



FRANCE

July 2019

2019 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 2019 Article IV consultation with France, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 22, 2019 consideration of the staff report that concluded the Article IV consultation with France.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 22, 2019, following discussions that ended on June 3, 2019, with the officials of France on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 1, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for France.

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

Selected Issues
Financial Stability System Assessment

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

Copies of this report are available to the public from

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

International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 19/295
FOR IMMEDIATE RELEASE
July 24, 2019

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

IMF Executive Board Concludes 2019 Article IV Consultation with France

On July 22, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with France. This also included a discussion of the findings of the Financial Sector Assessment Program (FSAP) exercise for France.²

Growth is expected to stay moderate in the near term, reaching 1.3 percent this year and 1.4 percent in 2020, after slowing last year on the back of decelerating global growth and reduced slack. The labor market continued to improve, with strong job creation leading to a further reduction in the unemployment rate. Inflation spiked in 2018 because of rising oil prices and tax hikes but has since moderated and is projected to reach 1.2 percent this year. The fiscal deficit declined to 2.5 percent of GDP at end-2018, while public debt continued to remain elevated, at around 98 percent of GDP.

Last year, the government revamped vocational training and professional development to foster labor market participation, especially for low-skilled workers, following key labor tax and labor code reforms enacted in its first year in office. A recent business environment reform has also been enacted, which should spur competition, innovation, and productivity growth. Regarding fiscal policy, the government is providing substantial tax relief to boost households' purchasing power. Some expenditure savings are expected to emerge in the context of planned reforms of the civil service, pensions, and unemployment benefits. As to the financial sector, to address a buildup of systemic risk from corporate leverage, the authorities further raised the countercyclical capital buffer, after having activated it last year, along with lowering the large exposure limit of banks to large indebted companies.

In the medium-term, growth is expected to gradually converge toward its long-run potential of around 1½ percent, supported by a recovery of domestic and external demand and ongoing structural reforms. Still, risks have risen, related to a disorderly Brexit, trade tensions, a softening of activity in the euro area, and a slowdown in the domestic reform agenda.

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.

² Under the FSAP, the IMF assesses the stability of the financial system, and not that of individual institutions. The FSAP assists in identifying key sources of systemic risk and suggests policies to help enhance resilience to shocks and contagion. In member countries with financial sectors deemed by the IMF to be systemically important, it is a mandatory part of Article IV surveillance, and supposed to take place every five years.

Executive Board Assessment³

Executive Directors noted that France's growth slowed last year but remained relatively resilient compared to peers, while labor market conditions continued to improve. The growth outlook remains solid, but downside risks have risen, related to global trade tensions, an uncertain Brexit outcome, and weaker-than-expected growth in Europe. In this context, Directors commended the authorities for their continued progress with structural reforms over the last year supporting jobs and growth. Looking forward, they recommended pursuing and building on the authorities' reform agenda to address France's remaining structural challenges: high public and private debt, still high structural unemployment, sluggish productivity growth, and inequality of opportunity. In prioritizing the recommended reforms, Directors highlighted the importance of carefully assessing the tradeoffs and the proper sequencing of structural reforms and fiscal consolidation.

Directors called for a sustained, growth-friendly consolidation effort to reduce the deficit and put public debt on a firm downward path. In this context, many Directors considered that a strong adjustment would be appropriate to rebuild buffers and not delay achievement of the medium-term objective under EU fiscal rules. A number of other Directors, however, supported a more gradual consolidation. Directors noted that France has some fiscal space that could be used in a sharp downturn but stressed the importance of carefully balancing the need to support growth and safeguard sustainability.

Directors urged the authorities to anchor their fiscal strategy in durable medium-term reforms to reduce public spending. In this context, they supported the authorities' planned civil service, pension, and unemployment benefit reforms, which could help generate some fiscal savings while also improving the efficiency of the public sector. Directors called for complementing these reforms with additional spending measures to reconcile the government's objectives of frontloading tax relief, making space for priority investment, and putting debt on a sustained downward path.

Directors welcomed recent labor market reforms, including revamping vocational training and professional development and overhauling unemployment benefits, in order to foster labor market participation and enhance opportunities for vulnerable groups. They encouraged the authorities to implement these reforms resolutely, monitor their effects carefully, and stand ready to deepen them if outcomes fall short of objectives. Directors also welcomed the recent reforms that led to an improved business environment and recommended complementing them with further efforts to liberalize regulated professions, retail trade, and the sale of medicines. Directors welcomed France's voluntary participation in the Fund's enhanced governance framework on the

³ 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>.

supply and facilitation of corruption. They also took positive note of the authorities' commitment to transition France to a low-carbon economy.

Directors commended the authorities' progress in bolstering the financial system's resilience, as reflected in the FSAP review, including by taking a proactive macroprudential response to the buildup of systemic risk from corporate leverage. Directors emphasized the need to continue to monitor systemic risks closely and stand ready to deploy additional macro- and micro-prudential policies as needed. Given the global significance and complexity of France's financial system, Directors called for further integration of monitoring and oversight at the conglomerate level, strengthening liquidity-risk management within conglomerates, and ensuring adequate liquidity buffers. Enhanced AML/CFT supervision of smaller banks will also be important.

France: Selected Economic Indicators, 2017-20				
			Projections	
	2017	2018	2019	2020
Real economy (change in percent)				
Real GDP	2.3	1.7	1.3	1.4
Domestic demand	2.3	1.0	1.3	1.4
Foreign balance (contr. to GDP growth)	-0.1	0.7	0.0	-0.1
CPI (year average)	1.2	2.1	1.2	1.4
GDP deflator	0.5	0.8	1.3	1.4
Public finance (percent of GDP)				
General government balance	-2.8	-2.5	-3.2	-2.3
Revenue	53.6	53.5	52.4	52.1
Expenditure	56.4	56.0	55.6	54.4
Primary balance	-1.1	-0.9	-1.8	-0.9
Structural balance (percent of pot. GDP)	-2.6	-2.4	-2.3	-2.4
General government gross debt	98.4	98.4	99.0	98.6
Labor market (percent change)				
Employment	0.9	0.7	0.6	0.4
Labor force	0.1	0.3	0.2	0.0
Unemployment rate (percent)	9.4	9.1	8.6	8.3
Credit and interest rates (percent)				
Growth of credit to the private non-financial sector	5.6	5.5	5.0	4.6
Money market rate (Euro area)	-0.4	-0.4	...	...
Government bond yield, 10-year	0.8	0.8	...	...
Balance of payments (percent of GDP)				
Current account	-0.7	-0.6	-0.6	-0.5
Trade balance of goods and services	-1.1	-1.1	-1.0	-1.0
Exports of goods and services	32.1	32.6	34.7	34.7
Imports of goods and services	-33.1	-33.7	-35.7	-35.7
FDI (net)	0.4	2.3	1.7	1.7
Official reserves (US\$ billion)	54.8	66.1	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.89	0.85	...	...
NEER, ULC-styled (2005=100, +=appreciation)	97.1	98.2	...	...
REER, ULC-based (2005=100, +=appreciation)	90.5	91.1	...	...
Potential output and output gap				
Potential output (change in percent)	1.3	1.4	1.4	1.5
<i>Memo: per working age person</i>	1.2	1.5	1.3	1.5
Output gap	-0.1	0.2	0.1	0.1

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



FRANCE

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

July 1, 2019

KEY ISSUES

Context: Growth slowed last year as the cyclical recovery ran its course and temporary domestic factors, coupled with slowing global growth, weighed on demand. Nonetheless, activity remained resilient relative to peers, and the labor market continued to improve. The fiscal deficit declined modestly, but public debt reached an all-time high. The government's structural reform agenda is being put in place and growth is expected to gradually return to its potential level over the medium run. However, risks have risen, related to a disorderly Brexit, trade tensions, and a softening of activity in the euro area, but also to a slowdown in the domestic reform momentum.

Policies: Building on the ongoing government reform agenda, policies should aim at addressing France's structural challenges—high public debt and spending, rising private sector indebtedness, high unemployment, inequality of opportunity, and sluggish productivity. The challenge is to attain social consensus around the key policy priorities:

- *Safeguarding fiscal sustainability and improving the efficiency of the public sector:* planned reforms—civil service, pensions, unemployment—should be pursued. But they need to be complemented with further reforms to contain spending if the ongoing reduction in the tax burden is to be sustained over time. Should downside risks materialize, fiscal policy will need to balance cyclical and sustainability concerns, while protecting vulnerable groups.
- *Boosting potential growth* by continuing reforms that reduce structural unemployment and improve labor force participation, especially by vulnerable groups, and enhance productivity. The recent labor market reforms, including of training and apprenticeship and unemployment benefits are welcome. Their full implementation, coupled with a sharper focus on product and service market reforms that support competition, will be important.
- *Strengthening the resilience of the financial sector* to support the allocation of savings to most productive uses. This requires bolstering the monitoring and oversight of financial conglomerates, proactively monitoring and addressing cyclical risks, including from rising corporate indebtedness, through micro and macroprudential tools, and continuing to enhance crisis management, resolution, and safety nets.

Approved By
Enrica Detragiache
(EUR) and
Vikram Haksar (SPR)

Discussions took place from May 21–June 3, 2019. The staff team comprised D. Velculescu (mission head), L. Antoun de Almeida, B. Gruss and L. Kemoe (all EUR), and A. Zdzienicka (FAD) and was assisted at headquarters by J. Lee, T. Mohd Nor, and K. Vanegas. 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

CONTEXT: LOWER GROWTH AMID RISING RISKS	4
A. Recent Developments	4
B. Outlook and Risks	6
POLICIES: SAFEGUARDING SUSTAINABILITY, INCLUSIVE GROWTH, AND RESILIENCE	8
A. Fiscal Policy: Safeguarding Sustainability	8
B. Structural Reforms: Supporting Inclusive Growth	15
C. Financial Sector: Strengthening Resilience	19
STAFF APPRAISAL	23
BOXES	
1. Policy Responses to the Gilets Jaunes Protest	25
2. Planned Fiscal Structural Reforms	27
3. Recent Efforts in Tackling Corruption and Supply-Side Bribery	28
FIGURES	
1. Real Sector Developments	29
2. Labor Market Developments	30
3. External Sector	31
4. Financial Sector	32
TABLES	
1. 2019 Key FSAP Recommendations	22
2. Selected Economic and Social Indicators, 2015–24	33
3. General Government Accounts, 2015–24	34
4. Balance of Payments, 2015–24	35
5. Vulnerability Indicators, 2010–18	36
6. Core Financial Soundness Indicators, 2013–18	37

7. Encouraged Financial Soundness Indicators, 2013–18	38
---	----

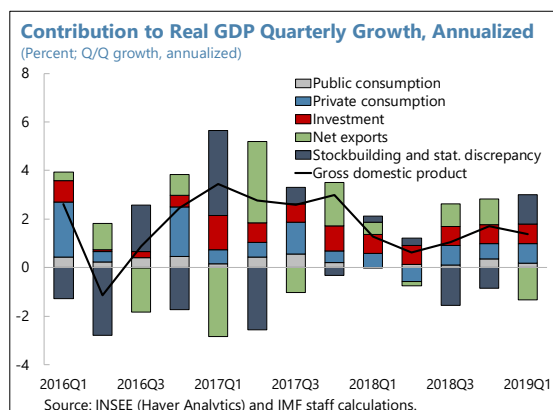
ANNEXES

I. Authorities' Response to Past IMF Policy Recommendations	39
II. External Sector Assessment	40
III. Risk Assessment Matrix	41
IV. Debt Sustainability Analysis (DSA)	42
V. Taking Stock of Inequality in France	53
VI. Benchmarking Spending Reforms in France	62

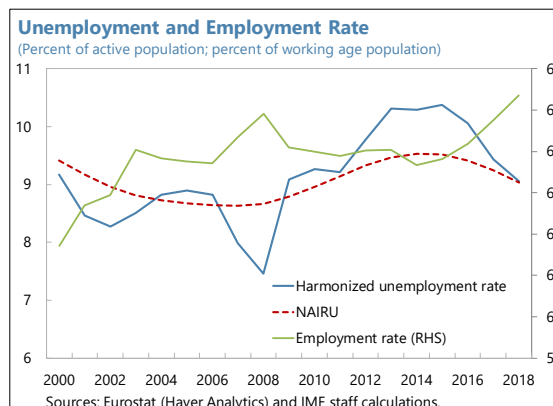
CONTEXT: LOWER GROWTH AMID RISING RISKS

A. Recent Developments

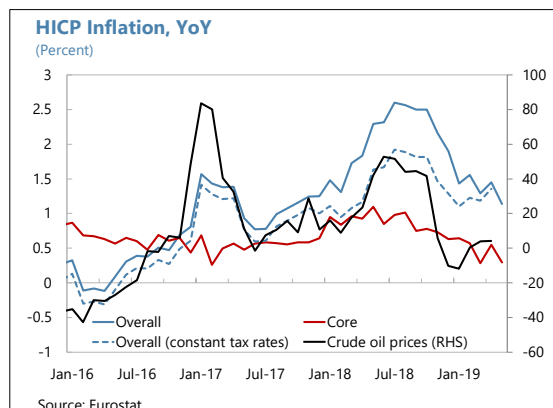
1. Growth declined in 2018 but remained relatively resilient (Figure 1). After the economy expanded by 2.3 percent in 2017, closing the output gap, real growth declined to 1.7 percent in 2018.¹ Export growth slowed in line with regional trends, while investment and private consumption moderated, including due to one-off domestic factors (railroad-transport strikes in the first half of the year and “yellow-vest” protests toward end-year). In the first quarter of 2019, growth declined slightly to 0.3 percent (q-o-q), from 0.4 in Q4:2018, as decelerating net exports offset a recovery in private consumption and restocking.



2. Unemployment declined further (Figure 2). Continued employment creation led to a decline in the unemployment rate to 8.7 percent at end-April 2019. Permanent contracts accounted for the lion’s share of job creation, which, together with a decline in long-term unemployment and the underemployment rate, point to improved conditions in the labor market. This could reflect, in part, the effect of labor-market and tax reforms implemented in recent years.



3. Inflation spiked in 2018 but has since moderated. Headline inflation peaked in October 2018, due to rising oil prices and an increase in energy and tobacco taxes. Although nominal wage growth picked up during 2017–18, averaging around 2 percent in 2018, core inflation remained contained, averaging about 0.9 percent last year. Inflation and core inflation moderated this year, reaching 1.4 and 0.5 percent, respectively, on average, between January and May.



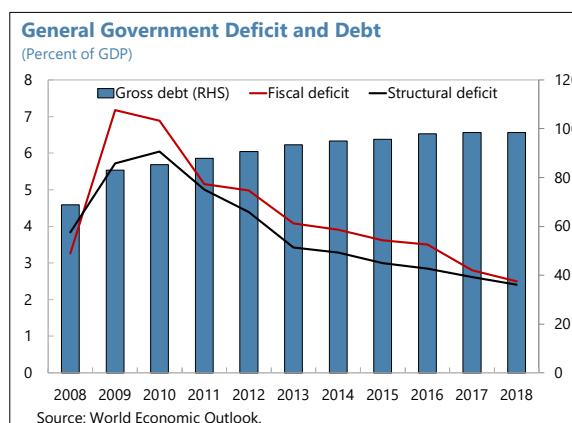
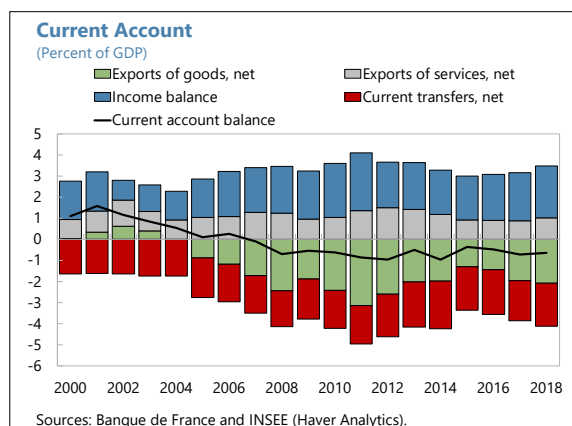
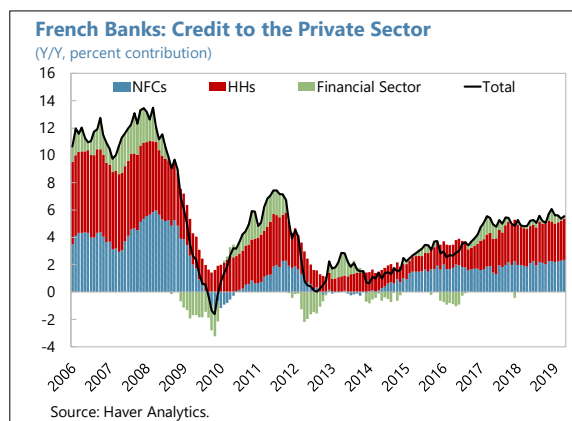
¹ See Box 1 in IMF Country Report No. 18/243 for a discussion of France’s output gap estimates.

4. Financial conditions remained supportive. Supported by an accommodative monetary policy, low borrowing costs in the last few years created an environment conducive to a rise in asset prices and encouraged non-financial companies to increase both bank debt and bond issuance. Bank credit growth was around 5½ percent in 2018 and has continued at a similar pace this year.

5. The current account deficit reached 0.6 percent of GDP in 2018 (Figure 3). This represents a slight narrowing (of 0.1 percent of GDP) relative to the revised 2017 level, reflecting a better performance of the service and non-oil goods trade balances, which offset the higher oil bill, as well as a continuation of the improving trend in the income balance. Still, France has not been able to recover the loss of about one third of its export market share since the early 2000s, in part due to the economy's specialization in medium to low-tech sectors that are relatively more exposed to price competition.²

6. The 2018 fiscal deficit declined to 2.5 percent of GDP, but debt remained high. Over the last two years, the deficit fell by a cumulative 1 percent of GDP, on account of exceptionally high cyclical tax revenues in 2017, a reduction in cyclical unemployment-benefit spending in 2017–18, and some spending restraint in 2018. Several tax relief measures became effective last year (e.g. lower social contributions, corporate income and accommodation taxes), largely compensated by an increase in other taxes (income, fuel, and tobacco). Public debt stayed around 98 percent of GDP in 2017–18.

7. Support for the government's agenda among the general public has declined compared to the start of the mandate. In its first 18 months in office, the government legislated important labor-market and tax reforms supporting investment, jobs, and growth. But the "yellow-vest" protests last November revealed popular discontent with the government's policies, especially



² See IMF Country Report No. 17/289.

with respect to planned fuel tax increases, higher pension taxation, and the 2017 reform of capital taxation, among others. In response to the protests, the authorities initiated a grand national debate on reforms and took measures to lower the tax burden and boost household disposable income, including by reversing some previously planned measures (Box 1). They have recently reaffirmed their intention to continue with planned structural reforms, including of unemployment benefits, civil service, and pensions (Box 2).

B. Outlook and Risks

8. Growth is expected to reach 1.3 and 1.4 percent this year and next, respectively.

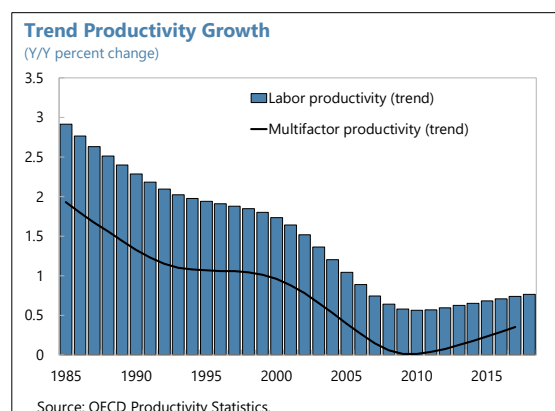
Projections are predicated on a gradual resumption of quarterly growth through 2019–20, as the effect of temporary factors fades, and regional and global growth recovers. Private consumption is expected to increase, supported by recent fiscal measures to boost household disposable income, lower oil prices, and improving labor market conditions. Investment and export growth are expected to remain subdued in the near term—as external demand in the Euro Area remains moderate and macroprudential policies dampen credit growth—and pick up gradually over the medium run. Given the level of the cyclically-adjusted current account (CA) relative to the revised model norm, the external position is now assessed to be broadly consistent with medium-term fundamentals and desirable policy settings, even as France’s estimated CA gap of -1 percent of GDP is in the upper range for this category, with a real effective exchange rate (REER) gap of 2 to 5 percent (Annex II). Inflation is projected to remain subdued at 1.2 and 1.4 percent this year and next, returning to the ECB’s target only toward the end of the projection horizon.

France: Selected Economic Indicators, 2017–24

	2017	2018	Projections					
			2019	2020	2021	2022	2023	2024
Real economy (change in percent)								
Real GDP	2.3	1.7	1.3	1.4	1.5	1.5	1.5	1.5
Domestic demand	2.3	1.0	1.3	1.4	1.5	1.5	1.6	1.6
Private consumption	1.4	0.9	1.4	1.6	1.6	1.6	1.6	1.6
Public consumption	1.5	0.8	0.6	0.4	0.6	0.6	0.9	1.2
Gross fixed investment	4.7	2.8	2.0	2.1	2.3	2.3	2.3	2.2
Foreign balance (contr. to GDP growth)	-0.1	0.7	0.0	-0.1	0.0	0.0	-0.1	-0.2
Exports of goods and services	3.9	3.5	3.5	3.5	3.8	3.8	3.6	3.5
Imports of goods and services	3.9	1.2	3.5	3.6	3.6	3.7	3.8	3.8
CPI (year average)	1.2	2.1	1.2	1.4	1.4	1.6	1.8	1.8
Unemployment rate (percent)	9.4	9.1	8.6	8.3	8.1	8.0	8.0	8.0
Output gap (percent of pot. GDP)	-0.1	0.2	0.1	0.1	0.0	0.0	0.0	0.0

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

9. Long-term growth prospects remain subdued. Output growth is expected to converge to its long-run potential level of around 1½ percent on the back of recovering domestic demand. Labor productivity growth has declined during the past two decades, largely reflecting falling multi-factor productivity growth and is expected to recover only somewhat over the medium term, as recent and ongoing structural reforms (including product market reforms legislated in 2015, the 2018 liberalization of rail transport, and the more recent *Loi PACTE*) start to bear fruit.



10. Uncertainty around the outlook is large, and downside risks have risen (Annex III):

- *Weaker-than-expected growth in Europe* and deteriorating market sentiment could weigh on export growth and confidence in France.
- *Rising protectionism and retreat from multilateralism*, in particular a further escalation of trade tensions between the United States and the European Union (including a possible response to EU subsidies to Airbus and potential car tariffs) could induce firms to postpone investment, weighing on employment and activity.
- *Sharp tightening of global financial conditions*, related to a disorderly Brexit or concerns about debt levels in some euro-area countries could also affect France's growth outlook. A disorderly Brexit could lower France's growth by some 0.2–0.3 percentage points by 2021, largely through real sector channels.³ If border disruptions in key ports are high, the short-term impact could be larger. Financial volatility linked to Brexit or concerns about high-debt countries could weigh on public and private balance sheets through higher financing costs.
- *Domestic risks* have also risen, related to potential resistance to reforms, which could compromise fiscal objectives, dampen confidence, and, through higher financing costs, have second-round effects on growth. Given the observed steady decline in inflationary pressures, there are also downside risks that inflation does not converge to target in the medium run, which could further weigh on private and public debt burdens.

Authorities' Views

11. There was broad agreement on the economic outlook and risks. The authorities expect growth at 1.4 percent this year and next, driven by a strong effect on private consumption of fiscal

³ The authorities estimate that the effect of a disorderly Brexit for France would be about 0.2 percent of GDP in the short term (excluding effects from rising uncertainty; see France 2019 Stability Program). Staff's estimate is around 0.3 percent, somewhat smaller than the cost for the EU, estimated at 0.5 percent (see Box 1.1 of the April 2019 *World Economic Outlook*).

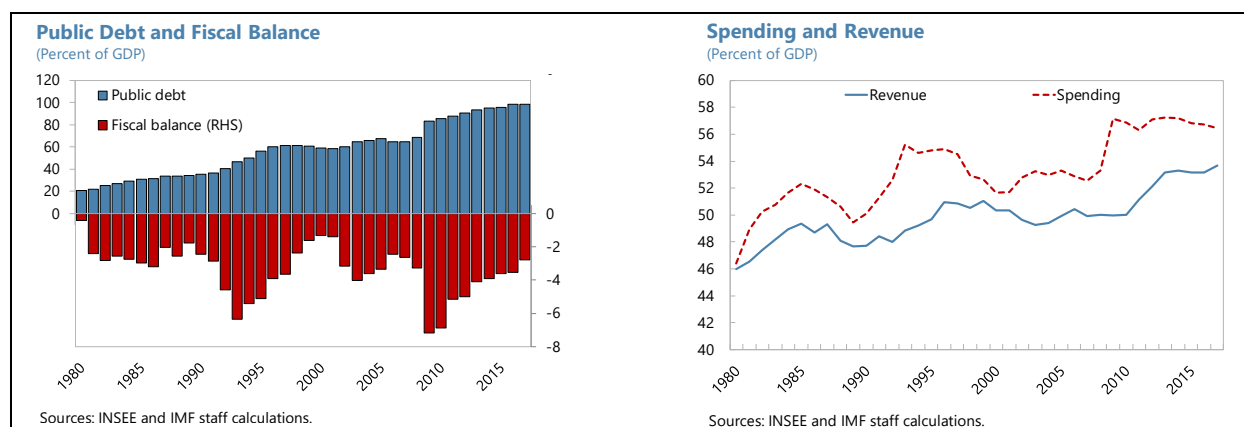
measures supporting purchasing power in the near term. They broadly shared staff's view that external risks have risen—including trade tensions and Brexit—but considered that France is relatively more insulated than some other European neighbors due to a less open economy. At the domestic level, they did not share staff's views on reform risks, as they remained committed to pursue their reform agenda and understood the conclusions of the grand national debate as supportive of a strong reform process

POLICIES: SAFEGUARDING SUSTAINABILITY, INCLUSIVE GROWTH, AND RESILIENCE

12. Policies need to continue to address France's long-standing challenges while ensuring resilience and inclusive growth. The key structural challenges are high public debt and spending, rising private sector indebtedness, low labor force participation, high unemployment, inequality of opportunity, and sluggish productivity growth. The authorities have put in place an ambitious structural agenda to tackle some of these challenges and are working on further fiscal structural reforms of the civil service, pensions, and unemployment benefits (Box 2). The challenge will be to modulate, enhance, and prioritize the agenda to attain economic objectives while also addressing social concerns and lingering pockets of inequality (Annex V). In this regard, policies should prioritize safeguarding fiscal sustainability in a growth-friendly manner, while protecting vulnerable groups, and supporting employment and productivity.

A. Fiscal Policy: Safeguarding Sustainability

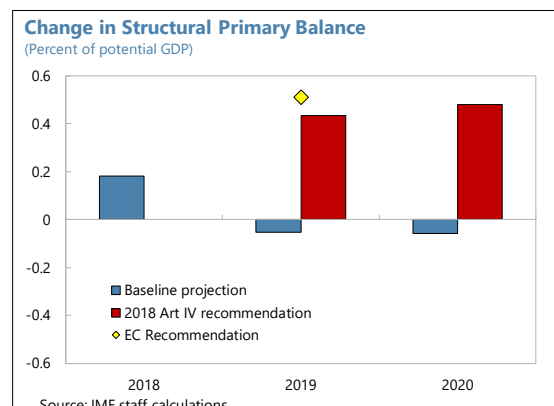
13. France's public debt has reached historical highs, raising vulnerability to adverse shocks. Public debt increased by about 80 percent of GDP between 1980 and 2018, reflecting sizeable deficits, as successive governments did not take full advantage of good times to reverse the spending increases undertaken during downturns. Even in recent years, with interest rates at record lows and well below the growth rate of the economy, debt has continued to rise as a share of GDP, and adverse shocks could set in motion a worrisome medium-term trajectory (Annex IV). For instance, a shock to growth, the primary balance and real interest rates could bring debt well above 100 percent of GDP in the medium run.



14. The deficit and debt are expected to remain elevated over the medium run, given substantial ongoing tax relief.

Staff's baseline projections are based on legislated and announced policies (including recent measures to boost purchasing power in response to the "yellow-vest" movement, amounting to close to 1 percent of GDP in the medium run; text table and Box 1). The key revenue measures include legislated and planned reductions of corporate income taxes, social contributions, accommodation taxes, and more

recently personal income taxes, costing around 1.3 percent of GDP this year, and a cumulative 2.1 percent during 2018–24. Legislated spending-containment measures—estimated at 2.2 percent of GDP, including the elimination of the CICE tax credit in 2020 and a rule limiting spending growth of local governments until 2022—largely offset the ongoing tax relief in the medium run, lead to a deficit of 3.2 percent of GDP this year, and 2.7 percent by 2024.⁴ Thus, the primary structural deficit is projected to deteriorate by about 0.3 percent of GDP over the medium term, compared to a recommended improvement of 0.5 percent per year over 2019–22 in the 2018 Article IV Consultation. Public debt is projected to stay elevated, at 97 percent of GDP by 2024. These projections are subject to downside risks, should the yield of the above-mentioned spending-containment measures turn out lower than expected.



Baseline Expenditure and Tax Measures (Cumulative, in percent of GDP)

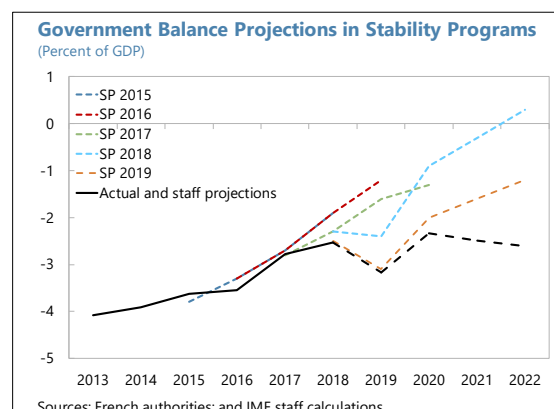
	2018	2019	2020	2021	2022	2023	2024
Tax measures	-0.1	-1.3	-1.6	-1.9	-2.1	-2.1	-2.1
Conversion CICE into a permanent cut in social contributions	0.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Larger CIT tax base from CICE conversion	0.0	0.1	0.3	0.2	0.2	0.2	0.2
Increase CSG (conversion social contributions to CSG)	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Reduction social contributions (conversion social contributions to CSG)	-0.6	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Elimination of accommodation tax	-0.1	-0.3	-0.4	-0.5	-0.7	-0.7	-0.7
Reduction in CIT rate	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4
Reduction in CIT rate (postponment for large firms)	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Green taxes	0.1	0.2	0.3	0.4	0.5	0.5	0.5
Reversal green taxes	0.0	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3
Lower PIT for lower-income taxpayers	0.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.2
Narrowing of wealth tax base	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
PIT exemption on overtime pay	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Tax on dividends	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Additional exonerations of employers social charges	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Exoneration of the CSG increase for group of retirees	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Tax credit (CITE) recentered	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Taxes on cigarettes	0.0	0.1	0.1	0.1	0.1	0.1	0.1
GAFA tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	-0.1	0.1	0.0	0.0	0.0	0.0	0.0
Spending measures	-0.5	-0.6	-1.9	-2.0	-2.2	-2.2	-2.2
End of CICE	0.0	0.0	-0.9	-0.9	-0.9	-0.9	-0.9
Local governments spending rule	-0.1	-0.2	-0.3	-0.4	-0.5	-0.5	-0.5
De-indexation of pensions and of social benefits	0.0	-0.2	-0.4	-0.4	-0.4	-0.4	-0.4
Re-indexation of lower pensions	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Contrats aides (2018 and 2019 budgets)	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Health spending (ONDAM)	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.2
Wage scale frozen nominally	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Housing benefits (2018 and 2019 budgets)	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Unemployment benefit reform	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Revalorisation of the Prime d'activite	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Total measures (+ = improvement in balance) ^{1/}	0.3	-0.7	0.3	0.1	0.1	0.1	0.0

Sources: IMF staff estimates.

1/ The measures in response to the "yellow vest" movement imply a deterioration in the fiscal balance of about 0.4 percent of GDP in 2019 and 0.9 percent of GDP in the medium run (Box 1).

⁴ The projected increase in the 2019 deficit reflects the temporary double effect of the tax credit (CICE) and social contribution cut that companies will receive this year before the tax credit is eliminated next year.

15. The authorities are projecting somewhat lower deficits but are no longer planning to reach their MTO by 2022. In their latest Stability Program (submitted before the April 2019 fiscal relaxation announcements), the authorities project the deficit to reach 1.2 percent of GDP by 2022, 1½ percent of GDP higher than the level targeted in the 2018 Stability Program, and close to 1 percent larger than the MTO, postponing reaching their fiscal objective to beyond the end of the government’s mandate. They expect revenues to decline broadly in line with planned measures, while yet-to-be-identified spending cuts of some 1.2 percent of GDP are expected to contribute to the projected reduction in the fiscal deficit. In terms of fiscal effort, the authorities expect the structural primary balance to stay broadly constant in 2019–20 and improve by 0.4 percent annually in 2021–22.



16. France requires an ambitious structural consolidation effort of around 2 percent of GDP during 2020–23 to place debt on a firm downward path and achieve the MTO. Achieving this sizeable structural adjustment needed to reduce the structural deficit to 0.4 percent of GDP (MTO) and debt to around 90 percent will be challenging, given France’s mixed experience with sustaining consolidations, as reflected in the difficulty in bringing its public finances to balance and reversing the rising trend in public debt over the last several decades.⁵ Doing so will require a steady improvement in the structural primary balance of around 0.5 percent of GDP per year during 2020–23. Staff’s recommended adjustment takes into account the cyclical stance of the economy (a small but still positive output gap) and the need to safeguard the credibility of fiscal policy (given

		Projected Fiscal Outturns (in percent of GDP, unless otherwise noted)						
		2018	2019	2020	2021	2022	2023	2024
Baseline projections	Fiscal balance	-2.5	-3.2	-2.3	-2.5	-2.6	-2.7	-2.7
	Structural fiscal balance (percent of potential GDP)	-2.4	-2.3	-2.4	-2.5	-2.6	-2.7	-2.7
	Structural primary balance (percent of potential GDP)	-0.8	-0.8	-0.9	-1.0	-1.1	-1.1	-1.1
	<i>Change in structural primary balance</i>		-0.1	-0.1	-0.1	-0.1	0.0	0.0
	Public debt	98.4	99.0	98.6	98.3	97.9	97.4	97.0
Staff recommendations	Fiscal balance	-2.5	-3.2	-1.7	-1.3	-0.8	-0.4	-0.4
	Structural fiscal balance (percent of potential GDP)	-2.4	-2.3	-1.8	-1.3	-0.8	-0.4	-0.4
	Structural primary balance (percent of potential GDP)	-0.8	-0.8	-0.3	0.2	0.7	1.2	1.2
	<i>Change in structural primary balance</i>		-0.1	0.5	0.5	0.5	0.5	0.0
	Public debt	98.4	99.0	98.2	96.8	94.8	92.2	89.7
Authorities’ projections (2019 Stability Programme)	Fiscal balance	-2.5	-3.1	-2.0	-1.6	-1.2	.	.
	Structural fiscal balance (percent of potential GDP)	-2.1	-2.1	-1.9	-1.6	-1.3	.	.
	Structural primary balance (percent of potential GDP)	-0.4	-0.6	-0.4	0.0	0.4	.	.
	<i>Change in structural primary balance</i>		-0.2	0.2	0.4	0.4	.	.
	Public debt	98.4	98.9	98.7	98.1	96.8	.	.

Sources: IMF staff estimates and 2019 France Stability Programme.

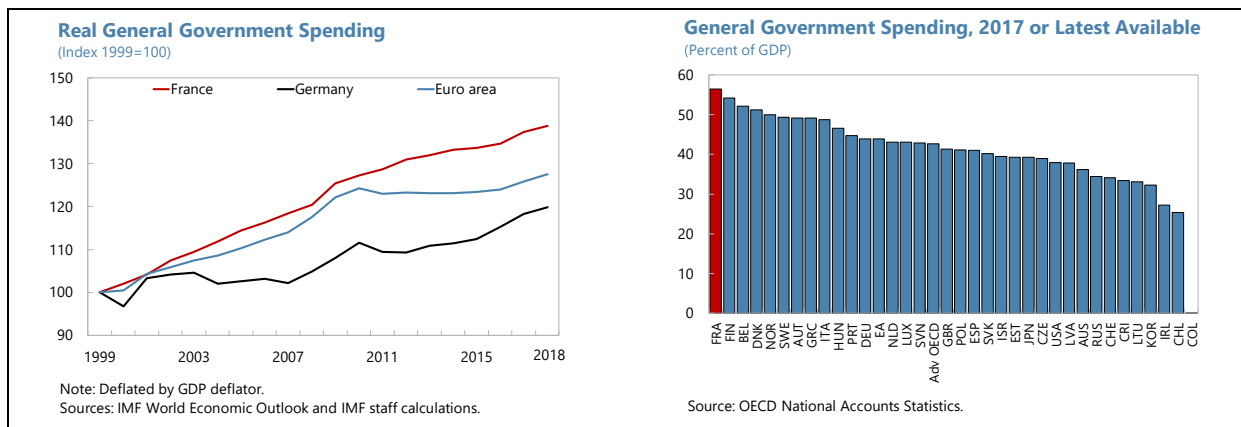
⁵ Also see Box 3 of IMF Country Report No. 18/243 and Martin et Al. (IMF Working Paper 11/89).

frontloaded tax relief) and debt sustainability.⁶ Achieving a lower level of debt will be key to build buffers, improve intergenerational equity and help avoid procyclical tightening—which could affect vulnerable groups disproportionately—should a softening in activity bring the deficit above the 3 percent of GDP Maastricht limit.

17. Cyclical and sustainability concerns need to be carefully balanced if downside risks materialize. France is deemed to have some fiscal space to absorb potential shocks (though less than before the global financial crisis, when its debt was around 70 percent of GDP), but the space would be at risk when EU fiscal rules are taken into account. Thus, in a downside scenario, policymakers would face difficult tradeoffs between supporting growth on one hand, and preserving market confidence and debt sustainability on the other hand. Thus, the policy response will need to be carefully calibrated to the severity of the specific shock. For example, in a mild downside scenario generating a small output gap, automatic stabilizers should be allowed to operate fully around the recommended structural adjustment path. In a sharp downturn, where all risks materialize simultaneously, and France and the euro area fall into recession, in addition to automatic stabilizers, a moderate and temporary structural relaxation could be appropriate, financing conditions allowing. In this case, it will be critical to preserve policy credibility and sustainability, including by clearly pre-specifying future reforms to bring down the debt and deficit in the medium run, while protecting vulnerable groups.

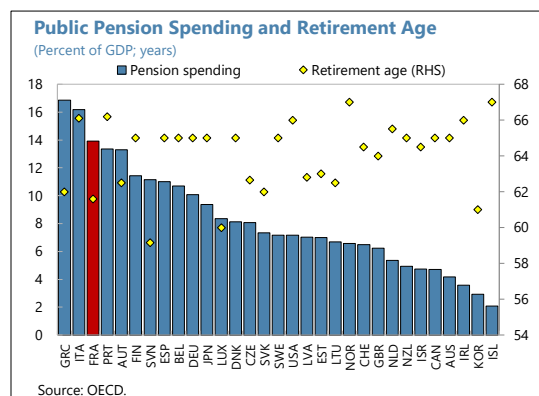
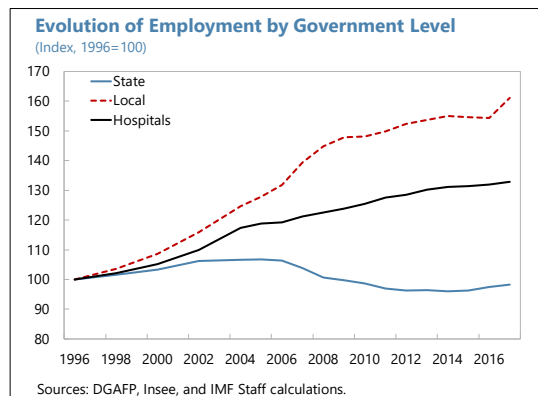
18. The fiscal strategy should focus on specifying credible reforms to reduce public spending over the medium term. While various governments have resorted to tax increases to rein in deficits, followed by periods of tax relief, they have been unable to curb public spending, which has increased by about 10 percent of GDP since the 1980s (largely reflecting higher spending on social benefits) to the highest level relative to GDP among OECD countries. Even during periods of spending-based consolidation (1985–89 and 1996–2000), spending restraint was modest, often targeted at the wage bill, and to a lesser extent social benefits and other spending. Looking forward, a credible and sustained effort to reduce spending in a growth-friendly manner, while increasing its efficiency, will thus be essential to safeguard fiscal sustainability and policy credibility. This is especially important given current plans to frontload substantial tax relief (costing 2 percent of GDP, as noted above), as well as boost medium-term investment in key areas, including skill-upgrading for the long-term unemployed and the youth, environmental protection and digitalization of public services, and scaling up high-speed broadband internet (Box 2).

⁶ Staff's analysis based on a structural model calibrated to France reaches a broadly similar conclusion regarding the need for a sizeable structural adjustment in the medium run that can help balance cyclical and sustainability considerations (see accompanying Selected Issues Paper *"The Appropriate Fiscal Stance in France: A Model Assessment"*). While the model recommends a somewhat more frontloaded adjustment, the results should be interpreted with caution, as they are dependent on the chosen parametric specification and model parsimony (e.g. the model does not account for already legislated policies, among others).



19. Planned fiscal structural reforms could help support consolidation efforts while improving spending efficiency and equity and boosting long-term growth (Box 2):

- The planned *civil service reform* can help provide the tools to streamline and make the public sector more flexible and efficient. To help generate medium-term savings and improve equity, the authorities should target an ambitious decline in the workforce through attrition, especially at the local government level.⁷
- The upcoming *pension reform* unifying the multiple existing pension systems under one umbrella with common rules can help improve transparency, efficiency, and equity of the system. The authorities have not indicated the duration of the transition or a savings objective for this reform but noted their intention to incentivize longer work. To generate savings, improve intergenerational equity, and boost labor-force participation, the reform should be implemented resolutely, ensuring that the transition period balances social concerns, while accelerating the planned increase in the effective retirement age—one of the lowest in Europe—and linking it to life expectancy, as has been done in other countries in Europe (e.g. Denmark, the Netherlands, Portugal, etc.).⁸



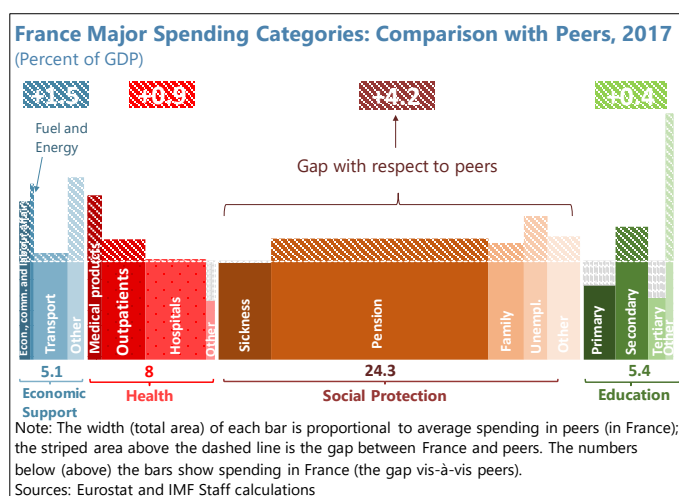
⁷ For example, a reduction in the number of public employees by 120,000 over five years would require halving the replacement ratio of retiring government workers (from 1¼ over the last five years to ¾), yielding 0.1–0.2 percent of GDP in savings.

⁸ The current system already envisages a gradual increase in the effective retirement age to 64 by 2040. An acceleration of this reform (to achieve an effective retirement age of 64 by 2030) could, for example, generate savings of 0.4–0.6 percent of GDP by 2024.

- Finally, the *unemployment benefit reform* now underway could also help generate some (albeit limited) fiscal savings by tightening eligibility requirements, revising the rules to calculate and cumulate benefits, and introducing degressivity in benefits for high-salary workers, while supporting employment and growth.⁹ The planned reorganization of the *health system* could also bring long-run benefits, but should be carefully implemented to minimize medium-run costs.

20. Ongoing efforts should be complemented with additional spending reforms, several of which are being considered by the authorities. Staff analysis indicates that there are several areas where France's level of spending is high relative to peers and where efficiency savings could be achieved (Annex VI):

- The spending gap vis-à-vis peer countries is large in *social protection*, (especially pensions, where France spends almost 20 percent more than peers, but also housing and family benefits), *economic affairs* (including tax expenditures and subsidies, where France spends about 30 percent more than peers), *health* (including 40 percent more spending on medical products and equipment, and almost 20 percent more on outpatient services), and *education* (including 26 percent more on secondary education). Together, these four spending areas represent three-fourths of France's total government expenditure, and account for around 85 percent of the spending gap between France and peers.



- A credible plan to reduce spending will require a careful identification of potential efficiency gains in the above-mentioned areas (saving some 1–1.5 percent of GDP in total in the medium term), which could be obtained by: (i) streamlining corporate tax expenditures and subsidies; (ii) rationalizing spending on medical products and hospital services, while protecting the quality of public health and R&D spending; (iii) improving the allocation of resources in education (tackling high teacher-student ratios and low teaching hours in secondary and upper education, while improving teacher-student ratios in primary education where needed); (iv) better targeting social benefits (e.g. family, housing) to those most in need and streamlining administrative costs;¹⁰ and (v) merging small municipalities and eliminating overlaps between the local and central government.

⁹ Staff estimates savings of around 0.04 percent of GDP per year from this reform.

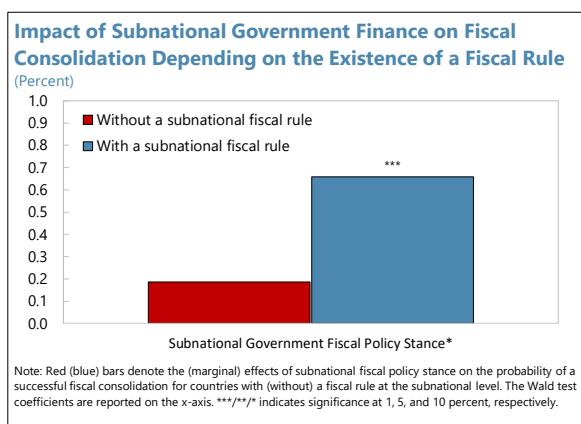
¹⁰ The evidence in Annex VI suggests that some of France's social benefits are less targeted compared to peers.

- Indeed, the authorities have indicated an intention to address many of these areas through upcoming reforms (e.g. tax expenditures, increased focus on preventive healthcare and primary education, further reforms of social benefits, as well as a better allocation of public resources at various levels of government). Such reforms can be compatible with preserving the important redistributive characteristics of fiscal policy, while improving equity (e.g. by limiting costly subsidies to selected groups of the population, reducing duplication of public functions, and better targeting benefits and education resources to where they are needed most).

21. A successful consolidation plan will need to involve a credible commitment across government levels.

Staff's cross-country empirical analysis finds that successful fiscal adjustments require strong coordination across all government levels.¹¹ This is particularly relevant for France, where 20 percent of total spending is undertaken by local governments. Greater revenue decentralization at the subnational level and credible fiscal rules have also been found to be supportive of fiscal adjustments. In France, the

experience so far with the recent local government spending rule is promising: current real spending of local administrations increased by 0.7 percent last year (against the objective of 1.2 percent). Sustaining these gains will be essential, while ensuring that the provision of key public services and support for vulnerable groups is not compromised.



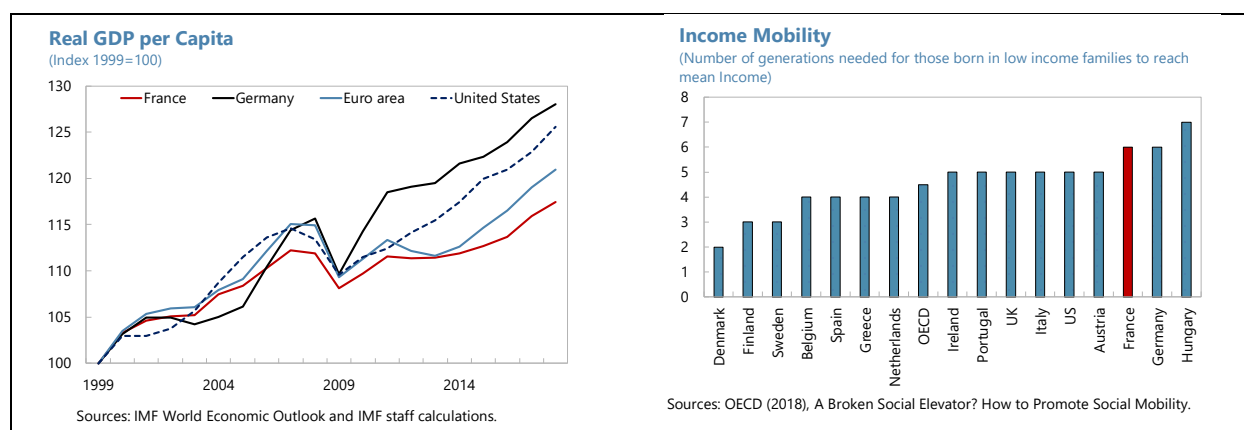
Authorities' Views

22. The authorities concurred with the need to reduce the deficit and debt through durable spending reforms but favored a more gradual pace of consolidation than that recommended by staff. In view of difficult tradeoffs between ambitious structural reforms and fiscal consolidation, their strategy prioritizes addressing structural challenges upfront, while pursuing consolidation in a more gradual manner. In this regard, they reiterated their commitment to undertake fiscal structural reforms that not only support growth but can also achieve fiscal savings in the medium run, such as the unemployment and pension reforms. They agreed with the need to continue to reduce public spending and increase its efficiency over the medium term, including to make space for priority investment (e.g. environment, innovation), noting recent progress including through the local government contractual approach and a better and more transparent budgeting process. As to the policy response in a downside scenario where external risks materialized simultaneously, they saw a need not only for domestic fiscal policy to support growth while ensuring sustainability, but also for a more coordinated policy response at the European level.

¹¹ See accompanying Selected Issues Paper "The Role of Subnational Fiscal Policy, Institutional, and Socio-political Factors in Successful Fiscal Consolidations—Lessons for France."

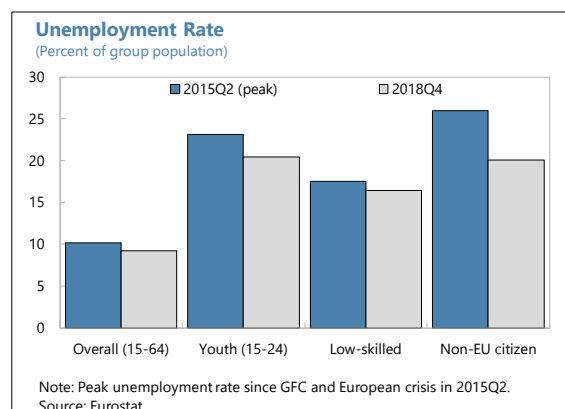
B. Structural Reforms: Supporting Inclusive Growth

23. Living standards have been sluggish, and pockets of inequality persist. Increases in real GDP per capita have been modest over the last two decades, reflecting France’s long-standing challenges related to sluggish productivity growth and low labor force participation rates. The global crisis has magnified these challenges, with France’s living standards falling further behind peers and the euro-area average. While France scores well on aggregate inequality metrics based on disposable income, market income inequality is high, reflecting unequal educational and training opportunities and weak intergenerational mobility (France lags peers on the number of generations it takes to move from the bottom 10 percent to mean income: 6 versus the 4.5 OECD average, Annex V).¹²



24. The government frontloaded labor-market reforms fostering labor market participation, flexibility, and inclusiveness:

- *Key labor-tax-wedge and labor-code reforms* were enacted in 2017, reducing labor tax rates, simplifying social dialogue, facilitating bargaining at the firm level, and reducing judicial uncertainty around dismissals.¹³
- *Additional reforms of apprenticeship and professional-training* were enacted in the fall of 2018, aimed at improving opportunities and skill acquisition particularly for vulnerable groups (such as the young, low skilled, and non-EU born immigrants), whose unemployment rates have been consistently higher. While there has been some progress on the ground (the regulating agency France Competence has been set up, the

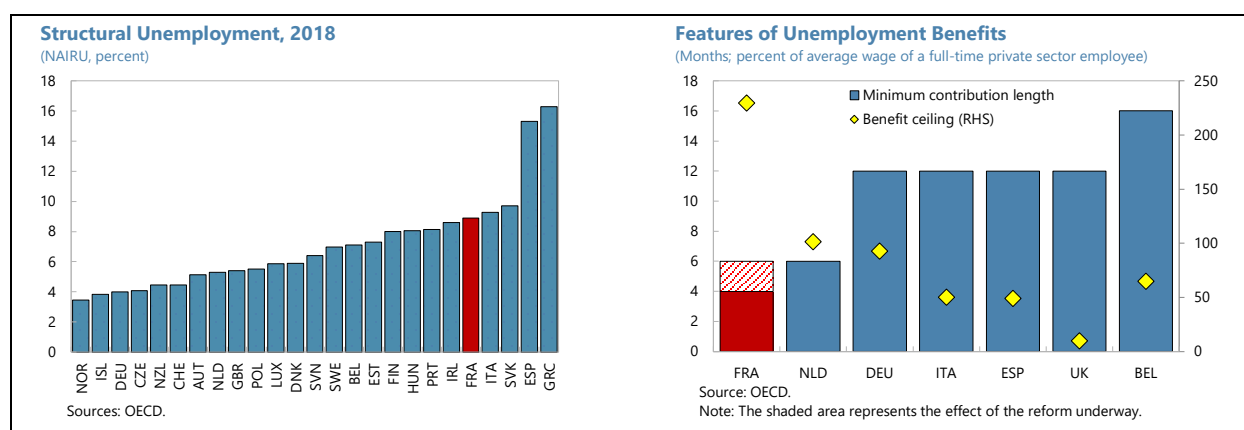


¹² OECD, 2018, “A Broken Social Elevator? How to Promote Social Mobility,” OECD Publishing Paris.

¹³ The OECD estimates that gains from these reforms can be material, especially for the lower and middle part of the income distribution (OECD Economic Surveys: France 2019).

cost of some 800 apprenticeship programs has been identified, some firms have created their own centers, and the number of high-school applicants for apprenticeship programs increased by 40 percent), reforms are expected to take time to be fully implemented (regulation of new training centers is still being developed, the training app is yet to be fully rolled out, etc.). In the meantime, the government is setting aside €15 billion for the training of 1 million unemployed and 1 million low-skilled youth until 2022.

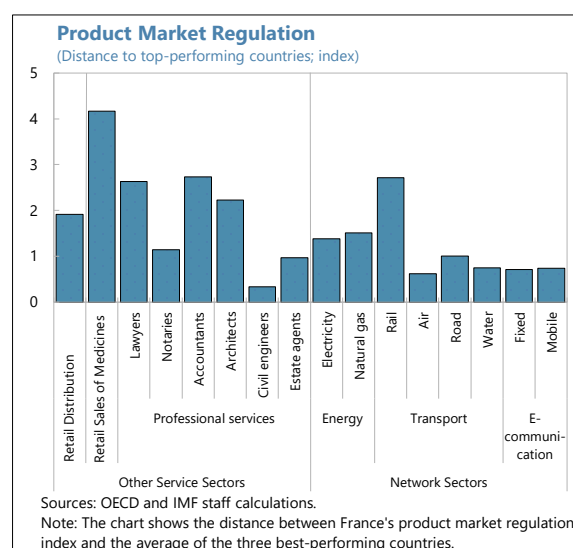
- The authorities have also introduced measures to further reduce *gender gaps*, such as a novel index measuring gender pay inequality, with attendant penalties for companies that fall behind standards (Annex V).
- Finally, as noted earlier, a reform of the *unemployment benefit system* is underway, aiming at reducing structural unemployment, which is high relative to peers, by tightening eligibility requirements and improving work incentives (Box 2). The reform constitutes an important step in bringing minimum contribution requirements and maximum benefit levels after some period closer to those of peers, though the new system will continue to remain relatively more generous in international comparison.



25. These reforms should be implemented ambitiously, their effects should be closely monitored, and they should be reinforced if needed. The apprenticeship and professional training reforms aimed at providing opportunities especially for vulnerable groups will require sustained efforts to implement the new systems enacted in late 2018, by finalizing the electronic training app and regulating training centers, among others. Expediting decision-making regarding the possibility of non-extension of branch agreements to those not represented in the negotiation will also be key for effectively facilitating bargaining at the firm level. The authorities should monitor the effects of these reforms carefully, including of the recent unemployment benefit reform, and stand ready to adjust them if outcomes fall short of desired objectives.

Early Effects of the 2017 Labor Code Reform		
Collective Bargaining	Employment Protection	Permanent Contracts
10,500 new social and economic committees were created merging multiple consultation bodies into one (as of October 2018).	96 firms initiated the new mutually-agreed collective dismissal procedure (<i>rupture conventionnelle collective</i>) as of December 2018.	Flexible permanent contracts (<i>contrats à durée indéterminée de chantier</i>) have been introduced in construction and metal industries.
142 collective performance agreements were concluded; 11 agreements were ratified by referendum in firms with less than 11 employees; 88 agreements were signed in firms with 11–250 employees (as of April 2019).	The number of Labour Court disputes (<i>Prud'hommes</i>) to solve abusive dismissals decreased by 15 percent in 2017 in relation to 2016, in line with the trend since 2009.	In Q3:2018, firms intending to hire on permanent contracts increased by 10 percent compared to the previous year.

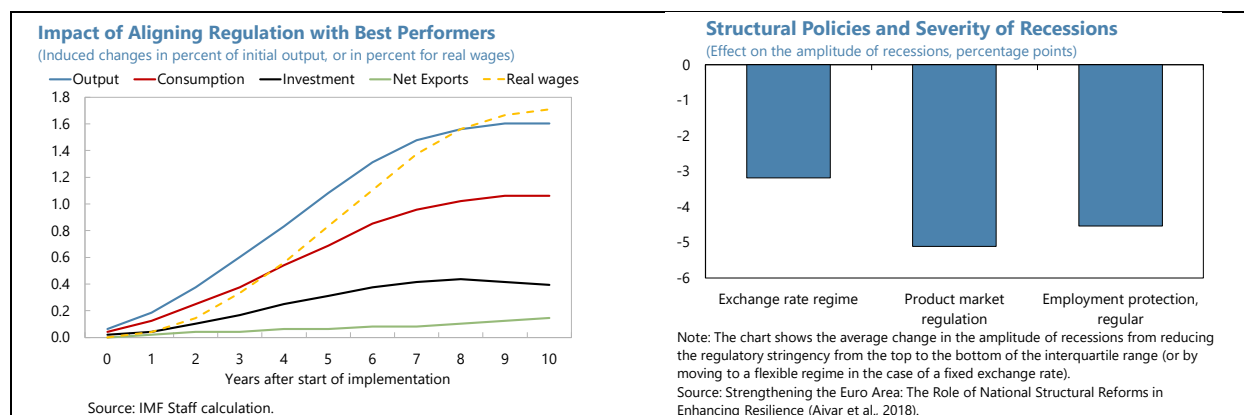
26. The authorities have also initiated key product market reforms, but restrictive regulations in some areas continue to hamper productivity growth. The 2018 railway reform introduced measures to increase competition in passenger transport. The recent *Loi PACTE* aims to facilitate firm creation and growth, promote entrepreneurship and innovation, support the reallocation of savings toward longer term investment, and improve the insolvency regime. But firms are still burdened by restrictive regulations in product and service markets, where France lags peers on several dimensions, such as professional services (especially entry restrictions), retail services (registration and licensing requirements, opening-hour restrictions, retail-price regulations, and online-sales limitations), and network sectors. These obstacles have likely contributed to the rising productivity gap between French firms and the best performing global firms, particularly in the service sector.¹⁴



27. A sharper focus on product and service market reforms can bring synergies, support productivity growth, and further improve resilience. Bringing France on par with best performers by easing the administrative burden on start-ups and fostering competition in regulated professions (e.g. accountants, lawyers, architects), retail trade (authorization and registration requirements), and sales (medicines) would curb profit margins and prices, with positive spillovers in downstream industries and for consumers. The government's planned measures to liberalize personal transport (driving schools and auto parts) and online sales of medicines can also help in this regard. Staff model analysis suggests that aligning regulations with OECD best practices in all these areas could boost the level of potential output per capita by

¹⁴ OECD Economic Surveys: France 2019.

up to 1.6 percentage points over 10 years (equivalent to up to 0.16 percent additional growth per year), which could also help to lower the public debt ratio modestly.¹⁵ Staff's empirical analysis also suggests that continued implementation of both labor and product market reforms can not only create synergies, but also reduces real and nominal rigidities and facilitates the reallocation of labor and capital, leading to milder downturns.¹⁶



28. Addressing corruption at home and abroad is also important to support an equitable and level playing field. Corruption can distort competition, damage the business climate, and lead to a suboptimal allocation of resources.¹⁷ In recent years, France has taken important steps to address corruption, including that of French firms on a global level. In 2016, France passed the Law on Transparency, the Fight Against Corruption, and the Modernization of the Economy (*Loi Sapin 2*) aimed at strengthening anti-corruption framework and enforcement efforts. This law introduced several new measures (Box 3), including a deferred prosecution resolution mechanism (*Convention Judiciaire d'Intérêt Public* CJIP), and created the French Anti-Corruption Agency to support the prevention, detection, investigation and prosecution of corruption. Enforcement capacity has also been bolstered, including with the creation of a National Financial Prosecutor. Looking forward, France should continue to enhance its enforcement capabilities, including by being proactive in instances where French companies have already been sanctioned by foreign authorities, and ensuring that sanctions imposed are effective, dissuasive, and proportionate.

Authorities' Views

29. The authorities agreed with the need to lower structural unemployment, address inequality of opportunity, and boost long-run growth. Their policy agenda has been centered around growth-enhancing structural reforms and reforms providing everyone with equal opportunities through employment, which they see as the main policy priorities. In this regard, they noted the progress made with recent reforms of the labor market, capital taxation, education and

¹⁵ See accompanying Selected Issues Paper "Potential Gains from Product Market Reforms."

¹⁶ See "Strengthening the Euro Area: The Role of National Structural Reforms in Enhancing Resilience" (Aiyar et al., forthcoming).

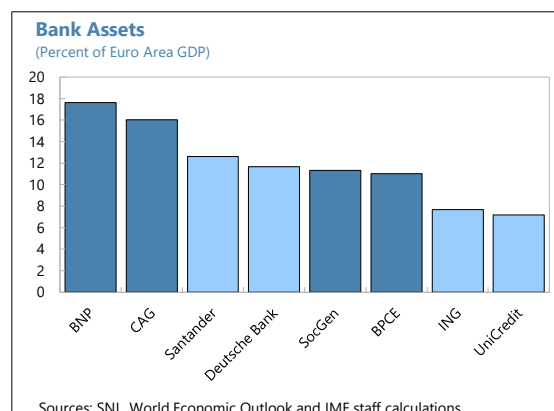
¹⁷ See Chapter 2 of the April 2019 *Fiscal Monitor*.

training, liberalization of rail transport, and the *Loi Pacte*. Looking forward, they saw merit in implementing announced measures to liberalize product markets, building on earlier reforms of transport and regulated professions, among others. Finally, they welcomed the focus on supply-side corruption, noting that the establishment of the new *Convention Judiciaire d'Intérêt Public* and the increase in the number of sanctions through trials constitute some illustrations of their efforts to respond to the recommendations of the OECD's Phase 3 report.

C. Financial Sector: Strengthening Resilience

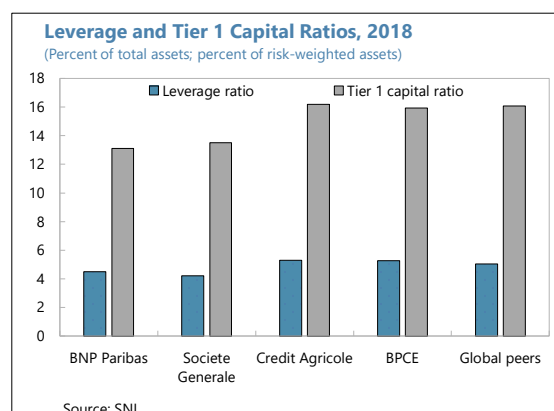
30. France's financial system is complex and global

(Figure 4). France is home to four global systemic banks (G-SIBs), and one global insurer. Banks, insurance companies, and investment funds are interlinked in the context of complex financial conglomerate structures. Total financial system assets are about 600 percent of GDP, and French financial conglomerates operate in more than 80 countries. The banking sector's asset structure is highly diversified, including not only reliance on domestic credit, but also a sizeable share of traded assets, of which a significant exposure to sovereign debt—pointing to the importance of safeguarding fiscal sustainability. On the liability side, banks are relatively more reliant than peers on wholesale funding, which has declined but remains high (including in USD).



31. Banks have improved capital positions and asset quality, but profitability is being challenged.¹⁸

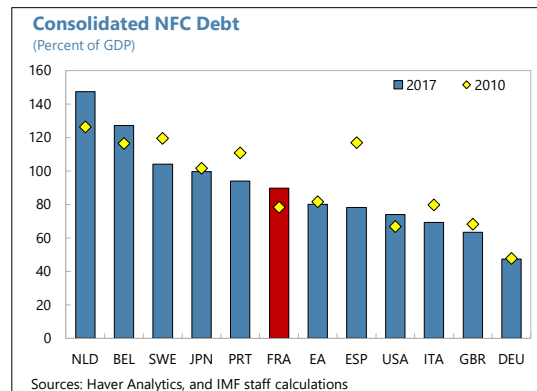
The large banks' CT1 ratio has increased in recent years, averaging 14.7 percent at end-2018, the leverage ratio is in line with peers, and NPLs fell below 3 percent. The liquidity-coverage ratio is well above 100 percent and has been rising recently, although the net-stable-funding ratio (NSFR) hovers around 100 percent, having increased in 2018. Successive increases in fees and commission income and earnings from *bancassurance* products have supported overall profitability, which is in line with global peers, but net-interest margins have been compressed and are below peers, given low interest rates, regulated savings, and competition among banks and from fintech. Insurers' solvency ratios have been stable, and implementation of Solvency II is ongoing.



¹⁸ France underwent a financial stability assessment under the IMF's Financial Stability Assessment Program (FSAP) this year. For details, see accompanying France Financial System Stability Assessment.

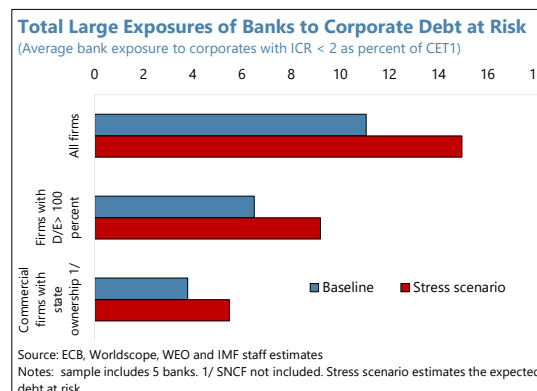
32. To address a buildup of systemic risk from corporate leverage, the authorities activated macroprudential policies.

Staff estimates the credit gap to have reached 2.7 percent of GDP last year (slightly below the 3.2 percent level attained in 2017).¹⁹ Corporate debt has been rising sharply since the global financial crisis—reflecting strong corporate debt issuance—to around 140 percent of GDP at end-2017 on an unconsolidated basis. Nonetheless, given large intra-company lending, consolidated debt is lower, at 90 percent of GDP, while many firms have also built up cash buffers.²⁰ Similarly, household debt has increased but is mitigated by an increase in household assets; and residential house prices, while having risen, remain broadly in line with fundamentals at the national level. In this context, while there are some mitigating factors, a rise in systemic risk cannot be excluded if risk premia rise rapidly or asset prices fall, which could constrain the ability of more vulnerable corporates and households to service debt, which in turn, would affect banks through both credit-risk exposures in the loan portfolio and corporate-bond holdings. In this context, last year, the authorities lowered the large exposure limit of banks to large indebted corporates and introduced a countercyclical capital buffer (CCyB) of 0.25 percent, raised to 0.5 percent this year, in line with staff’s 2018 Article IV recommendation.²¹



33. Stress-test analysis undertaken in the context of France’s 2019 Financial-Sector Assessment Program (FSAP) indicates that banks, corporates, and insurers are broadly resilient to simulated shocks, although some pockets of vulnerability remain.

Overall, banks appear to have sufficient capital and liquidity buffers (notwithstanding high volatility in dollar liquidity ratios) to withstand an adverse shock.²² However, an increase in wholesale funding costs could challenge profitability and solvency, and large outflows of wholesale funding could strain liquidity positions. Corporate debt-at-risk would increase under stress, but overall risks from corporate exposures appear manageable. Insurers are broadly resilient to market shocks, but some risks stem from concentrated exposures, mostly to parent banks; they are also vulnerable to a combination of a rise in interest rates and a mass-lapse event.



¹⁹ The credit-to-GDP gap is constructed as the deviation from a moving average of the credit-to-GDP ratio over previous eight quarters. The BIS/ECB credit gaps (based on HP-filtered measures) are estimated at 3.2 and 1.2 percent of GDP in mid-2018, respectively, significantly below their estimated peak of 12 percent at end-2009.

²⁰ See IMF Country Report No. 18/244 and the accompanying Financial Sector Stability Assessment.

²¹ Banks have until April 2020 to comply with the latest increase in the CCyB.

²² The shock assumes that GDP would be 7.1 percent below baseline, asset prices would be lower by 25 percentage points, and risk premia for the sovereign and corporates would rise by 100 and 150 basis points.

34. Financial sector policies need to continue to focus on bolstering the financial system’s resilience. The authorities have made important progress in improving the institutional and policy framework to support financial stability, both at the national and EU level. Domestically, key accomplishments include the establishment of the High Council of Financial Stability (HCSF), closer monitoring of structural risks, readiness to manage the Brexit fall-out, the proactive use of macroprudential policies, and new initiatives on digital finance, crypto assets, and combating cyber risk. At the European level, significant changes include the Banking Union, Capital Requirements Regulation II/Capital Requirements Directive V (CRR II/CRD V), and Solvency II, among others. Looking forward, policies should build on progress to date to address remaining challenges (text table):

- *Bolstering the monitoring and oversight of financial conglomerates:* Currently, even as efforts at the national and EU level are being made to enhance conglomerate oversight, operations of conglomerates are monitored and supervised primarily by separate institutions, and data-reporting gaps exist. To address potential risks stemming from risk transfer and cross-exposures within and across conglomerates, improved cooperation among supervisory agencies is needed to develop common reporting templates, provide supervisory guidance, increase oversight of liquidity including stress testing, and set requirements at the conglomerate level. Intensifying monitoring of insurers’ exposures toward parent banks, which can reach more than 50 percent of insurers’ capital, would also help, and concentration limits on these exposures could be considered.
- *Building resilience against cyclical risk, including related to corporate indebtedness:* In view of the existing macro-financial vulnerabilities, the authorities should stay vigilant, continue to monitor financial conditions closely, and stand ready to make use of additional micro- and macro-prudential policies proactively if risks intensify. In this case, the supervisory authorities could consider the introduction of a systemic risk buffer and Pillar II capital measures calibrated to corporate exposure or could further adjust the CCyB. Further reducing the fiscal tax bias favoring debt rather than equity financing could help curb corporate leverage, while further work will be needed to consider development of additional measures to address non-bank financing pressures.
- *Ensuring adequate liquidity buffers:* As noted above, while liquidity indicators have improved in aggregate terms, in some cases, banks rely on collateral swaps, and the NSFR in US dollars is still well below 100 percent.²³ To minimize residual risks related to potential disruptions in wholesale funding, the supervisory authorities are encouraged to consider imposing liquidity buffers to cover at least 50 percent of wholesale funding outflows up to a five-day horizon for all currencies, which could be linked with monitoring of banks’ use of collateral swaps, to improve liquidity ratios.

²³ Also see Box 1 of the accompanying Financial System Stability Assessment.

Table 1. France: 2019 Key FSAP Recommendations

Recommendation	Agency	Timing*
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. (¶146)	ACPR	I
Develop analytical framework for borrower-based measures for corporates. Consider sectoral SRB (Systemic Risk Buffer) if risks intensify. (¶146)	HCSF	NT
Evaluate options to further incentivize corporates to finance through equity rather than debt. (¶147)	MoF	NT
Ensuring Adequate Liquidity Management and Buffers		
Develop with the ECB options to manage any disruptions in wholesale funding markets. Consider liquidity buffers to cover at least 50 percent of wholesale funding outflows over/up to five days horizon for all major currencies. (¶125, 26)	ACPR, HCSF ECB	NT
Actively engage with the ESRB and others for a speedy development of liquidity and leverage related tools for insurers and investment funds. (¶148)	BdF, HCSF, ACPR, AMF	NT
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. (¶131, 49)	ACPR, AMF	NT
Develop with the ECB and other EU agencies liquidity risk management requirements and stress testing at the conglomerate level. (¶152)	ACPR, AMF	NT
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. (¶151–54)	ACPR, AMF	NT
Enhancing Governance, Financial Policies and Financial Integrity		
The ACPR and AMF should have autonomy to determine their own resource levels based on a forward-looking review of supervisory and monitoring needs (¶141)	ACPR, AMF, MoF	I
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. (¶142)	MoF	
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. (¶157)	MoF	NT
Enhance AML/CFT supervision of smaller banks rated as high-risk. (¶167) Explore ways to provide systematic guidance on detection of potential terrorist financing activities. (¶168)	ACPR, Tracfin	I
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. (¶171)	ACPR	MT
The eligibility of the FGDR's Supervisory Board membership, which is formed by bank executives in activity, should be changed to independent members only. (¶173)	FGDR	MT
Develop modalities for providing ELA in currencies other than euros and establish general rules that may assist banks in identifying assets, which might be proposed as ELA collateral and buttress their operational readiness to pledge them. (¶174)	BdF, ACPR	MT

* I= immediate (within one year), NT= near term (1–3 years), MT= medium term (3–5 years).

- *Enhancing crisis management, safety nets, resolution arrangements and financial integrity:* The medium-term challenge is to integrate the existing crisis-preparedness tools by pooling safety-net resources and broadening recovery and resolution-planning exercises to cases where failure within a conglomerate impedes internal support. The insurer-resolution framework could also be enhanced by providing powers to the regulator (ACPR) to mandate the bail-in of liabilities and privately-financed resolution funding. Finally, the authorities should continue to enhance the AML/CFT supervision of smaller high-risk rated banks and develop consistent approaches to risk-based compliance monitoring procedures.

Authorities' Views

35. The authorities welcomed the FSAP and broadly concurred with its findings. They stressed that the conglomerate structure of the financial system had been a source of strength, including as a result of its ability to diversify risks and revenue streams in a low interest-rate environment. They considered that integrating a conglomerate dimension in the resolution framework could be an interesting option, but that this issue could only be addressed from a European perspective. They deemed that liquidity and macroprudential risks are appropriately managed, including on account of preemptive macroprudential measures. Looking forward, they expressed concern about the profitability of the traditional banking business and its ability to generate adequate profits, not least due to a rise in competition from fintech, and rising costs associated with combating cyber and associated risks and urged a speedier progress with the capital markets union and completion of the banking union at the European level. The authorities welcomed the specific recommendations on AML-CFT, an important priority for France.

STAFF APPRAISAL

36. France's growth has moderated but remained job rich. Activity decelerated last year from its 2017 peak but remained relatively resilient compared to peers. Importantly, the employment rate reached a ten-year high, permanent work contracts increased, and the unemployment rate declined. The external position is assessed to be broadly consistent with medium-term fundamentals and desirable policy settings. Growth is expected to remain solid in the near and medium term, predicated on a recovery of domestic and external demand and gains from recent structural reforms.

37. A number of structural challenges remain, and risks have risen. The government has made notable progress in legislating key labor, tax, education, transport, and business-environment reforms over the last year. But high public and private debt, still high structural unemployment, sluggish productivity growth, and inequality of opportunity remain impediments to long-term growth. Moreover, risks have increased, related to trade tensions, an uncertain Brexit outcome, possible renewed tensions inside the Euro Area, weaker-than-expected growth in Europe, and, in France, support for necessary economic reforms among the general public may falter.

38. Reversing the rising trend of public debt is a key priority. While there is no immediate risk, the elevated debt level could create vulnerabilities from a medium and long-term perspective. Reducing debt is thus key to build buffers against shocks to avoid pro-cyclical tightening—which could affect vulnerable groups disproportionately—and support intergenerational equity. A structural primary fiscal effort of some ½ percent of GDP per year during 2020–23 could put debt on a sustained downward path and bring the fiscal balance to its medium-term objective.

39. To reconcile the government priorities with debt reduction, a significant fiscal effort on the spending side is needed. While the fiscal deficit was reduced in recent years, it will widen again if forthcoming tax cuts are not offset by durable spending cuts. The planned civil service, unemployment benefit, and pension reforms can help in this regard. But additional measures will be needed to underpin consolidation efforts (including on tax expenditures and subsidies, health, education, better targeting social benefits, and eliminating overlaps between central and local government functions), while improving efficiency and supporting social objectives.

40. Fully implementing recent labor-market reforms, coupled with further liberalization of product and service markets, is essential to support inclusive, long-run growth. To reap the benefits of recent collective bargaining and training reforms, efforts should focus on making them fully effective. The authorities should monitor the effects of reforms and stand ready to adjust them if outcomes fall short of objectives. Combining them with further product-market reforms (e.g. regulated professions, sales of medicines, and retail distribution) can create virtuous synergies, improve resilience, and boost living standards. Efforts to combat the supply side of corruption by continuing to enhance enforcement capabilities should be sustained.

41. In line with the findings of the recent FSAP, the authorities need to continue to strengthen financial stability, building on important progress to date. Given the systemic significance and complexity of France’s financial system, further integration of conglomerate-level monitoring and oversight can help ensure that risks are promptly identified and addressed. Having been proactive in responding to the buildup of cyclical risks, the authorities should continue to monitor risks closely and stand ready to make further use of macro- and micro-prudential policies as needed. Ensuring adequate liquidity buffers in all currencies and strengthening liquidity-risk management within financial conglomerates can also help build resilience against risks.

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

Box 1. Policy Responses to the Gilets Jaunes Protests

Recurrent street protests against the government's policies took place in the last quarter of 2018.

Demonstrations by the social movement of the "gilets jaunes" (yellow vests) were sparked in November 2018 by planned fuel tax increases expected to take effect in January 2019. The movement subsequently expanded to protest against high living costs, the burden of recent tax reforms on the middle class, and the government's overall reform agenda. Violent rioting in Paris and other cities during the recurrent weekend demonstrations disrupted retail sales and weighed on consumption spending, with an estimated negative impact of about 0.1 percent on output growth in the last quarter of 2018 and first quarter of 2019. While they have not fully subsided, the protests diminished substantially this year.

In response to the protests, the government legislated a number of expansionary fiscal measures in the 2019 budget to support households' purchasing power (costing an estimated 0.4 percent of GDP in 2019, and 0.6 percent by 2024).

The set of measures adopted last December included: (i) the elimination of planned fuel tax increases over 2019–22; (ii) increasing the in-work benefit at the minimum wage by €90 per month; (iii) eliminating, for pensions below €2,000 per month, the 1.7 percent increase in the generalized tax (CSG) introduced in January 2018; (iv) reducing overtime pay tax; and (v) temporarily allowing firms to pay tax-free bonuses for workers earning less than three times the minimum wage. To partially offset the cost of these measures, the government postponed by one year the CIT reduction planned for 2019 (from 33 percent to 31 percent) for firms with annual revenues above €250 million; introduced a tax on large digital service providers (expected to bring in €500 million) and announced intentions to compress spending further by better managing appropriations and reserves.

Fiscal Impact of Key Legislated and Announced Measures						
(Cumulative, in percent of GDP; positive = improvement in fiscal balance)						
	2019	2020	2021	2022	2023	2024
Measures legislated in December 2018						
Elimination planned fuel tax increase	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3
Employment subsidy at min. wage	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Eliminating CSG increase for lower pensions	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Making overtime pay tax free	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Measures announced in April 2019						
PIT cut for lower income taxpayers	0.0	-0.2	-0.2	-0.2	-0.2	-0.2
Re-indexation of lower pensions	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Increase in min. pension	0.0	0.0	0.0	0.0	0.0	0.0
Specified compensatory measures						
Postponement in CIT cut for large firms	0.1	0.0	0.0	0.0	0.0	0.0
Tax on large digital service providers (GAFA)	0.0	0.0	0.0	0.0	0.0	0.0
Total measures	-0.3	-0.8	-0.8	-0.9	-0.9	-0.9

The government also launched a three-month nationwide debate ("Grand Débat National") in response to the gilets jaunes protests. The debate—a series of town hall style discussions and internet questionnaires—sought popular input on issues such as taxation and public services, the organization of the state and public bodies, the ecological transition and democracy and representation. The debate, which consisted of 10,134 local meetings and included 1,932,884 online contributions, concluded in mid-March.

Drawing on the conclusions of the debate, the government announced in April 2019 a series of additional fiscal measures (estimated to cost an additional 0.3 percent of GDP). The measures, which are expected to be part of the 2020 budget, include: (i) a reduction in the income tax for middle income taxpayers through a readjustment of the lower tax brackets (cost of 0.2 percent of GDP); (ii) the re-indexation of pensions below €2,000 to inflation rather than to the fixed level of 0.3 percent and an increase in the minimum pension to €1,000 for new retirees (combined cost of 0.1 percent of GDP); (iii) more support to single mothers; and (iv) further decentralization. The government has announced that the

Box 1. Policy Responses to the Gilets Jaunes Protests (concluded)

measures would be financed through a rationalization of subsidies and tax expenditures (niches fiscales) and incentivizing longer work but has not yet identified specific measures. The authorities have also announced the closure of the administrative elite school (ENA), have committed not to close any hospitals or schools until 2022, indicated that the statutory pensionable age and the 35-hour week will remain unchanged, and have noted that the target for reducing public employment by 120,000 by 2022 may no longer be feasible. The government has maintained the reform replacing the wealth tax with a real estate tax but committed to reassess it in early-2020.

Box 2. Planned Fiscal Structural Reforms

In the course of 2019, the government plans to legislate a number of fiscal structural reforms to improve government spending efficiency and the quality and fairness of social protection plans.

These would also help boost long-term output growth by boosting labor-force participation, tackling potential misallocation of labor, and reducing structural unemployment.

- **Civil service:** The planned reform aims at increasing flexibility within the public administration and improving labor allocation by: (i) encouraging the use of contractual employment, including at managerial level; (ii) introducing new types temporary contracts; (iii) simplifying social dialogue; (iv) allowing for voluntary dismissals, as in the private sector; (v) simplifying procedures to change jobs within the public administration and increasing the portability of acquired rights and benefits; (vi) imposing a minimum 35 hour week for all civil servants; and (vii) introducing a merit-based pay system while harmonizing remunerations and promotions criteria across the administration. The reform, currently in parliament, is expected to be legislated by mid-2019.
- **Pension system:** The government plans to unify the 42 existing pension systems under one scheme for all private and public workers, with benefits based on points. The new system will require the calculation of pension rights over the whole career, instead of a number of best years, for all groups of workers. It will also introduce a single definition for labor revenues to be used as basis for calculating pension contributions, including bonuses for the public sector. The reform is expected to kick-in gradually, starting from 2025. The authorities have also announced their intention to provide incentives to retire later, such as by accelerating the planned gradual increase in the effective retirement age. The law is expected to be finalized and legislated in 2019 or early 2020.
- **Unemployment benefit system:** The authorities have announced a reform aiming to reduce the system's generosity, improve work incentives, and disincentivize precarious work arrangements. The key measures include: (i) computing unemployment benefits on the basis of average monthly salaries, rather than average earnings over worked days, while ensuring that benefits are between 65 percent and 96 percent of net monthly salaries; (ii) introducing a 30 percent reduction in benefits after six months for high-salary earners (above €4,500), while maintaining the initial maximum benefit cap of €7,700 and introducing a floor of €2,261; (iii) extending the minimum contribution length to six months over the past 24 months (from four months over the past 28 months); (iv) raising from one to six months the minimum working period needed to recharge unemployment insurance rights during the benefit period; and (v) introducing a bonus-malus scheme for firms with 11 workers or more in selected sectors (accommodation and restauration; food; transport and storage; water and sanitation; rubber and plastic; wood, paper, and printing; and certain specialized activities) by which employers would contribute more to the system for using short-term contracts excessively, coupled with a lumpsum tax of €10 for the use of very short term contracts. The new system will also expand rights for independent workers and those quitting jobs and will reinforce support for job seekers. The reform is expected to be implemented in the summer of 2019 (no further legislation is required) with measures taking effect from November 2019 to mid-2020.
- **Healthcare system**—The reform aims to improve the quality of health services by “placing the patient at the heart of the system.” The key measures include: (i) introducing a flat price system for hospital stays for certain diseases; (ii) creating 1,000 new territorial health centers by 2022, and 4,000 new positions of doctor assistants; (iii) reforming the administrative authorizations for health services and reinforcing the role of doctors in hospital management; and (v) reforming undergraduate and graduate medical studies. The authorities expect to cover reform costs by the increase of the ceiling on health spending from 2.3 to 2.5 percent in 2019. The reform, now in parliament, is expected to be legislated in mid-2019.

In future years, the authorities aim to introduce further reforms to unify social minimum benefits into a single universal activity benefit, reform old-age care for dependent elderly citizens, and further decentralize powers from the central to local governments.

Box 3. Recent Efforts in Tackling Corruption and Supply-Side Bribery

In its 2012 report, the OECD Working Group on Bribery raised concerns about anti-corruption enforcement efforts in France.

The Working Group on Bribery concluded that foreign bribery enforcement in France was not commensurate with the size and significance of France's economy. Despite the global presence of French companies in vulnerable sectors, such as defense, transport, infrastructure, and telecommunications, only five convictions for foreign bribery – of which only one (not yet final) was for a legal person – had been secured since France's ratification of the OECD Anti-Bribery Convention. French authorities were also perceived as exhibiting a "lackluster" response in pursuing cases against companies sanctioned by other Parties to the Convention. Consequently, the Working Group on Bribery recommended that France intensify its efforts to combat the bribery of foreign public officials, including by enhancing the independence of the prosecutors, dedicating sufficient resources to the investigation and prosecution of foreign bribery, and protecting whistleblowers. The next assessment of France by the Working Group on Bribery will take place in 2020.

Since the Phase 3 review in 2012, France has improved its anti-corruption legal framework.

In December 2016, France passed the Law on Transparency, the Fight Against Corruption, and the Modernization of the Economy (*Loi Sapin 2*), expanding France's jurisdiction with respect to corruption offences by eliminating the dual criminality requirement for prosecution of foreign bribery offences, imposing mandatory compliance requirements for French companies of a certain size and above the statutory threshold, and introducing a deferred prosecution resolution mechanism (*Convention Judiciaire d'Intérêt Public* – CJIP). *Loi Sapin 2* also created the French Anti-Corruption Agency (AFA) to support the prevention, detection, investigation and prosecution of corruption.

France has also bolstered its enforcement efforts against French companies bribing public officials abroad.

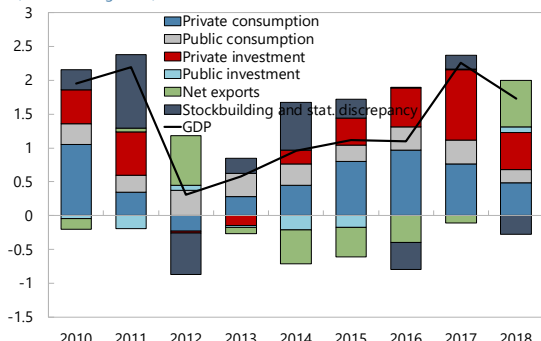
Efforts since 2013 include the establishment of a new National Financial Prosecutor, cessation of individual instructions from the Minister of Justice to prosecutors, protection for all whistleblowers from retaliation, an increase in criminal sanctions for the foreign bribery offence, and an end to the monopoly of the Public Prosecutor's Office on foreign bribery prosecutions. As of December 2017, 15 natural persons and 2 legal persons had been convicted of foreign bribery and sanctioned since the entry into force of the Convention in 2000. Further, in 2018, French prosecution authorities entered into the first ever CJIP in close cooperation and coordination with the United States.

Figure 1. Real Sector Developments

Growth declined in 2018, ...

Contribution to Annual Real GDP Growth

(Percent; Y/Y growth)

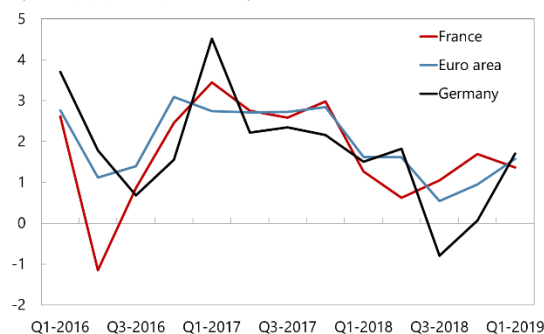


Source: INSEE (Haver Analytics) and IMF staff calculations.

... but was relatively resilient compared to peers.

Real GDP Quarterly Growth, Annualized

(Percent, Q/Q Growth, Annualized)

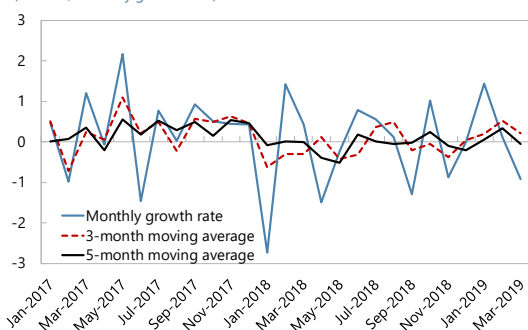


Sources: National authorities (Haver Analytics)

Industrial activity picked up modestly in early 2019...

Industrial Production excl Construction

(Percent; Monthly growth rate)

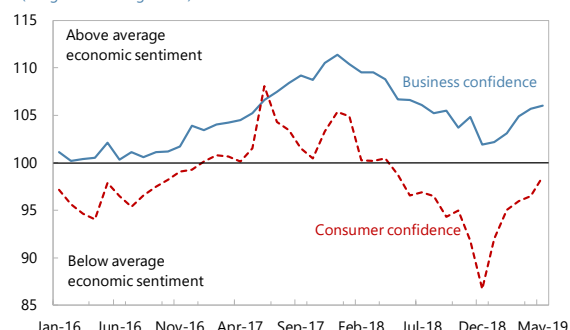


Sources: INSEE (Haver Analytics) and IMF staff calculations.

... and consumer and business sentiment indicators are recovering.

Business and Household Confidence

(Long-term average=100)

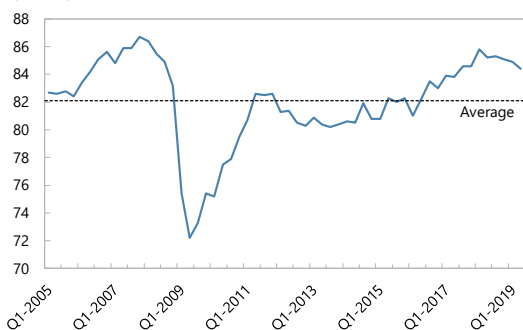


Source: INSEE (Haver Analytics).

After peaking in late 2017, capacity utilization rates stabilized...

Capacity Utilization: Industry

(Percent)

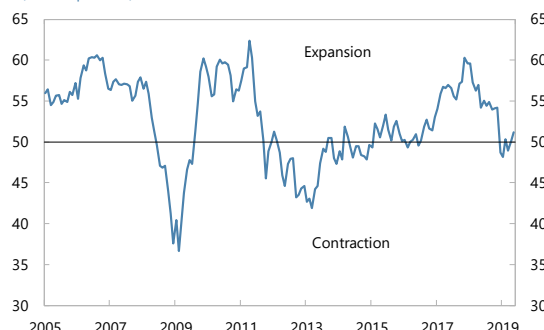


Sources: INSEE (Haver Analytics).

... and other activity indicators have retreated, pointing to waning cyclical momentum.

Purchasing Managers' Index: Composite Output

(50+=Expansion)

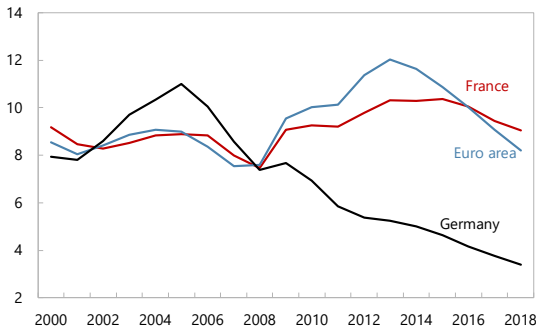


Source: CDAF/IHS Markit (Haver Analytics).

Figure 2. Labor Market Developments

The unemployment rate declined further in 2018 but remains above peers.

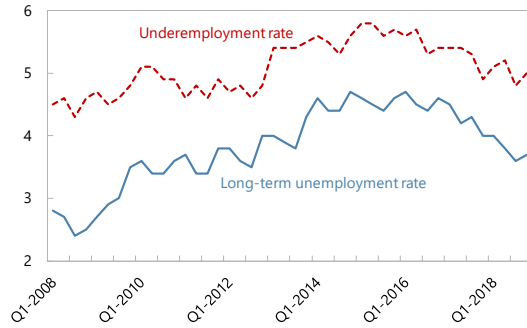
Harmonized Unemployment Rate
(Percent of active population)



Source: Eurostat (Haver Analytics).

Both long-term unemployment and underemployment rates declined.

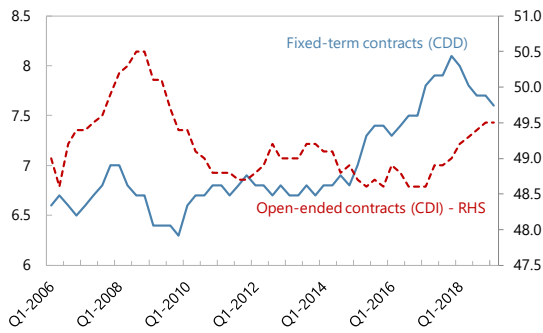
Long-Term Unemployment and Underemployment Rate
(Percent of active population, NSA)



Source: Eurostat (Haver Analytics).

Permanent contracts accounted for the bulk of new jobs in 2018, pointing to improving labor market conditions,

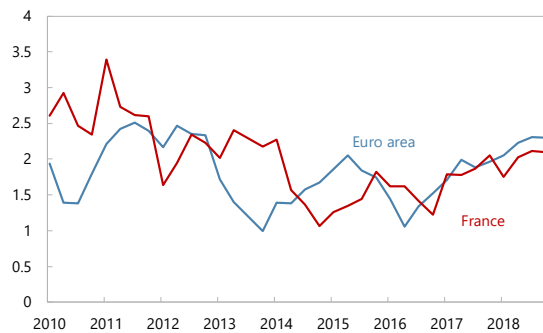
Employment Rate, by Contract Type
(Percent of working age population)



Source: INSEE (Haver Analytics).

... but nominal wage growth remains subdued.

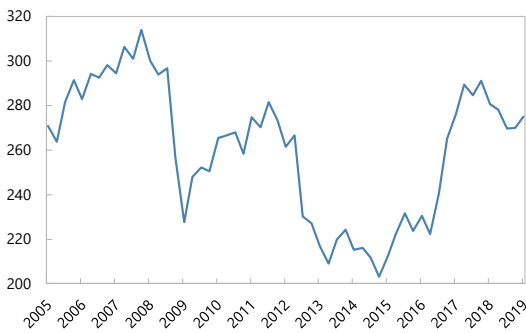
Hourly Wages: Industry, Construction and Services
(YoY Percent Change)



Sources: Haver Analytics (Eurostat).

Job vacancies are declining but are still elevated...

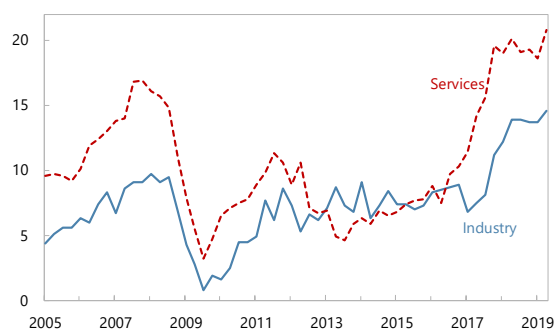
Job Vacancies
(Thousands, EOP)



Source: INSEE (Haver Analytics).

...and the share of firms stating that labor shortage is a key factor limiting production remains high.

Labor Force as a Production Constraint
(Percent of firms reporting lack of manpower)



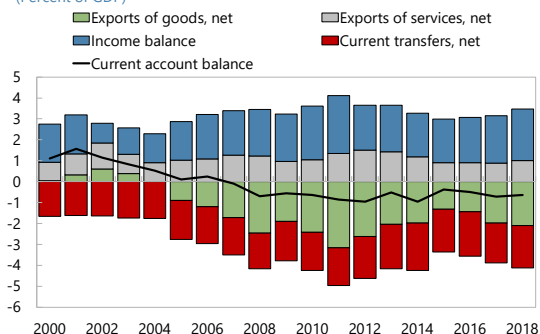
Source: European Commission (Haver Analytics).

Figure 3. External Sector

The current account deficit narrowed slightly in 2018...

Current Account

(Percent of GDP)

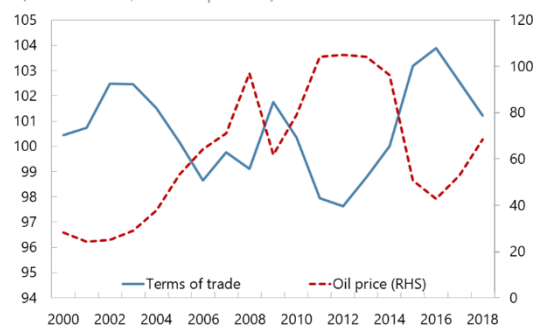


Sources: Banque de France and INSEE (Haver Analytics).

... as the non-oil goods and services trade balance developments offset the higher oil bill.

Terms of Trade and Oil Prices

(Index 2014=100; US dollars per barrel)

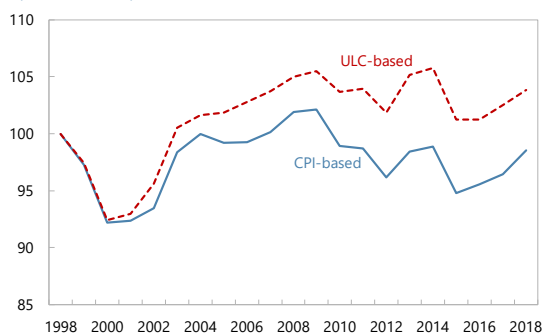


Sources: IMF staff calculations.

Despite some depreciation in the ULC and CPI-based REER over the past decade...

Real Effective Exchange Rate, 37 Trading Partners

(Index 1998=100)

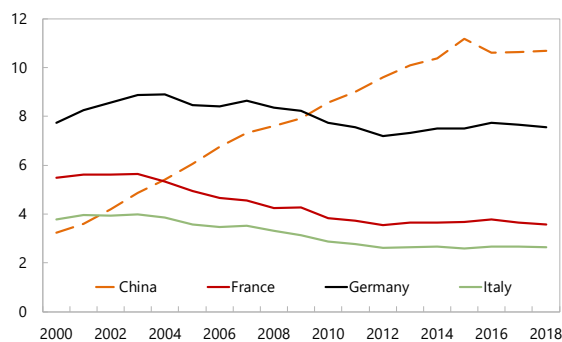


Source: Eurostat.

... France has not been able to recover the loss of export market share registered since the late 1990s.

World Market Share: Exports of Goods and Services

(Percent)

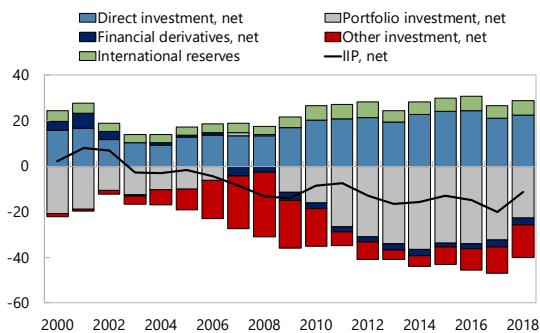


Source: World Economic Outlook.

While the Net International Investment Position remains only moderately negative...

Net International Investment Position

(Percent of GDP)

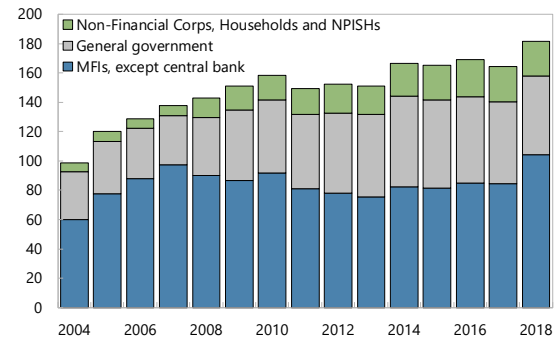


Source: IMF BOP.

... gross liabilities are large, particularly for financial institutions, reflecting their global presence.

External Debt

(Percent of GDP)



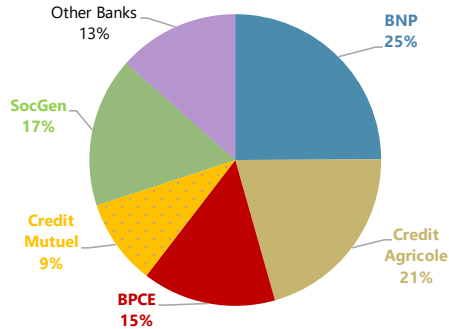
Source: IMF BOP and Eurostat.

Figure 4. Financial Sector

The banking sector is concentrated in large financial groups...

Banking Sector

Market Shares as of June 2017

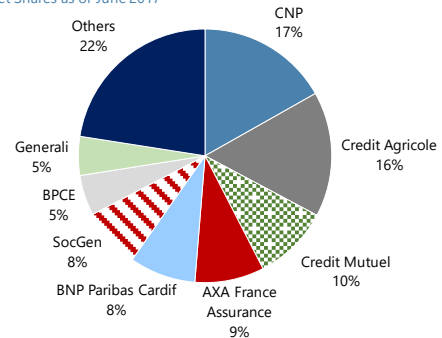


Sources: BMI Research

... and banks are also active in the insurance sector.

Life Insurance Sector

Market Shares as of June 2017

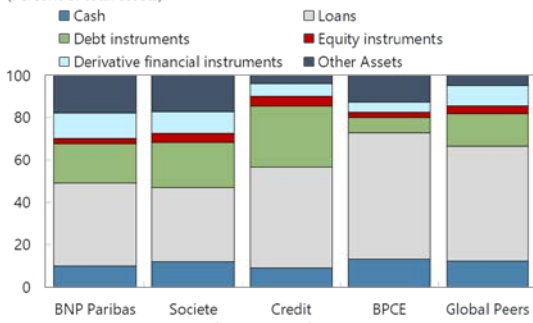


Source: Fitch Connect and IMF staff calculations.

Banks' assets are highly diversified ...

Decomposition of Bank Assets, 2018

(Percent of total assets)

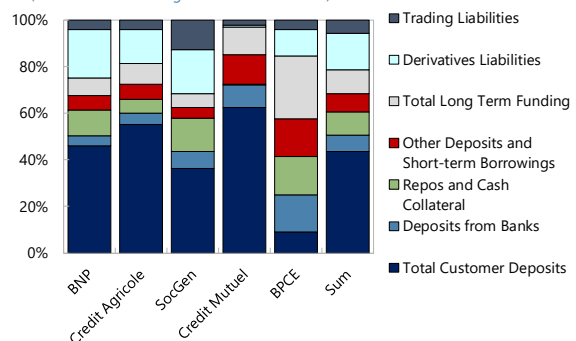


Sources: SNL and IMF staff estimates.

... and funded to a large extent by wholesale funding.

Bank Funding Structure

(Share of total funding as of December 2016)

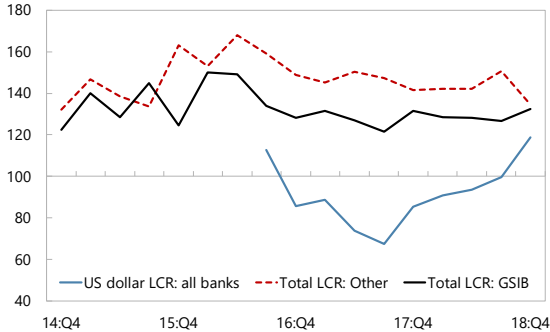


Sources: Fitch Connect and IMF staff calculations.

The liquidity coverage ratio is above 100 percent.

Liquidity Coverage Ratio (LCR)

(Percent)

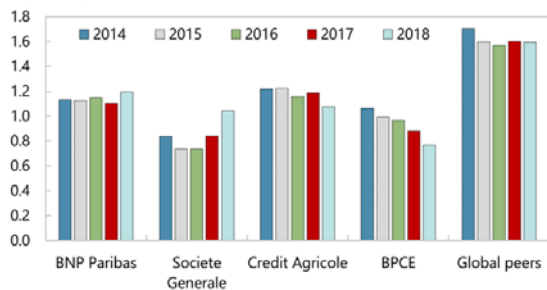


Sources: COREP Templates

Banks' net interest margins are low, challenging their profitability.

Net Interest Margin

(Percent)



Source: SNL.

Table 2. France: Selected Economic and Social Indicators, 2015–24

	2015	2016	2017	Est. 2018	Projections					
					2019	2020	2021	2022	2023	2024
Real economy (change in percent)										
Real GDP	1.1	1.1	2.3	1.7	1.3	1.4	1.5	1.5	1.5	1.5
Domestic demand	1.5	1.5	2.3	1.0	1.3	1.4	1.5	1.5	1.6	1.6
Private consumption	1.5	1.8	1.4	0.9	1.4	1.6	1.6	1.6	1.6	1.6
Public consumption	1.0	1.4	1.5	0.8	0.6	0.4	0.6	0.6	0.9	1.2
Gross fixed investment	1.0	2.7	4.7	2.8	2.0	2.1	2.3	2.3	2.3	2.2
Foreign balance (contr. to GDP growth)	-0.4	-0.4	-0.1	0.7	0.0	-0.1	0.0	0.0	-0.1	-0.2
Exports of goods and services	4.6	1.8	3.9	3.5	3.5	3.5	3.8	3.8	3.6	3.5
Imports of goods and services	5.9	2.9	3.9	1.2	3.5	3.6	3.6	3.7	3.8	3.8
Nominal GDP (billions of euros)	2,198	2,234	2,295	2,353	2,415	2,484	2,557	2,637	2,725	2,816
CPI (year average)	0.1	0.3	1.2	2.1	1.2	1.4	1.4	1.6	1.8	1.8
GDP deflator	1.1	0.5	0.5	0.8	1.3	1.4	1.4	1.6	1.8	1.8
Gross national savings (percent of GDP)	22.3	22.1	22.6	22.9	22.9	22.9	22.9	23.0	23.0	22.9
Gross domestic investment (percent of GDP)	22.7	22.6	23.4	23.5	23.5	23.5	23.3	23.3	23.3	23.2
Public finance (percent of GDP)										
General government balance	-3.6	-3.5	-2.8	-2.5	-3.2	-2.3	-2.5	-2.6	-2.7	-2.7
Revenue	53.2	53.0	53.6	53.5	52.4	52.1	51.7	51.5	51.4	51.4
Expenditure	56.8	56.6	56.4	56.0	55.6	54.4	54.2	54.1	54.1	54.1
Primary balance	-1.8	-1.8	-1.1	-0.9	-1.8	-0.9	-1.0	-1.1	-1.1	-1.1
Structural balance (percent of pot. GDP)	-3.0	-2.8	-2.6	-2.4	-2.3	-2.4	-2.5	-2.6	-2.7	-2.7
Nominal expenditure (change in percent)	1.5	1.3	2.3	1.9	1.8	0.7	2.6	2.8	3.4	3.4
Real expenditure (change in percent)	1.4	0.9	1.2	-0.2	0.6	-0.7	1.2	1.2	1.5	1.5
General government gross debt	95.6	98.0	98.4	98.4	99.0	98.6	98.3	97.9	97.4	97.0
Labor market (percent change)										
Employment	0.7	0.6	0.9	0.7	0.6	0.4	0.2	0.2	0.2	0.1
Labor force	0.8	0.3	0.1	0.3	0.2	0.0	0.0	0.1	0.1	0.1
Unemployment rate (percent)	10.4	10.1	9.4	9.1	8.6	8.3	8.1	8.0	8.0	8.0
Total compensation per employee	0.6	1.3	2.1	2.1	...	...	...	...	...	...
Credit and interest rates (percent)										
Growth of credit to the private non-financial sector	3.7	3.8	5.6	5.5	5.0	4.6	4.0	3.4	3.5	3.5
Money market rate (Euro area)	-0.1	-0.3	-0.4	-0.4	...	...	...	...	...	...
Government bond yield, 10-year	0.8	0.5	0.8	0.8	...	...	...	...	...	...
Balance of payments (percent of GDP)										
Current account	-0.4	-0.5	-0.7	-0.6	-0.6	-0.5	-0.4	-0.2	-0.3	-0.3
Trade balance of goods and services	-0.4	-0.5	-1.1	-1.1	-1.0	-1.0	-0.8	-0.7	-0.7	-0.8
Exports of goods and services	31.9	31.6	32.1	32.6	34.7	34.7	35.0	35.1	35.3	35.5
Imports of goods and services	-32.3	-32.1	-33.1	-33.7	-35.7	-35.7	-35.8	-35.8	-36.0	-36.3
FDI (net)	0.3	1.7	0.4	2.3	1.7	1.7	1.8	1.9	1.9	2.0
Official reserves (US\$ billion)	55.2	56.1	54.8	66.1	...	...	...	...	...	...
Exchange rates										
Euro per U.S. dollar, period average	0.90	0.90	0.89	0.85	...	...	...	...	...	...
NEER, ULC-styled (2005=100, +=appreciation)	95.6	96.2	97.1	98.2	...	...	...	...	...	...
REER, ULC-based (2005=100, +=appreciation)	90.3	90.8	90.5	91.1	...	...	...	...	...	...
Potential output and output gap										
Potential output (change in percent)	1.0	1.1	1.3	1.4	1.4	1.5	1.5	1.5	1.5	1.5
<i>Memo: per working age person</i>	1.2	1.2	1.2	1.5	1.3	1.5	1.6	1.4	1.4	1.4
Output gap	-1.0	-1.0	-0.1	0.2	0.1	0.1	0.0	0.0	0.0	0.0

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

Table 3. France: General Government Accounts, 2015–24
(In percent of GDP unless otherwise indicated)

	2015	2016	2017	Est.		Proj.				
				2018	2019	2020	2021	2022	2023	2024
Revenue	53.2	53.0	53.6	53.5	52.4	52.1	51.7	51.5	51.4	51.4
Taxes	28.7	28.7	29.4	30.1	29.9	29.7	29.4	29.2	29.2	29.2
Direct taxes	12.7	12.5	12.8	13.3	13.2	13.1	12.9	12.8	12.8	12.8
Indirect taxes	16.1	16.2	16.6	16.8	16.7	16.6	16.5	16.4	16.4	16.4
Social contributions	18.8	18.7	18.8	18.0	17.1	17.0	17.0	16.9	16.9	16.8
Other revenue	5.7	5.6	5.5	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Expenditure	56.8	56.6	56.4	56.0	55.6	54.4	54.2	54.1	54.1	54.1
Expense	56.7	56.5	56.2	55.8	55.3	54.2	54.0	53.8	53.8	53.9
Compensation of employees	12.8	12.7	12.7	12.5	12.3	12.3	12.2	12.1	12.0	12.0
Goods and services	5.1	5.0	5.0	4.9	4.9	4.9	4.8	4.8	4.8	4.8
Interest	2.0	1.8	1.7	1.7	1.5	1.6	1.6	1.6	1.6	1.7
Social benefits	25.9	25.9	25.7	25.5	25.5	25.3	25.2	25.3	25.3	25.4
Other expense	10.9	11.0	11.1	11.1	11.1	10.2	10.1	10.1	10.1	10.0
Gross public investment	3.4	3.4	3.3	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Net acquisition of nonfinancial assets	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Net lending / borrowing	-3.6	-3.5	-2.8	-2.5	-3.2	-2.3	-2.5	-2.6	-2.7	-2.7
Primary balance	-1.8	-1.8	-1.1	-0.9	-1.8	-0.9	-1.0	-1.1	-1.1	-1.1
Memorandum items:										
Structural balance (percent of potential GDP)	-3.0	-2.8	-2.6	-2.4	-2.3	-2.4	-2.5	-2.6	-2.7	-2.7
Structural primary balance (percent of potential GDP)	-1.1	-1.1	-1.0	-0.8	-0.8	-0.9	-1.0	-1.1	-1.1	-1.1
Change in structural primary balance	0.1	0.0	0.1	0.2	-0.1	-0.1	-0.1	-0.1	0.0	0.0
Public gross debt (Maastricht definition)	95.6	98.0	98.4	98.4	99.0	98.6	98.3	97.9	97.4	97.0
Nominal GDP (in billion of Euros)	2,198	2,234	2,295	2,353	2,415	2,484	2,557	2,637	2,725	2,816
Real GDP growth (in percent)	1.1	1.1	2.3	1.7	1.3	1.4	1.5	1.5	1.5	1.5
Nominal expenditure growth	1.5	1.3	2.3	1.9	1.8	0.7	2.6	2.8	3.4	3.4
Real expenditure growth (in percent)	1.4	0.9	1.2	-0.2	0.6	-0.7	1.2	1.2	1.5	1.5
of which: primary	1.7	1.2	1.3	-0.2	0.9	-0.9	1.1	1.2	1.5	1.5
of which: structural primary	1.7	1.2	1.5	-0.1	0.9	-0.9	1.0	1.2	1.5	1.5

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

Table 4. France: Balance of Payments, 2015–24
(In percent of GDP)

	2015	2016	2017	2018	Projections					
					2019	2020	2021	2022	2023	2024
Current account	-0.4	-0.5	-0.7	-0.6	-0.6	-0.5	-0.4	-0.2	-0.3	-0.3
Net exports of goods	-1.3	-1.4	-2.0	-2.1	-2.1	-2.0	-1.9	-1.8	-1.9	-1.9
Exports of goods	21.4	21.1	21.6	22.0	23.7	23.7	23.9	24.0	24.1	24.2
Imports of goods	22.7	22.5	23.5	24.1	25.8	25.8	25.8	25.8	25.9	26.1
Net exports of services	0.9	0.9	0.9	1.0	1.1	1.1	1.1	1.2	1.2	1.2
Exports of services	10.5	10.5	10.5	10.6	11.0	11.0	11.1	11.2	11.2	11.3
Imports of services	9.6	9.6	9.6	9.6	10.0	10.0	10.0	10.0	10.0	10.1
Income balance	2.1	2.2	2.3	2.5	2.4	2.4	2.4	2.4	2.4	2.4
Current transfers	-2.0	-2.1	-1.9	-2.0	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Capital and financial account										
Capital account	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	0.0	-0.8	-1.4	-1.2	-0.5	-0.5	-0.3	-0.2	-0.2	-0.3
Direct investment	0.3	1.7	0.4	2.3	1.7	1.7	1.8	1.9	1.9	2.0
Portfolio investment	1.8	0.0	1.0	-0.2	1.8	2.1	2.5	3.0	3.2	3.4
Financial derivatives	0.6	-0.7	-0.1	-1.1	-1.5	-1.9	-2.3	-2.7	-3.1	-3.5
Other investments net	-3.0	-1.8	-2.6	-2.6	-2.6	-2.5	-2.4	-2.4	-2.3	-2.2
Reserve assets	0.3	0.1	-0.1	0.4	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions	0.4	-0.3	-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, 2010–18
(In percent of GDP unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
External Indicators									
Exports (annual percentage change, in U.S. dollars)	6.7	15.8	-3.1	5.6	2.0	-10.4	0.3	6.5	9.1
Imports (annual percentage change, in U.S. dollars)	8.1	17.1	-5.4	3.9	2.7	-11.6	0.8	8.2	9.0
Terms of trade (annual percentage change)	-1.4	-2.4	-0.3	1.2	1.2	3.2	1.0	-1.3	-1.3
Current account balance	-0.6	-0.9	-1.0	-0.5	-1.0	-0.4	-0.5	-0.7	-0.6
Capital and financial account balance	-0.1	-2.8	-1.9	-0.7	-0.4	-0.1	-0.7	-1.3	-1.1
<i>Of which</i>									
Inward portfolio investment (debt securities, etc.)	4.3	3.6	1.0	4.9	4.1	0.2	1.6	1.3	1.0
Inward foreign direct investment	1.5	1.5	1.2	1.1	0.2	1.8	1.3	1.5	2.2
Other investment (net)	4.4	9.2	-0.1	3.5	-0.1	-3.0	-1.8	-2.6	-2.6
Total reserves minus gold									
(in billions of U.S. dollars, end-of-period)	55.8	48.6	54.2	50.8	49.5	55.2	56.1	54.8	66.1
Euros per U.S. dollar (period average)	0.8	0.7	0.8	0.8	0.8	0.9	0.9	0.9	0.8
Market Indicators									
Financial Markets									
Public sector debt 1/	85.3	87.8	90.6	93.4	94.9	95.6	98.0	98.4	98.4
3-month T-bill yield (percentage points)	0.4	0.7	0.0	0.0	0.1	-0.2	-0.6	-0.6	0.0
3-month T-bill yield in real terms (percentage points)	-1.4	-1.8	-1.3	-0.7	0.00	-0.38	-1.17	-1.81	-1.59
US 3 month T-bill	0.1	0.1	0.1	0.1	0.0	0.0	0.3	0.7	0.0
Spread with the US T-bill (percentage points)	0.2	0.6	0.0	0.0	0.03	-0.25	-0.87	-1.37	0.00
10-year government bond (percentage points)	3.1	3.3	2.5	2.2	1.7	0.8	0.5	0.8	0.8
10-year government bond (United States)	3.2	2.8	1.8	2.4	2.5	2.1	1.8	2.4	0.0
Spread with US bond (percentage points)	-0.1	0.5	0.7	-0.1	-0.9	-1.3	-1.4	-1.6	0.8
Yield curve (10 year - 3 month, percentage points)	2.7	2.6	2.5	2.2	1.6	1.0	1.0	1.4	0.8
Stock market index (period average, 1995=100)	200.3	192.1	179.0	211.1	231.7	258.2	236.1	276.7	282.6
Real estate prices (index, Q1-10=100, period average)	100.6	106.6	106.0	103.8	101.9	100.0	100.9	104.0	107.2
Credit markets (end-of-period 12-month growth rates)									
Credit to the private sector	5.6	4.4	2.0	0.5	0.5	2.5	4.3	4.6	6.3
Bank credit to households	6.2	4.8	2.3	2.7	1.9	3.3	3.3	5.6	5.3
Housing Loans	8.2	6.1	3.2	3.8	2.2	4.0	3.5	6.1	5.8
Bank credit to nonfinancial enterprises	1.5	4.5	0.4	-0.3	2.6	4.3	4.3	5.8	5.7
Sectoral risk indicators									
Household sector									
Household savings ratio	16.0	15.7	15.7	14.2	14.6	14.1	14.0	13.9	14.2
Household financial savings ratio	6.6	5.9	6.2	4.7	5.2	4.8	4.5	3.8	...
Real estate household solvency ratio (index, 2001=100) 2/	99.4	100.9	98.2	98.5	...	...	...	...	...
Corporate sector									
Gross margin ratio	0.31	0.31	0.30	0.30	0.30	0.32	0.32	0.32	...
Investment ratio	0.22	0.23	0.23	0.23	0.23	0.23	0.23	0.24	...
Savings ratio	0.21	0.20	0.19	0.21	0.21	0.22	0.23	0.23	...
Self-financing ratio	0.94	0.89	0.84	0.92	0.92	0.97	0.97	0.98	...
Banking sector									
Share of housing loans in bank credit to the private sector	40.2	40.8	41.2	42.6	41.3	41.6	41.8	42.4	42.4
Share of nonperforming loans in total loans	3.5	3.5	4.0	4.5	4.0	3.9	3.9	3.1	2.8
Ratio of nonperforming loans net of provisions to capital	10.0	9.2	10.7	11.4	9.6	9.1	9.2	15.0	13.6
Liquid assets to total short-term liabilities 3/	144.4	136.3	164.0	165.2	178.5	17.5	19.9	20.7	19.6
Return on assets	0.6	0.4	0.3	0.4	0.4	0.6	0.5	0.4	0.4
Return on equity	11.8	8.2	6.6	8.1	6.2	9.2	8.4	6.3	6.7
Regulatory capital to risk-weighted assets	12.5	12.2	14.0	15.1	15.3	16.6	17.4	18.9	18.7

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

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

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

3/ 2015 data is based on new methodology which is not comparable to older figures.

Table 6. France: Core Financial Soundness Indicators, 2013–18

	2013	2014	2015	2016	2017	2018
Deposit-taking institutions 1/						
Regulatory capital to risk-weighted assets 2/	15.1	15.3	16.6	17.4	18.9	18.7
Regulatory Tier I capital to risk-weighted assets 2/	13.2	13.6	13.8	14.5	15.3	15.4
Nonperforming loans net of provisions to capital 3/	11.4	9.6	9.1	9.2	15.0	13.6
Bank provisions to Nonperforming loans 3/	104.7	103.8	104.2	103.0	50.6	50.4
Nonperforming loans to total gross loans 3/	4.5	4.0	3.9	3.9	3.1	2.8
Sectoral distribution of loans to total loans, of which						
Deposit-takers 3/	39.2	39.1	38.5	38.6	3.0	3.2
Nonfinancial corporation 3/	19.0	19.5	18.8	19.1	16.3	15.7
Households (including individual firms) 3/	30.3	29.8	28.1	28.1	25.7	25.5
Nonresidents (including financial sectors) 3/	5.4	5.5	5.3	5.3	37.5	40.4
ROA (aggregated data on a parent-company basis) 3/ 4/ 5/	0.4	0.2	0.3	0.7	0.4	0.4
ROA (main groups on a consolidated basis) 2/ 5/	0.4	0.4	0.6	0.5	0.4	0.4
ROE (aggregated data on a parent-company basis) 3/ 4/ 5/	10.1	4.4	7.7	14.8	6.4	6.5
ROE (main groups on a consolidated basis) 2/ 5/	8.1	6.2	9.2	8.4	6.3	6.7
Interest margin to gross income 3/	43.7	44.1	41.3	41.3	36.4	41.9
Noninterest expenses to gross income 3/	66.5	67.8	65.5	65.3	74.5	88.6
Liquid assets to total assets 6/	30.6	27.1	12.5	12.6	13.9	13.7
Liquid assets to short-term liabilities 6/	165.2	178.5	17.5	19.9	20.7	19.6

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/ 2017-18 based on consolidated data, and thus not comparable with previous years' unconsolidated data.

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

5/ ROA and ROE ratios are calculated after taxes (same calculation as the ECB consolidated data ratios).

6/ 2015-18 data is based on new methodology which is not comparable to older figures.

Table 7. France: Additional Financial Soundness Indicators, 2013–18
(In percent unless otherwise indicated)

	2013	2014	2015	2016	2017	2018
Corporate sector						
Total debt to equity	79.6	90.0	86.0	88.9	86.4	90.8
Return on equity	5.1	5.9	5.7	5.7	5.6	5.6
Interest paid to financial firms 1/	...	...	...	...	...	...
Corporate net foreign exchange exposure to equity	...	...	...	...	...	...
Number of enterprise bankruptcies (thousands)	62.5	62.4	63.0	58.0	54.5	54.0
Number of enterprise creations (thousands)	538.2	550.8	525.1	554.0	591.3	691.3
Deposit-taking institutions						
Capital (net worth) to assets 2/	5.5	5.8	6.3	6.4	6.6	6.5
International consolidated claims of French banks, of which (BIS data, as percent of total international claims)						
Advanced countries	78.6	77.6	77.5	77.0	76.1	75.6
Developing Europe	6.8	6.7	6.6	6.5	6.5	6.5
Latin America and Caribbean	1.4	1.5	1.8	1.7	1.7	1.6
Africa and Middle East	4.2	4.3	4.4	4.7	4.6	4.8
Asia and Pacific Area	4.8	5.6	4.6	4.8	5.6	5.3
Offshore Financial Centers	4.2	4.4	4.1	4.3	4.7	5.4
Gross asset position in financial derivatives to capital 2/	205.8	238.2	190.2	175.3	138.7	126.7
Gross liability position in financial derivatives to capital 2/	206.8	238.7	188.1	174.1	145.9	131.3
Large exposures to capital 2/	5.4	5.5	6.1	6.1	14.9	14.4
Trading income to total income 2/	10.6	-0.1	-6.7	-7.6	9.6	10.5
Personnel expenses to noninterest expenses 2/	32.7	35.1	34.2	44.0	40.6	40.0
Spread between reference lending and deposit rates	217.1	214.3	214.7	197.6	157.7	146.0
Spread between highest and lowest interbank rate	9.1	7.9	10.9	11.0	11.1	11.7
Customer deposits to total (noninterbank) loans 2/	70.1	82.6	84.5	82.0	77.1	81.5
FX loans to total loans 3/	7.6	8.0	8.4	8.7	7.8	8.0
FX liabilities to total liabilities 3/	14.3	16.2	17.6	19.4	17.6	18.0
Net open position in equities to capital	...	...	...	...	...	...
Market liquidity						
Average bid-ask spread in the securities market 4/	...	...	...	...	...	...
Average daily turnover ratio in the securities market	...	...	...	...	...	...
Other financial corporations						
Assets to total financial system assets	16.8	16.7	16.4	16.6	16.3	15.9
Assets to GDP	193.1	203.4	205.2	213.8	216.7	207.0
Households						
Household debt to GDP	55.3	55.4	55.9	57.1	58.4	59.9
Household debt service and principal payments to income	13.0	12.3	12.3	15.0	14.7	15.0
Real estate markets						
Real estate prices	-2.1	-1.8	-1.9	0.9	3.0	3.1

Sources: Banque de France ; ACPR ; BIS

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

2/ 2017 uses consolidated data, and thus not comparable with previous years' unconsolidated data.

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

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

Note: Due to a benchmark revision of national accounts in 2018, some series have been substantially revised.

Annex I. Authorities' Response to Past IMF Policy Recommendations

IMF 2018 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Identify and implement deep structural spending reforms at all levels of government, including by reducing the wage bill, consolidating local governments, improving the targeting of social benefits, and making health spending more efficient.	The authorities have legislated with the 2019 budget nominal spending growth ceilings for local authorities, public wages, social benefits, and health spending. However, important tax cuts have also been legislated, which almost offset the impact of legislated spending measures. The authorities are also working on reforms of the civil service, pension system, unemployment benefits, and healthcare, but have yet to identify fiscal savings from some of these reforms.
Structural Reforms	
Better link education systems to labor market needs, re-examine the level and accumulation rate of unemployment benefits, expand firm-level flexibility in setting base wages, and re-evaluate the minimum wage mechanism.	Substantial progress was made in reforming the organization, governance, and funding of apprenticeship and training systems in late 2018, while a reform of the unemployment benefit system is underway, aiming to reduce the system's generosity, improve work incentives, and disincentivize precarious work arrangements.
Simplify business regulations, address disincentives to company growth, and further reduce barriers to competition in regulated professions.	The <i>Loi Pacte</i> , enacted in early 2019, simplifies further administrative burdens for firms, particularly for smaller ones.
Financial Sector	
Closely monitor financial risks, in particularly the rise in corporate debt.	The authorities have continued to monitor financial risks and decided in 2019 to further increase the countercyclical capital buffer.

		France										Overall Assessment	
Foreign asset and liability position and trajectory		<p>Background. Since 2015, the net international investment position (NIIP) has averaged around -16 percent of GDP, largely driven by public sector and banking sector net external debt, as the net FDI position is positive and over 20 percent of GDP. The NIIP improved slightly from -20 percent of GDP in 2017 to -11 percent of GDP in 2018, due to lower nonfinancial firms' portfolio equity liabilities partly reflecting valuation effects. While the net position is moderately negative, gross positions are large, particularly for financial (bank and non-bank) institutions, reflecting their global activities. Specifically, the gross asset position stood at 290 percent of GDP in 2018, of which banks' non-FDI related assets account for about one-third, and other non-bank financial institutions close to another one-third. On the other hand, gross liabilities reached 301 percent of GDP in 2018, of which external debt is estimated at 199 percent of GDP (of this, the public-sector accounts for 54 percent of GDP, and banks for 104 percent of GDP). Target 2 balances averaged at around -€36 billion (-1.5 percent of GDP) in 2018.</p> <p>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 and banks' gross financing needs—bank debt maturing in 2019 is estimated at €75 billion (3.2 percent of GDP) and financial derivatives stand at 30 percent of GDP.</p>										<p>Overall Assessment:</p> <p><i>The external position in 2018 was broadly consistent with medium-term fundamentals and desirable policy settings.</i></p> <p>Potential policy responses:</p> <p>Although the external position is in line with fundamentals, a coordinated policy response that addresses domestic policy distortions with offsetting effects is needed. Steadfast implementation of recently legislated structural reforms (e.g. labor market reforms), together with further efforts to reduce corporate administrative burdens, promote innovation, and strengthen competition in service sectors, would help improve competitiveness, investment and support long-run growth. Steady medium-run fiscal consolidation would also help keep the external position in line with medium-term fundamentals.</p>	
	2018 IIP (% GDP)	NIIP	-11.4	Gross Assets	289.9	Debt Assets	164.2	Gross Liab.	301.2	Debt Liab.	199.3		
Current account		<p>Background. The current account (CA) deficit, which has hovered around 0.7 percent of GDP since 2010, narrowed slightly to 0.6 percent in 2018 (from 0.7 percent in 2017). The lower CA deficit in 2018 took place despite a deterioration in the oil balance, and largely reflected a better performance of the service and non-oil goods trade balances as well as a continuation of the improving trend in the income balance.</p> <p>Assessment. The 2018 cyclically-adjusted CA deficit is estimated at 0.5 percent of GDP, compared to an EBA-estimated norm of a surplus of 0.5 percent. On this basis, staff assesses that the CA gap in 2018 was between -1.5 to -0.5 percent of GDP.</p>											
	CA Assessment 2018	Actual CA	-0.6	Cycl. Adj. CA	-0.5	EBA CA Norm	0.5	EBA CA Gap	-1.0	Staff Adj.	0.0		Staff CA Gap	-1.0
Real exchange rate		<p>Background. After depreciating by around 4–9 percent since 2010, mainly due to the euro depreciation, both the ULC-based and the CPI-based REER appreciated moderately by 0.4–2.2 percent in 2018 relative to their 2017 average. Through May 2019, the CPI-based REER has depreciated by 1.6 percent. From a longer perspective, the ULC-based REER appreciated by around 3–9 percent since the late 1990s, notwithstanding relatively stable CPI-based REER indices. As a result, France has lost about one-third of its export market share in the 2000s and has not regained it since.</p> <p>Assessment. The EBA REER-Index model points to a REER gap of -0.5 percent, while the EBA REER-Level model points to a REER gap of 7.7 percent. Meanwhile, given an elasticity of 0.27, the EBA CA gap points to an overvaluation of 2–5 percent. In line with estimates derived from the CA assessment, staff assesses the REER gap to be in the range of 2 to 5 percent.</p>											
		<p>Background. The CA deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Financial derivative flows have grown sizably both on the asset and the liability side since 2008. The capital account is open.</p> <p>Assessment. France remains exposed to financial market risks owing to the large refinancing needs of the sovereign and banking sector.</p>											
Capital and financial accounts: flows and policy measures	<p>Background. The euro has the status of a global reserve currency.</p> <p>Assessment. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.</p>												
FX intervention and reserves level													

Sources of Risk	Likelihood of Risk (High, Medium, Low)	Expected Impact of Risk (High, Medium, Low)	Policy Response
Weaker-than-expected global growth	High Europe: In the near term, weak foreign demand makes euro area businesses delay investment, while faltering confidence reduces private consumption. Adverse financial market reaction to debt sustainability concerns further dampens growth. A disorderly Brexit could cause market disruption with negative spillovers. In the medium term, disregard for the common fiscal rules and rising sovereign yields for high-debt countries test the euro area policy framework, with adverse impact on confidence and growth.	High <ul style="list-style-type: none"> Lower medium-term growth due to weaker investment, consumption, and export growth. Further deterioration in public finances and private balance sheets. 	<ul style="list-style-type: none"> Accelerate structural reforms to spur investment, productivity and competitiveness, and strengthen private-sector balance sheets Early identification of deep spending reform to put debt solidly on a downward path, increase economic resilience.
Rising protectionism and retreat from multilateralism	High In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	High <ul style="list-style-type: none"> A retaliatory cycle of trade restrictions could hurt France's exports and investment impairing the growth momentum. A rise in euro skepticism could lead to a resurfacing of populism sentiment in France, leading to political opposition to the current government which is largely pro-Europe. 	<ul style="list-style-type: none"> Continued support for the multilateral rules-based trading system, trade liberalization and pursuit of high-standard free-trade agreements. Re-double efforts to secure the benefits of economic integration and cooperation across the EU. Strong collaboration to ensure smooth and predictable transition to a new economic relationship between the U.K. and the EU.
Sharp tightening of global financial conditions	Low Market expectation of tighter U.S. monetary policy triggered by strong wage growth and higher-than-expected inflation.	High <ul style="list-style-type: none"> Less favorable borrowing conditions could weigh on private-sector and public-sector balance sheets, with implications for growth. 	<ul style="list-style-type: none"> To build buffers against adverse shocks, the government must press on expeditiously with structural reforms, strengthening balance sheets, and fiscal consolidation.
	Medium Sustained rise in risk premium in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.		
Weakening of reform implementation in France, including due to increased resistance.	High Non-implementation of remaining structural and fiscal reforms could undermine confidence and lead to higher financing costs.	High <ul style="list-style-type: none"> Lower medium-term growth due to weaker investment and persistent unemployment. Further deterioration in public finances and private balance sheets. 	<ul style="list-style-type: none"> Accelerate structural reforms to spur investment, productivity and competitiveness, and strengthen private-sector balance sheets Early identification of deep spending reform to put debt solidly on a downward path, increase economic resilience.

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 IV. Debt Sustainability Analysis (DSA)

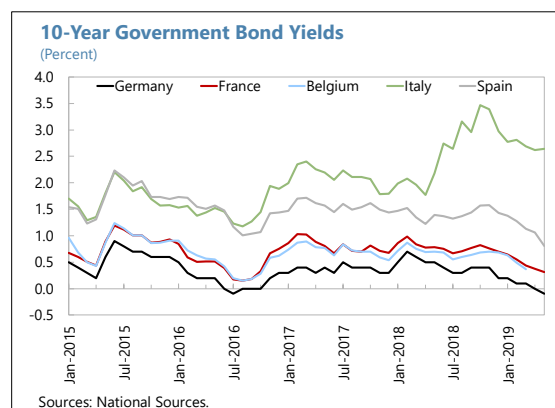
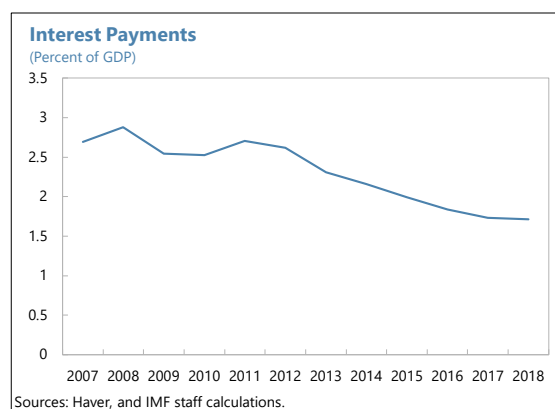
A. Public Debt Sustainability Analysis

Under the baseline scenario, the debt-to-GDP ratio is projected to decline modestly to 97 percent of GDP by 2024 from 98 percent in 2018, on the back of continued growth, low interest rates, and a broadly constant structural primary balance. Due to the maturity structure of the French debt, gross financing needs are expected to peak at 21 percent of GDP in 2022 and gradually decline to 19 percent in 2024. Public debt remains high and vulnerable, especially if faced with a combined macro-fiscal shock.

1. Background. The persistence of high fiscal deficits led to an increase in the debt-to-GDP ratio by 30 percent of GDP since 2008, to 98 percent at end-2018. Public debt was revised up by 1.7 percent of GDP in 2017 due to the absorption of the debt from the state railway SNCF. Owing to the sharp decline in interest rates and inflation (except for the spike in 2018),¹ the rising debt has had a limited impact on the debt service. Interest payments were at the historically low level of 1.7 percent of GDP in 2018.² Moreover, yields remain at a historical low. The benchmark yield (10 years) has declined from 4.2 percent in 2008 to 0.8 percent in 2018. The spreads over German Bunds, which had increased to almost 190 basis points in November 2011, were at around 50 basis points at the end of 2018.

2. Baseline. Staff projects the debt-to-GDP ratio to decline modestly by 1.4 percent of GDP to 97.0 in 2024. The primary deficit will contribute to a 6.9 percent of GDP increase in debt over this period, which will be more than compensated by a 7.8 percent of GDP contribution from the interest-growth dynamics. Under the baseline, the gross financing needs of the government would peak at 20.8 percent of GDP in 2022 and gradually decline to 19.3 percent in 2024.

- **Macroeconomic assumptions.** The economy grew by 1.7 percent in 2018 compared with 2.3 percent in 2017, and growth is expected to decline to 1.3 percent in 2019 and then gradually



¹ About 13 percent of French debt is indexed to inflation (end-2018).

² This is the lowest level since 1982 when the debt-to-GDP ratio was at 25 percent.

stabilize at its potential of 1.5 percent over the medium term. The effective interest rate is expected to be around 1.7 percent over the medium term.

- **Fiscal outlook.** Primary structural adjustment has averaged 0.1 percent of GDP in 2017–18 and is expected to be -0.1 percent of GDP on average over the next 5 years. At around 1.1 percent of GDP, the primary deficit would remain below its debt stabilizing level of 1.5 percent of GDP.

3. Realism of Projections. The median forecast error for real GDP growth during 2009–17 was -0.3 percent, suggesting an upward bias in staff projections during that period. This is associated with a median forecast error of -0.5 percent for the primary balance and a -0.3 percent median forecast bias for inflation. Cross-country experience suggests that the projected adjustment and level of the cyclically-adjusted primary balance (CAPB) are below the thresholds that would cast doubt on the feasibility of the adjustment, based on high-debt country experience. More specifically, at 0.7 percent of GDP, the largest projected adjustment over any three years during the projection is below the threshold of 3 percent of GDP. In addition, the maximum average level of the cyclically-adjusted primary deficit for any consecutive 3-year period during the projection horizon reaches -1.0 percent of GDP, well below the threshold of 3.5 percent of GDP.

4. Alternative scenarios. Under the scenario of a constant primary balance equal to the 2019 value,³ public debt would remain high at around 100 percent of GDP by 2024. Under the historical scenario of real GDP growth, real interest rates, and primary balance at their 2009–2018 historical average, gross public debt would be on a rising path, approaching 108 percent of GDP by 2024, while gross financing would reach 24 percent of GDP.

5. Shocks and Stress Tests. The baseline scenario suggests that France’s government debt-to-GDP ratio would stay on a downward path, although it would remain high during the projection horizon.

- **Growth shocks.** Under this scenario, real output growth rates are lowered by one standard deviation over 2020–21, i.e. 1.5 percentage points relative to the baseline scenario. The assumed decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth) and the interest rate is assumed to increase 25 basis points for every 1 percent of GDP worsening of primary balance. Public debt increases the most under this scenario. It would peak at 105 percent of GDP in 2021 and decline to 104 percent by 2024.
- **Primary balance shock.** This scenario examines the implications of a dual shock of lower revenues and rise in interest rate, leading to a deterioration of -0.6 percent of GDP in the primary balance in 2020–21. Under this scenario, the debt-to-GDP ratio would peak at 100 percent of GDP in 2021 and then decline to 98 percent of GDP by 2024.

³ The CICE conversion results in a temporary worsening of the balance in 2019.

- **Interest rate shock.** This scenario assumes an increase of 341 basis points in the cost of debt throughout the projection period.⁴ The deterioration of public debt and gross financing needs are back-loaded, as old debt gradually matures and new debt is contracted at higher interest rate.⁵ In 2024, the impact on gross financing needs is 2.3 percent of GDP and 3.4 percent of GDP for the debt-to-GDP ratio.
- **Real exchange rate shock.** This scenario assumes a 13 percent devaluation of the real exchange rate in 2020 and examines the impact on debt through the inflation channel. Under this scenario, the debt-to-GDP ratio would remain very close to the baseline.
- **Combined macro-fiscal shock.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance. Under this scenario, debt would reach 105 percent of GDP in 2021 and then increase to 107 percent in 2024. Gross financing needs would peak at 25 percent of GDP in 2021.

6. Heat map. Risks from the debt level and gross financing needs are deemed high, given that France is above the respective thresholds of 85 and 20 percent of GDP under the baseline and all stress scenarios. The share of public debt held by non-residents is high but has been declining since the euro area crisis. As of end-2018, non-residents held 54 percent of French debt, a level substantially lower than the peak of 71 percent reached early 2010. The high share of public and private (mainly banks) debt held by non-residents results also in high external financing requirements.

B. External Debt Sustainability Analysis

The external DSA provides a framework to examine a country's external debt sustainability that complements the External Sector Assessment (Annex II). Under the baseline scenario, external debt is projected to decline from 217 percent of GDP in 2018 to 206 percent of GDP in 2024, helped by non-interest current account surpluses and favorable growth interest rate differentials. France has a high level of external debt, but some mitigating factors include the current low cost of debt, the high amount of foreign assets, the limited share of debt in foreign currency, and a positive non-interest current account.

7. Background. External debt increased from 209 percent of GDP in 2014 to 217 percent of GDP in 2018. Globally active banks account for about half of the external debt (104 percent of GDP), while the government accounts for another quarter (54 percent of GDP). Intercompany loans account for about 10 percent of GDP in external debt. France also holds a substantial stock of foreign assets (around 290 percent of GDP in 2018).

⁴ The interest rate is increased by the difference between average real interest rate level over the projection period and maximum real historical level.

⁵ As of end-2018, the average maturity of debt was 7 years and 336 days.

8. Assessment. France's external debt, while high, is sustainable over the medium term. Under the baseline scenario, external debt is projected to decline from 217 percent of GDP in 2018 to 206 percent of GDP in 2024, helped by projected non-interest current account surpluses of close to 3 percent of GDP in the medium term, and favorable growth interest rate differentials. Some mitigating factors include the current low cost of debt, the high amount of foreign assets, the limited share of debt in foreign currency, and a positive non-interest current account. The path of external debt is robust to standard stress test scenarios. Only under the historical scenario, in which macroeconomic variables are set equal to their historical averages, would external debt not decline over the medium term. Under this scenario, external debt would increase from 217 percent of GDP in 2018 to 266 percent of GDP in 2024. External debt is more vulnerable to a real depreciation and growth shock, while the effect of an interest shock as well as a non-interest current account shock would be small.

Figure 1. France: Public DSA Risk Assessment



Source: IMF staff.

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

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

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

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

4/ Long-term bond spread over German bonds, an average over the last 3 months, 20-Mar-19 through 18-Jun-19.

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

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

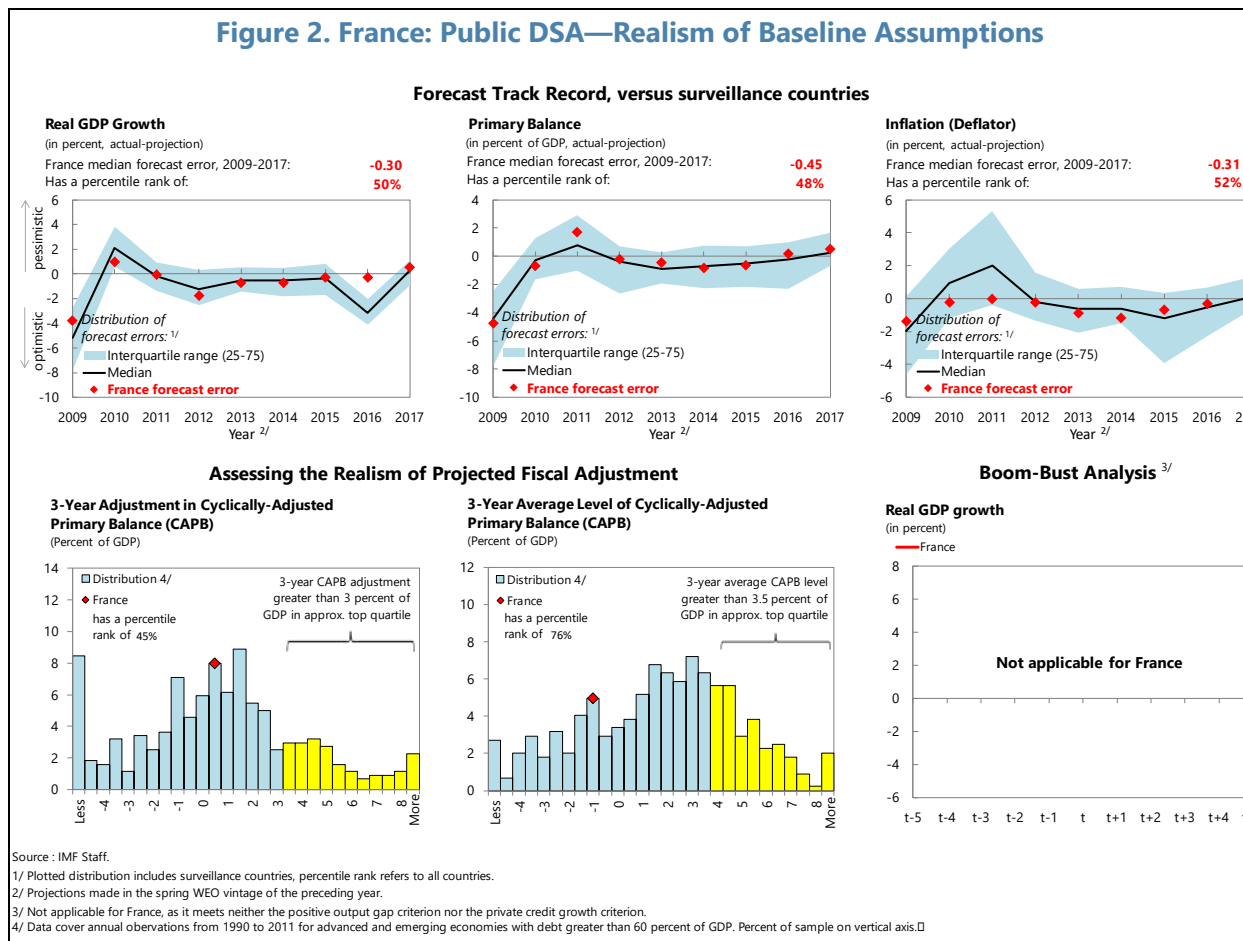
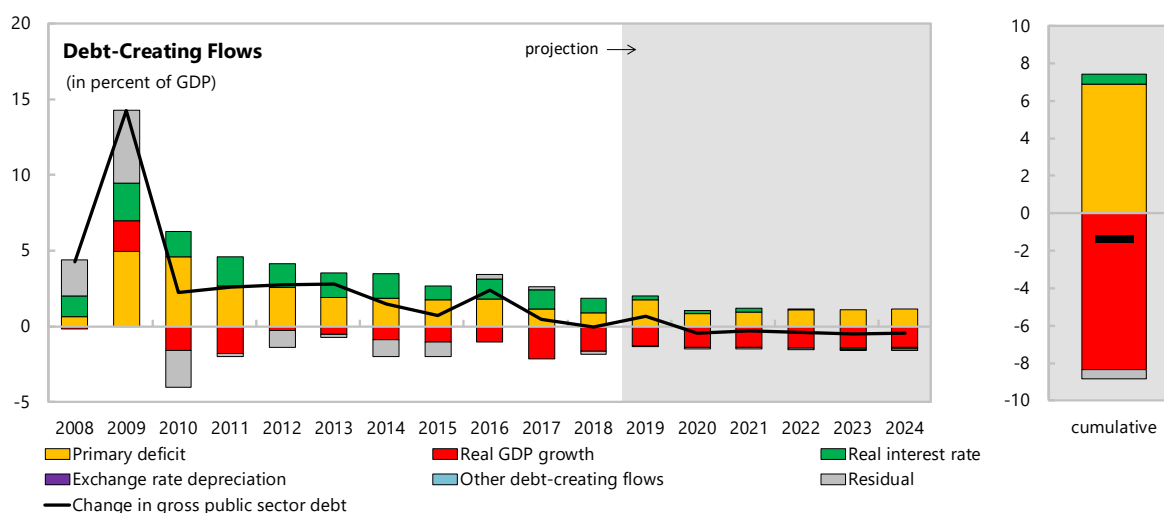


Figure 3. France: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}										As of June 18, 2019		
	Actual			Projections								
	2008-2016 ^{2/}	2017	2018	2019	2020	2021	2022	2023	2024			
Nominal gross public debt	88.6	98.4	98.4	99.0	98.6	98.3	97.9	97.4	97.0	Sovereign Spreads		
Public gross financing needs	20.9	17.3	16.6	16.9	19.5	20.7	20.8	20.4	19.3	EMBIG (bp) ^{3/}	33	
Real GDP growth (in percent)	0.6	2.3	1.7	1.3	1.4	1.5	1.5	1.5	1.5	5Y CDS (bp)	27	
Inflation (GDP deflator, in percent)	1.0	0.5	0.8	1.3	1.4	1.4	1.6	1.8	1.8	Ratings	Foreign	Local
Nominal GDP growth (in percent)	1.6	2.7	2.5	2.6	2.9	2.9	3.2	3.3	3.3	Moody's	Aa2	Aa2
Effective interest rate (in percent) ^{4/}	3.0	1.8	1.8	1.6	1.6	1.7	1.7	1.7	1.8	S&Ps	AA	AA
										Fitch	AA	AA

Contribution to Changes in Public Debt											
	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024		
Change in gross public sector debt	3.7	0.5	0.0	0.7	-0.4	-0.3	-0.4	-0.5	-0.4	-1.4	
Identified debt-creating flows	3.6	0.3	0.2	0.7	-0.3	-0.2	-0.3	-0.4	-0.4	-0.9	
Primary deficit	2.5	1.1	0.9	1.8	0.9	1.0	1.1	1.1	1.1	6.9	-1.5
Primary (noninterest) revenue and grants	51.6	53.5	53.4	52.3	52.0	51.7	51.4	51.3	51.3	310.0	
Primary (noninterest) expenditure	54.1	54.6	54.3	54.1	52.8	52.6	52.5	52.4	52.4	316.9	
Automatic debt dynamics ^{5/}	1.0	-0.9	-0.7	-1.0	-1.2	-1.2	-1.4	-1.5	-1.5	-7.8	
Interest rate/growth differential ^{6/}	1.0	-0.9	-0.7	-1.0	-1.2	-1.2	-1.4	-1.5	-1.5	-7.8	
Of which: real interest rate	1.6	1.3	0.9	0.3	0.2	0.2	0.0	-0.1	-0.1	0.5	
Of which: real GDP growth	-0.6	-2.2	-1.7	-1.3	-1.4	-1.4	-1.4	-1.4	-1.4	-8.3	
Exchange rate depreciation ^{7/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of d0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{8/}	0.2	0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

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

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

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

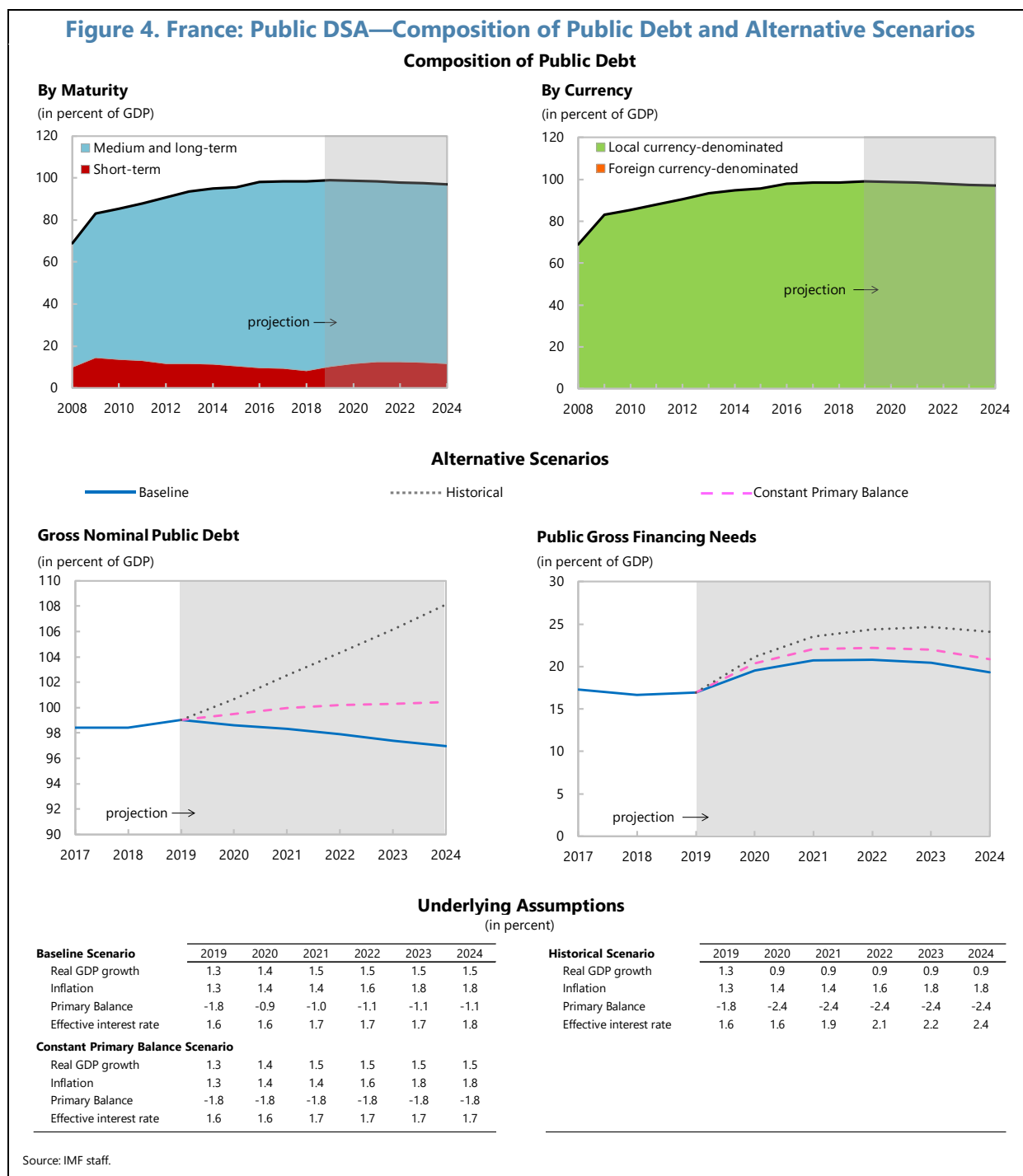
Figure 4. France: Public DSA—Composition of Public Debt and Alternative Scenarios

Figure 5. France: Public DSA—Stress Tests



Table 1. France: External Debt Sustainability Framework, 2014–24
(in percent of GDP unless otherwise indicated)

	Actual					Projections							
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024		
Baseline: External debt	209.1	209.2	213.0	210.5	216.9	219.2	217.5	215.3	212.4	209.2	205.9		
Change in external debt	15.3	0.1	3.8	-2.5	6.4	2.3	-1.8	-2.2	-2.9	-3.2	-3.3		
Identified external debt-creating flows (4+8+9)	-3.8	7.2	-3.8	-7.5	-9.0	-3.7	-4.0	-4.3	-4.7	-4.8	-4.9		
Current account deficit, excluding interest payments	-2.2	-2.7	-2.3	-2.0	-2.5	-2.5	-2.4	-2.7	-2.8	-2.8	-2.7		
Deficit in balance of goods and services	0.8	0.4	0.5	1.1	1.1	1.0	1.0	0.8	0.7	0.7	0.8		
Exports	30.4	31.9	31.6	32.1	32.6	34.7	34.7	35.0	35.1	35.3	35.5		
Imports	31.2	32.3	32.1	33.1	33.7	35.7	35.7	35.8	35.8	36.0	36.3		
Net non-debt creating capital inflows (negative)	-1.8	0.1	-1.1	-1.4	-1.9	-1.4	-1.5	-1.7	-1.8	-2.0	-2.2		
Automatic debt dynamics 1/	0.2	9.8	-0.4	-4.1	-4.7	0.1	-0.1	0.0	-0.1	0.0	0.1		
Contribution from nominal interest rate	3.2	3.0	2.8	2.7	3.0	3.0	3.0	3.1	3.0	3.1	3.1		
Contribution from real GDP growth	-1.8	-2.7	-2.3	-4.6	-3.4	-2.9	-3.1	-3.0	-3.1	-3.1	-3.0		
Contribution from price and exchange rate changes 2/	-1.1	9.5	-0.9	-2.2	-4.3	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	19.1	-7.1	7.7	5.0	15.5	6.1	2.3	2.2	1.9	1.6	1.6		
External debt-to-exports ratio (in percent)	688.3	655.9	674.7	656.6	665.3	631.3	626.1	616.0	604.8	593.4	580.1		
Gross external financing need (in billions of US dollars) 4/	1919.2	2058.7	2124.5	2260.7	2377.0	2678.6	2670.5	2739.8	2809.7	2882.1	2954.4		
in percent of GDP	67.2	84.4	85.9	87.2	85.5	10-Year	10-Year	98.5	94.8	93.7	92.4	91.2	89.7
Scenario with key variables at their historical averages 5/						222.0	229.8	238.3	247.2	256.3	266.3		
Key Macroeconomic Assumptions Underlying Baseline						Historical	Standard						
						Average	Deviation						
Real GDP growth (in percent)	1.0	1.1	1.1	2.3	1.7	0.9	1.5	1.3	1.4	1.5	1.5	1.5	
GDP deflator in US dollars (change in percent)	0.6	-15.5	0.2	2.5	5.5	-1.2	6.7	-3.5	2.1	2.3	2.4	2.4	
Nominal external interest rate (in percent)	1.7	1.2	1.4	1.3	1.6	1.6	0.2	1.4	1.4	1.5	1.5	1.5	
Growth of exports (US dollar terms, in percent)	2.0	-10.4	0.3	6.5	9.1	1.3	10.2	4.2	3.6	4.4	4.5	4.4	
Growth of imports (US dollar terms, in percent)	2.7	-11.6	0.8	8.2	9.0	1.3	10.9	3.7	3.6	3.9	4.1	4.4	
Current account balance, excluding interest payments	2.2	2.7	2.3	2.0	2.5	2.6	0.3	2.5	2.4	2.7	2.8	2.8	
Net non-debt creating capital inflows	1.8	-0.1	1.1	1.4	1.9	0.9	1.2	1.4	1.5	1.7	1.8	2.0	

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

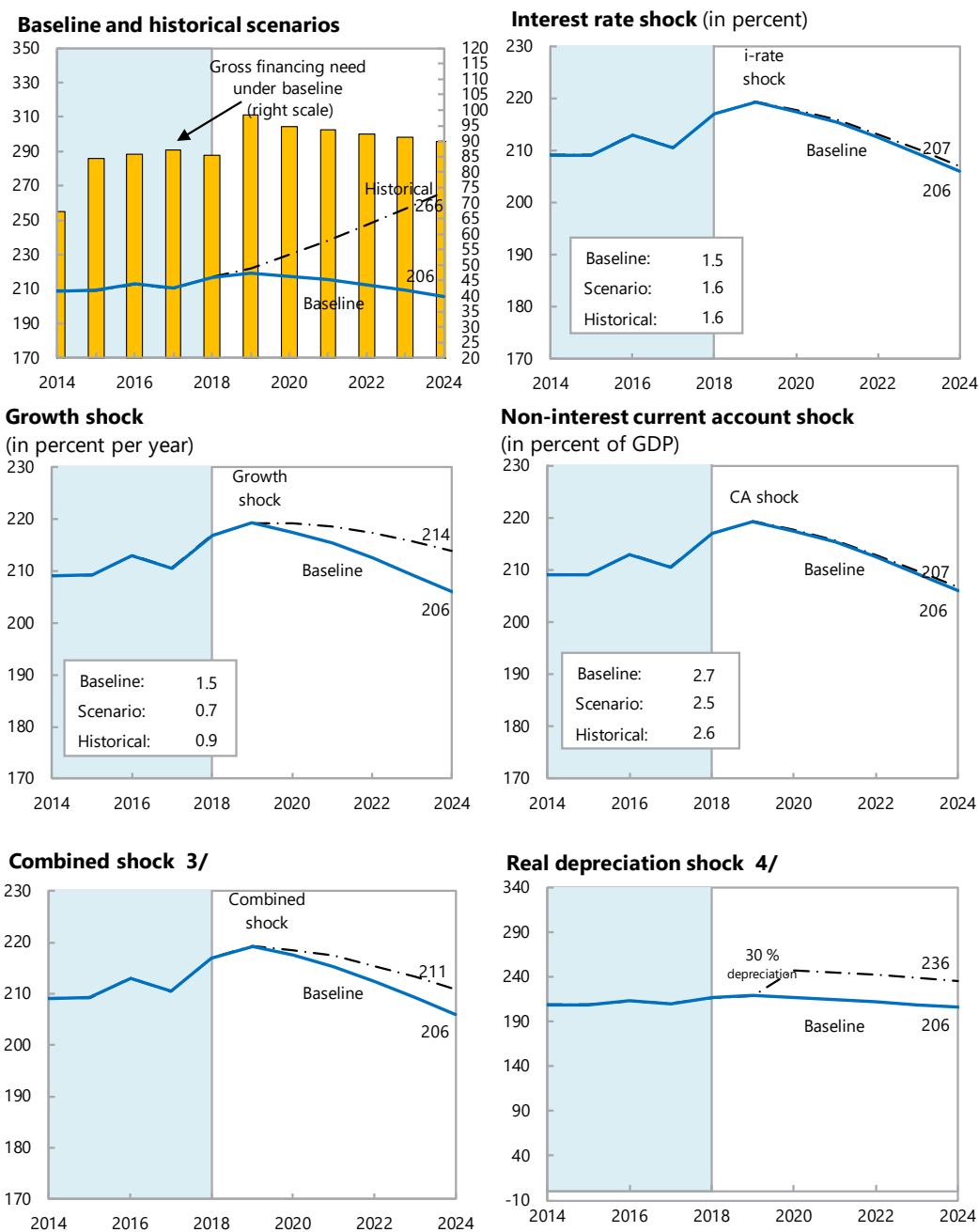
2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP

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

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

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

Figure 6. France: External Debt Sustainability: Bound Tests ^{1/2/}
 (External debt in percent of GDP)

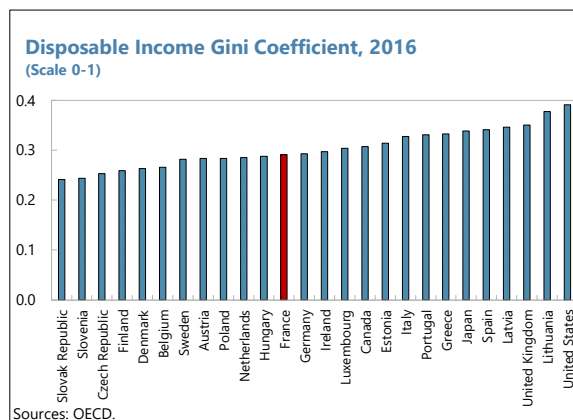


Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2010.

Annex V. Taking Stock of Inequality in France¹

1. France's disposable income inequality is slightly below the euro area average, and its poverty rate is low (Figure 1).

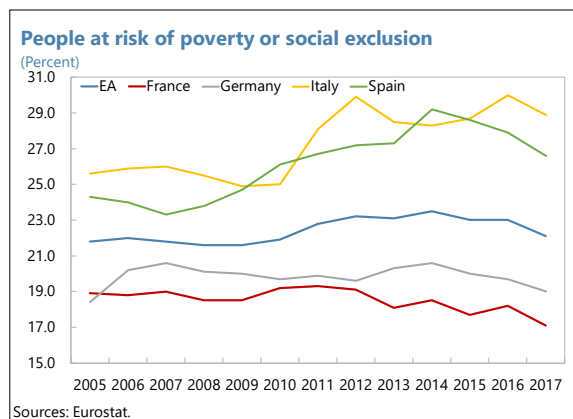
France's Gini coefficient of disposable income is around 0.3, higher than the one of Nordic countries, about the same as Germany's, and lower than Italy's and Spain's. The ratio between the 80th and 20th income quintiles in France is below the euro area average. France has one of the lowest poverty rates² among OECD countries, with 8 percent poverty rate against 10 percent in Germany and



14 percent in Italy. However, the poverty rate among the youth (age 18–25) is 14 percent, while the poverty rate among the elderly (age 51–65) is 7 percent. Finally, wealth concentration—defined as the ratio of mean to median wealth and the share of the richest 1 percent in wealth—is about the OECD average and lower than in Denmark, Germany, and the Netherlands.

2. Aggregate disposable income inequality has been broadly stable over time (Figure 2).

France's Gini coefficient of disposable income declined between 1984 and 2004, but has been increasing since then, especially during the crisis, and remains above pre-crisis levels. The income shares of the bottom 50 percent have been broadly stable, while the pre-tax income share of the top 1 percent has increased from 8 to 11 percent between 1980 and 2014 (Garbinti et al., 2018). Similarly, the share of people at risk of



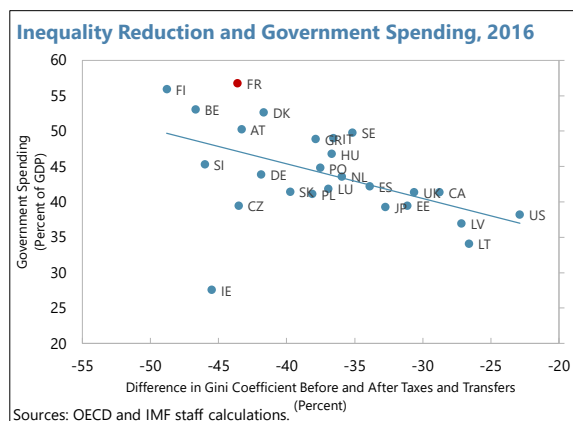
poverty or social exclusion increased slightly during the crisis but has been declining since 2013—while it remained persistently higher than before the crisis in other European countries. From a longer perspective, aggregate poverty rates have remained broadly stable since the mid-80s. However, Azkenazy and Palier (2018) note different developments across age cohorts: while the poverty rate of the youth (age 18–25) has increased from 9 to 14 percent over this period, the poverty rate of the elderly (age 51–65) has declined from 11.3 to 6.9 percent, suggesting that a relatively generous pension system has protected the elderly while the youth have suffered from relatively higher unemployment rates or, if employed, from lower wages (Chen et al., 2018).

¹ Prepared by Luiza Antoun de Almeida (EUR).

² Poverty rate is defined as the share of those whose disposable income is below half the median household income.

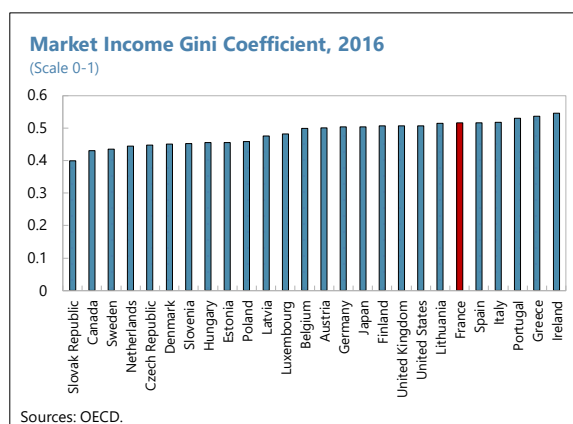
3. France's good aggregate disposable income inequality outcomes are due to the redistributive character of its fiscal policies (Figure 3).

Fiscal policies (transfers and taxes) reduce market income inequality in France by 44 percent, against an OECD average of 36 percent. As in other countries, market income inequality in France is reduced mainly through transfers rather than taxes (37 versus 7 percent, respectively). Nonetheless, a cross-country comparison suggests that the reduction in market income inequality in France comes at a relatively large fiscal cost. Recent literature (Madec et al., 2018, Biotteau et al., 2018, and IPP, 2019)³ suggests that fiscal measures introduced over the last decade have contributed to a decline in inequality: the bottom 65 percent households have gained in terms of disposable income, while the richest 35 lost.



4. Redistribution through social transfers and taxes masks relatively high market income inequality, reflected in inequality of opportunity, where France lags peers on several dimensions (Figure 4):

- Income mobility:* A recent OECD study (OECD, 2018) shows that in France it takes 6 generations for someone born in a family at the bottom 10 percent income to reach the mean income, among the highest in the OECD, but similar to Germany (6 generations) and slightly worse than the United States (5 generations). On another measure of intergenerational income persistence (Corak, 2016) France ranks toward the middle of the distribution, worse than Germany or Denmark.
- Educational performance:* France performs worse than the OECD average on measures of educational performance dependence on socioeconomic background. Specifically, a student coming from the top wealth quintile is 5.6 times more likely to have a high score in the PISA Science test than a student coming from the bottom wealth quintile. Similarly, a well-off student is 3.6 times more likely to complete tertiary education than a poor student.



³ The studies by Madec et al. (2018) and IPP (2019) are largely but not completely comparable. For instance, Madec et al. (2018) do not take into account changes in housing and wealth taxes in their analysis, while IPP (2019) does. If Madec et al. (2018) would take the increase in wealth taxes into account, this would likely reduce the disposable income of the richest by even more. As Biotteau et al (2018) find that the 2017 budget had almost no effect on inequality, we leave this year out of our aggregation.

- *Vulnerable groups:* Batini, Gbohoui, and Mumssen (2019) show, using micro-level data, that conditional on individual characteristics, the youth, the low-skilled, and non-EU born migrants face a significantly higher probability of being unemployed than the rest of the population. Differences in unemployment rates between vulnerable groups and the rest of the population tend also to be higher in France than in other crisis-resilient euro area countries (Table 1).
- *University premium:* France's university premium (the percentage difference between the employment rate of those with a tertiary education and those with a secondary education) is 25 percent, among the highest in the EU, compared to 7–12 percent in Sweden, Germany, and the Netherlands. This suggests that students who do not go to university are not well prepared through vocational training and apprenticeship to enter the labor market.

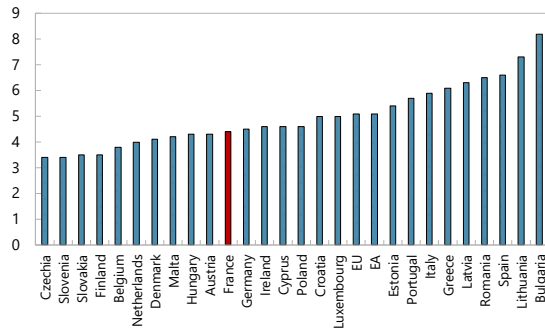
5. France performs relatively well on gender equality, but there is room for improvement (Figure 5). The World Bank's Women, Business and the Law (WBL) index, which measures gender equality before the law, has granted France together with only other 5 countries the best possible score. France also scores well on other measures of gender inequality: France has the highest female share in boards of listed companies (43 percent against an OECD average of 22 percent); it has one of the lowest gender wage gaps (10 percent against an OECD average of 14 percent); it has relatively high female relative to male labor market participation, and the third largest enrolment rate in early childhood education (60 percent relative to the OECD average of about 30 percent). Nonetheless, the ratio of the share of female managers to the share of male managers is one of the lowest among OECD countries.

6. Recent and planned reforms are a step in the right direction to reduce inequality further. Fiscal measures introduced in the 2018–19 budgets are supportive of the middle classes and active population, and more recently announced measures (e.g. the income tax reduction for the middle class, support to single mothers) should also contribute to a reduction in inequality. Furthermore, the training and apprenticeship reforms as well as the reduction in class sizes in primary schools in disadvantaged areas should reduce inequality of opportunities. The recent introduction of an index measuring gender pay inequalities together with financial penalties should reduce even further the gender wage gap and gender inequality. Looking forward, the government's new Poverty Plan aims at increasing early childhood education in disadvantaged areas, introducing mandatory training until age 18, and supporting labor market integration, among others. New policy efforts will need to continue to take into account inequality considerations.

Figure A1. Aggregate Inequality

a. The ratio of 80th to 20th income quintiles in France is below the EA average, and...

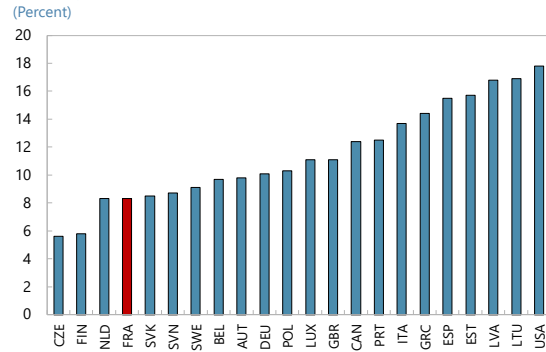
80th/20th Income Quintile Share Ratio, 2017



Sources: Eurostat.

b. ... the poverty rate is one of the lowest among OECD countries.

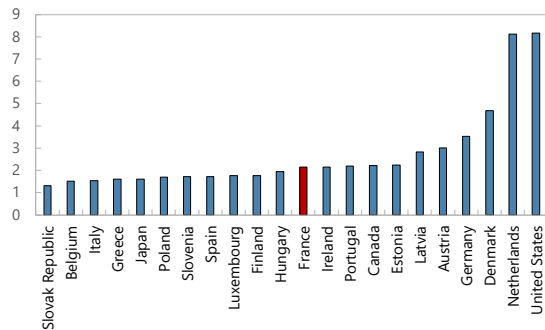
Poverty rates, 2016



Sources: OECD.

e. Wealth inequality measured by the mean to median wealth ratio as well as...

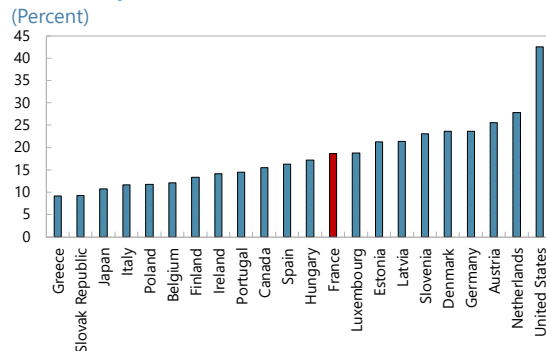
Mean to Median Wealth, 2014



Sources: OECD.

f. ... the share of the top 1 percent richest in wealth is much lower than in peer countries.

Share of Top 1% in Wealth, 2014

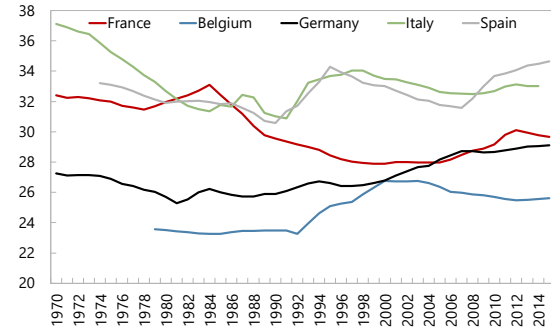


Sources: OECD.

Figure A2. Aggregate Inequality in Historical Perspective

a. France's current Gini coefficient is lower than in the mid-80s but higher than in the early 2000s.

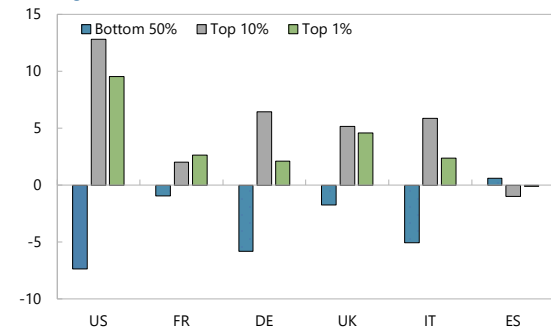
Gini Coefficient of Disposable Income
(scale 0-100)



Sources: The Standardized World Income Inequality Database.

c. However, the increase in inequality was more accentuated in other countries.

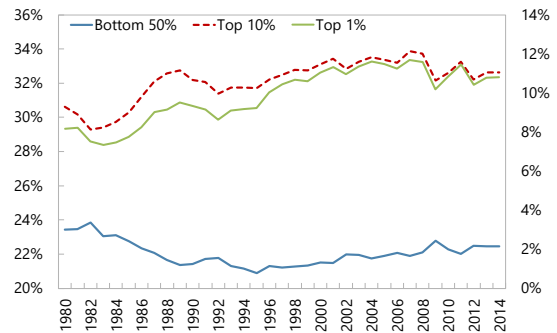
Difference in Income Shares 1980-2014
(Percentage Points)



Sources: Wealth and Income Database (WID).

b. The pre-tax income share of the top 1% has increased considerably between 1980 and 2008, while the share of the bottom 50% has stayed broadly stable.

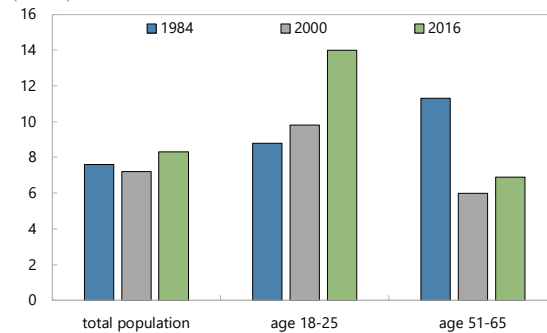
Income Shares 1980-2014



Sources: Wealth and Income Database (WID).

d. Stable poverty rates over time mask different developments across age cohorts.

Poverty Rates Across Different Age Cohorts
(Percent)

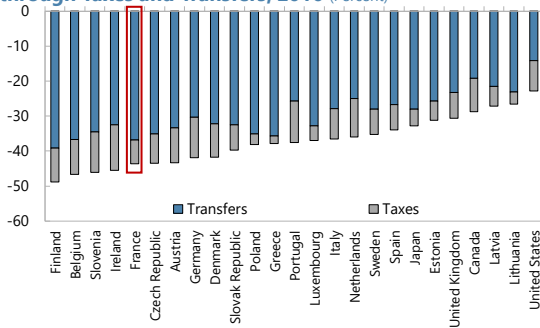


Sources: OECD, and Askenazy and Palier (2018).

Figure A3. Inequality and Fiscal Policy

a. France is one of the countries which most reduces market income inequality via fiscal policy.

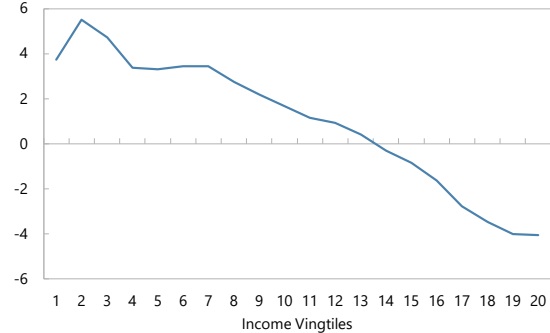
Percentage Reduction in Gini Coefficient through Taxes and Transfers, 2016 (Percent)



Sources: OECD, and IMF staff calculations.

b. New fiscal measures introduced in 2008–19 have contributed to a decline in inequality.

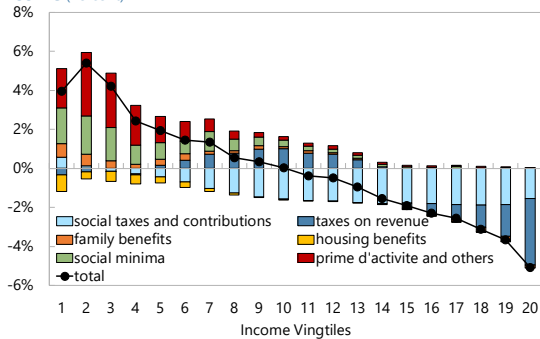
Effect of Fiscal Measures on Disposable Income, 2008-19 (Percent)



Sources: Madec et al. (2018), IIP (2019), and IMF staff calculations.

c. New measures introduced between 2008–16 have led to a decline in inequality.

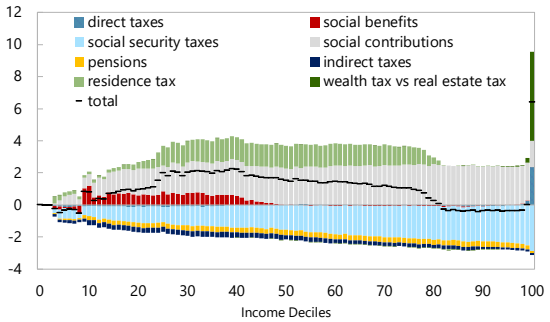
Effect of the 2008-16 Fiscal Measures on Disposable Income (Percent)



Sources: Madec et al. (2018).

d. The 2018–19 budget measures have benefitted the most the middle of the distribution as well as the top 1%, ...

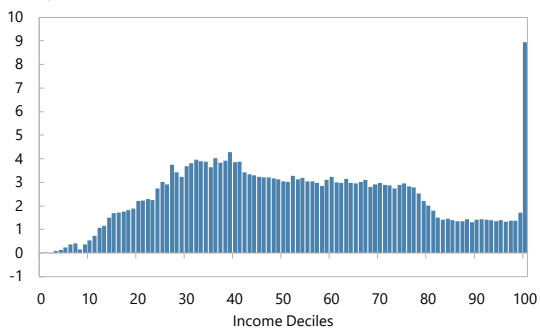
Effect of the 2018-19 budgets on Disposable Income* (Percent)



Sources: IPP (2019).
* Including the yellow vests' measures.

e. ... in particular the active population to the detriment of the inactive population.

Effect of the 2018-19 budgets on Disposable Income of the Active Pop* (Percent)

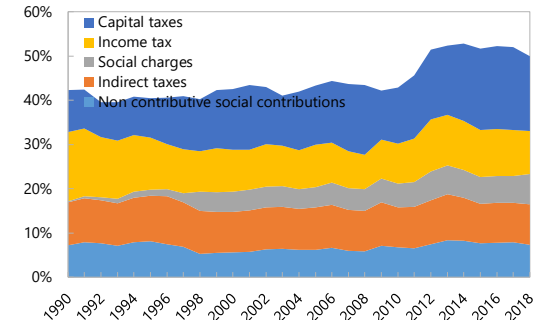


Sources: IPP (2019).
* Including the yellow vests' measures.

f. The top 1 percent pay a higher share of their pre-tax income in taxes today than in the 90s.

Taxes paid by Top 1% , 1990-2018

(Percent of Pre-Tax Income)



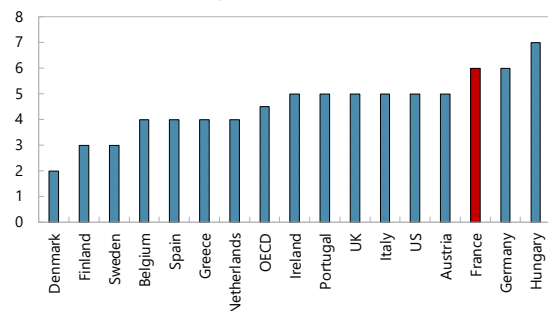
Sources: Bozio et al. (2018).

Figure A4. Inequality of Opportunities

a. In France, it takes 6 generations for someone born in a low-income family to reach the mean income...

Income Mobility

(Number of generations Needed for Those Born in Low Income Families to Reach Mean Income)

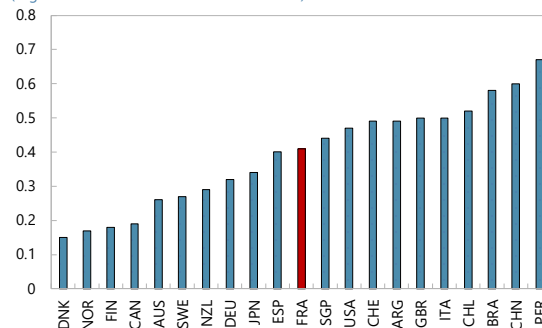


Sources: OECD (2018), A Broken Social Elevator? How to Promote Social Mobility.

b. ..., while France ranks in the middle of the distribution in other metrics of intergenerational income persistence.

Intergenerational Income Persistence

(Higher Number Indicates More Persistence)

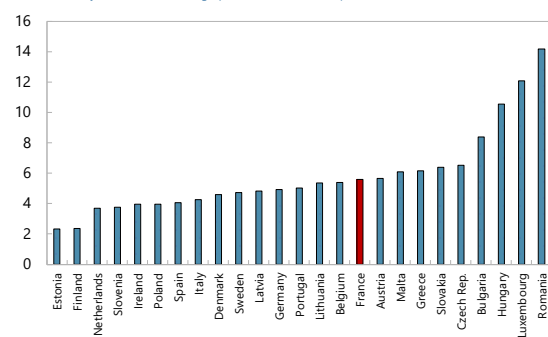


Sources: Corak (2016).

c. The odds of high performance of wealthier students are 6 times higher than the ones of poor students.

Inequality in PISA Science Scores

(Ratio of wealthy students' odds of high performance to that of poor students)

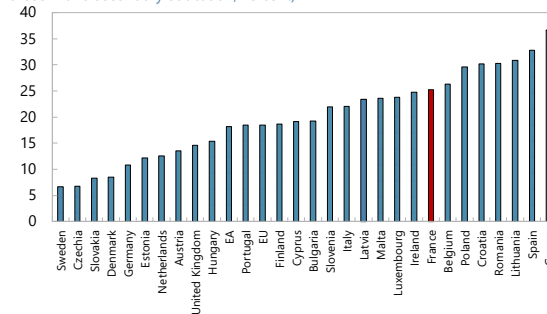


Sources: UNESCO, and IMF staff estimations.

d. Those with a tertiary education have much better labor market perspectives than those with secondary education.

University Premium

(Employment rate of those with a tertiary education to the one of those with a secondary education, Percent)



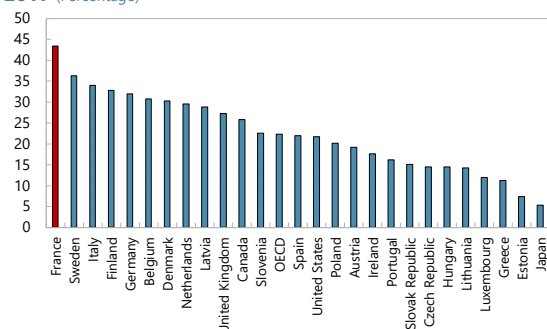
Sources: Eurostat, and IMF staff calculations.

Figure A5. Gender Inequality

a. France has the highest female share in boards of listed companies, ...

Female Share in Boards of Listed Companies,

2017 (Percentage)

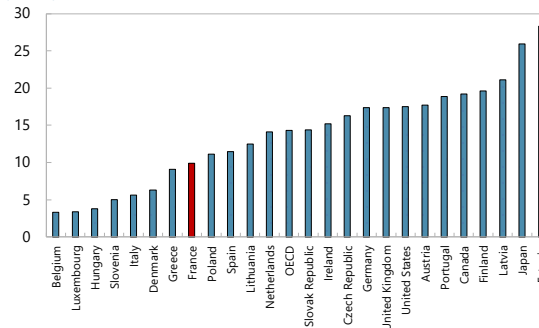


Sources: OECD and IMF calculations.

b. ... a relatively low gender wage gap, and ...

Gender Wage Gap, 2014

(Percent)

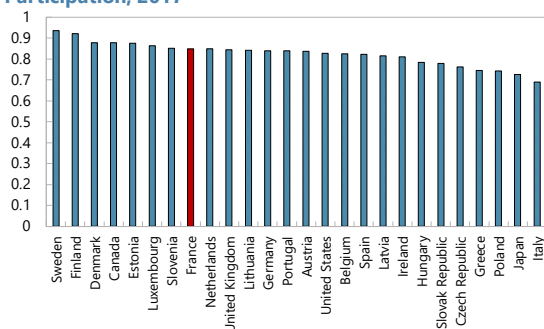


Sources: OECD and IMF calculations.

c. ... a high ratio of female to male labor market participation.

Ratio of Female to Male Labor Market

Participation, 2017

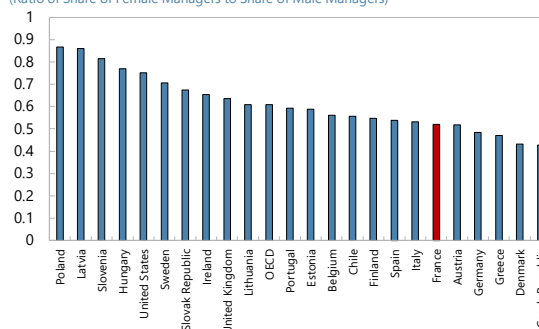


Sources: OECD, and IMF staff calculations.

d. However, the ratio of the share of female to male managers is low.

Manager Gap, 2017

(Ratio of Share of Female Managers to Share of Male Managers)



Sources: OECD and IMF staff calculation.

Table A1. Unemployment Probability of Different Groups

Probability of Being Unemployed¹

	France		Crisis-Resilient Countries ²		Crisis-Impacted Countries ³	
	2005-07	2012-14	2005-07	2012-14	2005-07	2012-14
Individual Characteristics						
Age						
25-54 years (base probability)	0.073	0.090	0.053	0.061	0.064	0.156
15-24 years	0.103	0.114	0.040	0.050	0.063	0.160
Education						
Lower secondary(base probability)	0.121	0.152	0.094	0.108	0.093	0.230
Tertiary	-0.063	-0.086	-0.059	-0.066	-0.045	-0.127
Country of birth						
Native (base probability)	0.076	0.090	0.049	0.056	0.067	0.154
Non-EU born	0.088	0.103	0.105	0.104	0.030	0.066

¹ Coefficients indicate the margins (change in the probability of being unemployed) compared to the base category. In the rows of the base categories, they represent the probability of being unemployed. All reported margins are significant at the 10 percent level.

² Countries with mild labor market impact following the 2008 crisis: Austria, Belgium, and the Netherlands.

³ Countries with significant labor market impact following the 2008 crisis: Italy, Ireland, Portugal, and Spain.

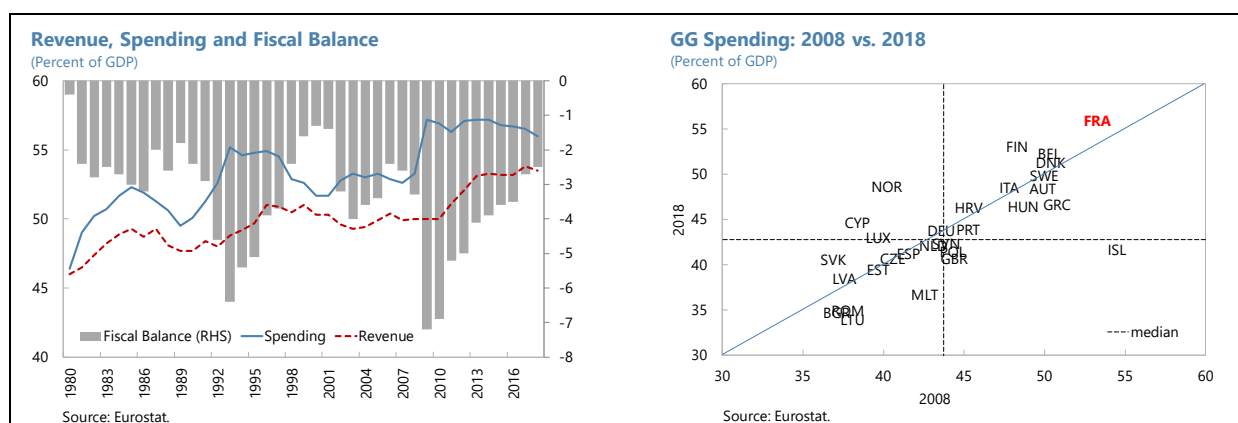
Sources: Eurostat LFS, and IMF staff estimations.

References

- Askenazy, P., and B. Palier, 2018, "France: rising precariousness supported by the welfare state," Chapter 6 in B. Nolan (ed.) *Inequality and Inclusive Growth*, Oxford University Press: Oxford.
- Batini, N., W. Gbohoui, and C. Mumssen, 2019, "A Cross-Country Analysis of Vulnerable Groups Using Micro Data," forthcoming as IMF Working Paper, manuscript May 13, 2019.
- Biotteau, A., S. Fredon, F. Paquier, and K. Schmitt, 2018, "Dossier —Réformes socio-fiscales de 2017," in INSEE (eds) France, *Portrait Social*, Édition 2018.
- Bozio, A., B. Garbinti, J. Goupille-Lebret, M. Guillot and T. Piketty, 2018, "Inequality and Redistribution in France: Evidence from Post-Tax Distributional National Accounts (DINA)", PSE, in progress.
- Chen, T., J. Hallaert, A. Pitt, H. Qu, M. Queyranne, A. Rhee, A. Shabunina, J. Vandebussche, and I. Yackovlev, 2018, "Inequality and Poverty Across Generations in the European Union," IMF Staff Discussion Note 18/01, International Monetary Fund, Washington, DC.
- Corak, M., 2016, "Inequality from Generation to Generation: The United States in Comparison," IZA Discussion Paper No. 9929 (Bonn: Institute for the Study of Labor (IZA)).
- Garbinti, B., J. Goupille-Lebret, and T. Piketty, 2018, "Income Inequality Dynamics in France 1900–2014: Evidence from Distributional National Accounts (DINA)", *Journal of Public Economics* 162: 63–77.
- Institut des Politiques Publiques (IPP), 2019, "Budget 2019: Quels effets pour les ménages," *Les Notes de l'IPP*, Janvier 2019, Nr. 37.
- Madec, P., P. Malliet, M. Plane, R. Sampognaro, and X. Timbeau, 2018, "Dossier —Les réformes socio-fiscales en 2008–2016," in INSEE (eds) France, *Portrait Social*, Édition 2018.
- OECD, 2018, "A Broken Social Elevator? How to Promote Social Mobility," OECD Publishing Paris.

Annex VI. Benchmarking Spending Reforms in France¹

1. France needs to make efforts to reduce its public spending, which is the highest in Europe. Spending increased by about 10 percent of GDP since the early 1980s to reach 56 percent of GDP at end-2018, 10 percent higher than the EU average. While tax revenues have also increased, they were insufficient to reverse the rising trend in public debt, which has now reached close to 100 percent of GDP. In 2018, the authorities reduced slightly spending relative to GDP (to 56 percent from 56.4 percent in 2017), by limiting the growth of the wage bill and social spending. However, they also legislated substantial and frontloaded tax cuts. In this context, further structural spending reforms will be needed to bring down the deficit and debt.



2. By comparing spending in France with peer countries, this annex aims to identify some areas where consolidation efforts could focus going forward. The analysis builds on work by Hallaert and Queyranne (2016), updating and extending it using data on the Classification of Functions of Government (COFOG). The analysis, which aims to assess spending on various categories and selected outcome measures, compares France with “peer countries” that are similar in terms of level of development, demographics, and other country characteristics: Finland, Germany, Italy, Sweden and the United Kingdom.²

3. Social protection, health, education, and economic support account for the bulk of the spending gap between France and peer countries (Figure 1). France’s public spending is 8.3 percent of GDP higher than that of peers, of which 7 percent is explained by the four categories noted above (Table 1).³ Social protection accounts for 50 percent of the gap with respect to peers,

¹ Prepared by Laurent Kemoe (EUR).

² Hallaert and Queyranne (2016) used Germany, Italy and the UK. Mareuge and Merckling (2014) used Germany, Sweden, and the UK. Gouardo and Lengart (2019) compare France to the 11 Western European countries (excluding Ireland), including our chosen countries.

³ The remainder of the gap is explained by spending on Defense, Public order and safety, Environment protection, and Recreation, culture and religion, which are not covered in this analysis.

most of which comes from spending on pensions.⁴ Another 20 percent of the gap is explained by support to the economy through subsidies (including tax expenditures) and investment in infrastructure.⁵ France also spends 12 percent more than peers on health and almost 7.5 percent more on education (mostly on secondary education).

4. Social protection spending accounts for the lion's share in total government expenditure (44 percent), but also contributes to lower income inequality and poverty (Figure 2). Social protection spending stands at 24 percent of GDP, higher by 4.2 percent of GDP than peers. This reflects, in part a social choice to rely more on public rather than private insurance. The impact of social benefits (along with that of taxes) on inequality in France is among the highest in Europe (45 percent decrease in income GINI in 2016 from 0.52 to 0.29). Poverty in France (at close to 8 percent) is also low by European standards.

5. High pension spending is associated with positive social outcomes for the elderly, but at the expense of weaker intergenerational equity (Figure 3). At 15 percent of GDP in 2017, France's pension spending is among the highest in the EU, reflecting a relatively generous system with high replacement rates and a low effective retirement age. As a result, and accounting for both private and public pension spending, old-age poverty is lower than the overall country level and peers (by about 5 percentage points), retirees' living standards are 6 percent higher than the population average, and life expectancy at retirement is higher than in peers.⁶ These outcomes, while positive, also suggest that the generous pension system protects older generations at the expense of younger ones, which experience higher rates of poverty and lower standards of living. Moreover, the system is fragmented (42 different regimes with differing rules), resulting in a lack of transparency and intra-generational inequities among various groups.

6. Spending on family and child benefits results in broadly positive outcomes but is less effective at addressing child poverty for vulnerable groups, given low means-testing (Figure 4). France spends nearly 1 percent of GDP more than countries with similar demographics on family and child benefits. This translates into relatively better outcomes than peers regarding fertility and female labor participation, and positive rates of enrollment of young children in childcare or pre-primary education. Nevertheless, French children of less educated parents face a 15 percent higher risk of poverty than in peer countries.⁷ Moreover, family and child benefits in France are largely not means-tested, which is similar to Sweden and Finland, despite the latter

⁴ Pensions alone account for one third of the spending difference with peers.

⁵ Throughout this section, the tax credit for employment and competitiveness (CICE), which has been legislated to be replaced with a social contribution cut, is excluded from subsidies in the "General Economic, Commercial and Labor Affairs" sub-function of the "Economic Affairs" function.

⁶ See also the 2018 report of the Conseil d'Orientation des Retraites (COR).

⁷ The authorities have taken steps, through the new "Plan Pauvreté", to provide more targeted child benefits to those in need (e.g. nurseries and free breakfast at school in poor neighborhoods).

having much lower market income inequality than France.⁸

7. Unemployment benefits are also high and generous in France, which leads to higher income smoothing but also to weaker incentives to work (Figure 5). Spending on unemployment benefits, at 1.9 percent of GDP, is twice the European average and higher than peers (except for Italy), reflecting a generous unemployment benefit system, which in turn is associated with a relatively high unemployment level. Indeed, at 64 percent, the replacement rate is more than 10 points higher than the average level of peers, and more than 20 points higher than in Germany. This translates into a lower risk of poverty for the unemployed in France relative to peers (59 percent in France compared to 84 percent in Germany and 73 percent in the UK). However, in part due to the generosity of the system, along with other factors, there may be less incentives for the unemployed to rejoin the labor market, leading to a relatively high share of youth unemployment and structural unemployment.⁹

8. Spending on housing is among the highest among European countries, with mixed outcomes for vulnerable groups (Figure 6). Similar to the UK, France spends 1.3 percent of GDP on housing development and housing benefits compared to 0.4 percent and 0.2 percent in Germany and Italy respectively. However, this is associated with mixed outcomes: while the overburden rate of poor households is among the lowest in France (16 percent compared to 37 percent in the UK), the number of rooms per person in poor households is lower in France than in the UK and in Germany, and houses of those at the lowest end of the income distribution in France are three times more overcrowded than in the UK.¹⁰

9. Spending on some health categories in France is higher than in peers, which translates into relatively high life expectancy (Figure 7). On aggregate, health spending in France, at 8 percent of GDP, is about 1 percent of GDP higher than peers (although the gap with peers may partly reflect the more prevalent use of private schemes in other countries). But spending on outpatient services and medical products, appliances and equipment is substantially larger than in peers, while spending on public health services and research and development is well below peers. The high level of health spending in France is associated with a life expectancy that is among the highest among peers. Other indicators suggest that health-adjusted life expectancy is close to the

⁸ For example, the website of the French national office for family allowances reveals that, for some benefits, a household with 2 or more eligible children and earning a gross annual income of €20 000 receives the same family allowance as a similar household earning €65 000. See <http://www.caf.fr/allocataires/actualites/2017/le-simulateur-des-allocations-familiales#>

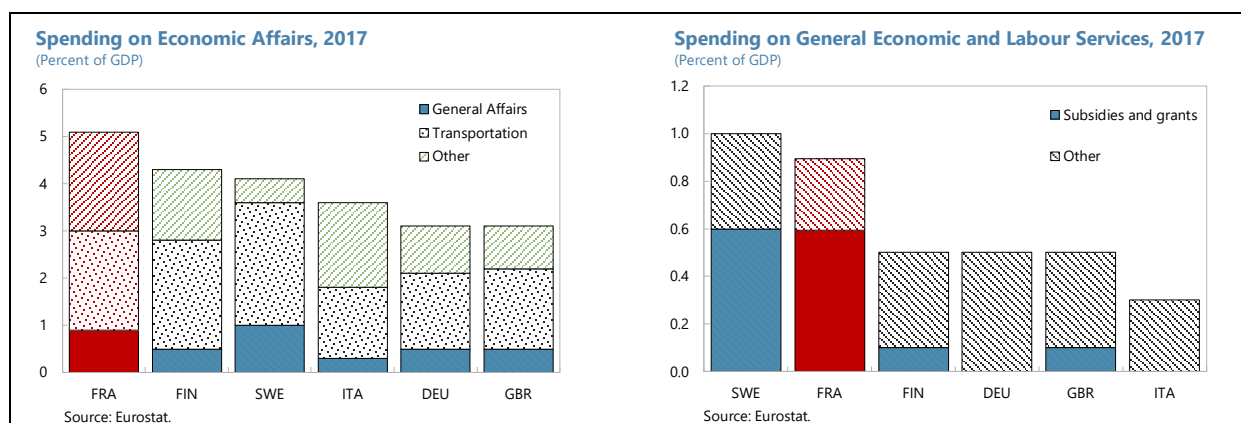
⁹ Some evidence suggests that at least 20 percent of unemployment benefit recipients receive more than their last salary; see Pôle Emploi analysis at: <http://www.pole-emploi.org/statistiques-analyses/en-savoir/taux-de-remplacement-mensuel-net.html?type=article> (accessed on May 26, 2019).

¹⁰ The number of rooms per person is a limited proxy of the quality of an accommodation and should be interpreted with care. Cross-country data on the size of accommodation per person, which may be a better proxy for the quality of public spending on housing development and housing benefits, is not available and thus does not allow to compare France with peers.

peer average,¹¹ while cancer death rates and infant mortality are somewhat higher.

10. France spends more than peers on secondary education, but outcomes are less favorable (Figure 8). While France spends less than peers on pre-primary, primary, and post-secondary education, it spends more on secondary education both relative to peers (even when both public and private spending on secondary education are considered) and to other education categories in France. The bulk of secondary education spending is on teachers' compensation, which represents 80 percent of the total spending. France has less students per teacher at the upper-secondary education level. However, France's overall PISA score is lower than several peers, with France below some peers in all three competencies (Math, Science and Reading).

11. France also spends more than peers on direct support to its economy. France spends slightly more than 5 percent of GDP to support its economy directly, and nearly two-thirds of this amount is dedicated to general affairs and transportation. Relative to peers, this spending is 1.5 percent of GDP higher in France than elsewhere, largely on subsidies and other tax expenditures supporting various activities. While direct measures of their effectiveness are difficult to identify, a 2018 Report of the *Cour de Comptes* had identified 474 tax expenditure programs, a vast majority of which were "small programs, whose efficiency, pertinence, or impact could not be established," and a quarter of them had not been updated in decades.



12. In sum, there are a number of areas where France spends more compared to peers, which, if reformed, could contribute to the consolidation effort and generate efficiency gains:

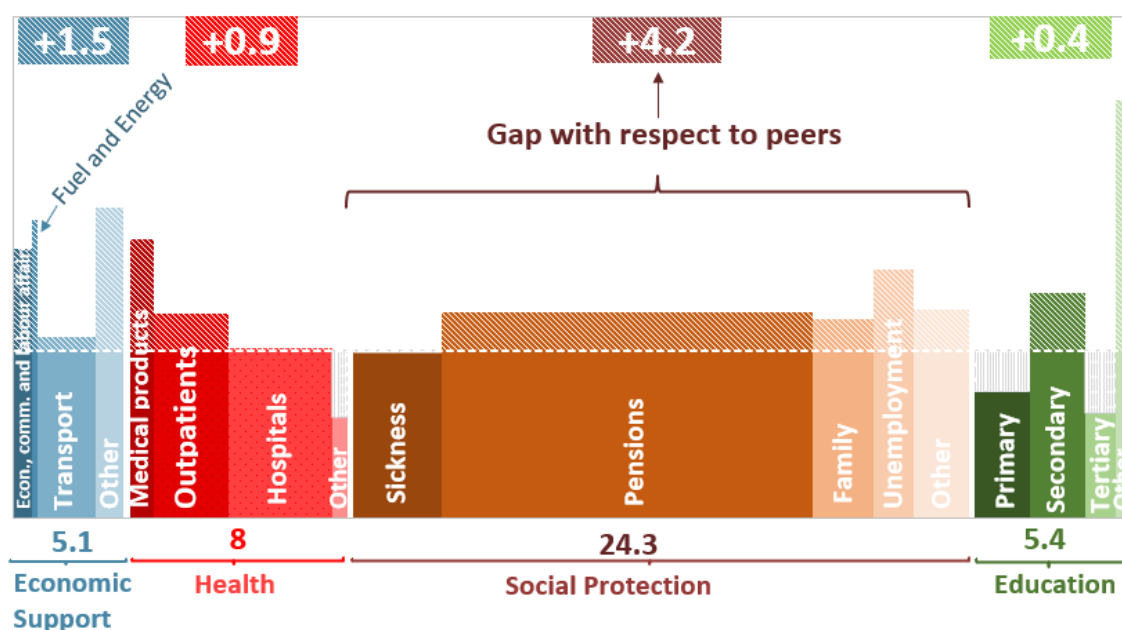
- **Pensions:** To improve intra- and inter-generational equity, reform efforts should aim to simplify the system and address its generosity, including by improving work incentives, while ensuring that low pensions are protected. The government's planned pension reform could go a long way in this direction, by unifying the existing regimes under one umbrella, better linking contributions to benefits through a point system, and accelerating the planned increase in the effective retirement age.

¹¹ Health-adjusted life expectancy is life expectancy adjusted for years of life lost due to health issues.

- **Social benefits:** An ambitious implementation of the authorities' planned unemployment reform—aiming to tighten compensation and benefit cumulation rules, as well as introduce degressivity for high benefits, among others—could help provide additional incentives to return to work. The authorities have also taken steps to adjust housing benefits and are aiming to simplify and unify some social minima under a unique universal activity benefit in the coming years. These reforms should be pursued, aiming to further improve targeting of social benefits to those most in need, while generating efficiency savings.
- **Health:** Efficiency savings could be obtained without compromising outcomes by supporting preventive healthcare, fostering the use of generic drugs, and improving procurement and the management of health service purchases (also see *Cour de Comptes*, 2017). The upcoming health reform aiming to decentralize healthcare and improve hospital management could help provide long term benefits, but care should be taken to ensure that medium-term costs are minimized.
- **Education:** The authorities have initiated important education reforms in 2017–18, including reducing class sizes at the primary level in disadvantaged areas, and a reform of the *Baccalauréat* and higher education. Building on these efforts, they could consider further measures to align teacher-student ratios in secondary education with level of peers, increase teaching hours in secondary public schools and reform teachers' training to increase their versatility.

13. Subsidies and tax expenditures: The authorities have legislated the replacement of the CICE tax credit with a reduction in social contributions, which improves transparency and generates some fiscal gains. But there is room for improvement in rationalizing and simplifying tax expenditures further, while complementing these efforts with product market reforms to support competitiveness.

Figure A1. Benchmarking Spending in France Relative to Peers (Percent of GDP)



Sources: Eurostat and IMF Staff calculations

Note: The width of each band is proportional to average spending in peers. The volume of the band (including the striped area) is proportional to spending in France, and the striped area above the dashed line is proportional to the gap between France and peers. A band below the dashed line means that France spends less than peers. For each function of government, the number below the bars represents total spending in France (5.1 percent of GDP for Economic Affairs) and the number above the bars represent the gap vis-à-vis peers (1.5 percent of GDP for Economic Affairs).

Table A1. Benchmarking Public Spending in France Against Peers (Percent of GDP)¹

Year	General Public services		Defence		Economic affairs							Health					Education			Social protection												
	Total	Exec.&Legis. Organs, Fiscal, Financial & External affairs	Total	Military defence	Total	General econ., commercial and labour affairs	Agriculture, forestry, fishing and hunting	Energy and Communication	Transportation	Environmental protection	Housing and community amenities	Total	Medical products, appliances and equipment	Outpatient services	Hospital services	Public health services	R&D Health	Recreation, culture and religion	Total	Pre-primary and primary education	Secondary education	Post-secondary education	Total	Sickness and disability	Pensions	Family and children	Unemployment	Housing	Social exclusion			
2014	56.7	6.6	1.8	1.8	1.7	1.5	1.6	4.9	1.0	0.2	0.4	2.0	1.0	1.2	8.2	1.5	2.9	3.6	0.1	0.1	1.5	5.5	1.4	2.4	0.7	24.5	2.7	15.2	2.5	2.0	0.9	1.0
2015	56.0	6.3	1.7	1.8	1.8	1.5	1.6	4.9	1.1	0.3	0.4	1.9	1.0	1.1	8.1	1.4	2.9	3.5	0.1	0.1	1.4	5.4	1.4	2.4	0.7	24.3	2.8	15.1	2.4	1.9	0.9	1.0
2016	55.9	6.2	1.8	1.8	1.8	1.6	1.6	4.7	0.9	0.2	0.4	2.0	0.9	1.1	8.1	1.4	2.9	3.5	0.1	0.1	1.4	5.5	1.4	2.4	0.7	24.5	2.9	15.0	2.4	2.0	1.0	1.0
2017	55.7	6.0	1.8	1.8	1.8	1.5	1.6	5.1	0.9	0.2	0.5	2.1	0.9	1.0	8.0	1.4	2.9	3.4	0.1	0.1	1.4	5.4	1.4	2.4	0.6	24.3	2.9	14.9	2.4	1.9	1.0	1.1

Source: Eurostat and IMF Staff calculation

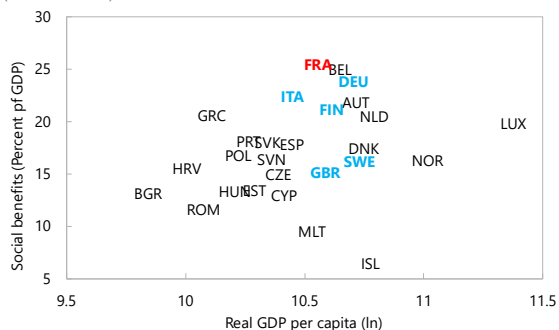
	Higher than peers by more than 25 percent		Lower than peers by 0-5 percent
	Higher than peers by 5-25 percent		Lower than peers by 5-25 percent
	Higher than peers by 0-5 percent		Lower than peers by more than 25 percent

¹ The tax credit for employment and competitiveness (CICE) is excluded from subsidies in the "General Economic, Commercial and Labor Affairs" sub-function of the "Economic Affairs" function.

Figure A2. Social Spending

Social benefits spending and Per Capita GDP, 2018

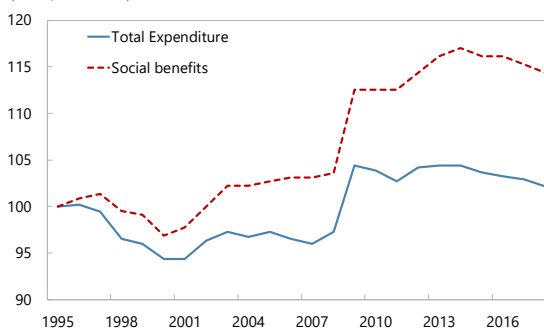
(Percent of GDP)



Source: Eurostat, OECD and IMF Staff calculations.

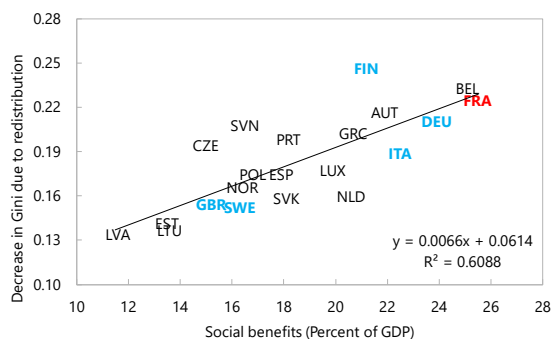
Evolution of Social Benefits Spending in France

(Index, 1995=100)



Sources: Eurostat and IMF Staff calculations

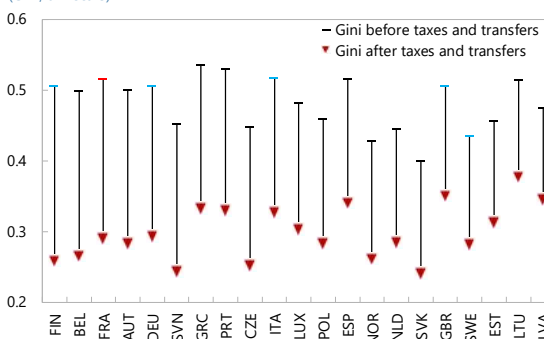
Social Benefits and Inequality Reduction, 2016



Source: Eurostat, OECD and IMF Staff calculations.

Effect of Redistribution on Inequality, 2016

(Gini, 0-1 scale)



Source: OECD

Table A2. Social Protection Spending by Function (PPS per inhabitant, 2016)

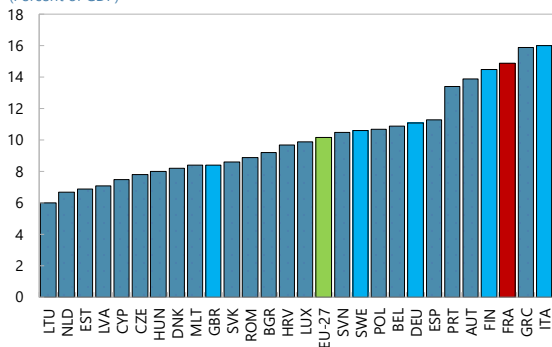
	Family and Children	Unemployment	Housing	Social exclusion	Sickness and disability	Pension
Germany	1198	370	204	153	4513	4060
France	768	627	259	308	3519	4582
Italy	486	478	10	72	2266	4527
Finland	999	833	245	354	3284	4373
Sweden	1038	356	145	474	3699	4349
United Kingdom	774	110	379	182	3049	3289
Avg. Peers	899	429	197	247	3362	4120

Source: Eurostat

Figure A3. Pensions

Public Pension Expenditure in the OECD, 2017

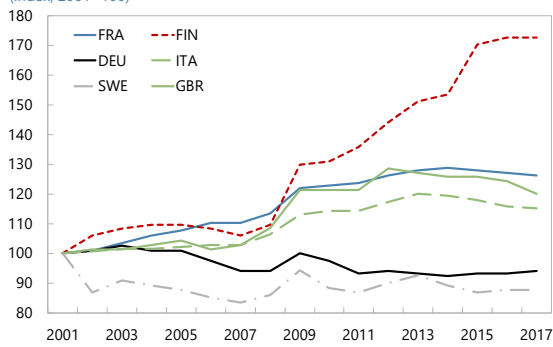
(Percent of GDP)



Source: Eurostat

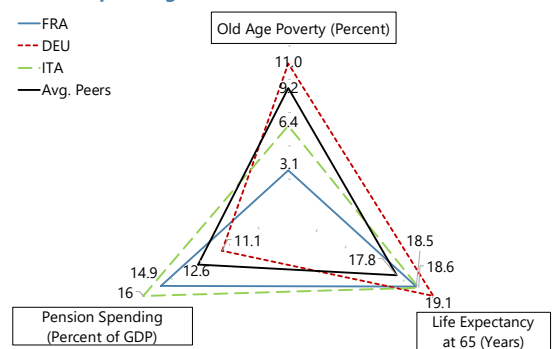
Evolution of Pension Expenditures

(Index, 2001=100)



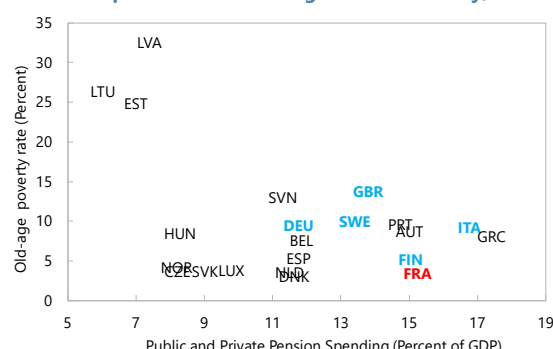
Sources: Eurostat and IMF Staff calculations

Pension Spending and Outcomes, 2017



Sources: Eurostat and OECD

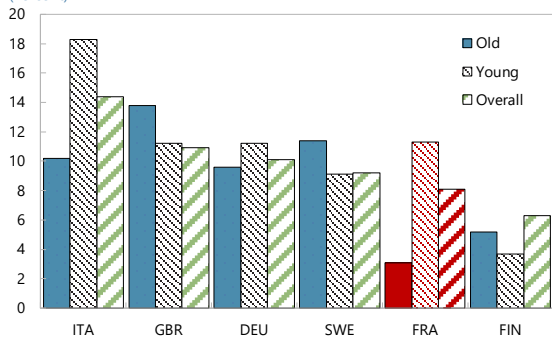
Pension Expenditure and Old-age Income Poverty, 2016



Sources: Eurostat, OECD and IMF Staff calculations

Poverty Rates Across Generations, 2015

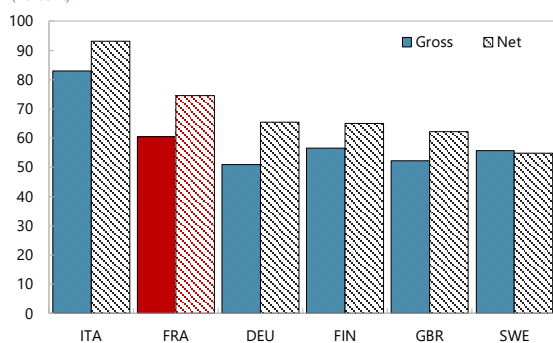
(Percent)



Source: Eurostat

Pension Replacement Rate, 2017

(Percent)

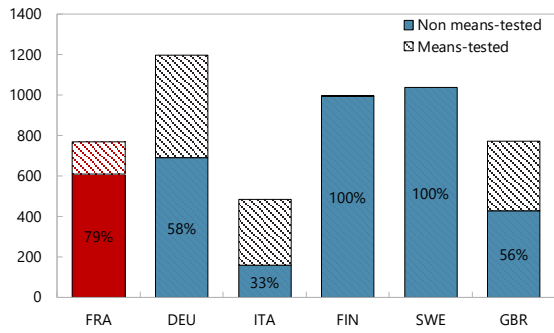


Sources: OECD and COR

Figure A4. Family and Child Benefits

Per Capita Spending on Family/Children Benefits, 2016

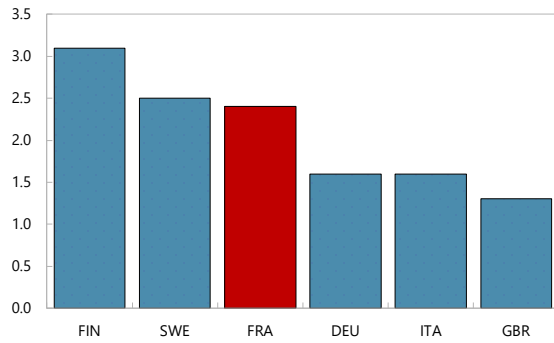
(Euros, PPS)



Source: Eurostat

Total Spending on Family/Children Benefits, 2017

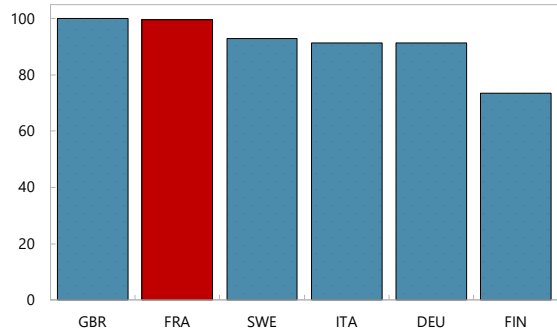
(Percent of GDP)



Source: Eurostat

Enrollment Rate in Pre-primary Education (3 year-olds, 2017)

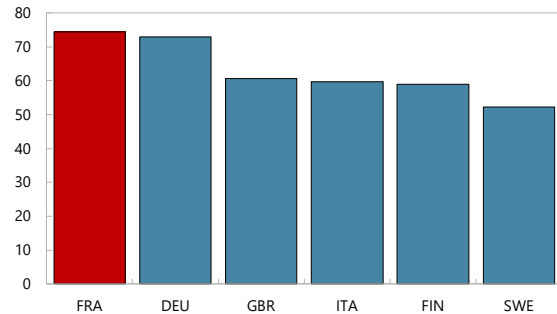
(Percent)



Source: Eurostat

Children's At-risk-of-poverty Rate (Parents less than Primary Education, 2017)

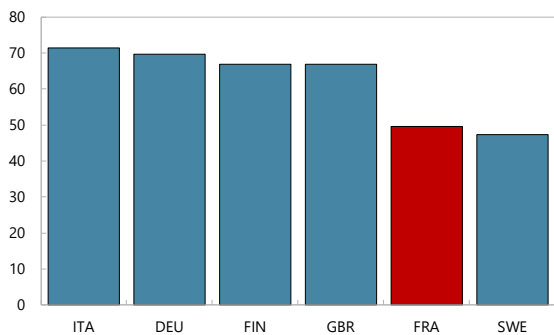
(Percent)



Source: Eurostat

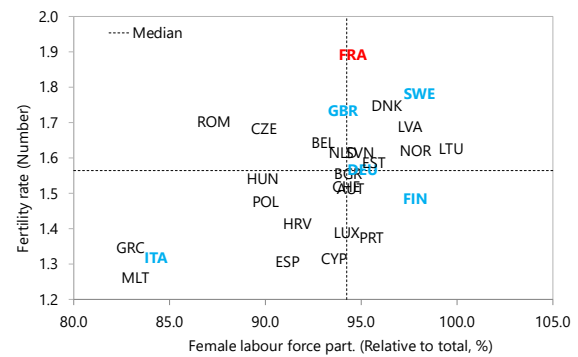
Children not in Formal Childcare (<3 year-olds, 2017)

(Percent)



Source: Eurostat

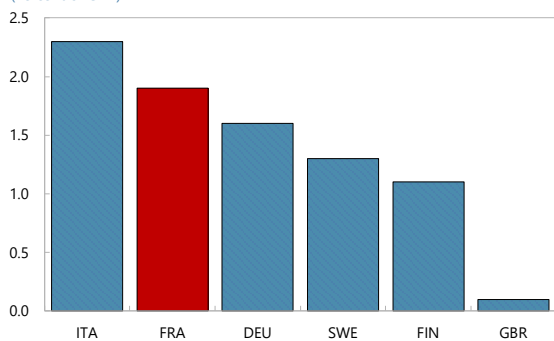
Fertility Rate and Female Labour Force Participation, 2017



Source: Eurostat

Figure A5. Unemployment Benefits**Spending on Unemployment Benefits, 2017**

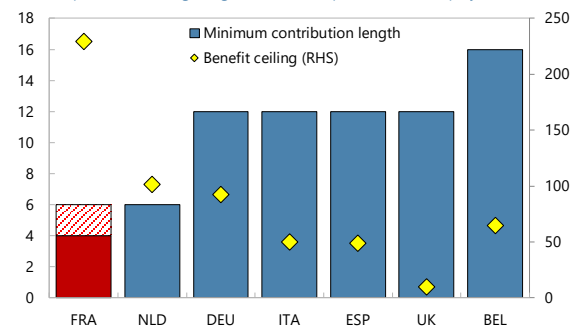
(Percent of GDP)



Source: Eurostat

Features of Unemployment Benefits

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

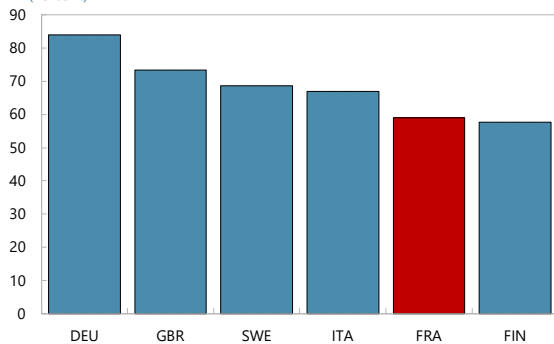


Source: OECD.

Note: The shaded area represents the effect of the reform underway.

At-risk-of-poverty Rate of Unemployed, 2018

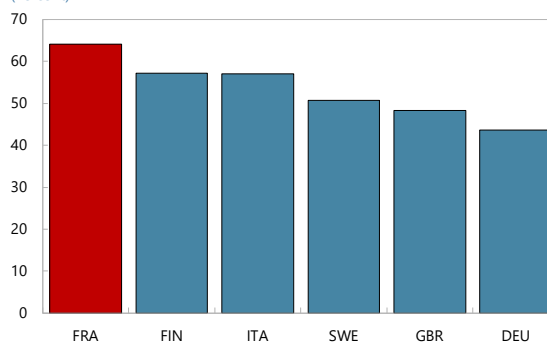
(Percent)



Source: Eurostat

Median Income of Unemployed over Employed, 2018

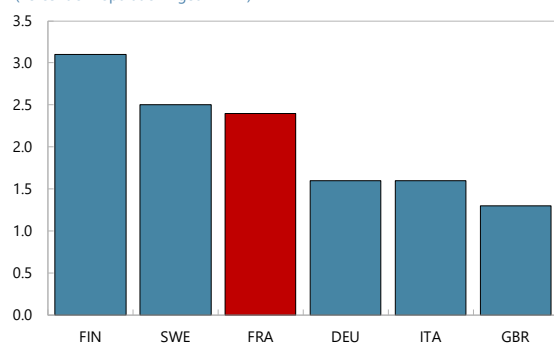
(Percent)



Sources: Eurostat and IMF Staff calculations

Unemployed Youth not in Training, 2018

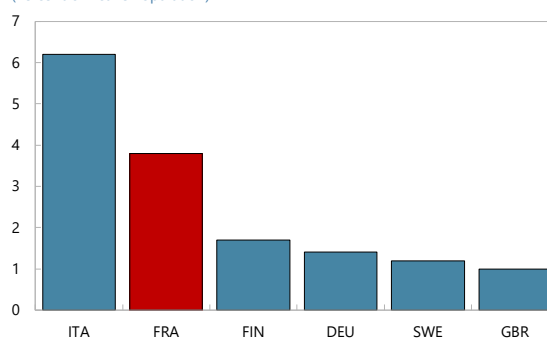
(Percent of Population Aged 17-24)



Source: Eurostat

Long-term Unemployment, 2018

(Percent of Active Population)

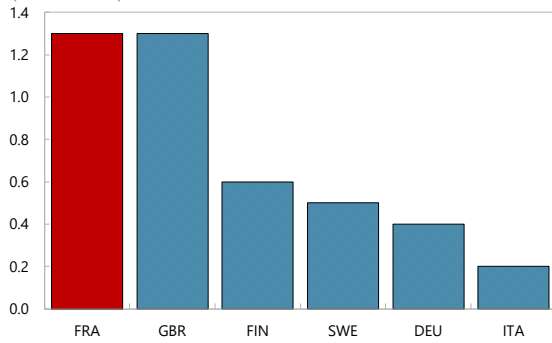


Source: Eurostat

Figure A6. Housing Benefits

Total Spending on Housing, 2017

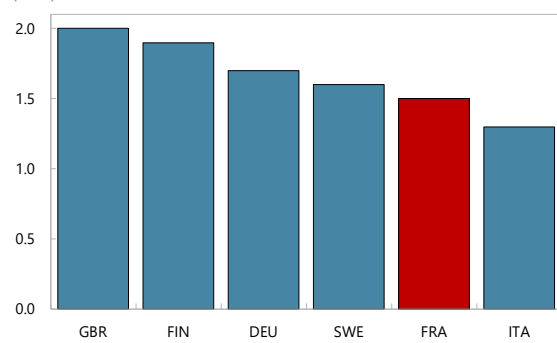
(Percent of GDP)



Source: Eurostat

Number of Rooms per Person in Poor HHs, 2017

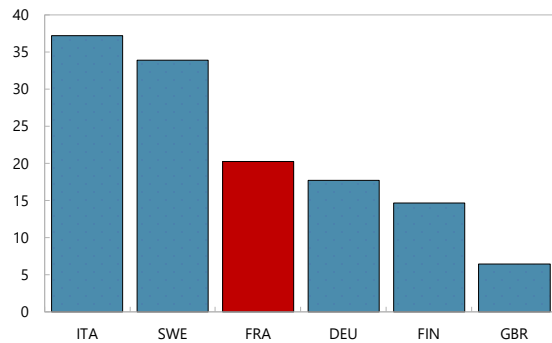
(Units)



Source: Eurostat

Housing Overcrowding Rate (1st Income Quintile), 2017

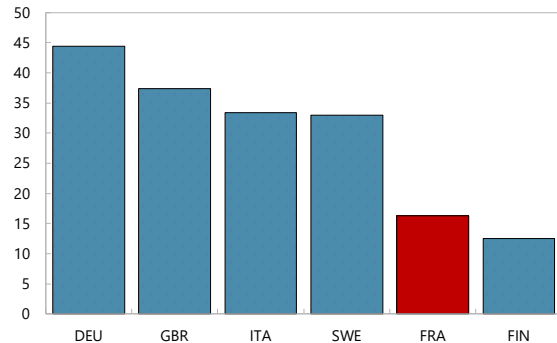
(Percent)



Source: Eurostat

Housing Cost Overburden rate (1st Income Quintile), 2017

(Percent)

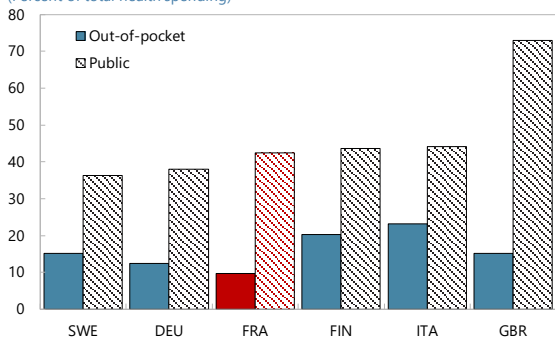


Source: Eurostat

Figure A7. Health

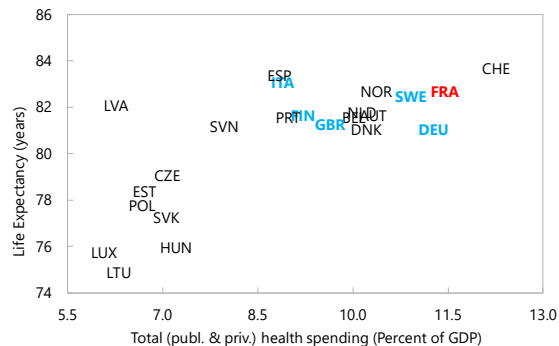
Public and Out-of-Pocket Hospital Services Spending, 2016

(Percent of total health spending)



Sources: Eurostat and OECD

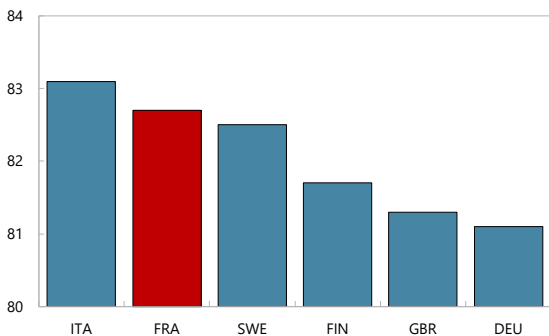
Health Spending and Life Expectancy, 2017



Sources: Eurostat, OECD and IMF Staff calculations

Life Expectancy, 2017

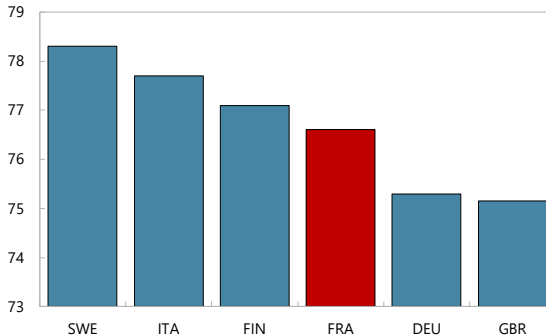
(Years)



Source: OECD

Health-Adjusted Life Expectancy, 2016

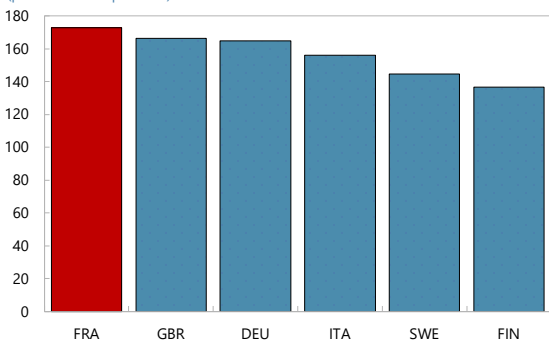
(Years)



Source: OECD

Cancer Death Rate, 2016

(per 100 000 Population)



Source: WHO

Infant Mortality, 2017

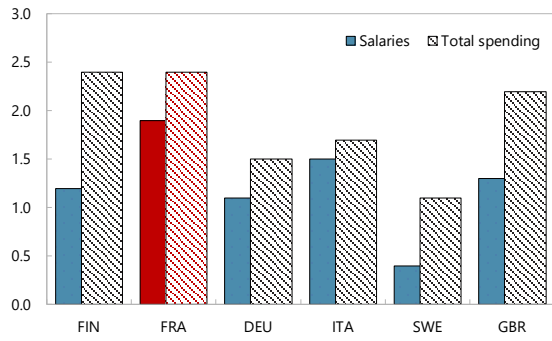
(per 1000 live births)



Source: WHO

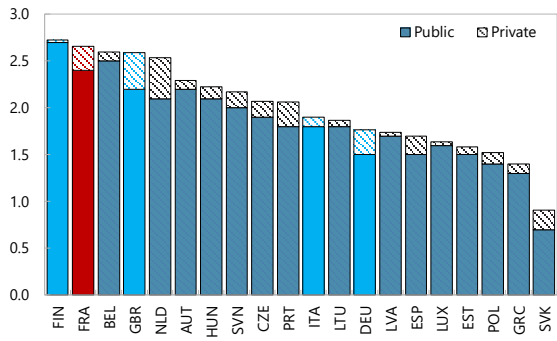
Figure A8. Education

Secondary Education's Total and Personnel Spending, 2017
(Percent of GDP)



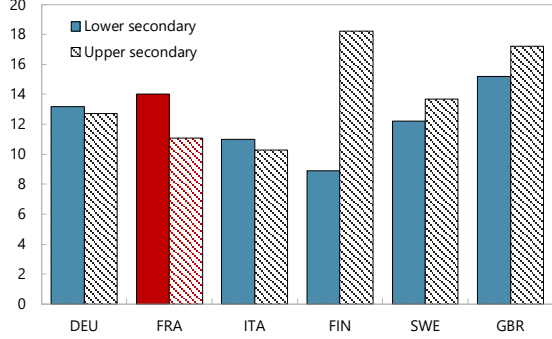
Source: Eurostat

Total Secondary Education Spending, 2015
(Percent of GDP)



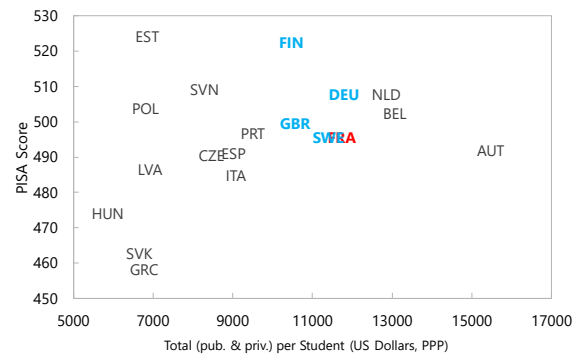
Sources: Eurostat and OECD

Student-Teacher Ratio, 2017
(Number of students per teacher)



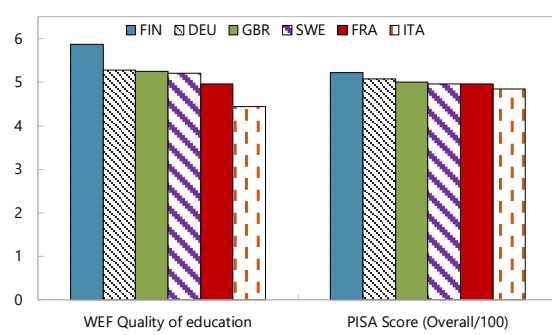
Source: Eurostat

PISA Score and Sec. Educ. Spending per Student, 2015



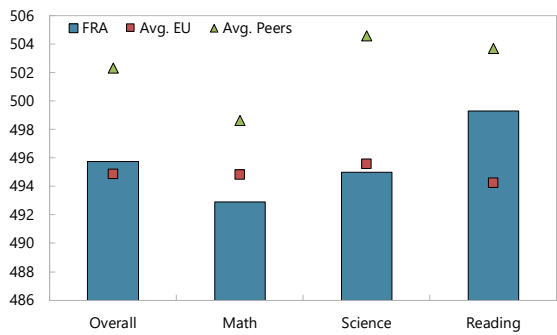
Source: OECD and WEF

Education Outcome, 2016 or Latest
(Score)



Source: OECD and WEF

Student Performance, 2015
(PISA score)



Source: OECD and IMF Staff calculations

References

- Conseil d'Orientation des Retraites (2018), "Évolutions et perspectives des retraites en France." Rapport Annuel du COR (Conseil d'Orientation des Retraites, Juin 2018).
- Cour des Comptes (2015), "Les Aides Personnelles au Logement." Communication à la Commission des Finances du Sénat (Juillet 2015).
- Cour des Comptes and Chambres Régionales & Territoriales des Comptes (2017), "Les Achats Hospitaliers." Communication à la commission des affaires sociales et à la mission d'évaluation et de contrôle des lois de financement de la sécurité sociale de l'Assemblée Nationale (Juin 2017).
- Gouardo, C. and Lenghart, F. (2019), "Où Réduire les Dépenses Publiques ?" La Note d'Analyse. (France Stratégie, Janvier 2019).
- Hallaert, J-J. and Queyranne, M. (2016), "From Containment to Rationalization: Increasing Public Expenditure Efficiency in France." IMF Working Paper 16/7 (Washington, January 2016).
- Mareuge, C. and Merckling, C. (2014), "Pourquoi les dépenses publiques sont-elles plus élevées dans certains pays ?" La Note d'Analyse. (France Stratégie, Juillet 2014).



FRANCE

July 1, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department

CONTENTS

FUND RELATIONS	2
STATISTICAL ISSUES	8

FUND RELATIONS

(As of May 31, 2019)

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)	17,110.03	84.89
Reserve Tranche Position	3,045.11	15.11
Lending to the Fund		
New Arrangements to Borrow	719.74	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	8,181.29	80.73

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):

	2019	Forthcoming			
		2020	2021	2022	2023
Principal					
Charges/Interest	10.98	21.85	21.83	21.84	21.84
Total	10.98	21.85	21.83	21.84	21.84

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:

- France's currency is the euro, which floats freely and independently against other currencies.
- France maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for exchange restrictions imposed solely for the preservation of international peace and security. These restrictions which mostly involve some individuals and entities and target specified countries have been notified to the Fund pursuant to Executive Board Decision No. 144-(52/51). In accordance with the relevant EU regulations and UNSC resolutions, certain restrictions are maintained on the making of payments and transfers for certain transactions with respect to the Democratic Republic of Congo, the former government of Iraq, the Democratic People's Republic of Korea, Guinea (republic of), Guinea Bissao, the former Government of Liberia, the former Government of Libya, the former Government of Tunisia, Transnistria, Eritrea, the former Government of Egypt, Somalia, Sudan and South Sudan, Syria, certain individuals associated with the murder of former Lebanese Prime Minister Rafiq Hariri, and, Central African Republic, Ukraine, Russia, Yemen, Zimbabwe. As regards the Islamic Republic of Iran, some restrictions still exist in accordance with the relevant United Nations Security Council Resolution 2224 (double use goods, ballistic and nuclear related goods) but the majority of the past restrictions (those imposed bilaterally by the European Union on oil, gold, minerals, etc) were dropped, in early 2016, pursuant to the Vienna Agreement.
- Measures have been taken to freeze accounts of listed persons and entities linked to terrorists pursuant to the relevant EU regulations (n°881/2002, n°2580/2001 and n°753/2011) and UN Security Council resolutions (resolutions 1267 and 1373 and subsequent resolutions).

Article IV Consultation:

The last Article IV consultation was concluded on July 25, 2018. The associated Executive Board assessment is available at <https://www.imf.org/en/News/Articles/2018/07/26/pr18311-imf-executive-board-concludes-2018-article-iv-consultation-with-france> and the staff report at <https://www.imf.org/en/Publications/CR/Issues/2018/07/26/France-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-46126>. France is on the standard 12-month consultation cycle.

FSAP Participation and ROSC:

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

<i>France–Financial System Stability Assessment (FSSA)</i>	IMF Country Report No. 04/344, 11/03/04
<i>FSAP Assessment and Reports on ROSCs</i>	IMF Country Report No. 04/345, 11/03/04
<i>FSAP Assessment</i>	IMF Country Report No. 05/185, 06/08/05
<i>Publication of FSAP—Detailed Assessment of Observance of Standards and Codes</i>	IMF Country Report No. 05/186, 06/08/05
<i>France–Financial System Stability Assessment (FSSA)</i>	IMF Country Report No. 12/341, 12/07/12
<i>France: Financial Sector Assessment Program—Detailed Assessment of Observance of Standards and Codes</i>	
<i>Basel Core Principles for Effective Banking Supervision</i>	IMF Country Report No. 13/180, June 2013
<i>Insurance Core Principles</i>	IMF Country Report No. 13/181, June 2013
<i>IOSCO Objectives and Principles of Securities Regulation</i>	IMF Country Report No. 13/182, June 2013
<i>Securities Settlement Systems and for Central Counterparties</i>	IMF Country Report No. 13/183, June 2013
<i>Financial Sector Assessment Program—Technical Notes</i>	
<i>Housing Prices and Financial Stability</i>	IMF Country Report No. 13/184, June 2013
<i>Stress Testing the Banking Sector</i>	IMF Country Report No. 13/185, June 2013

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

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

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

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

STATISTICAL ISSUES

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.

France: Table of Common Indicators Required for Surveillance (As of June 2019)					
	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	06/19	06/19	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	05/19	06/19	Monthly	Monthly	Monthly
International Investment Position	Q4:2018	Q1:2019	Quarterly	Quarterly	Quarterly
Reserve/Base Money	05/19	06/19	Monthly	Monthly	Monthly
Broad Money	05/19	06/19	Monthly	Monthly	Monthly
Central Bank Balance Sheet	05/19	06/19	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	05/19	06/19	Monthly	Monthly	Monthly
Interest Rates ²	06/19	06/19	Daily	Daily	Daily
Consumer Price Index	05/19	06/19	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	2018	05/19	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government ⁵	04/19	06/19	Monthly	Monthly	Monthly
Stock of Central Government Debt	05/19	06/19	Monthly	Monthly	Monthly
External Current Account Balance	04/19	06/19	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	04/19	06/19	Monthly	Monthly	Monthly
GDP/GNP	Q1:2019	Q2:2019	Quarterly	Quarterly	Quarterly
Gross External Debt	Q4:2018	Q1:2019	Quarterly	Quarterly	Quarterly
<p>¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.</p> <p>² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.</p> <p>³ Foreign, domestic bank, and domestic nonbank financing.</p> <p>⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.</p> <p>⁵ This information is provided on a budget-accounting basis (not on a national accounts basis).</p>					

**Statement by Hervé de Villeroché, Executive Director for France,
Armel Castets, Alternate Executive Director, Magail Veronique Gilliot, Senior Advisor,
and Arthur Sode, World Bank Advisor to Executive Director
July 22, 2019**

On behalf of our authorities, we thank staff for their report and policy discussions during the Article IV mission. Since the last review, growth remained resilient and broad based while unemployment continued to decrease, despite an environment marked by persistent trade tensions and a slow-down in many European partners. The public deficit and public expenditures declined further, allowing for the public debt to stabilize. Important structural reforms entered in application last year such as the labor market, the taxation and the vocational training reforms.

The sustained performance of the French economy is a sign that the reforms implemented over the past years start to bear fruits. Nonetheless, our authorities firmly believe that a continued reform effort remains warranted to tackle the simultaneous challenges of modernizing the French economy, accelerating the energy transition and enhancing equality of opportunities. In response to the social movement of the “yellow vest” that started last year, our authorities launched a *Grand Débat National* which confirmed the need to accelerate the transformation of France’s economic and social model. Based on this conclusion, our authorities reaffirmed their strong resolve to continue the implementation of a comprehensive and far-reaching structural reform agenda and took immediate measures that have reinforced work incentives for the middle class while easing the fiscal burden on the poorest households. Going forward, three major pillars of the French system are about to be profoundly modernized. A civil service reform is about to be adopted. The details of the unemployment insurance reform have been made public and will be implemented swiftly. Importantly, the consultations preparing a systemic reform of the pension system are also already well advanced. Our authorities are committed to further reduce the fiscal deficit by gradually reducing public expenditure and to put the public debt on a continuous downward path.

Looking forward, while solid domestic fundamentals should allow growth to remain robust in the coming years, we agree with staff that the external environment is a source of risk. Trade tensions could affect France and its main partners’ performance, through direct trade impacts and confidence effects weighing on future investment. To lower these risks, my authorities will therefore maintain their strong commitment towards multilateral cooperation, in particular as regards trade, international taxation and climate change, as well as towards enhanced European integration. In this regard, the French economy being highly integrated within the Euro Area, the strengthening of policy coordination at the eurozone level is seen as a crucial element.

Outlook

Despite the Euro Area slowdown and rising trade tensions, growth remains robust and broad based while the employment outlook continues to improve. GDP growth in 2019 is

projected at the same level than in the Euro Area (at +1.3 percent). Business climate and consumer confidence have significantly increased since the beginning of the year and are both above their long-term average levels. Tax measures targeted to the middle class and aimed at “making work pay” are increasing household’s purchasing power which in turn supports private consumption. Driven by favorable financing conditions and structural reforms such as the capital taxation reform or the conversion of the CICE into a social security contribution reduction, corporate investment is still dynamic and remains one of the prime engines of growth. While exports are suffering from the weakening of external demand, competitiveness gains underpinned by recent fiscal measures help to cushion the impact of this shock and export growth remains well-oriented overall. France’s international attractiveness is improving significantly with inward FDI at historically high levels (France ranked second among European economies in the EY Europe attractiveness survey of June 2019). It is particularly attractive for R&D activities of multinationals and an ecosystem of innovation is building up around tech-oriented entrepreneurs. Reflecting this robust growth performance, job creations have been once again particularly dynamic during the first quarter 2019 and they are expected to remain elevated during the rest of the year. Hence unemployment is decreasing for the 4th consecutive year. The significant increase in the share of new hiring made under open-ended contracts and the long-term unemployment rate decreased are additional signs of the good health of the labor market.

The current account remains closed to balance (-0,6 percent) and the external position is broadly in line with fundamentals as highlighted by staff. Net exports contributed positively to growth in 2018. Export performance in key sectors such as aeronautics, pharmacy and luxury goods notably helped the non-energy good balance to improve while the service balance remains in positive territory. The primary income balance is largely positive reflecting the capacity of French multinationals to generate revenue abroad. Price competitiveness of French exports has been strengthened by measures taken over the last years to lower the cost of labor. Thanks to a significant rebound in their profit margins, French firms are now better able to compete internationally. Moreover, French competitiveness is also underpinned by a wage growth which is aligned with productivity dynamics over the medium term. Recent labor market reforms aiming at decentralizing further wage bargaining will reinforce the wage setting process to ensure faster wage adjustments in case of shocks. Better wage coordination at the European level, notably thanks to the European Semester and the establishment of National Councils of Productivity, should also help to balance price competitiveness within the Euro Area. In terms of non-price competitiveness, the numerous structural reforms aiming at improving the investment climate and strengthening human capital will translate into further innovation capacity and should contribute to give an edge to French firms on international markets. Higher profit margins will also help firms to invest and innovate.

We broadly agree with staff forecast that next year growth will remain resilient and that the unemployment rate will continue to decline. Supported by the various structural reforms undertaken over the last years, France growth will continue to benefit from its strong domestic

demand (+1,3 percent). Increased households' purchasing power coming from tax reduction will continue to support domestic consumption. Firms will benefit from improvement in the business climate and workers from better income prospects. Nonetheless, we also agree with staff that there are several downside risks to the outlook notably stemming from a potential weakening of the external environment. An upside scenario, where activity picks-up more than expected as reforms recently implemented produce their full impact earlier than planned, cannot be ruled out.

Reform Strategy

My authorities remain strongly committed to a comprehensive reforms plan aiming at modernizing the French economy while ensuring the conditions for equal opportunity.

One can acknowledge that the pace of structural reforms, not seen for decades in France, has not abated over the past year. Indeed, since the last Article IV review, the labor market reform, additional growth-friendly tax measures, an overhaul of the apprenticeship and vocational training system and several reforms of the education system have been implemented. In the context of the yellow vests movement, a package of additional measures have been decided to reinforce the orientation of the already-implemented reforms, namely strengthening the purchasing power of the low to middle-income workers and reducing the overall level of taxation. Staff should therefore feel reassured regarding the determination of our authorities to pursue the implementation of their reform agenda. In such a context, our authorities don't consider that there is a risk of a slowdown of the reform momentum.

Moving forward, a package of additional transformative structural reforms is already well advanced in its preparatory process:

- **Unemployment insurance reform:** while on a continued decline, the unemployment rate remains elevated. The reform, that has been made public in June 2019, will both strengthen the access of unemployed people to training and incentivize work by increasing the requirements to access to the unemployment benefits. Importantly, rules that define the possibility to cumulate unemployment benefits with wages from part-time activity will be reviewed to remove disincentives to return to full-time jobs. Additionally, the ceiling of unemployment benefits for high wage earners, that was elevated compared to other European economies, will be lowered and a *bonus-malus* mechanism aiming at disincentivizing abusive recourse to short term contracts in certain sectors will be introduced.
- **Pension reform:** the existing pension system relies on a pay-as-you-go mechanism, that is effective in preventing poverty within the elderly but is complex (with 42 different pension regimes) and does not entail an automatic mechanism to ensure the financial sustainability of the system depending on demographic variations. While past parametric reforms have created the conditions for the financial sustainability of the

pension system¹, some uncertainty remains due to the difficulty to predict demographic trajectories and to forecast growth over the long term. Moreover, the age of effective retirement is lower in France than in many peers. The reform under preparation would create a universal pension system with the same level of contribution giving access to the same right to pension, thus creating a major simplification of the system. The new mechanism will be calibrated so as to ensure intergenerational equity and the quasi-automatic financial stability of the system.

- Civil service reform: the reform aims at modernizing the civil service to make it more agile, more open and more attractive. It will create the conditions for public administrations to adapt more flexibly and swiftly to their changing missions and new environment, notably to reap the benefits of new technologies. One of the main features of this comprehensive reform will be to facilitate the recourse to temporary contracts (rather than relying quasi exclusively on employed-for-life civil servants) depending of the need of the different administrations. The reform will also simplify greatly the decision-making procedure for posting of civil servants with the aim to increase mobility between administrations.
- Healthcare: the reform presented by staff in Box 2 will be adopted by the end of the Summer.
- Competition: some precise measures have been announced to enhance competition, facilitate entry into several markets and increase the level the playing field. In the coming months, our authorities will engage reforms to combat rent-seeking behaviors in the car spare parts market, the driving license schools and the condominium associations (“syndic”). While we note staff’s assessment regarding possible progress on retail distribution, sales of medicines and professional services, we feel that the PMR index should be used with caution to derive potential growth gains, as it is done in the dedicated selected issues paper. Some features of the PMR calculation have no direct relation with the intensity of competition, such as the state ownership in some companies (for example, despite a publicly-owned operator, France telecommunication sector is very competitive with a comparatively high number of competing firms resulting in low prices).

While all those reforms will contribute to ensuring the financial sustainability of the social protection system, they also pursue wider objectives such as ensuring adaptation and modernization in a context of rapid socioeconomic transformation and creating the conditions for an inclusive growth model. On the latter, as highlighted in Annex V, France has one of the lowest poverty rates in the OECD and disposable income inequality has been broadly stable over time, which contrasts with the trajectory of many other advanced economies. Those positive results are the direct outcomes of a redistributive tax and benefit system and the constant attention to social cohesion. Those results could have received more emphasis in the core of the report since they are closely related to other dimensions, including

¹ Depending on the scenario, the share of the pension spending in GDP would decline from 13.8 percent in 2017 to between 11.6 percent to 13.3 percent of GDP by 2070 ; only in a scenario of very low growth productivity would the share of pension spending increase but moderately to reach 14.4 percent of GDP.

the chosen fiscal consolidation path. We have doubt on the robustness of the indicator on intergenerational mobility put forward in the core of the report, since cross-border comparison of intergenerational mobility is technically difficult and some literature points to different results. France also has one of the lower genders pay gap in the world and relatively high female participation. Nonetheless, some dimensions of inequality and the differentiated impacts of reforms remain insufficiently apprehended, such as the differentiated impact of carbon taxation on households' disposable income depending of their location.

Our authorities are committed to the transition to a low-carbon economy. France's ambitions in term of climate change mitigation is defined by its Nationally Determined Contributions set in the 2015 Paris agreement augmented by the objective of reaching carbon neutrality in 2050 set in the 2017 Climate Plan. To operationalize these commitments, France has designed and adopted a multiyear strategy to reduce carbon emissions (Stratégie Nationale Bas Carbon) which defines sectoral ceiling emissions and lays out concrete measures to reach these sectoral objectives. A wide range of tools have already been deployed to reduce the carbon footprint of the economy including an already high carbon tax, participation to the European emissions trading scheme and ambitious sectoral regulation notably in the housing and transportation sectors. Following the yellow vests protest, the government has decided to maintain the carbon tax at its current level. The *Grand Débat National* clearly highlighted that French citizens were deeply concerned by climate change and wanted the government to act decisively to accompany the transition toward a low carbon economy while taking compensation measures to ensure a fair burden sharing among the population. With these insights in mind, our authorities are thus committed to continue to implement a strong climate mitigation agenda.

Public finance

Maintaining a strategy to contain spending growth and durably put public debt on a downward path.

A consistent strategy has been implemented since the beginning of the presidential term aiming at reducing the level of public spending growth compared to GDP growth. The choice has been made to privilege a durable containment of the rise in public spending, despite inflationary trends related to ageing and health costs. This strategy seems adequate given the findings of the updated benchmarking exercise presented in Annex VI that France has a relatively high level of spending in most expenditure areas compared to peers with potential efficiency gains in several categories. At the same time, the comparatively high level of public spending in France should be read while bearing in mind the choice made, in contrast with some of its peers, to socialize large parts of the social protection system (health, education and pensions notably). This feature of the French social model makes international comparisons somewhat difficult to interpret and does not automatically entail lower value-for-money in

terms of services (health and education being good examples of sectors where public provision can prove particularly cost-effective).

The fiscal strategy is bearing fruits. The fiscal deficit has been reduced further to reach 2.5 percent and the fiscal debt stabilized at 98.4 percent of GDP at end 2018. Those results have been obtained thanks to a slow-down of the public spending increase (+0.3 percent in volume without the tax credits, compared to + 1.4 percent in 2017). Those efforts will be maintained in 2019. While the transformation of CICE into a permanent cut of social contributions will provoke a one-off increase of the public deficit to 3.1 percent of GDP, the deficit will be reduced toward 2.3 percent of GDP without this exceptional factor. The public deficit will then decline further to reach 2.1 percent in 2020, 1.7 percent in 2021 and 1.3 percent in 2022. Our authorities' projections diverge from staff's projections over the medium term given the new methodology used by staff that takes into account only the impact of legislated measures. We would insist in this regard that an increase of the public deficit after 2020 in a context of continued growth appears highly unlikely and contradicts our authorities' plan and intentions. According to our authorities' projections, the public spending ratio would decline by 2,9 points of GDP over the presidential 5-year term and the tax to GDP ratio would decline by 1,3 point over the same period. Moreover, the public debt structure, with long average maturities, is a factor of resilience to a rise in interest rates.

Clear objectives have been set for all the segments of public spending:

- Central government: the contribution of the central government to fiscal consolidation efforts has been significant. In real terms, the central government spending increased by +0,5 percent in 2018 and they decreased by 1,1 percent in volume.
- Local authorities: as highlighted in the selected issues paper on subnational fiscal policy, the innovative contractual relationship set up with local authorities has performed well. It created the conditions for a significant decrease of the current spending level of the local authorities (+0,3 percent in 2018 when the objective was set at +1,2 percent and when it increased by +2 percent in 2017).
- Social spending: for the second year, the financing need of social security administrations were in a positive territory. This is notably due to the target for health insurance (ONDAM) being met for the ninth year in a row.

A resilient and well capitalized financial sector, serving well the economy

Our authorities share the positive assessment of the French financial system and the recognition of its robustness and resilience. Significant progress has indeed been made since the last 2012 FSAP in many key areas as reflected in the report. The French banking and insurance industries have been experiencing an increasing amount of prudential regulation emanating mainly from European ruling (CRR/CRD IV, BRRD, Solvency II). As a consequence, capital, asset quality and liquidity coverage in the banking sector as well as solvency ratios in the insurance sector have markedly improved and are at adequate levels to absorb adverse shocks, including in tail scenarios. Regulatory Tier 1 capital to risk-weighted

assets reaching 15,4 % in 2018 from 13,2% in 2013, Liquidity Coverage Ratio and Net Stable Funding Ratio are above 100 percent for both G-SIBs and other banks. The insurance sector reached a general Solvency Capital Requirement coverage ratio of 240 percent at the end of 2018, following an increase by 6 percentage points from end-2017.

The Financial Conglomerate (FC) business model has been effective in allowing optimization of products generation and distribution, income flows, resources allocation albeit having led to internal reorganizations when necessary. The oversight of the latest key component of the French financial system including investment service providers and asset managers has been heightened in line with the 2012 FSAP recommendations. As duly underscored by staff, the supervision by the Autorité des Marchés Financiers (AMF) over investment service providers has been stepped up across all categories through onsite inspections and macroprudential tools are available, albeit not active, for the asset management industry.

In this regard, France has strengthened its institutional arrangements for macroprudential policymaking in a context of rising nonbank financial intermediation. Reforms set out in the Loi PACTE approved in April 2019 intended to facilitate SMEs' access to diversified financing included IPO, private equity, crowdfunding and ICO under the supervision of the AMF for the latter through the creation of a "visa". France is also advanced in terms of resolution preparedness, less significant banking institutions, which fall within the scope of the Autorité de Contrôle Prudentiel et de Résolution (ACPR), are at an advanced stage for recovery and resolution planning cycles. Moreover, a comprehensive resolution framework has been set up for insurance institutions.

The micro and macroprudential oversight have been strongly reinforced and financial stability risks have been mitigated through preemptive measures. Reacting to the main FSAP recommendations, we would like to add the following considerations:

Preemptive Management of Systemic vulnerabilities: the recommendations referring to the use of Pillar II measures to address residual risks related to corporate exposures do not fall directly and solely within the scope of French authorities. The development of an analytical framework for borrower-based measures for corporates seems difficult to endorse in an open economy like France where companies can raise funds from foreign investors. The French authorities assess this recommendation as smacking more of factual impossibility than a challenge as presented in the report. They also recall that the use of a sectoral systemic risk buffer, which will be included in the next banking legislation under the CRR II and CRD V, is not currently allowed by CRR/CRD IV which only allows to apply the SRB on all institutions or some of them, without distinguishing between exposures. The reduction of the debt-enhancing tax bias will come in the coming years through a decrease in the corporate income tax which the authorities consider adequate while preserving the balance between public finance considerations and fair tax competition. Moreover, and as

indicated above, the Loi PACTE already enlarges the long-term financing options for very small, small and medium-size companies.

- Ensuring adequate liquidity management and buffers: disruptions in wholesale funding markets could cause additional costs and translate into higher risks to profitability and solvency. Still, the issues raised on USD funding only concern a couple of banks and should not be made a general issue for the French banking system as a whole. At the same time, liquidity is not a major risk for life-insurance activities and liquidity and leverage related tools already exist in France in the 2016 Loi Sapin II which namely encompasses “gates” mechanisms to cap fund repurchases.
- Further integration of financial conglomerate oversight: the FC business model has acted as for now as a strong safeguard for banking and insurance groups’ profitability and risk profile through diversification effects that enable more regular revenue and economies of scale with respect to the distribution network. This model has proved to be relevant given the context of low interest rates environment and the digitalization process. However, we agree that operations of the conglomerates cannot be only contemplated from the point of view of their component bodies. Moreover, we see a link between applying a risk-based approach at the group level and removing the impediments to free circulation of capital and liquidity within the Banking Union. The integration of a conglomerate dimension in the resolution framework could be further examined in this respect and addressed from a European perspective as it would require a revision of BRRD.

Enhancing governance, financial policies and financial integrity: the institutional setup has been actively reinforced after the financial crisis and has proven to be effective in producing thorough and shared diagnostics on vulnerabilities and taking adequate actions to remedy them. The HCSF benefits from the contribution of its various members-institution and the principle of collegiality enables candid and open discussions. As regards the funding of those institutions, we do not share staff’s view that they should be exempted from the constitutional and legal framework that applies to budget appropriation. As for regulated savings products, their large popularity within the French population and their important role in the saving structure for low and middle-income earners could make radical shift difficult. Transitioning to more market-based products would be politically difficult. Nonetheless, steps have already been taken to upgrade the method of calculation of the interest rates of these products such as Livret A whose new rate calculation will come into force next year. Lastly, the authorities fully agree with the need to enhance AML-CFT supervision of smaller banks rated as high-risk.

Reinforcing crisis management safety, safety nets, resolution arrangement: the authorities feel that an enhanced resolution framework for insurers should be the task of European Union supervisory and enforcement authorities and would again insist on the need to focus on France’s fields of jurisdiction. Such a framework does not exist at the EU level and as said, France is clearly far more advanced in this regard.

The strengthening of the regulatory framework allows for a more effective fight against corruption.

France was pleased to volunteer to have its anti-corruption supply-side provisions reviewed by staff in partnership with the OECD's Working Group on Bribery. The Law on Transparency, the Fight Against Corruption, and the Modernization of the Economy (adopted in December 2016) has very effectively complemented the tools to better prevent, detect and sanction corruption and related offences with proportionate, effective and dissuasive sanctions. This is already being demonstrated by the resolutions of cases since the adoption of this law, whether they are resolved through trials or through settlement agreements, while enhancing cooperation with foreign authorities. Going forward, we encourage other IMF members to submit themselves to this voluntary review process.