequate. Currently, there is no need to add or change liquidity buffer requirements. However – in the context of evolving rate environment – the monitoring of liquidity risk will be reinforced through dedicated initiatives to monitor the effects of termination of extraordinary monetary policy actions (TLTRO reimbursement notably) and the impacts of higher funding prices.
Actively engage with the ESRB and others for a speedy development of liquidity and leverage related tools for insurers and investment funds.	BdF, HCSF, ACPR, AMF	NT	**PD** As regards investment funds, BdF substantially contributed to the "low-interest expert group report," in which the questions of leverage and liquidity are extensively discussed. BdF and AMF are taking an active part in the ESRB's Policy Task Force on macroprudential tools for investment funds. The group assesses the key transmission mechanisms and the adequacy of the existing tools in addressing macroprudential objectives, which are complementary to the microprudential ones. The next step of the reflections will focus on new tools reducing systemic risk. In addition, BdF and AMF are actively involved in the Research Task Force on ETFs vulnerabilities assessment. The group is in charge of the risk and vulnerabilities assessment of ETFs. Regarding insurers, the review of Directive 2009/138/EC aims at enhancing liquidity monitoring and supervising by introducing a liquidity risk management plan and new powers for the supervisor, such as temporarily stopping redemption of contracts.
			Further Integration of Financial Conglomerate Oversight
Report intragroup exposures and transactions within conglomerates on a flow and stock basis at quarterly or regular frequency. Develop guidance to address direct and indirect, and common exposures of entities in the conglomerate.	ACPR, AMF	NT	**PD** As of this date, French conglomerates report on common exposures and intragroup transactions within conglomerates on a flow and stock basis at a regular frequency (CONGLOMER reporting). An enhanced reporting has been developed by the European Joint Committee on Financial Conglomerate; the European Commission should adopt it through an Implementing Technical Standard by 2024. The first reporting date should be 31/12/2023
Develop with the ECB and other EU agencies liquidity risk management requirements and stress testing at the conglomerate level.	ACPR, AMF	NT	**PD** No liquidity risk management requirement has been considered at this stage because the current supervisory framework coinciding with the prudential consolidation perimeter is deemed satisfactory. Along with a market-wide stress test that typically encompasses conglomerates and allows distinguishing their performance compared with other financial groups, ACPR is carrying out ad hoc research projects on liquidity analysis and the conduct of stress testing at the conglomerate level, recently presented to the ACPR Scientific Committee. Thorough research is still ongoing and will improve ACPR oversight and assessment of liquidity risk.
Strengthen conglomerate oversight and work with the Joint Committee of the ESAs to finalize common reporting templates, and with the ECB on common supervisory guidance for conglomerates.	ACPR, AMF	NT	**PD** The ACPR maintained a high level of engagement in both arenas in order to strengthen conglomerate supervision. An ACPR's deputy Secretary General chairs the works of the JC of the ESAs on common reporting templates and the group should be in position to deliver the full set of reporting by end 2021. ACPR actively participated in ESA's work to answer The Commission's call for advice on digital finance, including questions on a potential review of FICOD to supervise mixed-activity groups. As an "integrated" supervisor, the ACPR actively favors the exchange of information between the insurance supervision side and the banking one, which encompasses discussions with ECB staff members. These discussions also include the development of joint supervisory guidance. ACPR and the ECB are putting in place coordination arrangements for each Financial conglomerate to formalize and strengthen their cooperation on this matter.

Enhancing Governance, Financial Policies and Financial Integrity			
The ACPR and AMF should have autonomy to determine their resource levels based on a forward-looking review of supervisory and monitoring needs.	ACPR, AMF, MoF	I	**NA (constitutional constraint)** The NSAs are free to allocate resources towards the most needed fields, but it is not constitutionally possible to let them determine their global resource level as these resources are fiscal by nature thus requiring a parliamentary decision. Note that the parliamentary decision is informed by an independent report from the NSA. The current arrangement with a vote on a resource threshold is guaranteeing a stable funding of the NSAs.
To avoid any perception of a potential conflict of interest and facilitate operationally independent functioning, the government should recuse itself from all supervisory decision-making committees at the ACPR and the AMF.	MoF	I	**NA (provides the legal underpinning to sharing confidential information)** The presence of the MoF as an observer at the NSAs' board does not prevent the decisions to be taken independently. On the contrary, the cross participation of the NSA and the attendance of a MoF representative on a non-voting basis give a robust legal framework for sharing information between the NSAs and with the MoF both on policy (where the MoF has regulatory responsibilities) and oversight issues (as it contribute to informative feedbacks) .
Reduce further the spread between market interest rates and the return on regulated savings products. Ensure timely and effective implementation of CDC governance reform under the Loi PACTE and undertake a full review of regulated savings framework at the appropriate time.	MoF	NT	**NA**
Enhance AML/CFT supervision of smaller banks rated as high-risk. (¶67) Explore ways to provide systematic guidance on detection of potential terrorist financing activities.	ACPR, Tracfin	I	**D** The ACPR implements a risk-based AML/CFT supervisory approach that links the supervisory intensity applied to any supervised entity (banks, insurance companies, payment services, and electronic money providers) to its individual risk assessment. The AML-CFT supervisory approach provides for different supervisory tools with different levels of intrusiveness, from annual returns and meetings to onsite visits and inspections. Thus, over the 2015-2020 onsite inspection cycle, 88% of the higher-risk banks were subject to an onsite inspection, compared to 44% of the medium-high-risk banks, 9% of the medium-low risk banks, and 1% of the lower-risk banks. As regards guidance on the detection of terrorist financing activities, the ACPR/TRACFIN joint Guidelines list several criteria, including weak signals that oblige entities to have to take into account. In addition, the Sectoral Risk Assessment published by ACPR describes the risks of each category of institutions and gives a focus on CFT for each activity
Reinforcing Crisis Management, Safety Nets, Resolution Arrangement			
Work toward an enhanced resolution framework for insurers by including wider powers to restructure liabilities (bail-in), and enhanced safeguards and funding.	ACPR	MT	**NA (EU single market issue)** The French authorities recognize that the resolution framework would benefit from additional tools, especially bail-in powers and adequate resolution funding arrangements. In September 2021, the European Commission published a proposal for a directive for a harmonized regime in recovery and resolution in the European Union within its Solvency II package review. This proposal includes a write-down or conversion tool, a solvent run-off tool, an asset and liability separation tool, a sale of business tool, and a bridge undertaking tool. However, no funding arrangements or harmonization of national Insurance Guarantee Schemes are foreseen in the first version of this proposal. The authorities consider an EU Directive essential to further advance the recovery and resolution framework in the context of a level playing field for insurers in the European Union. During the French Presidency of the EU, the ACPR was heavily involved in providing technical input to discussions on the various themes covered by the directive proposal and will continue to provide this support thereafter.
The eligibility of the FGDR's Supervisory Board membership, which is formed by bank executives in activity, should be changed to independent members only.	FGDR	MT	**NA**
Develop modalities for providing ELA in currencies other than euros and establish general rules that may assist banks in identifying assets, which might be proposed as ELA collateral and buttress their operational readiness to pledge them.	BdF, ACPR	MT	**PD** The main responsibility for the provision of ELA lies with National Central Banks but must comply with general principles laid down in ECB ELA agreement. Banque de France has an internal and recently updated procedure in place to ensure efficient and quick implementation of ELA. These arrangements are, however, confidential.

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

Annex III. External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: On a preliminary basis, the external position in 2022 is moderately weaker than the level implied by medium-term fundamentals and desirable policies. The CA balance is expected to decline in 2022 driven by the large terms-of-trade shock and lower external demand from trading partners affected by the war in Ukraine, as well as through supply-chain effects. Over the medium term, the CA deficit is expected to shrink as the effects of the pandemic and the war fade and fiscal consolidation and structural reforms to improve competitiveness of the economy are implemented. This assessment is preliminary; a final assessment for 2022 will be presented in the 2023 External Sector Report.

Potential Policy Responses: In response to the energy crisis, France deployed significant fiscal resources to shield households from the impact of high energy prices. Maintaining consistency of the external position with medium-term fundamentals will require structural reforms to continue enhancing productivity and sustain higher private investment to facilitate the green transition and digitalization, while rebuilding fiscal space once the shock dissipates.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. The NIIP stood at 26 percent of GDP in the second quarter of 2022, only slightly below the range observed during 2014–19 (between −16 and −23 percent of GDP). The NIIP improved by about seven percent of GDP since the end of 2021, largely driven by an increase in direct and portfolio investment. While the net position is moderately negative, gross positions are large. Gross assets stood at 329 percent of GDP in the second quarter of 2022, of which banks' non-FDI-related assets accounted for about 43 percent, reflecting their global activities. Gross liabilities fell to 354 percent of GDP in the second quarter of 2022, of which external debt was about 228 percent of GDP (56 percent accounted for by banks and 23 percent by the public sector). About three-quarters of France's external debt liabilities are denominated in domestic currency. The average TARGET2 balance in 2022 was about €61.4 billion.

Assessment. The NIIP is negative, but its size and projected stable trajectory do not raise sustainability concerns. However, there are vulnerabilities coming from large public external debt (52 percent of GDP in the second quarter of 2022) and banks' gross financing needs—the stock of banks' short-term debt securities was €96 billion in the second quarter of 2022 (3.5 percent of GDP), and financial derivatives stood at about 43.5 percent of GDP.</td></tr>
<tr><td>2022 (% GDP)</td><td colspan="2">NIIP: −34.3</td><td>Gross Assets: 341</td><td>Debt Assets: 194.3</td><td>Gross Liab.: 375.2</td><td colspan="2">Debt Liab.: 237.2</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The CA balance is expected to move to a deficit of 1.5 percent of GDP (from a surplus of 0.4 percent in 2021), driven by the large terms-of-trade shock and lower external demand. Temporary COVID-19 factors are expected to gradually normalize (for example, services balance, including business and tourism travel). Despite limited direct trade and investment linkages with Russia and Ukraine, the CA balance is expected to move to a deficit of 1.5 percent of GDP in 2022, driven by a large terms-of-trade shock (increase in the energy bill of about 1 percent of GDP in 2022) and lower external demand from trading partners affected by the war as well as through supply-chain effects. Over the medium term, the IMF staff projects the CA deficit to shrink by 2026 as temporary factors from the pandemic dissipate, the effects from the war fade, and reforms to improve France's competitiveness start to pay off. Fiscal consolidation will help reduce the CA deficit over the medium term.

Assessment. The 2022 cyclically adjusted CA balance is estimated at -0.8 percent of GDP compared with an EBA-estimated norm of 0 percent. The IMF staff estimates CA net adjustments related to COVID-19 at -0.8 percent of GDP, driven by transport (-1 percent of GDP), and exports of aeronautics (0.2 percent of GDP). On this basis, the IMF staff assesses that the CA gap in 2022 is between −2.1 and -1.1 percent of GDP (compared with −0.5 to 0 percent of GDP in 2021), with a midpoint of −1.6 percent of GDP. Despite an important domestic gap from looser fiscal policy of about -1.1 percent of GDP, the total policy gap is zero.</td></tr>
<tr><td>2022 (% GDP)</td><td>CA: -1.5</td><td>Cycl. Adj. CA: -0.8</td><td>EBA Norm: 0</td><td>EBA CA Gap: −0.8</td><td>COVID-19 Adj.: -0.8</td><td>Other Adj.: 0.0</td><td>Staff CA Gap: −1.6</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. Following an appreciation in 2020 of the REER based on the ULC of 4.7 percent and a depreciation of the REER based on the CPI of 0.9 percent, both REER measures depreciated in 2021 and in H1 2022. The ULC-based REER depreciated by 2.3 percent with respect to the 2021 average, while the CPI-based REER depreciated by 3.9 percent. From a longer-term perspective, although both REER measures depreciated by about 7 to 9 percent between 2008 and 2020, France has not managed to regain the loss of about one-third of its export market share registered in the early 2000s (while the export market share of the euro area remained broadly stable between 2000 and 2020). As of September 2022, the REER was 6.8 percent below the 2021 average.
Assessment. The IMF staff CA gap implies a REER gap of 6.1 percent in 2022 (applying an estimated elasticity of 0.26). The EBA REER index model points to a REER gap of −5.3 percent, while the EBA REER level model points to a REER gap of 4.2 percent. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be overvalued in the range of 4.2 to 8 percent, with a midpoint of 6.1 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="7">Background. Inward foreign direct investment normalized in 2021 after decreasing significantly between 2019 and 2020, by 2.3 percent of GDP. The capital account is open.

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

Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</td></tr>
</table>

Annex IV. Risk Assessment Matrix

Risks	Likelihood of Risk[1]	Expected Impact of Risk	Policy Response
Intensifying spillovers from Russia's war in Ukraine. Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility, with Europe among the worst hit.	**High**	**High:** Lower consumption and production (i.e. manufacturing industry) due to weakened consumer and business confidence. Lower investment due to heightened uncertainty and tightening of financial conditions.	Accelerate green transitions and diversify energy sources further. Conserve energy and provide targeted financial support to vulnerable households and firms.
Commodity price shocks. A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.	**High**	**Low:** Gas shortages and further supply disruptions could lead to spikes in gas and electricity prices fueling higher and more persistent inflation, lowering the purchasing power of consumers and increasing input costs for firms. Rising commodity prices could also increase the current account deficit. Trade partner growth could also be affected, further weakening the external position.	Provide targeted financial support to vulnerable households and firms impacted by high energy prices. If inflation became substantially higher and/or more protracted, the policy mix may need to be rebalanced.
Systemic social unrest. Rising inflation, declining incomes, and worsening inequality amplify social unrest and political instability, slowing economic growth, and giving rise to economically damaging populist policies (e.g., preserving fossil fuel subsidies).	**High**	**Medium:** Social unrest could impact consumer and business confidence and slow growth.	Provide targeted financial support to vulnerable households and firms.
De-anchoring of inflation expectations and stagflation. Supply shocks to food and energy prices sharply increase headline inflation and pass through to core inflation, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets. Central banks tighten monetary policy more than envisaged leading to weaker global demand. Together, this could lead to the onset of stagflation.	**Medium:**	**Medium:** Persistently high inflation, pressure for second-round effects, and lower purchasing power. Weaker confidence could reduce consumption and investment.	Diversify supply sources and undertake competitiveness enhancing reforms.

Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices. Europe: The fallout from the war in Ukraine is exacerbated by a gas shutoff by Russia, resulting in acute gas shortages and further supply disruptions, which triggers an EU recession.	**High**	**Medium:** Lower exports due to weakened external demand. Larger economic scarring and increase in unemployment, wiping out previous gains.	Fiscal policy could remain flexible and cushion shocks in the near term, including through targeted support to vulnerable households and firms. Fiscal policy should coordinate and be in accordance with the stance of monetary policy.
Local Covid-19 outbreaks. Emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce.	**Medium**	**Medium:** Tourist arrivals remain low, lowering the current account. Domestic demand especially in contact-intensive sectors will weaken. Larger economic scarring.	Targeted support to affected businesses and households. Maintain public health safeguard measures. Use available fiscal space to support households and firms and encourage reallocation of resources.
Structural risks: Deepening geo-economic fragmentation and geopolitical tensions. Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth.	**High**	**Medium:** Increased geo-economic fragmentation could undercut France's already decreasing trade market share and lower potential growth.	Diversify supply chains and undertake competitiveness enhancing reforms.
Structural risks: Cyberthreats. Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability and disrupt economic activities.	**Medium**	**Medium/Low:** Cyberattacks could trigger confidence shocks and threaten financial stability ultimately disrupting the real economy.	Strengthen the operational resilience of the financial system. Adopt best practices and prevention and crisis management tools and strengthen coordination at the European/international level.

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

Annex V. OECD Phase 4 Report

1. **A recent report by the OECD Working Group on Bribery evaluates France's implementation of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.**[1] The report,[2] published in December 2021, highlights progress by France in combatting foreign bribery, but also identifies some critical shortcomings. France is a voluntary participant in the Fund's assessment of transnational aspects of corruption under the Framework for Enhanced Engagement on Governance. France's efforts to combat transnational corruption were last discussed in the 2019 Article IV staff report.

2. **The Working Group on Bribery commended France for steps taken to strengthen legal and institutional frameworks and notable progress enforcing the foreign bribery offence.** Since the last OECD evaluation, in 2012, France has introduced major legislative and institutional reforms aimed at strengthening the criminal justice framework and judicial bodies, some of which are described in the 2019 staff report.[3] Important legal reforms since the 2019 staff report include amendments strengthening the plea-bargaining procedure, improving the operational autonomy of prosecutors, broadening the types of information to which judicial authorities have access, and prohibiting the tax deductibility of bribes paid to foreign public officials in overseas territories as well. France has also undertaken a reorganization of its criminal court system to improve efficiency in the delivery of justice. The report noted a marked increase in the number of criminal investigations and prosecutions, including proceedings resulting in sanctions against five legal persons. The report noted that the number of investigations initiated for foreign bribery increased by almost three and a half times since the last OECD evaluation. Moreover, concluded cases also involved larger corruption schemes than before.

3. **The OECD report also noted some shortcomings and concerns that could undo the good progress made by France in recent reforms.** A bill approved by the Parliament in November 2021 limits the duration of preliminary investigations to two or three years. This legislation could have a detrimental impact on complex and time-consuming cases, such as those involving foreign bribery. Further, while commending France's progress initiating criminal proceedings against perpetrators of foreign bribery, the Working Group deemed the number of resolved cases – especially against legal persons – to be low considering France's economic situation and the exposure of French companies to corruption risks, the Working Group found the number of cases against legal persons to be relatively low. The report also noted the increasing number of foreign bribery allegations that are not pursued. The Working Group therefore recommended France to take all necessary measures to enable the various components of the criminal justice system to

[1] Information relating to supply-side corruption in this section of the Report draws on the OECD Working Group on Bribery in International Business Transaction's Phase 4 report of France. The IMF provided additional views and information whose accuracy have not been verified by the WGB or the OECD Secretariat, and which do not prejudice the Working Group's monitoring of the implementation of the OECD Anti-Bribery Convention.

[2] Implementing the OECD Anti-Bribery Convention: Phase 4 Report—France.

[3] Staff Report for the 2019 Article IV Consultation.

proactively and effectively detect, investigate, prosecute, and sanction perpetrators of foreign bribery. The Working Group also recommended that France provide adequate resources to investigative and judicial bodies responsible for the investigation, prosecution, and sanctioning of foreign bribery and make full use of the confiscation measures provided for in law for both natural and legal persons.

Annex VI. Sovereign Risk and Debt Sustainability Analysis

The large fiscal response to successive shocks over 2020-22 pushed up deficit and debt levels that are expected to remain well-above precrisis baseline projections, reflecting permanent measures, output losses, and less favorable automatic debt dynamics. Having peaked at close to 115 percent of GDP in 2020, public debt is expected to bottom below 112 percent in 2022 before increasing to 116 percent over the medium term. With the primary deficit remaining well-above its debt-stabilizing level and the interest-growth differential narrowing, debt will remain on an upward path. However, moderate risk from debt non-stabilization and high gross financing needs are mitigated by France's large institutional investor base, home bias, lack of foreign currency debt, and long maturity profile.

1. **Background.** Despite the much stronger recovery from the pandemic and lower deficit and debt levels in 2021 than anticipated last year, and unwinding of pandemic support, France's fiscal position is not improving commensurately in 2022 and deteriorating in 2023 due to the large fiscal response to the energy shock, further permanent tax cuts, slowing activity, and reversal of temporary revenue windfalls. The debt ratio declined from its 2020 peak of 115 percent of GDP but remains 14 ppt of GDP above its pre-pandemic level in 2022 and is expected to resume its upward path from 2023. Borrowing costs have increased from historic lows as monetary policy started normalizing—with bond yields near 3 percent in late October (+270 bps since January and +310 bps since end-2020 lows) amid increased market volatility due to renewed sovereign debt concerns in Europe before subsiding to 2.3 by mid-December—and rising inflation pushed up the cost of inflation-indexed debt. Together with cyclical headwinds, this renders automatic debt dynamics less favorable.

2. **Baseline.** Staff's baseline scenario is based on the initial 2022 budget law, amendments voted in August and November, the Stability Program 2022-27, and the draft 2023 budget and medium-term programming bills. It excludes insufficiently specified measures or spending targets that are not underpinned by concrete measures. The economy is projected to slow to 0.7 percent in 2023 and recover in 2024 and beyond, growing above potential until converging in the medium term as the output gap closes. Interest rates are projected to increase over the forecast horizon, with effective rates following with a lag. The deficit is projected to widen to 5.3 percent of GDP in 2023 before gradually narrowing to 4.5 percent in the medium term—a faster decline in the primary deficit as temporary measures expire is offset by a rising interest bill. The primary deficit is projected to stabilize at about 2.2 percent of GDP, some 1.5 ppt above its debt-stabilizing level. This, together with lower deficit financing from the cash buffer accumulated in 2020, will lead debt to continue to increase, exceeding 120 percent of GDP by the end of the decade.

3. **Realism.** Forecast errors point to some optimism in staff's projections for near-term cyclical conditions, and medium-term primary balances, reflecting a larger and more persistent output gap in the aftermath of the GFC and smaller fiscal consolidation than anticipated despite conservative baseline assumptions. The projected fiscal adjustment and debt reduction are within the normal historical range observed in peer countries. While the maximum adjustment over any three years is an outlier, this reflects the unwinding of the large fiscal response to shocks over 2020-23.

4. Risks and mitigating factors. High and rising debt levels under a baseline where primary deficits remain well-above precrisis levels (½ ppt of GDP above its 2019 level and 1 ppt above the medium-term level projected before the pandemic) erode fiscal buffers and expose France to a range of shocks. Higher and more persistent inflation would weigh on France's debt service burden, as more than a tenth of debt is indexed to inflation—two thirds of which to European inflation. A faster normalization of monetary policy, with higher policy rates and lower reinvestment of maturing sovereign debt held by the ECB, would increase yields and possibly spreads were fragmentation risk to resurface (with investors penalizing a widening debt differential with EA peers). With tightening financial conditions and slowing activity eroding the debt service capacity of a highly-indebted private sector, contingent liabilities could be triggered, including through guarantees (bank loan guarantees under the PGE program amount to some 3.3 percent of GDP) or bailouts. However, mitigating factors include: a long average debt maturity that limits the pass-through from higher yields to effective interest rates; a large institutional investor base and home bias that mitigate liquidity risks; and low share of debt denominated in foreign currency that mitigates FX risks.

Figure VI.1. France: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	...	**Low**	Staff's assessment of the overall risk of sovereign stres is low. Mitigating factors include France's large institutional investor base, home bias, lack of foreign currency debt and long maturity.
Near term 1/			
Medium term	**Moderate**	**Moderate**	Staff's assessment of the medium-term risk of sovereign stress is moderate, consistent with the mechanical signal. Risks resulting from a high probability of debt non-stabilization and large financing needs are mitigated by the quality of France's institutions and market absorption capacity even under stress.
Fanchart	**Moderate**	...	
GFN	**Moderate**	...	
Stress test	...	...	
Long term	...	**Moderate**	Long-term risks are moderate, with modest aging-related spending pressures that are set to peak over the next 10 years before subsiding, yet less favorable debt dynamics as the primary deficit stabilizes well-above its debt-stabilizing level.
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: France is at a low overall risk of sovereign stress and debt is sustainable. However, the large response to successive shocks and permanent output losses keep deficit and debt levels elevated, with large financing needs and debt non-stabilization reflected in a moderate medium-term risk score. With higher borrowing cost increasingly weighing on France's debt service burden as low-cost debt matures, tailwinds from favorable debt dynamics will dissipate over the longer term, requiring an increasingly large effort to stabilize debt at a time that investment needs to facilitate the green and digital transition are rising.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

Figure VI.2. France: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						
Subsectors captured in the baseline					Inclusion	
1 Budgetary central government					Yes	
2 Extra budgetary funds (EBFs)					No	Not applicable
3 Social security funds (SSFs)					Yes	
4 State governments					Yes	
5 Local governments					Yes	
6 Public nonfinancial corporations					No	
7 Central bank					No	
8 Other public financial corporations					No	
3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	
4. Accounting principles:	Basis of recording		Valuation of debt stock			
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	

CPS / NFPS / GG: expected / CG

Reporting on Intra-government Debt Holdings

Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt									0
2 Extra-budget. funds									0
3 Social security funds									0
4 State govt.									0
5 Local govt.									0
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	0	0	0	0	0	0	0	0	0

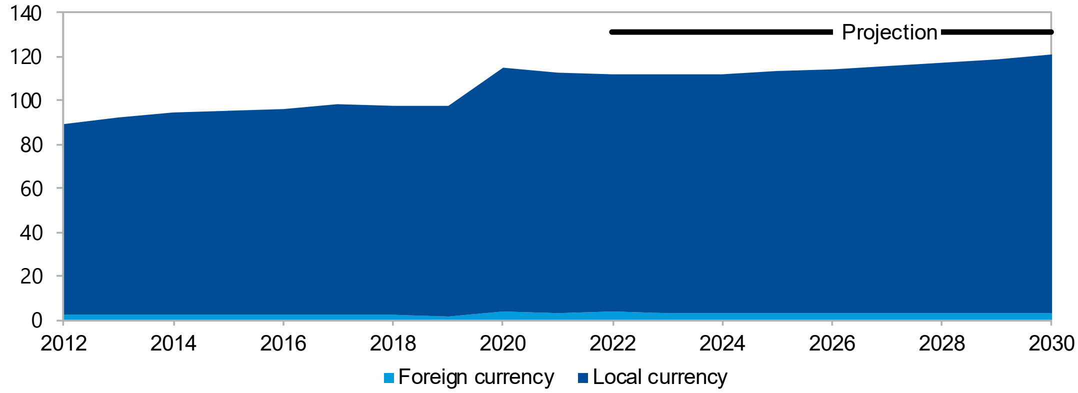
CPS / NFPS / GG: expected / CG

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The debt coverage is unchanged from recent Article IVs--i.e., it covers general government debt, with most debt issued by the central government. Bank loan guarantees issued in response to the pandemic and energy crisis (PGE) amount to some 6 percent of GDP.

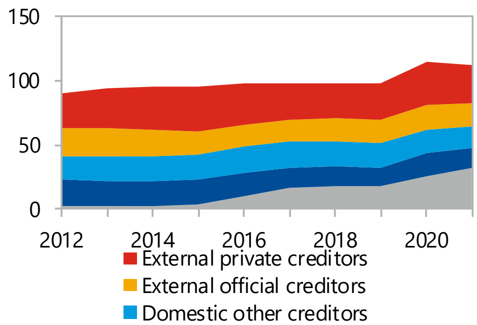
Figure VI.3. France: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



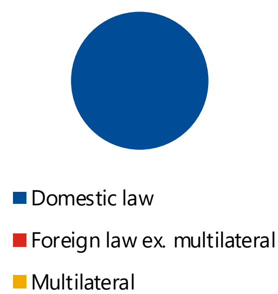
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



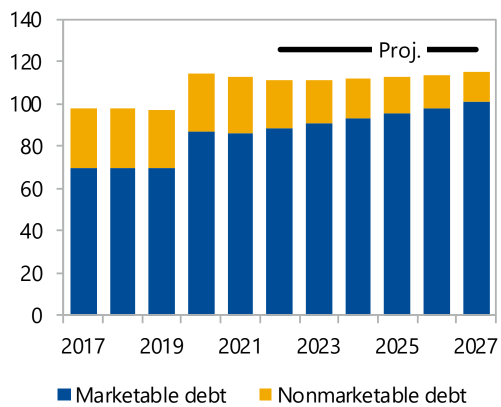
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2021 (percent)



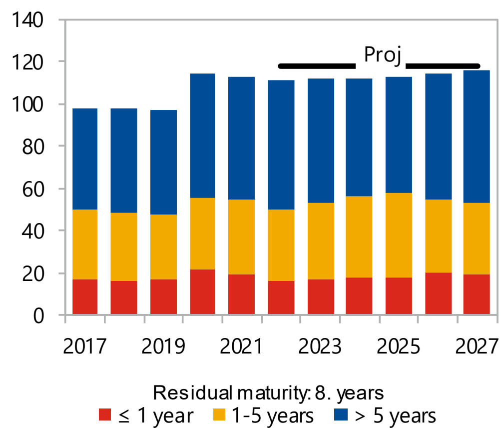
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



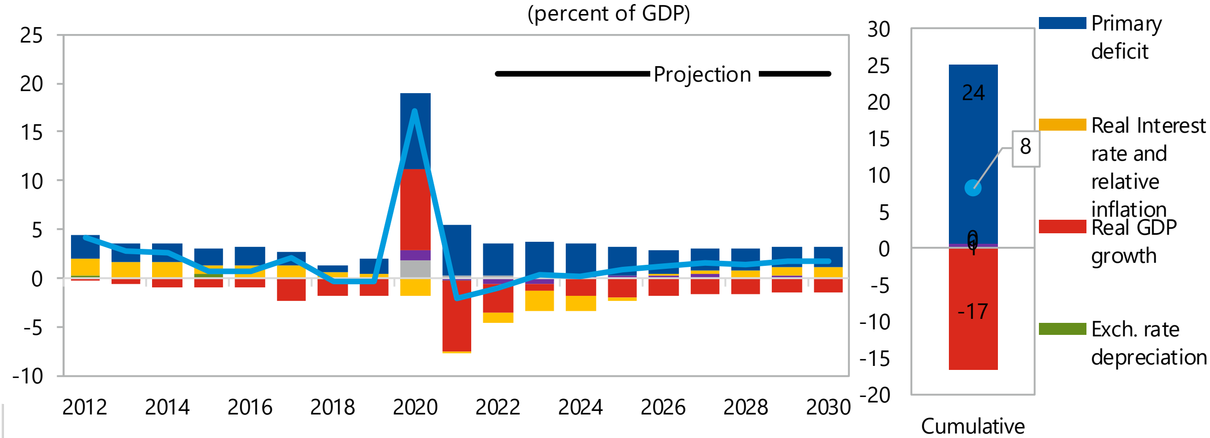
Note: The perimeter shown is general government.

Commentary: Debt is predominantly in domestic currency and marketable. The share held by the central bank has increased steadily since 2015 and holder shares are roughly similar across the five identified holder types. All public debt is governed by domestic law. Debt is mostly long-term, with the average residual maturity above 8 years (expected to increase during the forecast period).

Figure VI.4. France: Baseline Scenario
(Percent of GDP unless indicated otherwise)

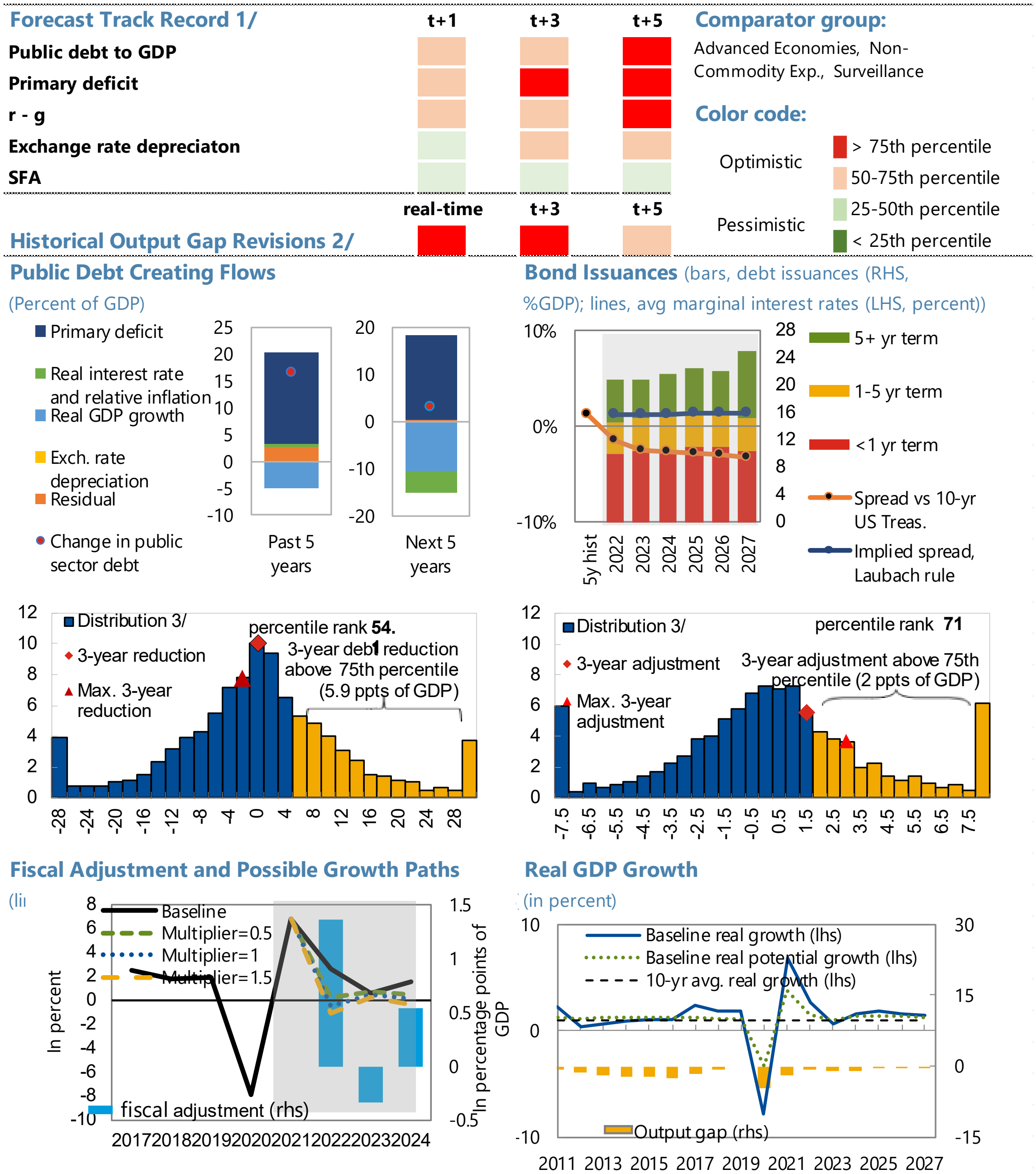
	Actual	Medium-term projection						Extended projection		
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Public debt	112.6	111.6	112.0	112.2	113.0	114.2	115.7	117.1	118.9	120.6
Change in public debt	-2.1	-1.0	0.4	0.2	0.8	1.1	1.5	1.4	1.8	1.7
Contribution of identified flows	-2.3	-1.3	0.6	0.3	0.9	1.1	1.5	1.5	1.7	1.7
Primary deficit	5.2	3.2	3.7	3.1	2.9	2.5	2.3	2.2	2.2	2.2
Noninterest revenues	52.4	53.4	52.7	51.5	51.3	51.2	51.1	51.1	51.1	51.1
Noninterest expenditures	57.7	56.6	56.4	54.6	54.2	53.7	53.4	53.4	53.3	53.3
Automatic debt dynamics	-7.4	-3.9	-2.8	-3.2	-2.4	-1.6	-1.2	-0.8	-0.6	-0.4
Real interest rate and relative inflati	-0.1	-1.0	-2.0	-1.5	-0.4	0.1	0.4	0.7	0.9	1.1
Real interest rate	0.0	-1.0	-2.1	-1.5	-0.4	0.1	0.4	0.7	0.9	1.1
Relative inflation	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-7.3	-2.9	-0.7	-1.7	-2.0	-1.8	-1.6	-1.5	-1.5	-1.5
Real exchange rate	0.0	…	…	…	…	…	…	…	…	…
Other identified flows	-0.2	-0.7	-0.4	0.4	0.3	0.2	0.4	0.1	0.2	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	-0.2	-0.7	-0.4	0.4	0.3	0.2	0.4	0.1	0.2	0.0
Contribution of residual	0.2	0.3	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Local currency	18.9	18.4	17.6	18.2	19.3	19.5	22.4	21.8	22.4	22.1
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:										
Real GDP growth (percent)	6.8	2.6	0.7	1.6	1.8	1.6	1.4	1.3	1.3	1.3
Inflation (GDP deflator; percent)	1.3	2.6	3.5	3.1	2.1	1.8	1.7	1.7	1.7	1.7
Nominal GDP growth (percent)	8.2	5.3	4.2	4.7	3.9	3.4	3.1	3.1	3.0	3.0
Effective interest rate (percent)	1.3	1.7	1.6	1.7	1.8	1.9	2.1	2.3	2.5	2.7

Contribution to Change in Public Debt
(percent of GDP)



Staff commentary: Public debt will continue rising over the forecast horizon, reflecting a primary deficit that remain some 1.5 ppts of GDP above its debt-stabilizing level.

Figure VI.5. France: Realism of Baseline Assumptions



Commentary: The realism analysis shows a large median forecast error for medium-term primary deficit projections over 2011-19, suggesting an optimistic bias, and more moderate ones for debt and r-g projections. The projected fiscal adjustment and debt reduction are well within norms; while the maximum adjustment over any three years (3.7) is above the threshold (2), this reflects the unwinding of the large fiscal response to shocks over 2020-23.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates and final estimates in the latest October WEO) in the total distribution of revisions across the data sample.

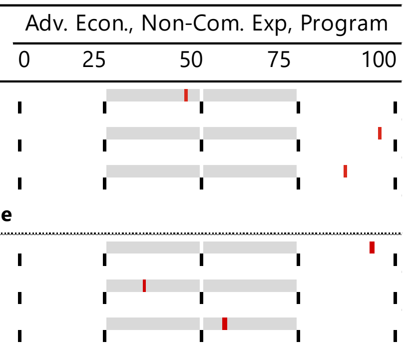
3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on verticle axis.

Figure VI.6. France: Medium-Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

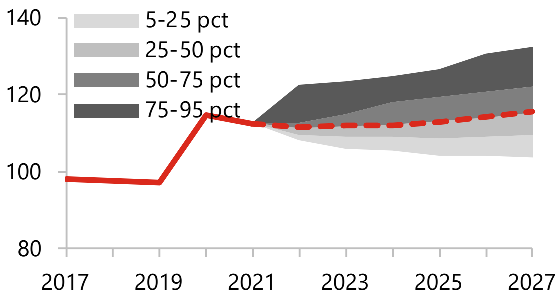
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	29.1	0.4	…
	Probability of debt not stabilizing (pct)	96.8	0.8	…
	Terminal debt level x institutions index	30.5	0.7	…
	Debt fanchart index	**…**	**1.9**	**Moderate**
GFN finance-ability module	Average GFN in baseline	22.1	7.5	…
	Bank claims on government (pct bank assets)	3.5	1.2	…
	Chg. in claims on govt. in stress (pct bank assets)	3.9	1.3	…
	GFN financeability index	**…**	**10.0**	**Moderate**

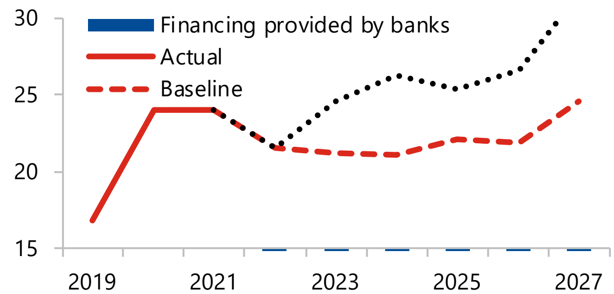


Legend: Interquartile range France

Final Fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

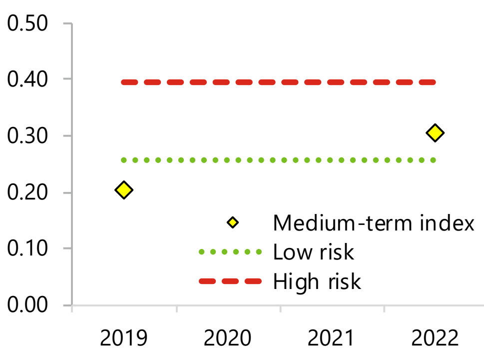


Triggered stress tests (stress tests not activated in gray)

Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-term Index

(index number)



Medium-term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.4
GFN finaceability index	7.6	17.9	0.5	0.2
Medium-term index (MTI)	0.3	0.4	…	0.3, Moderate

Prob. of missed crisis, 2022-2027 (if stress not predicted): 18.2 pct.

Prob. of false alarm, 2022-2027 (if stress predicted): 26.1 pct.

Commentary:The Debt Fanchart and GFN Financeability Modules both point to moderate risk. For the fanchart, this reflects a high probability of debt non-stabilization but moderate debt levels when adjusted for institutional quality. Moderate financing risk reflects high average GFNs but limited reliance on bank financing in the baseline, combined with moderate risk under a stress scenario with limited rollover of external private financing.

INTERNATIONAL MONETARY FUND

FRANCE

January 6, 2023

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

CONTENTS

FUND RELATIONS

(As of November 30, 2022)

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

General Resources Account	SDR Million	Percent of Quota
Quota	20,155.10	100.00
Fund Holding of Currency (Exchange Rate)	14,682.22	72.85
Reserve Tranche Position	5,473.05	27.15
Lending to the Fund		
New Arrangements to Borrow	111.52	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	29,451.96	100.00
Holdings	28,550.43	96.94

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			
	2023	**2024**	**2025**	**2026**
Principal				
Charges/Interest	25.36	25.31	25.28	25.29
Total	**25.36**	**25.31**	**25.28**	**25.29**

Implementation of HIPC Initiative: Not applicable

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

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

Exchange Arrangements:

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

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

Article IV Consultation:

The last Article IV consultation was concluded on January 19, 2022. The associated Executive Board assessment is available at https://www.imf.org/en/News/Articles/2022/01/26/pr2215-france-imf-executive-board-concludes-2021-article-iv-consultation-with-france and the staff report at https://www.imf.org/en/Publications/CR/Issues/2022/01/25/France-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-512171. France is on the standard 12-month consultation cycle.

FSAP Participation and ROSC:

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

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

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

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

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

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

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

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

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

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

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

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

Risk Analysis of Banking and Insurance Sector	*IMF Country Report No. 19/322, Oct 2019*
Select Topics in Financial Supervision and Oversight	*IMF Country Report No. 19/325, Oct 2019*

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

The FSAP Update undertaken in January and June 2012 confirmed the resilience of France's financial system to severe market pressures but also identified challenges faced by the system. While its structure has contributed to solid profit generation, the crisis exposed the risks posed by the banks' size, complexity, and dependence on wholesale funding. The larger banks have been actively restructuring their balance sheets—moving to more stable sources of funding; reducing their cross-border presence; and building up capital. They remain, however, vulnerable to sustained disruptions in funding markets and reduced profitability, which would cause delays in meeting capital-raising plans.

The 2012 report confirmed that the regulatory and supervisory regime for banks, insurance, and securities market was of a very high standard. Areas for improvement that emerged from the FSAP Update included greater de jure independence of supervisory authorities; disclosure of the capital treatment and related financial interactions within complex banking groups; a move toward a more economic risk-focused approach to insurance regulation and supervision; and enhanced supervision of investment service providers and financial advisors.

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

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

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

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

STATISTICAL ISSUES

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

Table 1. France: Table of Common Indicators Required for Surveillance
(As of December 2022)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	11/22	11/22	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/22	11/22	Monthly	Monthly	Monthly
International Investment Position	Q2:2022	Q4:2022	Quarterly	Quarterly	Quarterly
Reserve/Base Money	10/22	11/22	Monthly	Monthly	Monthly
Broad Money	09/22	11/22	Monthly	Monthly	Monthly
Central Bank Balance Sheet	09/22	11/22	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	09/22	11/22	Monthly	Monthly	Monthly
Interest Rates[2]	10/22	11/22	Daily	Daily	Daily
Consumer Price Index	10/22	11/22	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2021	11/22	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	09/2022	11/22	Monthly	Monthly	Monthly
Stock of Central Government Debt	09/22	11/22	Monthly	Monthly	Monthly
External Current Account Balance	09/22	11/22	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	09/22	11/22	Monthly	Monthly	Monthly
GDP/GNP	Q3:2022	Q4:2022	Quarterly	Quarterly	Quarterly
Gross External Debt	Q2:2022	Q4:2022	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).

FRANCE

STAFF REPORT FOR THE 2022 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

January 19, 2023

Prepared By European Department

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

1. **The latest high frequency indicators point to the continued resilience of the French economy**. The French composite flash PMI decreased slightly to 48, driven by services, while manufacturing output improved (although it remains below 50 as well). The Banque de France's latest business confidence survey (conducted Nov. 28-Dec. 5) suggests that economic activity has held up well in the major sectors, including industry, services, and construction, with business leaders expecting activity to remain stable in December. Furthermore, INSEE's household confidence indicator remained relatively stable in December. Based on the survey and other indicators, GDP growth is estimated to be around 0.1 percent (q/q) in the fourth quarter of 2022. The resilience of the economy is also reflected in better-than-expected state revenue performance, with some €1bn in additional collection driven by corporate and personal income taxes. In December, HICP inflation fell to 6.7 percent year-on-year from 7.1 percent in November, as energy prices and, to a lesser extent, service prices slowed, suggesting that inflation may have reached its peak and gradually decline over 2023.

2. **The government unveiled its pension reform plan, which faces strong public opposition.** The plan—presented on January 10, 2023—aims to balance the pension system by 2030 and increase the employment rate of older workers by raising the minimum retirement age and minimum contribution period, while aligning special regimes with the general regime for new hires.[1] Workers with long careers, a

[1] The minimum retirement age would be raised from 62 to 63 years and 3 months by the end of the current term (2027) and 64 years by 2030 at a rate of 3 months/year from September 2023. The minimum contribution period for a full pension would be raised from 42 years to 43 years by 2027 rather than 2035 (thus accelerating the rate of increase from one month per year to three months per year). The age at which workers can retire without having met the minimum contribution period and without incurring any discounts will remain 67. The main special schemes (RATP, electricity and gas industries, Banque de France, clerks and notaries, and CESE)

(continued)

disability/handicap or occupational disease, and arduous jobs will continue to be able to retire earlier, with access to such early retirement eased. The reform also envisages increasing minimum pensions to 85 percent of minimum wage for workers with a full career (about €100 increase to €1,200 per month) and complementary measures to enhance the employment of older workers. The latter includes: (i) easing access to partial retirement (*retraite progressive*); (ii) allowing retirees who return to work to continue acquiring rights; (iii) enhancing working time flexibility by introducing a universal time savings account (*compte épargne-temps universel*, CETU); (iv) changing rules regarding the accumulation of benefits and salary when job seekers resume work; and (v) introducing a "seniority index" to provide more transparency in firms' hiring and other practices or policies for older workers. Many of these complementary measures will need to be fleshed out and negotiated with social partners. The government's proposal has proven controversial and unpopular, and has been rejected by all major trade unions and by opposition parties on the far right and left. Nevertheless, the reform is likely to pass with the support of the conservative party (*Les Republicains*) that managed to extract some concessions. The unions have announced industrial action.

3. **France is pushing forward with the law to accelerate the development of renewable energy**. On January 10, 2023, Members of the Parliament in the lower chamber passed the 'Renewable Energy Acceleration Act' proposed by President Macron's government last fall which aims to promote renewable energy, including a 10-fold increase in solar capacity and building of 50 offshore wind plants by 2050. The law is now subject to compromise talks between Members of Parliament and senators before being approved.

will be eliminated for all new hires, who will be brought under the general regime. While current participants will be grandfathered, the *increase* in the minimum retirement age and contribution period for a full pension will also apply to them.

Table 1. France: Selected Economic Indicators, 2020-24

			Est.	Projections	
	2020	2021	2022	2023	2024
Output (%)					
Real GDP growth	-7.9	6.8	2.6	0.7	1.6
Nominal GDP (billions of euros)	2,310	2,499	2,631	2741	2871
Employment (%)					
Unemployment rate	8.0	7.9	7.5	7.6	7.5
Prices (year average, %)					
Inflation	0.5	2.1	5.9	5.0	2.8
General government finance (% GDP)					
General government balance	-9.0	-6.5	-5.0	-5.3	-4.8
Revenue	52.5	52.5	53.5	52.8	51.6
Expenditure	61.5	59.1	58.4	58.1	56.4
Structural balance (percent of pot. GDP)	-5.8	-5.2	-4.4	-4.5	12.2
Primary balance	-7.8	-5.2	-3.2	-3.7	-3.1
General government gross debt	114.7	112.6	111.6	112.0	112.2
Balance of payments (% GDP)					
Current account	-1.8	0.4	-1.5	-1.6	-1.0

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

Statement by Mr. Buissé, Mr. Grossmann-Wirth, Mr. Benac, and Ms. de Waziers on France

January 25, 2023

On behalf of the French authorities, we would like to express our appreciation for the work conducted by staff under this Article IV consultation. They strongly valued this engagement and exchange on the diagnosis, risks, and policy priorities at a challenging time for policymakers addressing the repercussions of Russia's war in Ukraine. This highlights the importance of the resumption of Article IV consultations. The article IV report and the selected issues paper on spending reforms are in our view a valuable contribution to the policy debate in France, and more generally to the membership.

Recent developments, outlook and risks

Our authorities broadly share staff's view on the short-term outlook: the economic recovery from the pandemic has been strong, though the consequences of Russia's war in Ukraine are now weighing on the 2023 forecasts. Following the publication of the 3rd quarter national account figures (+0.2% q/q, after +0.5% q/q – non annualized), the carry over for 2022 is +2.6% (after +6.8% in 2021). Regarding 2023, according to the latest official forecasts, the government was slightly more optimistic on growth at 1.0% versus 0.7% in the report) and expected slightly lower inflation (4.7%, HICP, versus 5% in the report). These differences are marginal compared to the still very volatile global outlook. As noted by staff, the labor market has been particularly strong, with the unemployment rate declining from 8.2% in the fourth quarter of 2019 to 7.3% in the third quarter of 2022, reflecting in part labor market reforms and programs targeted on the youth. France's dependence on Russian gas is more limited than its main EU partners; as mentioned in the report, the share of natural gas in French energy supply is lower than the EU average and imports by pipeline from Russia accounted for less than 15% of natural gas supply before 2022.

French authorities have a more balanced view on risks and are more optimistic on medium-term prospects. While we agree that the main downside risk to this outlook stems from a prolonged war and additional inflation pressure, risks seem more balanced than highlighted in the report. In particular, we consider that gas and electricity prices could go both ways going forward, a view supported by the marked decrease in prices observed over the last months and that, as documented by a recent Fund's Working Paper, the likelihood of a wage-price spiral is low. The risks to gas and electricity supplies are now limited for the current winter, thanks to the measures taken to replenish gas stocks before the winter, the reduction in energy consumption made possible by the sobriety plan, as well as the restarting of nuclear reactors that were under maintenance. Although gas supply issues for the winter of 2023-2024 warrants close monitoring, the risks have decreased thanks to the exceptionally high level of gas stocks at the beginning of 2023. Regarding the medium-term, we expect faster growth than the Fund, as we estimate less scarring from the Covid and energy crisis and thus more catch-up potential. Private consumption should also be supported by a gradual decline in the savings rate, from its current historically high level. Finally, as we will develop below, our authorities also expect a boost in potential growth over the medium term from the effect of labor market and pension reforms.

Fiscal policies

The Government's first priority is to respond to the urgency of the crisis by protecting households and businesses from exceptionally high short-term inflation, while maintaining public deficit under control and significantly reducing energy consumption. In 2022, France has put in place an extensive range of temporary protection measures to cushion swiftly the impact of the rise in energy prices for households and businesses, which has limited the adverse impact on confidence, investment, consumption and consequently growth. These measures were compatible with sound public financial management. Underpinned by the resilience of the French economy in the global uncertain context, the public deficit continued improving in 2022, reaching -5.0% GDP, and is expected to stabilize in 2023 as the Government continues to support most affected households and companies in the face of rising energy prices.

For households, income measures and transfers have been swiftly implemented and are gradually more targeted. As detailed in staff report, a tariff shield on electricity and gas prices benefiting also to some very small businesses has been deployed from October 2021 and extended until 2023. It is important to note that gas prices in October 2021 were already 50% higher than in January, which is already quite a sizeable price signal. As of January 2023, the gas price cap has been increased by 15%, whereas the electricity price cap will be increased by 15 % as well in February. For 2023, the existing untargeted "fuel discount" is removed and replaced by a "fuel allowance" targeted on the poorest households using their vehicles to go to work.

For businesses, a series of short-term measures has also been implemented to protect the most affected companies and the energy-intensive companies and attempt to limit the transmission of rising energy prices to sales prices. A new cushioning mechanism is currently being deployed to cover part of the electricity bill of very small businesses that do not benefit from the tariff shield and SMEs. France remains otherwise attentive to specific sectorial situations: targeted measures have been taken in favor of the sectors most exposed to rising input costs (agriculture, transport, construction and more recently, the bakery industry). The cost of all these measures would amount to 2 ½% of GDP but their impact on the public balance would be largely offset by fiscal windfalls from renewable energy producers funding (1.3% of GDP), for a net cost around 1% of GDP.

Going forward, the French authorities are committed to find the right balance between supporting the most exposed households and firms and recreating fiscal buffers that would reinforce the government's ability to handle future shocks. The policies implemented retain and fully integrate the objective of medium-term fiscal adjustment, based on a structural and sustainable adjustment which requires a broad buy-in in ambitious structural reforms and an effective mitigation of the risk of social unrest – hence the critical importance of the protection measures. Our authorities share the view that these protection measures are temporary and will gradually be better targeted. The pace of the adjustment will depend on energy market developments and will aim at gradually increasing the price signal passthrough, to keep incentives in line with our commitment to the green transition. The multiyear fiscal consolidation should strike the right balance between gradually rebuilding buffers, supporting the recovery and boosting potential growth. The fiscal trajectory considered by the authorities plans to bring the public deficit back to below 3% of GDP in 2027. It also aims to get the debt on a declining path by 2026. Given an already high tax-to-GDP ratio, this consolidation will be achieved by boosting potential growth factors, improving spending efficiency, and controlling public expenditure, while protecting investment needs for the green and digital transition. Reforms and some other areas for potential savings identified by staff in this regard appear broadly relevant and our authorities believe that the generated savings, growth and jobs will bring the deficit to target. Our authorities agree that the adoption of the medium-term programming bill is important for the credibility of fiscal targets and highlight that the new fiscal framework is already effective, with the spending review mechanism already been included in the annual financial bill. The medium-term programming bill is still in legislative procedure and the Government is working to get a positive vote in both houses of Parliament.

Unemployment benefits and pension reform are underway. Since the staff report was finalized, France has specified the key parameters of the pension reform, which are broadly in line with staff advice. It will aim to increase the active population and activity rate by increasing the effective retirement age, supporting the employment of seniors, and strengthening the sustainability of the system, while providing for careful adjustments to specific situations and increasing the minimum pension. The legal retirement age will be gradually raised to 64 by 2030, from 62 currently. The contribution period required to benefit from a full pension will also be gradually extended to forty-three years by 2027 – instead of by 2035. Finally, main special sectoral pension schemes will be extinguished.

Financial Sector

Our authorities broadly share staff's view on the buildup of financial risks amid the tightening of financial conditions and consider that the French financial system is in a favorable position to face this new environment. Banks and insurers are in a solid financial and prudential position; the CET1 capital ratio of the six main banking groups is close to its all-time high and insurers' solvency capital requirement coverage ratio increased in the first half of 2022. At the European level, the EBA with the SSM will carry out new stress tests in 2023 on the resilience of EU financial institutions. While staff recommends targeted liquidity support measures for critically integrated wholesale energy producers to cover margin requirements, the liquidity situation of French energy producers has been closely monitored by the authorities and such measures have not been deemed necessary so far. Despite extraordinary volatility in gas and electricity prices, these companies have been able to cover their margin requirement in 2022[1].

On other financial actors, our authorities consider that we collectively need to swiftly advance on reinforcing the regulatory framework for NBFI, with reforms currently under discussion at EU level. Advances are also made in Europe on cyber risks – as the DORA regulation will provide a framework for increased resilience and critical third-parties monitoring – and

[1] French banks, which are large clearing members, have provided liquidity support to the large French energy producers as part of this business, in line with their counterparty credit risk policies. French energy producers have also been able to access short-term and long-term market funding to cover their liquidity needs.

crypto-assets – with the adoption of the "Digital Finance" package including MiCA. To be effective, these efforts need to be pursued but also followed by the swift adoption of similar packages in other parts of the world.

As for the housing market, risks need to be monitored closely but are considered limited in France, thanks both to the implemented macroprudential measures, in particular borrower-based limits imposed by the High Council for Financial Stability on home loans, and the fact that over 97% of housing loans are at fixed rate, shielding current contracts from the effect of the increase in interest rate. In addition, the interest rate cap (usury rate) has proved successful in hedging borrowers from significant increases in interest rates. At this stage, with only limited constraints have been observed on first-time buyers.

Regarding macroprudential policy, in line with staff position, the High Council for Financial Stability decided in December 2022, following a previous announcement in September, to raise the credit protection reserve (i.e. the countercyclical buffer, CCyB) to 1%. In 2023, the economic slowdown calls for a balanced approach, avoiding to be procyclical or restrictive, in a context of monetary tightening. This could mean "pausing" the countercyclical buffer at 1%. We will also keep the "structural" measures in place regarding lending conditions for housing loans; and we will remain very vigilant regarding the detection of systemic risks, especially in commercial real-estate and the non-bank segment. The macroprudential measure regarding banks' exposure to highly indebted non-financial corporations remains in place

Finally, the current environment should not slow down progress towards better accounting for environmental risks, and our authorities will continue supporting the disclosure of sustainability-related information – which will become compulsory for European banks in 2023 under ESG Pillar 3 – and the operationalization of transition plans and stress tests. France will remain at the forefront of sustainability-related disclosure both regarding financial stakeholders and non-financial corporates.

Structural policies

The reforms introduced by the French government during the last presidential term are paying off, driving an unprecedented momentum in the labor market and putting an end to two decades of dwindling competitiveness for French companies. Ongoing efforts will deepen their effects. Hence, the government's actions revolve around four pillars.

First, the Government is investing massively to increase the pace for green transition and has implemented ambitious reforms and programs to deeply reduce the environmental impact of our consumption patterns. Recent GHG emission trends are encouraging, but the pace of emission cuts must increase. France will raise its greenhouse gas emissions reduction objective to around 50% versus 1990 levels by 2030 and achieve carbon neutrality by 2050. Two investment plans (France Relance and France 2030) are financing the decarbonization of industrial sites and the development of infrastructures, green mobility, low-carbon energies and technologies, and enhancing energy retrofitting of housing and public buildings. In addition, we share the view that carbon pricing should be enhanced, in particular at international level. We consider that increases in carbon pricing should be reflected in a medium-term manner, encompassed in a planned strategy of decarbonization and be part of a broader package of climate measures, for efficiency and acceptability reasons. France and the UE are implementing a clear medium-term strategy of strengthening the carbon price (*Fit for 55* with strengthening of the existing EU ETS and the extension to housing and road transport sectors).

Second, France aims at achieving full employment and reducing recruitment pressures notably by modulating the duration of unemployment insurance benefits according to the labour market situation, improving skills development, and promoting senior employment. The unemployment benefits reform, the pension reform, the expansion of the Youth Employment Contract, and various training measures (including amplify apprenticeship dynamics) will strengthen incentives to return-to-work and integration initiatives for workers who are far removed from the labor market, harness senior employment to strengthen the workforce, and expand skills and occupational horizons. Other priorities will be implemented to achieve this goal of full employment, including renovate the public employment service (by creating France Travail), and reform the support for RSA beneficiaries and better integrate those who are furthest from employment.

Third, the COVID-19 crisis and the Russia's war in Ukraine have shed the light on some strategic vulnerabilities, linked in particular to supply-chains disruptions. Our authorities aim at bolstering the resilience of our value chains and ensuring France's energy, economic and digital sovereignty. The implementation of a "sobriety" plan to reduce energy consumption and secure short-term supply, while contributing to a sustainable change in behaviors, will be coupled with a medium-term strategy of diversifying sources of supply with low-carbon energies, notably the Renewable Energy Fast-Tracking Bill and strengthening our nuclear industry (including the construction of new EPRs).The latest figures already reflect significant efforts to save energy, the average electricity consumption has been for instance 7,6% lower during the month of December 2022 compared to December 2021. The authorities also aim at bolstering the competitiveness of French businesses by simplifying further the business environment, strengthening their capacity for innovation in strategic sectors (notably hydrogen, batteries semiconductors, digital data) with the continuation of the Program of Investments for the Future (PIA 4) and more recently the France 2030 investment plan, and closing the digital divide in regions by finalizing the country-wide rollout of mobile and high-speed broadband coverage. We plan to go even further by becoming the first green industrial nation in Europe. Moreover, the removal of the remaining share of the value-added contribution for businesses (CVAE) will deepen the cut in distortive production tax initiated over the last five years to the benefit of firms' competitiveness.

Fourth, building equal opportunities remains a top government priority. The French authorities plan to increase investment in education by supporting pedagogical innovation and creating an environment conducive to the development of academic ambition for all. It also involves an increase in the attractiveness of the teaching profession, in particular by taking better account of salary and working conditions. We also aim to provide support in early childhood care with the massive creation of additional daycare spots, to promote access to healthcare and disease prevention for instance with free consultations at key moments in life, increase the assistance to elderly and the autonomy of people with disabilities to face the challenge of aging, and expand access to decent housing for all, in a context of increasing life costs