INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/227

FRANCE

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR FRANCE

July 2016

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 2016 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 11, 2016 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 11, 2016, following discussions that ended on May 25, 2016, with the officials of France on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 24, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for France.

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

Selected Issues

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

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July 12, 2016

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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with France

On July 11, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with France.

The recovery is solidifying. The economy is projected to expand by 1.5 percent this year, primarily driven by strong consumer spending. There are also signs of a cyclical recovery in investment, and the slump in residential construction appears to be bottoming out. By contrast, net exports are declining as demand from trading partners has slowed. Private sector job creation has remained lackluster and the unemployment rate has hovered around 10 percent. Structural fiscal adjustment is slowing to near zero this year and the public debt ratio is still rising.

Despite the cyclical recovery, structural rigidities and slower productivity growth across advanced countries weigh on medium-term prospects. Apart from regulations in the services sector and the high tax burden, a key obstacle to growth remains the labor market, where structural unemployment is projected to remain high in the absence of additional reforms. In an environment with modest medium-term growth prospects at home and in the euro area, France thus faces two central policy challenges: to support a more rapid creation of new private sector jobs and to ensure the sustainability of public finances via more efficient government spending growth.

The government has continued to advance important reforms to help create the conditions for improved economic performance. These include most notably the reduction in taxes under the *Pacte de Responsabilité et de Solidarité* and the *Crédit d'Impôt pour la Compétitivité et l'Emploi* (*CICE)* and the competition-enhancing structural reforms under the *Macron* law. Building on earlier labor market reforms including the *Rebsamen* law, the *El Khomri* law would be another step forward, increasing the scope for company-level labor agreements and reducing judicial uncertainty. As for budget policies, there are ongoing efforts to contain spending growth at all levels of government while easing taxes.

[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.

Executive Board Assessment[2]

Executive Directors welcomed France's continuing recovery, while highlighting increased downside risks including potential prolonged uncertainty in Europe in the wake of the U.K. referendum. To secure a durable reduction in unemployment and public debt in the context of a subdued medium term growth outlook, Directors encouraged the authorities to pursue reforms to rebuild fiscal buffers, revive job creation, and strengthen competitiveness and productivity growth.

Directors supported the government's expenditure based fiscal consolidation strategy, which aims to secure medium term sustainability while limiting the short term drag on aggregate demand. They noted, however, that structural fiscal adjustment is slowing and that more ambitious efforts to keep government spending flat in real terms would help achieve medium term fiscal targets and a durable reduction in public debt. Directors recommended that, to make consolidation sustainable and limit potential adverse social and economic effects, it should be underpinned by efficiency enhancing expenditure reforms at all levels of government.

In light of the high level of structural unemployment and modest medium term growth prospects, Directors encouraged the authorities to continue pursuing an ambitious structural reform agenda. They commended the authorities for the targeted reductions in the labor tax wedge and a range of reforms to improve the social dialogue, reduce judicial uncertainty around dismissals, and increase the scope for enterprise level labor agreements. To reduce unemployment more rapidly, Directors recommended additional measures to strengthen job search under the unemployment benefit system, reform the minimum wage formula, and further adapt education and training to evolving labor market needs. In order to boost private sector growth and competitiveness, they also encouraged the authorities to maintain the momentum on product market reform, including easing regulations for start-ups and the self-employed, combined with further opening up of access to regulated professions.

Directors welcomed the improved resilience of the financial sector since the crisis, with the large banks having buttressed their balance sheets, helping them cope with recent episodes of global financial stress. However, they stressed that, as in other euro area economies, banks and insurers need to further adjust their business models to an era of modest growth and low rates, while continuing to adapt to the evolving regulatory framework. Directors also recommended adjusting guaranteed interest rates under the regulated savings schemes to reflect market interest rate conditions. They stressed the need for supervisors to remain vigilant regarding potential risks, including search for yield behavior.

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

France: Selected Economic Indicators

	2014	2015	2016 (Proj.)	2017 (Proj.)
Real economy (change in percent)				
Real GDP	0.6	1.3	1.5	1.5
Domestic demand	1.1	1.5	2.1	1.6
Foreign balance (contr. to GDP growth)	-0.5	-0.3	-0.5	-0.2
Nominal GDP (billions of euros)	2140	2181	2231	2280
CPI (year average)	0.6	0.1	0.2	1.0
GDP deflator	0.5	0.6	0.7	0.7
Gross national savings (percent of GDP)	21.6	22.2	22.2	22.1
Gross domestic investment (percent of GDP)	22.5	22.4	22.7	22.5
Public finance (percent of GDP)				
General government balance	-4.0	-3.6	-3.3	-3.0
Structural balance (percent of potential GDP)	-2.4	-2.0	-2.0	-2.0
Primary balance	-1.9	-1.7	-1.5	-1.4
General government gross debt	95.3	96.1	97.1	97.9
Labor market (change in percent)				
Employment	0.1	0.5	0.7	0.5
Unemployment rate (in percent)	10.3	10.4	10.0	9.7
Money and interest rates (in percent)				
Money market rate (Euro area)	0.1	-0.2	...	...
Government bond yield, 10-year	1.7	0.8	...	...
Balance of payments (in percent of GDP)				
Exports of goods	20.6	21.1	20.2	21.0
Imports of goods	-22.2	-22.2	-21.8	-22.5
Trade balance	-2.5	-1.7	-2.1	-2.1
Current account	-0.9	-0.2	-0.5	-0.4
FDI (net)	1.0	-0.3	-0.2	0.0
Official reserves (US$ billion)	49.5	48.8	...	...
Exchange rates				
Euro per U.S. dollar, period average	0.75	0.90	...	...
Nominal effective rate, ULC-based (2000=100)	101.9	97.9	...	...
Real effective exchange rate, ULC-based (2000=100)	111.4	109.3	...	...

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

INTERNATIONAL MONETARY FUND

FRANCE

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

June 24, 2016

KEY ISSUES

France's economy is recovering, but major efforts are still needed to foster job creation and put public finances on a more sustainable footing. Clearly, policies have progressed in recent years, notably through labor tax cuts and competition-enhancing structural reforms. The *El Khomri* law is another necessary step toward a more dynamic labor market. There are also ongoing efforts to contain government spending while easing the tax burden.

However, the medium-term economic outlook remains subdued and subject to significant risks, implying that unemployment and public debt will remain uncomfortably high for some time to come. Important structural barriers to job creation remain, and high government spending is still an obstacle to fiscal sustainability, with structural fiscal adjustment projected to slow to zero. To bring about a faster and durable reduction in unemployment and debt, staff recommends:

- Reversing the trend of rising public debt by limiting growth of government spending to the rate of inflation, as targeted in the government's Stability Program. This could eventually make room for alleviating France's heavy tax burden.
- Making spending more efficient at all levels of government to make fiscal consolidation sustainable and consistent with growth and social objectives. This should include efforts to streamline the civil service and extend means-testing of social benefits.
- Complementing recent labor market reforms by strengthening job search incentives through the unemployment and welfare benefit systems, and by further efforts to adapt education and training to the labor market.
- Easing regulations for start-ups and the self-employed, while further opening up access to regulated professions to support a job-rich recovery.
- Ensuring that banks and insurers adapt their business models to a global environment of low growth and interest rates, while monitoring emerging risks, to ensure that the financial sector can provide adequate support to the real economy.

Approved By
Jörg Decressin and Vikram Haksar

Discussions took place in Paris and Frankfurt from May 10–25, 2016. The staff team comprised Messrs. C. Mumssen (mission head) Hallaert, Tressel, Gorbanyov, and Mses. Batini, and Kongsamut (all EUR), and Mses. Burova, Santos, and Mr. Mason (from HQ). Mr. de Villeroché and Mr. Badirou-Gafari (OED) participated in the discussions. Staff met with Ministers Sapin, Macron, and Eckert, Governor Villeroy de Galhau, senior officials in the prime minister's office, various ministries, and the Banque de France, various financial sector interlocutors and academics, and trade union and employer association representatives. The mission also met with SSM and ECB representatives. A press conference was held at the conclusion of the mission.

CONTENTS

APPENDICES

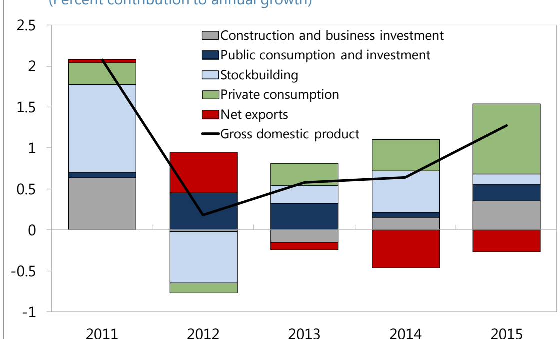
CONTEXT—RECOVERY AND REFORMS

France's economy is recovering. But unemployment remains stubbornly high and public debt is still rising. To address these challenges, the government has pushed forward an agenda of tax cuts, spending restraint, and supply-side reforms against significant political resistance.

1. **Gradual reform progress against political resistance.** Since 2013, the government has advanced a number of supply-side reforms, including services liberalization and income, labor, and corporate tax cuts (Box 1). The fiscal consolidation strategy switched from tax increases to spending restraint. These reforms were implemented against significant political resistance and in the context of rising anti-establishment sentiment as evidenced by the results of the December 2015 regional elections. The *El Khomri* reform of the labor code, unveiled earlier this year, has faced even stronger opposition, and the government relied on a constitutional procedure to move a modified version of the law through the lower house of parliament, triggering a confidence vote. This was followed by union-led strikes and fuel blockades. The political climate and social dialogue appear increasingly tense as France approaches the May 2017 Presidential elections.

2. **Recovery underway, but job creation still limited.** France's economy grew 1.3 percent in 2015, the fastest pace in four years. While the strong first quarter this year partly reflected one-off factors, growth appears to be solidifying and catching up with the euro area average. The recovery has been driven primarily by private consumption, which picked up in early 2015 as households gained purchasing power from falling energy prices and flat consumer price inflation against steady moderate wage growth, while some benefited from mortgage refinancing at lower interest rates. Corporate investment has also picked up alongside the cyclical recovery, supported by improved profit margins, low borrowing costs, phased-in tax cuts, and temporary fiscal incentives for amortization. By contrast, net external demand has remained weak, in part reflecting slower growth in trading partners. Despite the recovery, private sector job creation has remained lackluster, with the unemployment rate hovering around 10 percent. Headline inflation has remained flat, and core inflation was only 0.6 percent in May 2016, below the euro area average, pointing to continued economic slack.

GDP by Demand Components
(Percent contribution to annual growth)



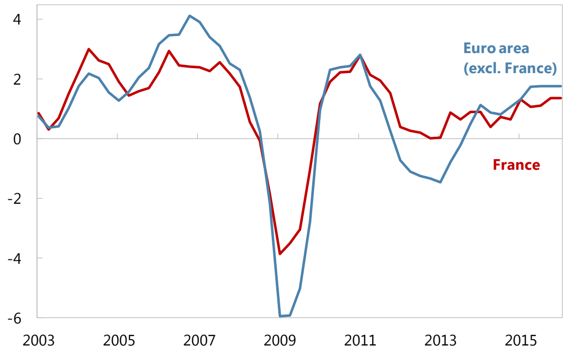
Sources: Haver Analytics and IMF Staff calculations.

3. **Continued credit growth despite volatility.** A bout of global financial volatility in the first quarter hit French banks' equity prices but CDS spreads remained far below 2011/12 peaks. The impact on France's banks was broadly similar to other euro area countries and stock prices have recovered since then. Despite the volatility, bank credit growth has remained positive—at around 4 percent in 2015 for both households and companies, well above the euro area—and larger firms have significantly stepped up bond market financing, supporting a pickup in investment by French companies both at home and abroad. Access to credit does not appear to be a major hurdle for France's SMEs.

Figure 1. A Subdued Recovery

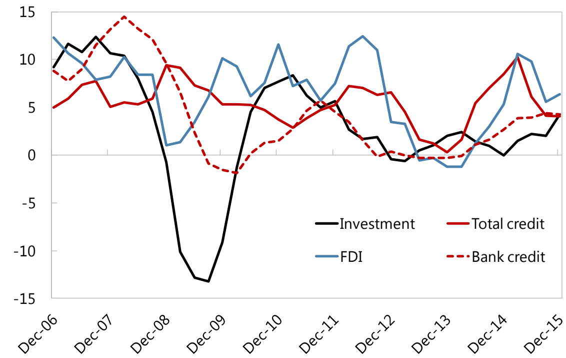
Growth is catching up to the euro area ....

Real GDP
(Percent change, year-on-year)



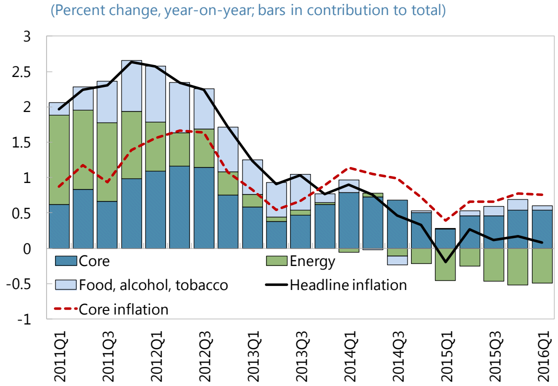
... as investment and credit growth are picking up.

Nominal Investment, Credit, and FDI of NFCs
(Percent year-over-year change)



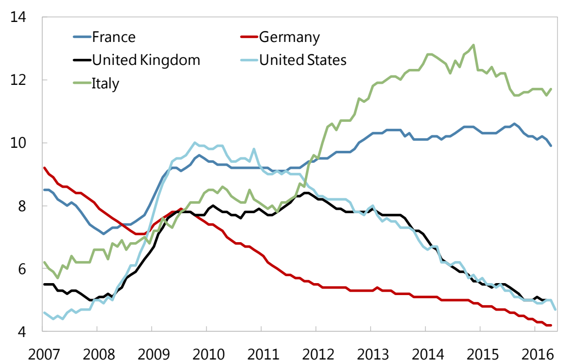
Consumer prices have drifted back to near zero ...

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



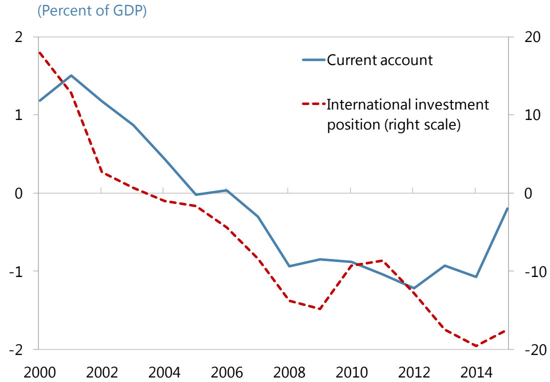
...while the jobless rate remains near 10 percent.

Unemployment Rate
(Percent)



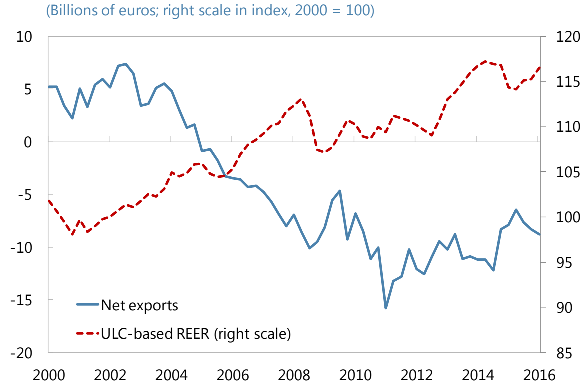
The current account deficit declined on improved terms of trade ...

External Sector
(Percent of GDP)



.... but competitiveness is still a concern.

Net Exports
(Billions of euros; right scale in index, 2000 = 100)



Sources: France Authorities, IMF *World Economic Outlook*, Haver Analytics, and IMF staff calculations.

4. Lower headline deficit, but slower structural adjustment and rising debt. After a pause in 2014, the overall fiscal deficit fell by almost half a percentage point to 3.6 percent of GDP in 2015, overperforming the authorities' projections (3.8 percent of GDP). Consolidation was supported by nominal containment measures, including the continued wage scale freeze and reduced central transfers to local governments, which in turn sharply curtailed investment spending for the second year in a row. However, policy measures explain less than a third of the improvement, with real primary spending continuing to grow faster than GDP. The main drivers of consolidation were the cyclical recovery and savings from lower interest rates, with the 10-year bond yield averaging 0.8 percent in 2015, supported by the ECB's quantitative easing program. Public debt continued to rise, reaching 96.1 percent of GDP at end-2015.

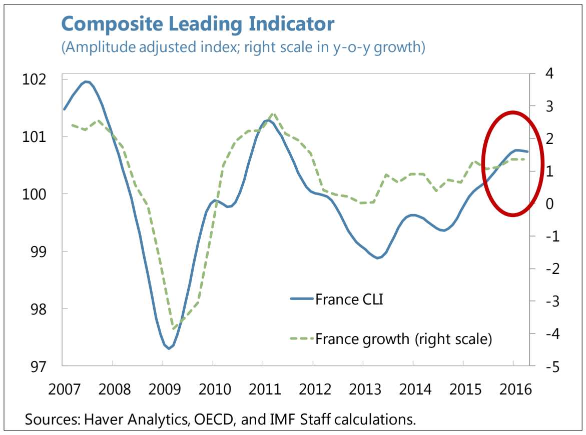
5. Some progress on competitiveness and external imbalances. France's share in world export markets has declined substantially over the past decade, while resilient domestic demand has sustained import growth throughout the crisis. The current account deficit narrowed to less than ¼ percent of GDP in 2015, partly on account of improved terms of trade. This was ½ to 2½ percent of GDP lower than staff's assessment of the cyclically-adjusted norm, with the real exchange rate 3 to 9 percent overvalued (Appendix IV). Competitiveness has been impaired by a prolonged period during which real wage growth remained solid despite declining productivity growth, combined with regulatory barriers and a high tax burden. A weaker euro and low oil prices, together with cuts in the labor tax wedge, have helped strengthen the external position somewhat but some of the underlying causes of the external imbalance remain, including elevated unit labor costs and a sizeable fiscal deficit.

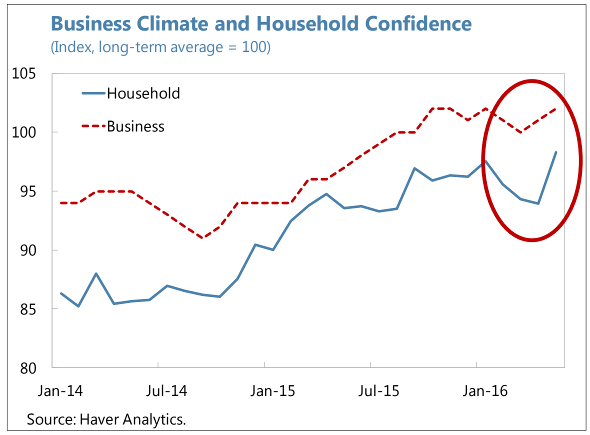
OUTLOOK—MODEST GROWTH WITH RISKS

A subdued medium-term outlook implies that unemployment and public debt will remain elevated for some time to come. France remains exposed to global financial stress, a protracted period of low growth in the euro area, and confidence losses from regional or domestic political developments.

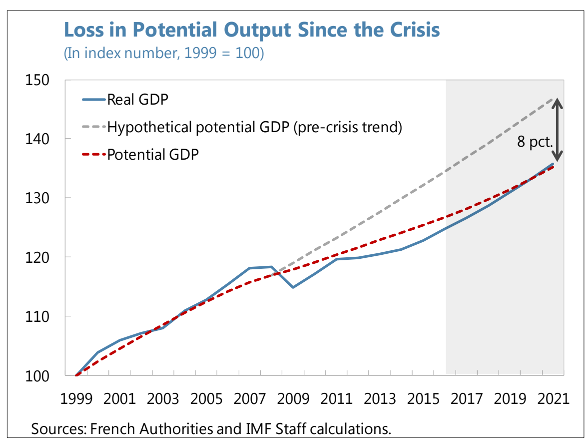
6. Solidifying recovery, with some uncertainty and downside risks. We project real GDP to grow by 1.5 percent this year. The latest data point to continued strong consumer spending, suggesting that consumer confidence continues to improve despite recent terrorist attacks and the still poor labor market. There are also clear signs that investment is picking up and that the slump in residential construction may be bottoming out. The slowdown in structural fiscal adjustment, while problematic for fiscal sustainability (see below), removes another headwind to growth. Conversely, net external demand remains weak, reflecting in part slow growth in trading partners, including in the euro area. Among the areas of uncertainty are the potential effects of strikes and blockades, the upcoming Presidential elections, and a number of regional risks (see below).

7. Inflation outlook still subdued. Despite higher energy prices, headline inflation is projected to remain just marginally above zero in 2016, reflecting continued economic slack and flat import prices. As the recovery firms up, wage growth accelerates, and energy prices rise, inflation is expected to increase to around 1 percent in 2017, still well below the rate consistent with medium-term inflation objectives for the euro area.





8. Modest medium-term growth prospects. Over past decades, growth has been supported by rising government spending, robust wage dynamics and productivity growth, and a steady expansion of the labor force. But the crisis has taken a toll and past drivers of aggregate demand are fading. Alongside a subdued euro area recovery, France's growth trajectory has flattened, with the level of output around 8 percent below the (hypothetical) pre-crisis trend line by 2021. Potential output growth—projected to rise gradually from around 1 percent in 2015 to 1½ percent by 2021—is held back by slowing productivity as in other advanced economies, but also by structural rigidities as discussed in last year's consultation. Apart from regulations in the services sector and the high tax burden, a key obstacle to growth remains the labor market, where structural unemployment is projected to remain high in the absence of additional reforms. On the demand side, growth is projected to be supported mainly by robust private consumption and accelerating investment as the recovery gains pace and confidence solidifies along with stronger growth in the euro area. This should prompt some catching up with respect to long-postponed durables consumption and machinery and equipment purchases. The subdued growth and inflation outlook implies that unemployment and public debt will remain elevated for some time to come.



9. Risks. There are a number of important downside risks that could have significant adverse effects on growth, financial stability, fiscal sustainability, and unemployment (see also the Debt Sustainability Analysis (DSA, Appendix II) and the Risk Assessment Matrix (RAM, Appendix III)):

- *Global financial stress and severe downturn.* An investment demand shock in the euro area caused by weaker confidence and financial stress, combined with a near-term global slowdown, could reduce French output by 3 percent cumulatively in real terms relative to baseline, and raise unemployment by about 1½ percentage points by 2021 (Appendix I). Global financial stress would transmit to France's real economy via export demand, confidence effects, and through the impact on France's banks, which (as some other euro area banks) remain exposed to such shocks in part due to modest profitability, elevated leverage, and still above average reliance on wholesale funding (see financial section below). Based on historical data and assuming no changes in the business model, this could imply a substantial loss in profitability for the globally systemic banks, according to staff's analysis (see paragraph 26).

- *Protracted stagnation in the euro area.* A prolonged demand shock from lower investment intentions and higher risk premia—reflecting low growth expectations, financial fragmentation, and balance sheet concerns—could push the euro area into a low growth, low inflation equilibrium, reducing potential output while leaving the output gap open and further eroding the profitability of the banks. In this scenario, real output in France could drop in cumulative terms by 1¾ percent by 2021 relative to baseline, and unemployment could rise by over ½ percentage points. This could squeeze banks' profitability and their ability to lend to the real economy (see paragraph 26).

- *Confidence losses due to domestic or regional politics.* Domestically, the possibility of an extended period of strike actions, social unrest, or a strengthening of populist forces in the run up to the 2017 Presidential elections could hurt investor and consumer confidence, hinder fiscal and structural reform efforts, and create a more euro-skeptical environment. At the regional level, there are a number of risks that could contribute to the above downside scenarios. The British referendum on EU membership could trigger financial volatility—France's direct banking system exposure to the UK is estimated at about 10 percent of GDP—and an extended period of political uncertainty, possibly compounded by other regional challenges such as refugees, Ukraine, Greece, and terrorism.

10. Potential spillovers. The above risks can create outward spillovers. A protracted period of economic stagnation or domestic political tensions in France could have an adverse effect on the euro area, both directly on aggregate demand and indirectly via confidence effects. Failure to deliver on fiscal consolidation and structural reform commitments could be seen as weakening the credibility of EU economic governance. Given their size and interconnectedness, French banks could create adverse effects if global financial stress forced them into further retrenchment from retail operations abroad (e.g., Italy, emerging Europe), trade and project finance, and correspondent banking activities (though de-risking is less relevant for global French banks than for some global peers).

POLICIES—TACKLING UNEMPLOYMENT AND DEBT

Reforms have progressed in recent years but more efforts are needed to bring down debt and unemployment. Limiting spending growth through efficiency reforms would help rebuild fiscal buffers and eventually allow alleviating France's high tax burden. Reforming unemployment insurance, strengthening training, and supporting creation of new enterprises would help support job creation. The health of the financial sector should be protected by adapting to a modest growth and low rate environment.

11. The government has made significant policy progress. In an environment with modest medium-term growth prospects at home and in the euro area, France faces two central policy challenges: (i) to support a more rapid creation of new private sector jobs and (ii) to ensure the sustainability of public finances via more efficient government spending growth. The authorities have made progress on both fronts in recent years, notably through the reduction in taxes under the *Pacte de Responsabilité et de Solidarité* (*PRS*) and the *Crédit d'Impôt pour la Compétitivité et l'Emploi* (*CICE)* and the competition-enhancing structural reforms under the *Macron* law. Building on earlier labor market reforms, the *El Khomri* law currently in parliament, would be another step forward, increasing the scope for company-level labor agreements and reducing judicial uncertainty around dismissals. As for budget policies, there has been progress on efforts to contain spending growth at all levels of government while easing taxes. These were necessary steps that, taken together, have created the conditions for improved economic performance.

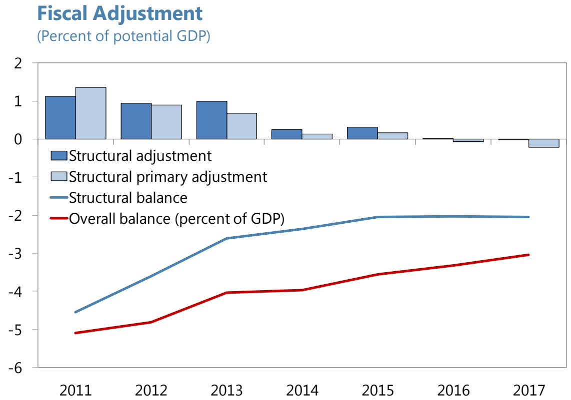
12. Further efforts will be needed to secure a durable reduction in debt and unemployment. First, despite the ongoing recovery, the public debt ratio is still rising and approaching triple digits, while structural fiscal adjustment is slowing to around zero. To rebuild fiscal buffers and place debt on a firm downward trajectory, it will be important to bring down the deficit further, and to do this based on deep reforms that make government spending much more efficient in order to safeguard important services and social protections, while eventually making room for alleviating the high tax burden. Second, with unemployment entrenched at a high level, recent tax cuts and labor reforms should be followed by other growth-friendly measures to improve the functioning of the labor market, while supporting growth opportunities for start-ups and SMEs and further deregulating regulated professions. Finally, it will be important to protect the health of the financial sector in an environment of modest growth and low margins.

A. Fiscal Policy on Knife's Edge

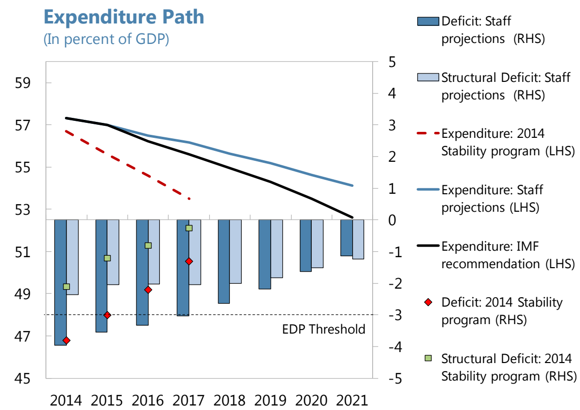
13. Fiscal consolidation is slowing and debt keeps rising. Structural fiscal adjustment, as measured by staff, fell from an annual average of 1 percent of GDP in 2011–13 to 0.3 percent in 2014–15, and is projected to be around zero in 2016−18. The slowdown reflects the effects of tax cuts and failure to curb real spending growth, which has been at the heart of France's fiscal problems. The government's consolidation strategy—relying heavily on broad-based nominal spending containment—has not delivered the hoped-for fiscal savings in the context of low growth and inflation.

Figure 2. Fiscal Adjustment Slowing and Debt Rising

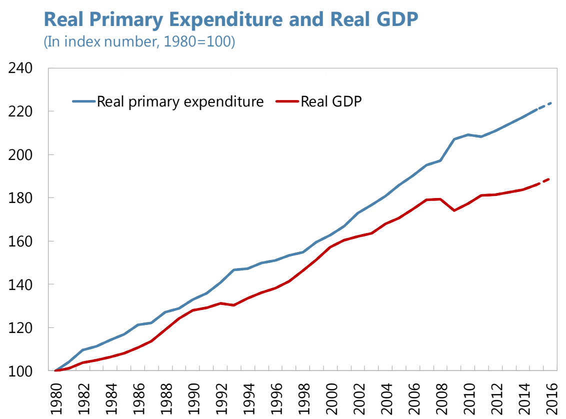
Structural adjustment is coming to a halt…



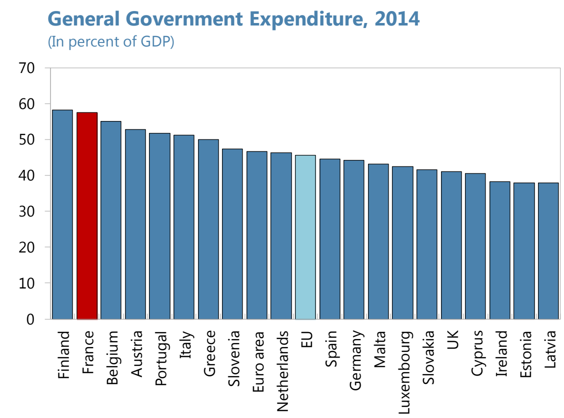
… and is projected to be slower than planned.



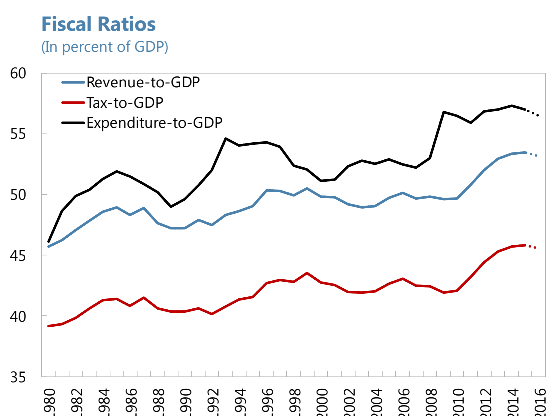
Primary spending has outpaced GDP…



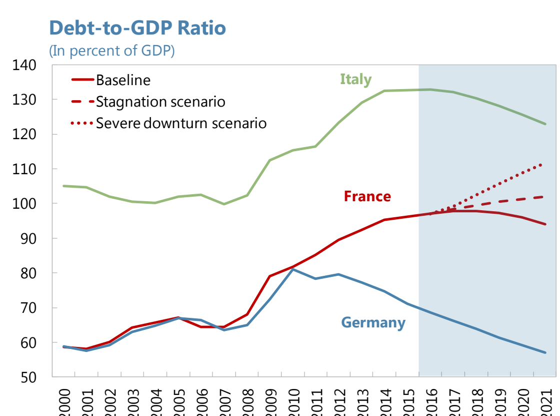
… leading to a high expenditure—GDP ratio.



Expenditure and revenue ratios are at historically high levels.



Public debt continues to rise and is sensitive to growth shocks.



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

- In 2016, real structural primary spending will continue to increase by more than 1¼ percent, partly reflecting inflation shortfalls, the recent decision to end the public sector wage-scale freeze, and new spending pressures such as increased security needs in the wake of recent terror attacks.

- Despite very favorable financing conditions, France will just barely meet the EDP deficit target of 3 percent of GDP in 2017 without further efforts.

- Structural adjustment over 2015–18 is projected to average 0.1 percent of GDP, well below the EC's recommendation. Without further efforts, France will not reach the structural balance objective within the five-year projection horizon.

- Debt is projected to peak at close to 98 percent of GDP in 2017, and decline only slowly thereafter.

14. Fiscal dynamics could easily derail. The fiscal strategy faces two major risks: implementation shortfalls and growth shocks. The government has committed to a sharp reduction in real spending growth over the medium term—this would require substantial additional policy measures that are not yet fully specified. Moreover, it is increasingly difficult to find offsets for new spending needs. To illustrate the implementation risks: if real structural primary spending was to continue growing at its current pace, the structural deficit would rise to 3.1 percent of GDP by 2021, against a baseline projection of 1.2 percent of GDP. Even if the necessary measures are taken, France's Stability Program objectives could still be derailed by growth shocks. Staff has simulated two such shocks—a protracted stagnation for the euro area and a severe global recession with financial stress (see Appendix I). In both scenarios, staff would advocate letting automatic stabilizers work, but this would also mean that the 2017 Excessive Deficit Procedure (EDP) objective will be missed, and that debt will climb to well above 100 percent of GDP (see Appendix II). Moreover, if the scale of the shock is such that coordinated fiscal action is pursued within the euro area, France may need to allow for additional loosening. While a coordinated response in such circumstances would prevent a sharper deterioration in near-term growth and debt dynamics (depending on the size of fiscal multipliers and intra euro area spillovers), it would further delay achieving the medium-term structural objectives, and could raise debt levels over the longer term as the stimulus is eventually withdrawn.

Fiscal Dynamics Could Derail Under Downside Scenarios
(In percent of GDP / Potential GDP)

	2015	2016	2017	2018	2019	2020	2021
		Projections					
Staff Baseline							
Fiscal Balance	-3.6	-3.3	-3.0	-2.6	-2.2	-1.6	-1.1
Structural fiscal balance	-2.0	-2.0	-2.0	-2.0	-1.8	-1.5	-1.2
Expenditure	57.0	56.5	56.2	55.6	55.2	54.6	54.1
Gross debt	96.1	97.1	97.9	97.8	97.3	96.0	94.0
Real GDP growth	*1.3*	*1.5*	*1.5*	*1.7*	*1.7*	*1.8*	*1.8*
Stagnation scenario 1/							
Fiscal Balance	-3.6	-3.3	-3.2	-3.1	-3.0	-2.8	-2.7
Structural fiscal balance	-2.0	-2.0	-2.2	-2.3	-2.4	-2.3	-2.3
Expenditure	57.0	56.5	56.3	56.1	56.0	55.8	55.7
Gross debt	96.1	97.1	98.4	99.4	100.5	101.3	101.9
Real GDP growth	*1.3*	*1.5*	*1.3*	*1.4*	*1.3*	*1.4*	*1.4*
Severe downturn scenario 1/							
Fiscal Balance	-3.6	-3.3	-3.4	-3.8	-3.9	-3.9	-3.9
Structural fiscal balance	-2.0	-2.0	-2.2	-2.4	-2.5	-2.5	-2.7
Expenditure	57.0	56.5	56.5	56.8	56.9	56.9	56.9
Gross debt	96.1	97.1	99.2	102.4	105.6	108.8	111.6
Real GDP growth	*1.3*	*1.5*	*1.0*	*0.8*	*1.1*	*1.2*	*1.4*

Sources: French authorities and IMF Staff calculations.
1/ The scenarios are described in Appendix I.

15. **It is thus important to use the current economic upturn for rebuilding fiscal buffers, based on sustained efforts to slow spending growth.** To anchor the needed fiscal consolidation, general government spending growth should be limited to the rate of inflation—as is broadly envisaged in the government's latest Stability Program from 2017 onwards. This would imply an annual structural adjustment of about ½ percent of GDP—a moderate effort by both international and historical standards—striking a reasonable balance between anchoring fiscal sustainability and limiting the impact on demand. It would help reach the medium-term target of structural balance in four years. Despite the impact on aggregate demand, the proposed adjustment path would place public debt on a firmer downward trajectory, and eventually make room for lowering France's still heavy tax burden.[1] A set of near-term measures that limit the impact on growth by addressing structural inefficiencies, duplication, and poorly targeted spending, in line with the broader agenda of spending reforms (see below), could include: (i) slowing recruitment and limiting the wage drift; (ii) further tightening budget constraints for local governments (e.g., tightening of the caps on local

[1] Assuming a fiscal multiplier of 1, the headline deficit would fall to about ½ percent by 2021, with public spending and debt respectively 1.2 and 1.8 percent of GDP below the baseline. The adjustment would reduce on average growth by 0.3 percentage point per year through 2020, allowing for further tax reductions starting the same year, partly offsetting the loss in growth in previous years. See the 2015 Article IV staff report for a fuller discussion on the impact of spending containment on debt and fiscal adjustment.

taxes and borrowing); (iii) enhancing means testing of social benefits; (iv) further curtailing the growth in health spending; and (v) saving any additional windfall from lower interest rates or excess revenues.

16. Deep reforms to enhance spending efficiency will be critical to ensure sustainability. The recent experience highlights the limits of a spending containment approach to consolidation. Efficiency-oriented reforms would help underpin the needed adjustment and fiscal sustainability while limiting its impact on growth and protecting the French social model. Staff's recently published study shows that such reforms could yield significant savings (Box 2).[2] In particular:

- Streamlining the large civil service and limiting the wage drift at all levels of government would help reduce the wage bill, which at 13 percent of GDP is appreciably above the levels in EU peer countries.

- Increasing the targeting of social spending, for instance by expanding means-testing (notably for family and housing allowances), could yield significant savings without adversely affecting social outcomes. For illustration, if the redistributive efficiency of social benefits was at the EU average, France could achieve the same reduction in income inequality at a fiscal cost that is lower by 3.5 percentage points of GDP.

- While demographics and recent reforms make France's pension liabilities more manageable than in some other EU countries, there is still room to further increase the effective retirement age and rationalize special regimes.[3]

- Slowing the growth in the cost of public health care, which already amounts to 8 percent of GDP, could be helped by further enhancing use of generic medicines, rationalizing hospital services and costs, and strengthening cost effectiveness evaluations.

17. *Authorities' views.* *The authorities underscored their commitment to a fiscal consolidation strategy that is fully based on expenditure efforts. They agreed that general government spending should be kept broadly flat in real terms, as the 2016 Stability Program stipulates for 2017–19. They acknowledged that structural fiscal adjustment is slowing, although less so than measured by staff, and that real spending is continuing to increase, while noting that the spending ratio partly reflects tax credits. They saw the slowdown in adjustment as necessary to preserve the economic recovery and noted that the public ratio would soon start declining. They agreed that strong spending control and additional measures will be required in 2017, but expressed confidence that the headline deficit would*

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[2] Jean-Jacques Hallaert and Maximilien Queyranne (2016) "From containment to rationalization: Increasing public expenditure efficiency," IMF Working Paper 16/7. The results of this study were presented at a workshop organized by the Treasury in November 2015 and, during the mission, at a seminar organized by the Audit Court.

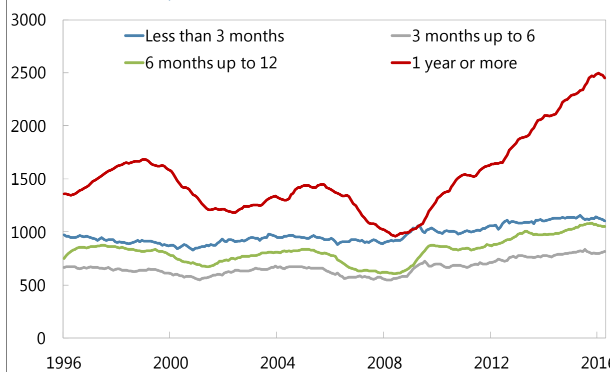
[3] According to the EC's *2015 Ageing Report*, the cost of public age-related spending will remain broadly at its current level until 2025, before declining by 2.8 percentage points of GDP by 2060, partly reflecting demographics and successive pension reforms. By comparison, public age-related spending cost is projected to decline by 0.2 percentage points on average in the EU by 2060, by 1.9 percentage points in Italy, and increase by 2.7 percentage points in Germany and 0.7 percentage point in the United Kingdom. The 2015 reform of supplementary pensions will further reduce incentives for early retirement, generating savings of 0.2−0.3 percent of GDP by 2060.

come in below 3 percent of GDP. They appreciated staff's recently published study on expenditure efficiency in France, and reiterated their objective to gradually reduce France's spending and tax ratios. To achieve this, they stressed that the approach of keeping tight budget constraints on all levels of government should help encourage spending units to seek efficiency gains. They also saw value in continuing the targeted annual spending reviews in selected areas initiated in 2015. Regarding euro area fiscal governance, they indicated support for simplifying the rules to increase their transparency and predictability.

B. Tackling Structural Unemployment

18. Much of France's high unemployment is structural, presenting a major social and economic challenge. Unemployment appears less responsive to the business cycle, see Selected Issues Paper (SIP) Chapter I, A. The unemployment rate has hovered around 10 percent for four years. Despite steady public sector hiring, employment rates in France have stagnated, underperforming peer countries, as job creation lagged behind previous recoveries. In April 2016, the number of unemployed reached 3.5 million, and those out of a job for more than one year numbered almost 2.5 million, more than double the pre-crisis level. The unemployment rate is projected to decline only very slowly, converging with the NAIRU (to around 8½ percent) over the medium term.

Unemployment by Duration
(Thousands of persons)



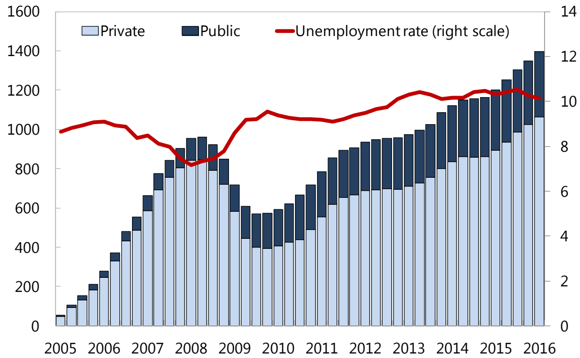
Sources: DARES and IMF Staff calculations.

19. The poor labor market performance reflects deep-rooted structural rigidities, not just a weak recovery. Several factors seem to have made France's labor market less adaptable to an evolving global economy—centralized labor agreements for over 700 branches; long and uncertain judicial procedures around dismissals; relatively easy access to unemployment and welfare benefits; a relatively high minimum wage; and a sizeable labor tax wedge. Moreover, real wages and unit labor costs have grown steadily since 2000, including during the crisis years, contributing to a labor cost competitiveness gap. Together with barriers to private sector growth, this has made it difficult for job creation to match the dynamically growing labor force. The adverse effects cut across the population but are particularly pronounced for the young, the low-skilled, and immigrants.

Figure 3. Lack of Dynamism in the Labor Market

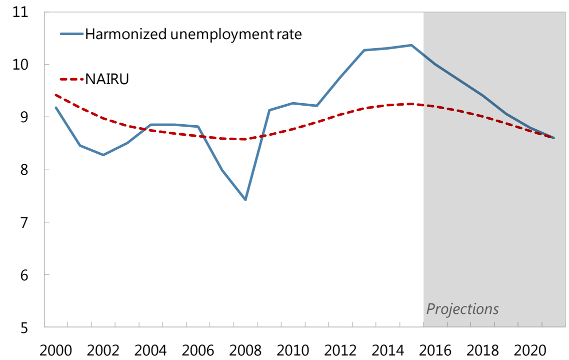
Slow job creation, despite public hiring, has kept unemployment high.

France: Cumulative Change in Employment
(In thousands of persons; right scale in percent)



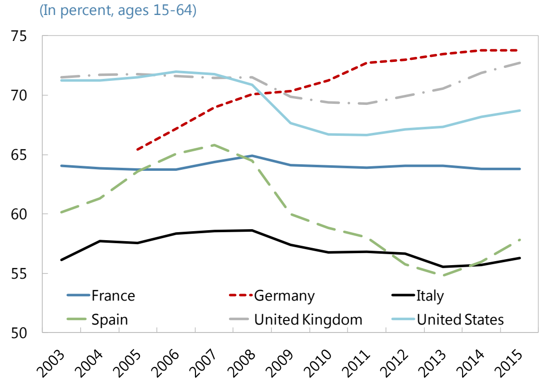
Much of France's unemployment is structural.

Unemployment Rate Outlook
(Percent)



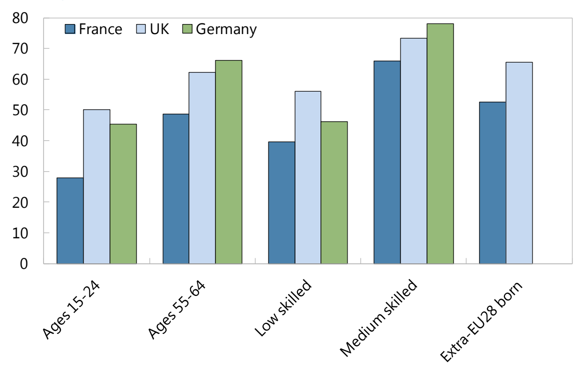
The employment rate has failed to pick up....

Employment per Working Age Population
(In percent, ages 15-64)



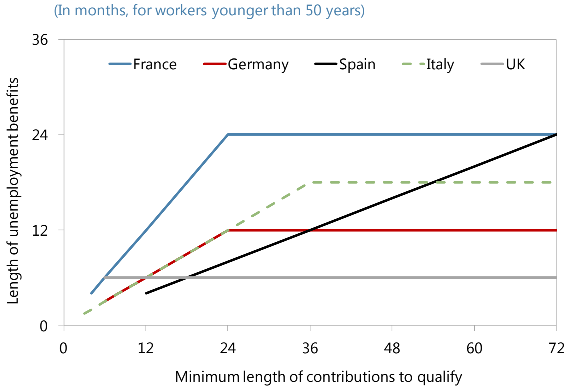
...and remains very low for a number of groups...

Employment Rate, 2015
(In percent)



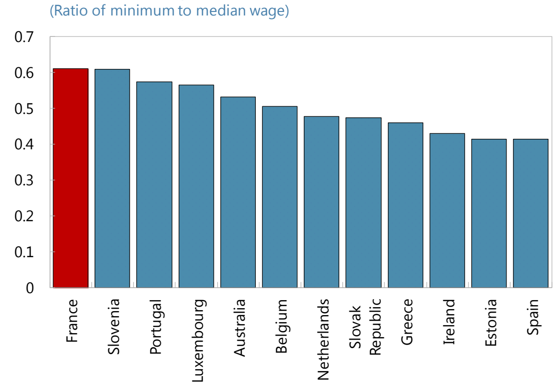
...partly reflecting easily accessible benefits...

Length of Contributions and Unemployment Benefits
(In months, for workers younger than 50 years)



...and above-average minimum wages.

Minimum Wages, 2014
(Ratio of minimum to median wage)



Sources: Europ'Info, 2012: "L'assurance chômage en Europe,"—Edition N°9, July 2012; France authorities, EuroStat, Haver Analytics, and IMF staff calculations.

20. Reducing unemployment has been the authorities' long-standing goal—and important steps have been taken in recent years. The labor tax wedge has been reduced significantly for low wage earners through the *PRS* and *CICE*, helping reduce unit labor costs The *Rebsamen* law has streamlined regulations for social dialogue in small and mid-sized companies and strengthened activity incentive schemes for lower wage earners. The *Macron* law has taken a step toward reforming the labor arbitration system (*prud'hommes*).[4] A new hiring subsidy for lower wage earners in small firms and a new training program for the unemployed were introduced earlier this year. Building on these reforms as well as the earlier labor law in 2013, the *El Khomri* law would increase the scope for company-level labor agreements and further reduce judicial uncertainty around dismissals—these measures should encourage more hiring on open-ended contracts and improve labor market dynamics as the recovery gathers pace.

21. Important barriers to job creation remain, however (see SIP Chapter I, B). Certain aspects of the unemployment and welfare benefits systems may contribute to inactivity traps, with relatively easy qualification for benefits and weak job search incentives.[5] Moreover, the education and training system has not kept up with a changing labor market, creating an increasing mismatch between the existing skills of the jobless and those sought by employers. Bringing down the high level of structural unemployment and raising the stagnant employment rate will be critical both for growth and social objectives. With a view to supporting a job-rich recovery, staff recommends a set of specific reforms that should raise France's medium-term employment and growth potential while improving opportunities for vulnerable groups without creating a drag on short-term demand:

- Reforming unemployment insurance rules to strengthen work incentives, including by (i) lengthening the minimum contribution period to qualify for unemployment insurance from the current four months; (ii) unifying the maximum unemployment benefit period to two years; (iii) changing the formula for calculating unemployment benefits to balance the treatment of part-time work and alternating short-term work contracts; and (iv) introducing "degressivity" of unemployment benefits.

- Enhancing job search support for unemployment and welfare benefit recipients, while tightening rules for accepting suitable job offers and strengthening enforcement of rules.

- Changing the minimum wage formula to limit indexation to inflation while unemployment is high.

[4] The OECD estimated the combined impact of labor and other tax cuts and structural reforms under the *Macron law* would raise real GDP growth by 0.3 percent per year through 2020.

[5] A person becomes eligible for benefits after working for just 4 months, and reaches eligibility for the maximum of 24 months of benefits after working for 2 years (with a the maximum is 36 months for persons over 50). While on benefits, the unemployed can reject the first "suitable" job offer, and can reject any offer with a wage of less than 85–100 percent of the previous wage. The French system also features Europe's highest cap for benefits, at about €7,000 per month. Moreover, an analysis by the *Conseil d'Analyse Economique* (September 2015) shows that there is an increasing number of workers who alternate between ultra-short term contracts and short-term unemployment within a month, receiving a total income close to the full monthly wage based on the current unemployment benefit formula. Job search requirements are often weakly enforced, including for welfare recipients.

- Further improving education and professional training to better match the skills of the young and unemployed to the needs of the labor market.

22. Product market reforms remain an important complement to fostering job creation and growth. The *Macron* law has liberalized legal professions and intercity bus transport, and opened the way for extending retail trade opening hours, while the *Rebsamen* law increased certain employee thresholds including for mandatory social dialogue, lifting the administrative burden on SMEs. Building on these reforms, there is still ample scope to boost potential growth and job creation, both in the short and medium term, by reducing red tape and enhancing competition:

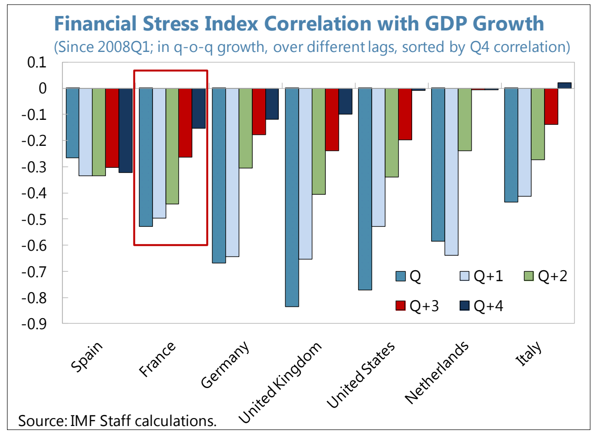
- Easing regulations for start-ups and the self-employed, enhancing data transparency, and streamlining qualification requirements for regulated professions, as envisaged in the "*Sapin II*" law on economic transparency.

- Reducing barriers to competition for regulated professions other than in the legal area, and further liberalizing retail trade (including by reviewing zoning restrictions).

- Enhancing the efficiency of the "Business Simplification" process aimed at cutting red tape, with additional monitoring from a new unit in the Ministry of Economy.

23. *Authorities' views.* *The authorities broadly agreed that a large share of unemployment is structural. They stressed their strong commitment to combat unemployment, noting that the El Khomri law builds on a series of reforms and fiscal measures that were all aimed at improving the functioning of the labor market. The law would be the first step in redrafting the labor code in order to increase the scope for collective bargaining. It would reduce the fragmentation of the labor market by enhancing incentives for hiring on open-ended contracts. It would also give more flexibility to firms while providing security to workers. They agreed that in order to bring down unemployment decisively, continued efforts are needed to strengthen education and professional training (such as through the recent presidential initiative to create a new training program for the unemployed), reform the unemployment insurance system, and further encourage the creation of new enterprises, growth, and development (as is the intent of the Sapin II law on economic transparency).*

C. Strengthening Financial Sector Resilience



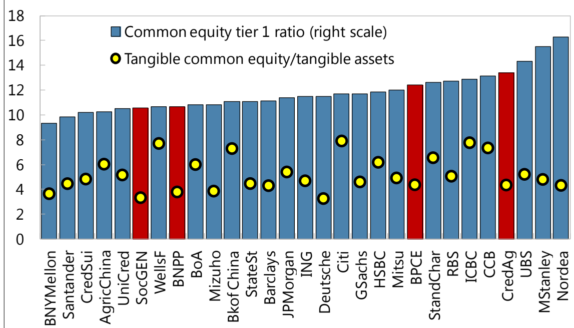
24. France's large financial sector plays a key role in the domestic economy, with institutional shock absorbers for households. Banking assets are roughly 375 percent of GDP, with domestic claims accounting for about 60 percent of the total. Despite the financial volatility in recent years, access to credit has generally not been a major problem for French enterprises compared to some other euro area countries, partly reflecting relatively low sovereign risk and bank funding costs, and households have benefited from continued access to mortgage credit at low interest rates. Historically, financial conditions have impacted the economy mainly through private investment and exports, while private consumption appeared less affected—in contrast to the UK and the US (see SIP Chapter II, A). The lower impact on consumption may reflect smaller wealth effects because of lower direct holdings of stocks or corporate debt securities by households, and relatively small reliance on consumer credit to finance consumption. Moreover, given the prevalence of fixed-rate mortgages, homeowners are cushioned from adverse financial shocks, while being able to benefit from lower rates through refinancing. Saving accounts are typically renumerated at rates which are regulated and insulated from financial stress, while life insurance saving instruments are tax advantaged and often guarantee investors' capital.

25. France's big banks have buttressed their balance sheets since the global financial crisis, which has helped them cope with recent bouts of financial volatility. The four global systemically important banks (G-SIBs) have strengthened their capital and liquidity buffers in line with tighter European regulations and global standards.[6] France's global banks have also reduced their leverage and their reliance on wholesale funding since the crisis. However, several banks are still more leveraged, with continued low risk weights, and still have a higher share of wholesale funding, than most G-SIBs.[7] Moreover, profitability remains fragile, as for other euro area banks. Staff's analysis of how recent periods of financial volatility affect the group of thirty G-SIBs suggests that wholesale funding, leverage, and profitability have been associated with greater equity price responses to shocks, although this was not observed for all French banks (see SIP Chapter II, B).

[6] They have raised capital adequacy to the fully loaded Basel III ratio, and adapted to new regulations on liquidity and funding by holding higher shares of public sector assets and reducing their exposure to foreign banks. Total exposure to emerging markets has increased recently, but remains moderate at 8 percent of total foreign claims.

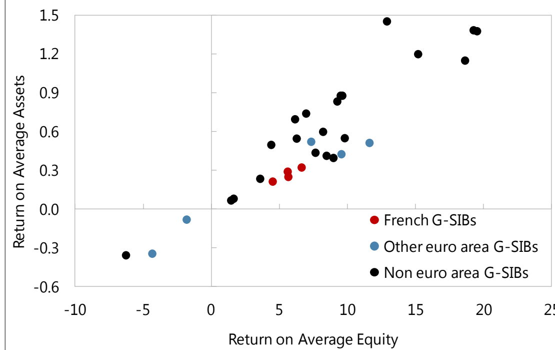
[7] U.S. dollar money market funding, which was a vulnerability in 2011 when funding dried up, was $160 billion in 2015. Banks rely on this and other U.S. dollar funding to finance assets in U.S. dollars, including deposits at the US Fed.

Measures of Capital, 2015
(Percent)



Sources: GFSR, SNL, Bankscope, and IMF Staff calculations.
Note: Leverage ratio adjusted for accounting differences (US GAAP versus IFRS)

Bank Profitability
(Percent, average 2013-15)



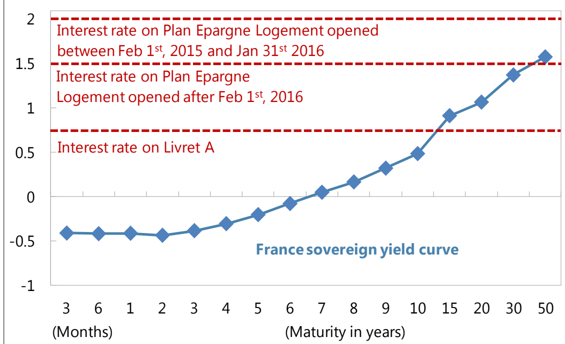
Sources: EBA and IMF Staff calculations.

26. The main challenge is for banks and insurers to operate in an era of modest growth and very low interest rates. While accommodative euro area monetary policy has lowered funding costs and supported the recovery and thereby bank lending, it has also further flattened the yield curve. The resulting pressure on margins, together with continued regulatory uncertainty, tends to constrain profitability of French and other euro area financial companies—likely contributing to the low price-to-book ratios. France's G-SIBs are vulnerable to a protracted period of low growth and low interest rates, because of (i) fee and commission income, as share of total assets, below non-EU peers (though temporarily boosted by mortgage refinancing in 2015), (ii) regulated savings rates above market rates, and (iii) a high share of fixed rate mortgages that have been refinanced at very low rates, which could become a profit challenge when policy rates and funding costs rise again.[8] Against this background, banks are further diversifying into asset management, private banking, and insurance. Banks may eventually be tempted to loosen lending standards or engage in more risky activities involving complex products, which could worsen portfolio quality.[9] Staff's empirical analysis shows that low inflation and growth in France have in the past been associated with smaller spreads, slower credit growth, and deteriorating credit quality. Moreover, for the group of thirty G-SIBs, staff's panel data regression analysis points to a significant association between growth, inflation, and bank profitability. Under staff's illustrative downside scenarios (Appendix I), this empirical relationship would suggest that the profitability of France's G-SIBs would decline appreciably assuming no change in their business models, although the initial degree of diversification and asset quality could be important mitigating factors that would limit the impact (see right chart below, and further details in SIP Chapter II, C). This would have adverse effects on bank's capital accumulation and lending to the real economy.

[8] Life insurance companies are also vulnerable to a low interest rate environment, but to a lesser degree than in other European countries, as returns are adjusted on a yearly basis and only the principal is guaranteed.

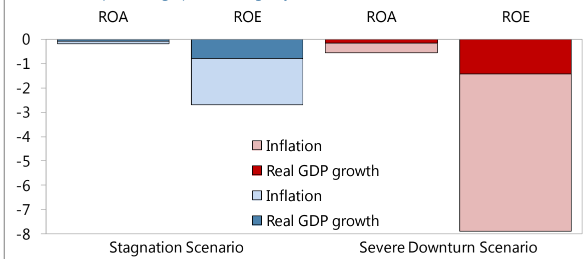
[9] At around 4 percent, non-performing loans (NPLs) are low by European standards, but are higher than for most G-SIBs, partly due to exposures in the Italian subsidiaries.

Interest Rates in France
(Percent, March 2016)



Sources: SNL, Agence France Trésor, and IMF Staff calculations.

Illustrative Medium-Term Impact of Lower Growth and Inflation on Bank Profitability[1]
(Cumulative percentage point change by 2021)



Sources: Bankscope, World Economic Outlook, and IMF Staff calculations.
[1] Scenarios based on simulations in Appendix 1. Gross impact on profitability based on past empirical relationships, not taking into account possible changes in the business model or mitigating effects from initial conditions of specific banks.

27. The financial sector will need to continue adapting to this environment, while supervisors should remain vigilant with respect to potential emerging risks. Protracted low growth and interest rates will likely require continued cost cutting, including through branch closures (SIP, Chapter II, D). It may also motivate further deleveraging and possibly sector consolidation within the euro area, although lingering regulatory uncertainty appears to dampen incentives for any larger strategic acquisitions. At the same time, supervisors should remain vigilant with respect to risks related to search for yield. In addition, the macroprudential authority should further study the reasons for the significant increase in corporate debt since the crisis, reaching about 125 percent of GDP in gross terms, though much lower when intra-group debt is consolidated, while carefully monitoring commercial real estate prices in certain locations.[10] Continuing the efforts to complete the Banking Union, including through the European Deposit Insurance Scheme proposal (EDIS), together with steps to enhance bank data transparency, will help reduce systemic risks in the euro area. Finally, regulated savings rates in France should continue to be adapted to reflect market interest rate conditions.

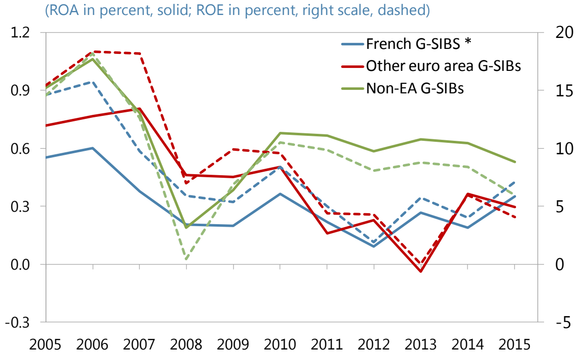
28. An additional ongoing challenge for the financial sector is to continue adapting to the evolving regulatory framework. New global requirements such as Total Loss-Absorbing Capacity (TLAC) will require further improvements in the capitalization of France's G-SIBs. The French authorities have proposed legislation to introduce a new class of senior debt, subordinated to existing senior debt, which will improve the clarity of bank resolution in France and fulfill TLAC requirements, and to add a cap on European Minimum Requirements for Own Funds and Eligible Liabilities (MREL) requirements. There is also a range of other regulatory initiatives that could imply additional capital needs or other adjustments, such as revisions to the treatment of risk-weighted assets and the banks' use of internal models, and standards on market risk, operational risk, interest rate risk, sovereign debt holdings, and the net stable funding ratio and leverage ratio still to be finalized at the EU and Basel Committee on Banking Supervision (BCBS) levels. After Bank Recovery and Resolution Directive (BRRD) passage in August 2015, interim resolution plans for the four G-SIBs are under preparation.

[10] House prices have stabilized since the crisis, and household debt remains manageable at 85 percent of gross disposable income and 55 percent of GDP, similar to the euro area average. However, commercial real estate appears to have become potentially overvalued in greater Paris, as indicated in recent publications by the macroprudential authority.

Figure 4. Improved Bank Balance Sheets But Fragile Profits

Profitability is improving but remains fragile…

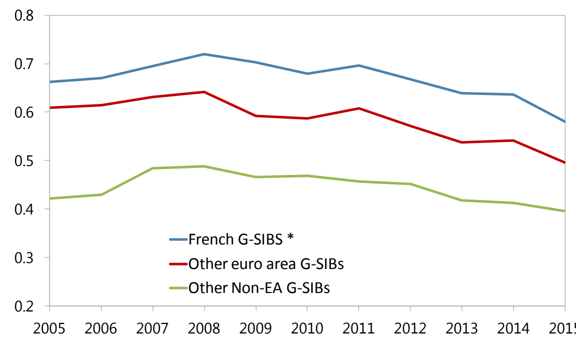
Return on Assets and Equity
(ROA in percent, solid; ROE in percent, right scale, dashed)



*BNP-Paribas, Societe Generale and Credit Agricole.

… and reliance on wholesale funding is still above other G-SIBs.

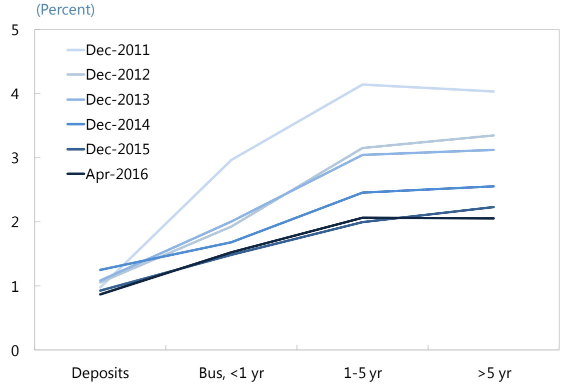
Wholesale Funding to Total Assets
(In ratio)



*BNP-Paribas, Societe Generale and Credit Agricole.

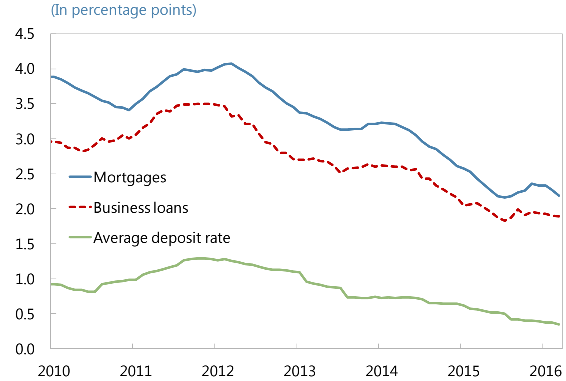
Profitability is under pressure from a flattening yield curve …

Term Structure of Interest Rates
(Percent)



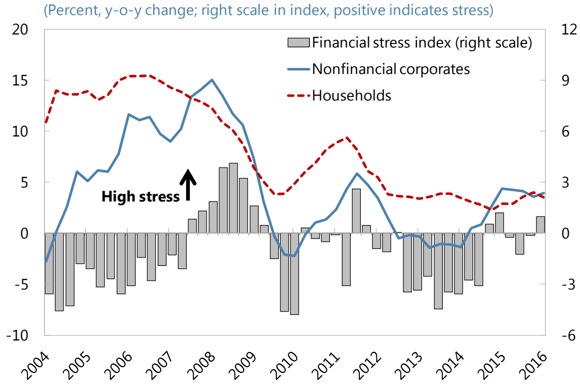
… though lending rates have stabilized since mid-2015.

Lending Rates and Average Deposit Rate
(In percentage points)



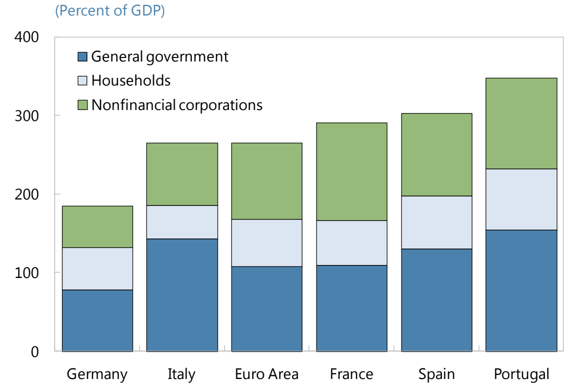
Lending has picked up since 2014, despite the recent financial volatility.

Financial Stress and Bank Lending
(Percent, y-o-y change; right scale in index, positive indicates stress)



Borrowers' indebtedness is close to the euro area average, but somewhat higher for corporates.

Indebtedness by Sector, 2015
(Percent of GDP)



1/ For corporate sector debt, after adjusting for inter-company lending and firms with group treasury operations in France, corporate debt is reduced to 69 percent of GDP (as of 2015).

Sources: Bankscope, Haver Analytics, and IMF staff calculations.

29. *Authorities' views.* *The authorities were confident that France's banks are well placed to cope with renewed global financial stress. They did not see leverage or wholesale funding as significant sources of vulnerability, noting that leverage is comparable to some other euro area banks, that asset quality is better and the cost of risk lower than for many euro area peers. Moreover, reliance on wholesale funding has declined substantially since the crisis, and U.S. dollar market funding is matched by deposits at the Federal Reserve Bank. They agreed that profitability remains fragile, and that a protracted period of low rates would over time create challenges, as for other banks and insurers in Europe. They saw regulatory uncertainty as a significant challenge, with several European and global regulations still being specified. The combination of low margins and regulatory uncertainty was seen by many as the main reason for low price to book ratios. They agreed on the need to keep regulated savings rates broadly in line with market conditions, while also pointing to the social role of these savings instruments. On macroprudential surveillance, they did not see major risks in the residential real estate market, and noted that they continue to monitor developments in the commercial real estate market and are analyzing the reasons for the increase in corporate debt since the crisis. The authorities stressed their strong commitment to completing the Banking Union, including the EDIS. They proposed to carefully calibrate the MREL at the EU level to ensure the resolvability of all failing or likely-to-fail banks that would apply a bail-in strategy.*

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30. The economy continues to improve, but the medium-term outlook is subdued, with several downside risks. The recovery is driven by domestic demand, reflecting purchasing power gains from low import prices, favorable financial conditions, and improved profit margins, including from recent fiscal measures. The external position has improved, but remains moderately weaker than that implied by fundamentals. Medium-term growth prospects are modest and France remains exposed to global financial stress, a protracted period of low growth in the euro area, and confidence losses from regional or domestic political developments.

31. Policies have clearly progressed in recent years, but more is needed to secure a durable reduction in unemployment and public debt. In an environment with modest growth, the two central policy challenges are to support the creation of new private sector jobs and to ensure the sustainability of public finances. The authorities have made progress on both fronts in recent years, notably through labor tax cuts and competition-enhancing structural reforms. There are also ongoing efforts to contain government spending while easing the tax burden. However, unemployment has remained stubbornly high, with structural bottlenecks continuing to hinder private sector growth and job creation. Moreover, the public debt ratio is still rising and approaching the triple digits, while structural fiscal adjustment is slowing to near zero. This makes France vulnerable to shocks.

32. Fiscal consolidation is slowing and could easily derail. High and rising government spending has been at the heart of France's fiscal challenges—a decisive break is needed to reverse the growth of public debt and make room for eventually alleviating the heavy tax burden on the economy. The government's expenditure-based adjustment strategy is thus appropriate. However, while the headline deficit is coming down, the structural fiscal effort is slowing to around zero, and real spending is continuing to increase. Without further efforts, France will just barely meet the 3 percent of GDP deficit target in 2017 and not reach the structural balance objective within the next five years. Fiscal risks are high—implementation shortfalls or external shocks could easily throw the fiscal strategy off course, and push public debt to over 100 percent of GDP.

33. Fiscal adjustment should be underpinned by efficiency-enhancing reforms to keep real spending flat. A fiscal anchor of zero real primary spending growth would deliver structural adjustment of about ½ percent of GDP per year, a moderate effort by international and historical standards. While not detracting unduly from demand, this would ensure that medium-term fiscal targets are safely met and debt is placed on a firm downward trajectory by 2017. In addition, consolidation should shift from broad nominal containment to deeper reforms to make spending more efficient at all levels of government, limiting the impact on demand and protecting the French social model. Key reforms include streamlining the large civil service, increasing the targeting of social spending, further increasing the effective retirement age, and continuing to slow the rise in public health care costs.

34. Combating unemployment is rightly at the top of the policy agenda. Much of France's high unemployment is structural and long-term unemployment is rising, creating major social and economic challenges. The government has advanced a series of helpful reforms to boost job creation, notably by reducing the labor tax wedge, streamlining regulations for small and mid-sized companies, and creating a new training program for the unemployed. The *El Khomri* law would be another important and necessary step forward—it should encourage more hiring on open-ended contracts and improve labor market dynamics as the recovery gathers pace.

35. Additional structural reforms are needed to boost private sector job creation. To improve the functioning of the labor market, it will be important to reform the unemployment and welfare benefit systems to strengthen work incentives and job search while continuing efforts to target education and professional training to the evolving needs of the young and the unemployed. The minimum wage formula should be reformed. However, to ensure that job creation keeps up with France's dynamic demographics, it will be critical to continue efforts to raise potential growth through product market reforms, including by supporting self-employment and the creation of new enterprises and further liberalizing regulated professions.

36. The financial sector has become more resilient since the crisis, but needs to further adapt to an era of modest growth and low rates. France's big banks have buttressed their balance sheets since the global financial crisis, which has helped them cope with recent bouts of financial volatility. They have reduced leverage and reliance on wholesale funding, although for several it remains above most other G-SIBs, and profitability is still fragile. A key challenge for both banks and insurers is to ensure profitability in prolonged period of modest growth and low rates, especially in the context of continued regulatory uncertainty. This will necessitate further cost cutting, diversification, and possibly consolidation within the euro area. Supervisors will need to remain vigilant of risks created by search for yield. Regulated savings rates in France should continue to be adapted to reflect market interest rate conditions. While private sector balance sheets remain generally solid, it will be important to monitor developments in the commercial real estate market and analyze the recent increase in corporate debt levels.

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

Box 1. Key Structural Reforms

Fiscal	
Key Issues	Spending at 57 percent of GDP. Social spending and wage bill among highest in euro area.
Recent reforms and measures	• Wage-scale freeze for all levels of government during 2010−15 • The 2014 pension reform (higher rates and longer contribution period for full pension) was complemented in 2015 by a reform of the supplementary pension • Tightened budgetary target for health spending (*ONDAM*) • Reduced transfers to local governments (phased over 2014−17) • Creation of indicative target for local government spending growth starting 2015 (*ODEDEL*)
Underway	• Targeted expenditure reviews in selected areas, starting in 2015
Additional measures recommended by staff	• Limit general government spending growth to inflation, with burden sharing mechanism • Institutionalize broad spending reviews to improve efficiency at all levels of government • Streamline the large civil service at all levels of government • Improve targeting of social benefits, including for unemployment, housing, and families • Further raise the effective retirement age and streamline special pension regimes • Tighten caps on local taxes and borrowing, and eliminate "universal competency" clause for municipalities
Labor market	
Key issues	High unemployment, especially among young and low-skilled. Uncertain dismissal costs. Minimum wage indexation regime. Easy access to unemployment and welfare benefits.
Recent reforms and measures	• Liberalization of certain regulated professions (*Macron* law) • Relaxing restrictions on Sunday and overtime work (*Macron* law) • Reforming union representation and streamlining mandatory social discussions (*Rebsamen* law) • Strengthen activity incentive schemes (*prime d'activité*) (*Rebsamen* law) • Subsidy of €500 per quarter for hiring low-paid workers in small and medium companies
Underway	• Reduce judicial uncertainty around dismissal procedures (*El Khomri* law) • Increase scope for company-level labor agreements (*El Khomri* law) • Broaden scope for employment protection agreements (*El Khomri* law) • Bi-annual renegotiation of the unemployment benefits terms • New hiring subsidy for lower wage earners and new training program for the unemployed
Additional measures recommended by staff	• Reform unemployment benefits to tighten eligibility • Strengthen job search requirements and incentives for unemployment and welfare benefit recipients • Improve the targeting of professional education and professional training • Change the minimum wage formula to limit indexation to inflation while unemployment is high
Product markets, real estate, and financial sector	
Key issues	Low productivity growth. Barriers to competition in services. Excessive business regulation. Lack of affordable housing. Distortive rates on regulated savings deposit.
Recent reforms and measures	• Liberalizing legal professions, coach transport, retail trade opening hours, and expanding the competencies of the Competition Authority (*Macron* law) • Easing labor-related regulations for firms above certain employee thresholds (*Rebsamen* law) • Temporary measure to boost investment through favorable amortization rules • Adoption of banking union (CRDIV, BRRD)
Underway	• Further clarification of bank resolution framework and deposit guarantee scheme
Additional measures recommended by staff	• Ease regulations for start-ups and the self-employed, enhance data transparency, and streamline qualification requirements for regulated professions, as envisaged in the draft "*Sapin II*" law • Enhance the effectiveness of the Business Simplification process • Alleviate constraints on the supply of affordable housing and improve targeting of benefits • Align regulated savings rates to market rates and review tax incentives for insurance products

Box 2. How to Increase Public Expenditure Efficiency

The fiscal consolidation that started in 2011 was initially supported by revenue-raising measures but is now intended to be fully expenditure-based. However, identifying areas for savings has proved difficult, and there is no clearly articulated consensus on the areas where spending is too high or inefficient. This is in part because of concerns about the social and economic impact of specific spending cuts, in particular the impact on inequality. Spending measures have thus mainly relied on across-the-board savings to limit nominal spending growth. These cuts have focused on central government spending and the health sector, while local governments and social security funds spending have continued to grow faster than GDP.

A shift from a policy of containment to broader and deeper efficiency-oriented reforms would increase the chance of success and the sustainability of the ongoing fiscal consolidation, while protecting the French "social model". The government has recently initiated some steps for structural savings e.g., family allowances, health, and pensions.

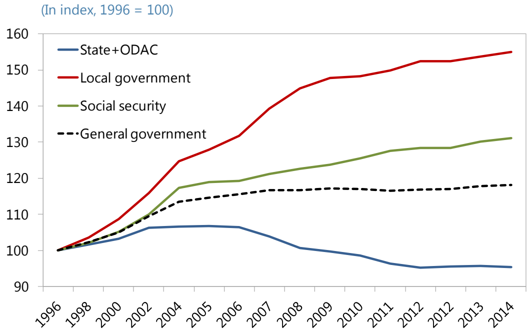
In a recent IMF working paper "From containment to rationalization: Increasing public expenditure efficiency", Hallaert and Queyranne undertake a three-step benchmarking to identify areas where there is scope for greater expenditure efficiency in France, while maintaining or even improving social and economic outcomes consistent with social preferences. First, the level of public expenditure is compared to other European countries with a focus on Germany, Italy, and the United Kingdom. These are large economies with comparable income levels per capita with France. Second, social and economic outcomes in each spending area are assessed against the performance in European peers. Third, the input mix is analyzed to understand what components are responsible for the level of spending and for the quality of outcomes.

This exercise shows that shifting from containment to deeper efficiency-oriented reforms could yield significant fiscal savings. Most could be achieved by rationalizing social benefits and the wage bill, which explain about 90 percent of the difference in the expenditure ratio between France and the EU average as well as the average for Germany, Italy, and the United Kingdom. More specifically:

- The wage bill accounts for 13 percent of GDP and almost one quarter of public spending. Recent efforts have focused on a wage-scale freeze, but low inflation has limited the effectiveness of this approach. Employment reduction (notably at the local level) and limiting the wage drift would promise greater scope for efficiency gains.

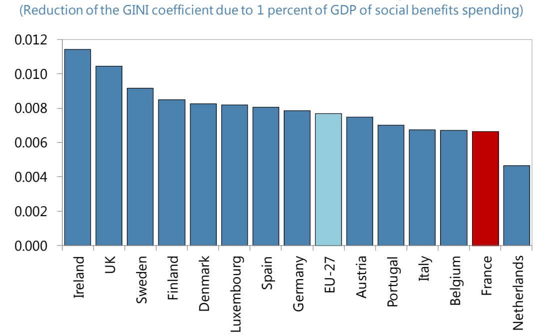
- There is significant scope to improve the impact of fiscal redistribution on inequalities and poverty through reforms of the welfare and pension systems. France has the largest social spending in Europe and the second highest tax-to-GDP ratio, but the reduction in inequality due to transfers is only slightly above the EU average. If the redistributive power of social benefits was at EU average, France could achieve the same reduction in income inequality at a fiscal cost lower by 3.5 percentage points of GDP.

Employment by Levels of Government
(In index, 1996 = 100)



Sources: INSEE and IMF Staff calculations.

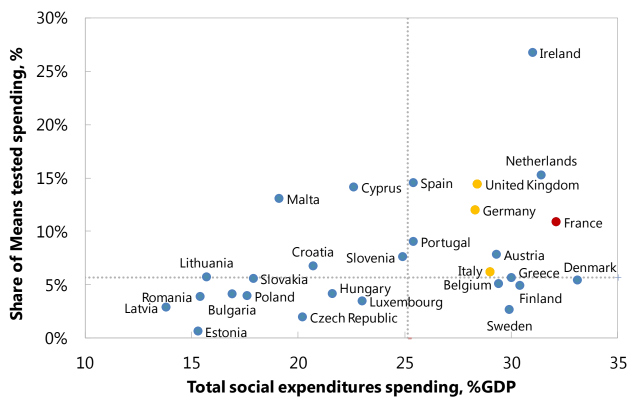
The Redistributive Power of Public Spending
(Reduction of the GINI coefficient due to 1 percent of GDP of social benefits spending)



Sources: EuroStat and IMF Staff calculations.

Box 2. How to Increase Public Expenditure Efficiency (concluded)

Share of Means-tested Social Expenditures in Europe, 2012



Source: IMF Staff calculations.

- Moreover, the social outcomes and poverty impact are uneven. Social protection benefits mostly the elderly due to a generous pension regime. While long-term demographic trends are more favorable than in many European countries, additional pension reforms would support consolidation and, together with a further increase in means-testing of family-related spending, make room for more resources to address child and youth poverty.

- Spending on housing is higher in France than in other European countries but outcomes do not appear much better than in other EU countries. This suggests potential for higher means-testing and lower institutional fragmentation and duplication.

- At over 8 percent of GDP, health spending is high by EU standards. While health outcomes are good, they are similar to comparator countries whose health spending is lower. Building on the National Health Strategy of 2014, France could consider reforms implemented in other countries such as further improving generics market penetration, rationalizing hospital services and streamlining costs, and strengthening cost-effectiveness evaluations to decide which services should be covered by public insurance.

- The unemployment benefits system, which accounts for about two-third of labor market policy spending, is comparatively generous. The reform of the unemployment benefit under negotiations is expected to lead to fiscal saving and reinforce work incentive (see section on unemployment for specific advice)

- The allocation of resources in education is less efficient than in many European countries, particularly at the secondary level, and has failed to address deteriorating test scores and rising educational inequalities. Organizational reforms could help improve both education quality and social outcomes, for instance by better allocating teaching resources to the neediest, rationalizing inefficient spending (especially in secondary education), and improving the targeting of vocational education and training for those who have difficulties getting a job.

- Public investment spending, which is at the European average, should focus more on maintenance rather than expansion given France’s high quality and quantity of infrastructure. Rationalizing local and state-owned enterprises investment would avoid duplication.

Table 1. France: Selected Economic and Social Indicators, 2012–2021

	2012	2013	2014	2015	Projections 2016	2017	2018	2019	2020	2021
Real economy (change in percent)										
Real GDP	0.2	0.6	0.6	1.3	1.5	1.5	1.7	1.7	1.8	1.8
Domestic demand	-0.3	0.7	1.1	1.5	2.1	1.6	1.7	1.7	1.7	1.8
Private consumption	-0.2	0.5	0.7	1.5	1.6	1.5	1.7	1.7	1.7	1.7
Public consumption	1.6	1.5	1.2	1.4	1.2	1.0	0.7	0.5	0.5	0.5
Gross fixed investment	0.2	-0.8	-0.3	1.0	2.9	2.7	2.9	3.2	3.1	3.3
Foreign balance (contr. to GDP growth)	0.5	-0.1	-0.5	-0.3	-0.5	-0.2	-0.1	0.0	0.0	0.0
Exports of goods and services	2.5	1.9	3.3	6.1	2.9	4.3	4.6	4.6	4.7	4.7
Imports of goods and services	0.7	2.1	4.7	6.6	4.3	4.4	4.4	4.3	4.3	4.3
Nominal GDP (billions of euros)	2087	2115	2140	2181	2231	2280	2341	2408	2484	2568
CPI (year average)	2.2	1.0	0.6	0.1	0.2	1.0	1.2	1.5	1.5	1.7
GDP deflator	1.2	0.8	0.5	0.6	0.7	0.7	1.0	1.1	1.3	1.5
Gross national savings (percent of GDP)	21.4	21.5	21.6	22.2	22.2	22.1	22.1	22.1	22.3	22.6
Gross domestic investment (percent of GDP)	22.6	22.3	22.5	22.4	22.7	22.5	22.4	22.4	22.6	22.8
Public finance (percent of GDP)										
General government balance	-4.8	-4.0	-4.0	-3.6	-3.3	-3.0	-2.6	-2.2	-1.6	-1.1
Revenue	52.0	52.9	53.4	53.5	53.2	53.1	53.0	53.0	53.0	53.0
Expenditure	56.8	57.0	57.3	57.0	56.5	56.2	55.6	55.2	54.6	54.1
Structural balance (percent of pot. GDP)	-3.6	-2.6	-2.4	-2.0	-2.0	-2.0	-2.0	-1.8	-1.5	-1.2
Primary balance	-2.4	-1.9	-1.9	-1.7	-1.5	-1.4	-1.0	-0.5	0.1	0.7
General government gross debt	89.6	92.4	95.3	96.1	97.1	97.9	97.8	97.3	96.0	94.0
Labor market (percent change)										
Employment	0.8	0.2	0.1	0.5	0.7	0.5	0.6	0.8	0.7	0.6
Labor force	1.4	0.8	0.1	0.6	0.3	0.2	0.3	0.4	0.4	0.4
Unemployment rate (percent)	9.8	10.3	10.3	10.4	10.0	9.7	9.4	9.1	8.8	8.6
Total compensation per employee	1.4	1.2	1.4	1.0	...	...	...	...	...	...
Credit and interest rates (percent)										
Growth of credit to the private non-financial sectc	2.3	1.3	1.9	3.2	4.1	5.2	5.8	6.1	6.4	6.7
Money market rate (Euro area)	0.1	0.0	0.1	-0.2	...	...	...	...	...	...
Government bond yield, 10-year	2.5	2.2	1.7	0.8	...	...	...	...	...	...
Balance of payments (percent of GDP)										
Exports of goods	20.9	20.7	20.6	21.1	20.2	21.0	21.6	22.0	22.3	22.7
Imports of goods	-23.5	-22.8	-22.2	-22.2	-21.8	-22.5	-23.0	-23.4	-23.8	-24.1
Trade balance	-3.2	-2.8	-2.5	-1.7	-2.1	-2.1	-2.1	-2.1	-2.2	-2.2
Current account	-1.2	-0.8	-0.9	-0.2	-0.5	-0.4	-0.3	-0.3	-0.3	-0.2
FDI (net)	0.7	-0.6	1.0	-0.3	-0.2	0.0	0.2	0.3	0.5	0.6
Official reserves (US$ billion)	54.2	50.8	49.5	48.8	...	...	...	...	...	...
Exchange rates										
Euro per U.S. dollar, period average	0.78	0.75	0.75	0.90	...	...	...	...	...	...
NEER, ULC-styled (2000=100)	100.0	102.1	101.9	97.9	...	...	...	...	...	...
REER, ULC-based (2000=100)	104.7	109.0	111.4	109.3	...	...	...	...	...	...
Potential output and output gap										
Potential output (change in percent)	1.0	1.0	1.0	1.0	1.1	1.1	1.2	1.3	1.4	1.4
Memo: per working age person	0.7	0.6	0.6	0.6	0.7	0.6	0.8	0.9	1.0	1.0
Output gap	-1.7	-2.1	-2.5	-2.2	-1.8	-1.4	-1.0	-0.6	-0.2	0.2

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

Table 2. France: General Government Accounts, 2012–2021

(In percent of GDP unless otherwise indicated)

					Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
General government										
Revenue	52.0	52.9	53.4	53.5	53.2	53.1	53.0	53.0	53.0	53.0
Tax revenue	44.4	45.3	45.7	45.8	45.5	45.4	45.4	45.4	45.4	45.4
Nontax revenue	7.6	7.6	7.7	7.6	7.6	7.7	7.6	7.6	7.6	7.6
Expenditures	56.8	57.0	57.3	57.0	56.5	56.2	55.6	55.2	54.6	54.1
Primary exp.	54.3	54.7	55.2	55.0	54.6	54.5	53.9	53.4	52.8	52.2
Debt service	2.6	2.3	2.2	2.0	1.9	1.7	1.7	1.8	1.8	2.0
Balance 1/	-4.8	-4.0	-4.0	-3.6	-3.3	-3.0	-2.6	-2.2	-1.6	-1.1
Primary balance	-2.4	-1.9	-1.9	-1.7	-1.5	-1.4	-1.0	-0.5	0.1	0.7
Structural balance 2/	-3.6	-2.6	-2.4	-2.0	-2.0	-2.0	-2.0	-1.8	-1.5	-1.2
Central government balance 1/	-3.9	-3.3	-3.5	-3.3	-3.3	-3.1	-2.5	-2.1	-1.7	-1.3
Social security balance 1/	-0.6	-0.4	-0.4	-0.3	0.0	0.0	0.0	0.1	0.1	0.2
Local government balance 1/	-0.2	-0.4	-0.2	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0
ODAC balance 1/	-0.1	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Gross debt 3/	89.6	92.4	95.3	96.1	97.1	97.9	97.8	97.3	96.0	94.0
Memorandum items:										
Nominal GDP (in billion of Euros)	2,087	2,115	2,140	2,181	2,231	2,280	2,341	2,408	2,484	2,568
Potential nominal GDP (in billion of Euros)	2,123	2,161	2,195	2,231	2,271	2,313	2,364	2,422	2,489	2,563
Real GDP growth (in percent)	0.2	0.6	0.6	1.3	1.5	1.5	1.7	1.7	1.8	1.8
Nominal expenditure growth	3.0	1.6	1.8	1.4	1.3	1.6	1.7	2.0	2.1	2.4
Real expenditure growth (in percent)	1.1	0.9	1.4	1.3	1.1	0.6	0.5	0.6	0.6	0.7
of which: primary	1.2	1.5	1.6	1.5	1.3	1.0	0.4	0.4	0.5	0.5
of which: structural primary	0.8	1.6	1.7	1.4	1.3	1.1	0.5	0.5	0.5	0.5

Sources: INSEE and IMF Staff calculations.
1/ Maastricht definition.
2/ In percent of potential GDP.
3/ The debt figure, based on Maastricht definition, does not include guarantees on nongeneral government debt.

Table 3. France: Balance of Payments, 2012–2021
(In percent of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections					
Current account	-1.2	-0.8	-0.9	-0.2	-0.5	-0.4	-0.3	-0.3	-0.3	-0.2
Net exports of goods	-2.6	-2.0	-1.6	-1.1	-1.5	-1.5	-1.4	-1.5	-1.5	-1.5
Exports of goods	20.9	20.7	20.6	21.1	20.2	21.0	21.6	22.0	22.3	22.7
Imports of goods	23.5	22.8	22.2	22.2	21.8	22.5	23.0	23.4	23.8	24.1
Net exports of services	1.2	1.1	0.8	0.4	0.9	1.0	1.0	1.0	1.1	1.1
Exports of services	8.8	9.1	9.7	10.0	9.7	10.0	10.3	10.5	10.7	10.8
Imports of services	7.6	8.1	8.9	9.6	8.8	9.1	9.3	9.5	9.6	9.7
Income balance	2.2	2.3	2.1	2.4	2.0	2.0	2.0	2.0	2.0	2.0
Current transfers	-2.1	-2.1	-2.2	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9	-1.9
Capital and financial account										
Capital account	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	-1.8	-0.8	-0.5	-0.5	-0.4	-0.3	-0.2	-0.2	-0.2	-0.2
Direct investment	0.7	-0.6	1.0	-0.3	-0.2	0.0	0.2	0.3	0.5	0.6
Portfolio investment	-1.9	-2.9	-0.3	1.7	1.7	1.5	1.2	0.8	0.5	0.2
Financial derivatives	-0.7	-0.8	-1.1	0.5	0.6	0.8	0.9	1.0	1.1	1.3
Other investments net	-0.1	3.5	-0.1	-2.8	-2.7	-2.6	-2.6	-2.5	-2.4	-2.3
Reserve assets	0.2	-0.1	0.0	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Errors and omissions	-0.6	-0.1	0.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0

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

Table 4. France: Vulnerability Indicators, 2008–2015

(In percent of GDP unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015
External Indicators								
Exports (annual percentage change, in U.S. dollars)	5.7	-19.6	7.0	15.9	-3.4	5.4	2.7	-12.7
Imports (annual percentage change, in U.S. dollars)	7.7	-20.4	8.3	18.0	-5.3	3.5	1.3	-14.2
Terms of trade (annual percentage change)	-0.6	2.6	-1.4	-2.4	-0.3	1.1	1.1	2.6
Current account balance	-0.9	-0.8	-0.8	-1.0	-1.2	-0.8	-0.9	-0.2
Capital and financial account balance	-0.8	-1.0	-1.2	-2.5	-1.8	-0.8	-0.4	-0.4
Of which								
Inward portfolio investment (debt securities, etc.)	6.2	16.2	4.3	3.6	1.0	5.0	4.0	0.6
Inward foreign direct investment	2.3	0.7	1.4	1.5	1.2	1.2	0.3	1.8
Other investment (net)	-2.9	7.9	4.0	8.4	-0.1	3.5	-0.1	-2.8
Total reserves minus gold								
(in billions of U.S. dollars, end-of-period)	33.6	46.6	55.8	48.6	54.2	50.8	49.5	…
Euros per U.S. dollar (period average)	0.7	0.7	0.8	0.7	0.8	0.8	0.8	0.9
Market Indicators								
Financial Markets								
Public sector debt 1/	68.1	79.0	81.7	85.2	89.6	92.4	95.3	96.1
3-month T-bill yield (percentage points, eop)	1.9	0.4	0.5	0.1	0.1	0.1	-0.03	-0.36
3-month T-bill yield in real terms (percentage points, eop)	0.9	-0.5	-1.3	-2.3	-1.3	-0.6	-0.09	-0.54
US 3 month T-bill	0.0	0.1	0.2	0.0	0.1	0.1	0.04	0.26
Spread with the US T-bill (percentage points, eop)	1.9	0.3	0.3	0.1	0.0	0.1	-0.07	-0.62
5- to 8-year government bond (percentage points, eop)	3.5	3.5	3.3	3.2	2.0	2.3	0.9	0.9
10-year government bond (United States)	2.4	3.6	3.3	2.0	1.7	2.9	2.2	2.2
Spread with US bond (percentage points, eop)	1.1	-0.1	0.1	1.2	0.3	-0.6	-1.3	-1.3
Yield curve (10 year - 3 month, percentage points, eop)	1.6	3.1	2.8	3.0	1.9	2.2	0.9	1.3
Stock market index (period average, 1995=100)	232.0	178.6	200.3	192.1	179.0	211.1	213.4	216.2
Real estate prices (index, Q1-10=100, period average)	106.0	98.5	103.5	109.7	109.1	106.8	104.9	103.0
Credit markets (end-of-period 12-month growth rates)								
Credit to the private sector	6.2	-0.7	5.6	4.4	2.0	0.5	0.5	2.5
Bank credit to households	5.7	2.9	6.0	5.8	2.1	2.4	-1.9	2.6
Housing Loans	7.5	3.7	8.2	6.2	3.0	4.0	-2.7	3.4
Bank credit to nonfinancial enterprises	10.6	-2.1	1.4	4.7	-0.2	-1.1	2.7	3.5
Sectoral risk indicators								
Household sector								
Household savings ratio	15.0	16.2	15.8	15.6	15.1	14.3	14.4	14.5
Household financial savings ratio	4.2	7.1	6.5	6.1	5.6	5.3	6.1	0.0
Real estate household solvency ratio (index, 2001=100) 2/	101	102.0	99.4	100.9	98.2	98.5	…	…
Corporate sector								
Profitability of business sector (financial margin)	39.5	37.3	37.9	37.4	36.5	35.9	35.7	…
Investment ratio	21.6	20.0	20.4	21.0	21.0	21.1	21.4	…
Savings ratio	16.8	16.7	18.9	18.2	16.4	16.8	17.3	…
Self-financing ratio	72.1	77.7	85.6	80.3	72.3	73.7	74.9	…
Banking sector								
Share of housing loans in bank credit to the private sector	37.6	39.2	40.2	40.8	41.2	42.6	41.3	41.6
Share of nonperforming loans in total loans	2.8	3.6	3.5	3.5	4.0	4.5	4.0	3.9
Ratio of nonperforming loans net of provisions to capital	8.2	10.8	10.0	9.2	10.7	11.4	9.6	9.1
Liquid assets to total short-term liabilities	139.6	150.1	144.4	136.3	164.0	165.2	178.5	17.5
Return on assets	0.1	0.3	0.6	0.4	0.3	0.4	0.4	0.6
Return on equity	3.8	6.4	11.8	8.2	6.6	8.1	6.2	9.2
Regulatory capital to risk-weighted assets	10.5	12.4	12.5	12.2	14.0	15.1	15.3	16.6

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

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

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

Table 5. France: Core Financial Soundness Indicators, 2008–2015

	2008	2009	2010	2011	2012	2013	2014	2015 Estimate
Deposit-taking institutions 1/								
Regulatory capital to risk-weighted assets	10.5	12.4	12.5	12.2	14.0	15.1	15.3	16.6
Regulatory Tier I capital to risk-weighted assets	8.5	10.2	10.7	10.9	13.3	13.2	13.6	13.8
Nonperforming loans net of provisions to capital	8.2	10.8	10.0	9.2	10.7	11.4	9.6	9.1
Bank provisions to Nonperforming loans	131.0	109.5	112.0	115.3	106.7	104.7	103.8	104.2
Nonperforming loans to total gross loans	2.8	3.6	3.5	3.5	4.0	4.5	4.0	3.9
Sectoral distribution of loans to total loans, of which								
Deposit-takers	33.6	5.0	36.5	40.2	40.7	39.2	39.1	38.5
Nonfinancial corporation	18.3	17.5	20.5	19.2	18.8	19.0	19.5	18.8
Households (including individual firms)	24.1	24.5	30.5	28.7	28.9	30.3	29.8	28.1
Nonresidents (including financial sectors)	4.7	4.6	6.1	5.9	5.6	5.4	5.5	5.3
ROA (aggregated data on a parent-company basis) 2/	0.0	0.4	0.3	0.0	0.2	0.4	0.2	0.3
ROA (main groups on a consolidated basis) 3/	0.1	0.3	0.6	0.4	0.3	0.4	0.4	0.6
ROE (aggregated data on a parent-company basis) 2/	-1.0	8.2	7.9	1.2	5.5	10.1	4.4	7.7
ROE (main groups on a consolidated basis) 3/	3.8	6.4	11.8	8.2	6.6	8.1	6.2	9.2
Interest margin to gross income	40.4	34.9	49.4	51.5	41.4	43.7	44.1	41.3
Noninterest expenses to gross income	84.2	63.1	65.7	67.4	63.2	66.5	67.8	65.5
Liquid assets to total assets 4/	18.3	18.3	23.0	24.1	26.2	30.6	27.1	12.5
Liquid assets to short-term liabilities 4/	139.6	150.1	144.4	136.3	164.0	165.2	178.5	17.5

Sources: Banque de France, ACPR.

1/ These may be grouped in different peer groups based on control, business lines, or group structure.
2/ All credit institutions' aggregated data on a parent-company basis.
3/ Consolidated data for the seven main banking groups (2005, IFRS).
4/ 2015 data is based on new methodology which is not comparable to older figures.

Table 6. France: Encouraged Financial Soundness Indicators, 2008–2015

(In percent unless otherwise indicated)

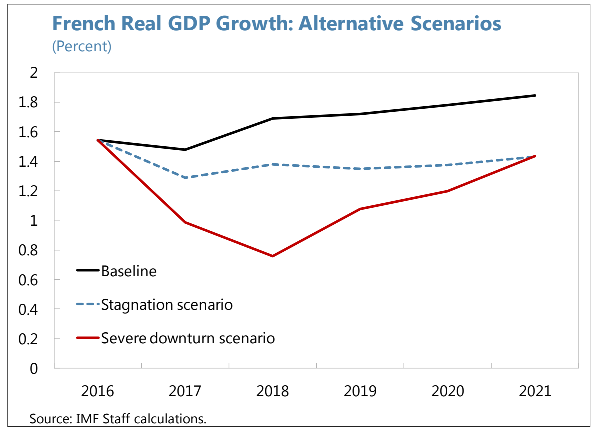
	2008	2009	2010	2011	2012	2013	2014	2015 Estimate
Corporate sector								
Total debt to equity	86.1	83.9	79.0	86.1	93.5	90.5	96.3	89.4
Return on equity	11.2	8.0	7.9	8.1	8.1	7.0	7.0	6.9
Interest paid to financial firms 1/	...	...	...	...	...	...	...	...
Corporate net foreign exchange exposure to equity	...	...	...	...	...	...	...	...
Number of enterprise bankruptcies (thousands)	55.6	63.2	60.3	59.5	61.1	62.5	62.4	63.2
Number of enterprise creations (thousands)	331.4	580.2	622.0	549.8	550.0	538.2	550.8	525.1
Deposit-taking institutions								
Capital (net worth) to assets	4.2	4.5	4.6	5.5	4.8	5.5	5.8	6.3
International consolidated claims of French banks, of which (BIS data, as percent of total international claims)								
Advanced countries	84.2	83.3	79.8	79.4	78.0	78.6	77.6	77.5
Developing Europe	4.3	4.6	5.7	6.0	7.1	6.8	6.7	6.6
Latin America and Caribbean	1.1	1.2	1.4	1.4	1.5	1.4	1.5	1.8
Africa and Middle East	3.1	3.5	4.4	5.1	5.2	4.2	4.3	4.4
Asia and Pacific Area	2.6	2.9	4.0	3.6	4.1	4.8	5.6	4.6
Offshore Financial Centers	4.7	4.4	4.7	4.6	4.1	4.2	4.4	4.1
Gross asset position in financial derivatives to capital	633.2	362.7	286.2	388.8	346.2	205.8	238.2	190.2
Gross liability position in financial derivatives to capital	616.3	361.9	286.7	388.0	346.0	206.8	238.7	188.1
Large exposures to capital	3.1	4.1	14.1	26.9	7.6	5.4	5.5	6.1
Trading income to total income	-63.9	16.4	10.3	-13.2	6.4	10.6	-0.1	-6.7
Personnel expenses to noninterest expenses	51.6	61.1	44.9	42.1	36.0	32.7	35.1	34.2
Spread between reference lending and deposit rates	218.3	236.4	244.4	224.7	217.2	217.7	229.9	228.0
Spread between highest and lowest interbank rate	...	...	...	...	...	...	...	...
Customer deposits to total (noninterbank) loans	78.0	85.3	79.5	78.4	67.9	70.1	82.6	84.5
FX loans to total loans 2/	10.5	10.4	9.8	8.9	8.4	7.6	8.0	8.4
FX liabilities to total liabilities	16.8	15.3	16.4	15.4	13.9	14.3	16.2	17.6
Net open position in equities to capital	...	...	...	...	...	...	...	...
Market liquidity								
Average bid-ask spread in the securities market 3/	...	...	...	...	...	...	...	...
Average daily turnover ratio in the securities market	...	...	...	...	...	...	...	...
Other financial corporations								
Assets to total financial system assets	15.6	16.5	16.8	15.7	16.2	16.7	17.0	16.8
Assets to GDP	151.8	176.5	183.5	172.0	183.7	189.2	200.1	209.0
Households								
Household debt to GDP	47.7	51.7	52.9	54.0	54.4	54.8	55.4	55.5
Household debt service and principal payments to income	11.7	12.3	13.2	13.1	12.5	12.8	12.0	11.2
Real estate markets								
Real estate prices	-3.8	-4.1	7.6	3.7	-2.1	-1.9	-2.5	-0.2

Sources: Banque de France ; ACPR ; BIS.

1/ In percent of financial firms' gross operating surplus.
2/ Data cover interbank and customer lending to residents and nonresidents on a metropolitan basis.
3/ Or in other markets that are most relevant to bank liquidity, such as foreign exchange markets.
4/ Other indicators such as additional balance sheet data (e.g. maturity mismatches in foreign currency), data on the life insurance sector, or information on the corporate and household sector may be added where available and relevant.

Appendix I. Growth Shock Scenarios[1]

This appendix describes the shocks simulated for the euro area to generate the "stagnation" and "severe downturn" scenarios in the fiscal policy section. The shocks are in line with those contemplated in the Selected Issues Paper for the 2016 Euro Area Article IV.



Source: IMF Staff calculations.

- **Stagnation scenario.** This scenario examines the impact of a demand shock in the euro area that triggers prolonged stagnation. In this scenario, France's growth persistently disappoints, falling to around 1.4 percent in 2017 and only gradually increasing to 1.5 percent by the end of the projection period. The shock is triggered by a drop in investor confidence due to lower growth expectations or the slow progress in reforms pushing down equity prices and raising the real corporate interest rate by about 0.5 percent, cumulatively, by 2021. This, in turn, reduces real investment by around 2.3 percent on average, annually, during 2017–21. As a result, the output gap persists over the medium term, reflecting an assumed decline in the annual growth rate of total factor productivity by 0.1 percentage point each year in 2017–21. This reduces real GDP in cumulative terms by 1.7 percent by 2021 relative to the baseline as, alongside slower capital accumulation, consumption grows significantly less rapidly in cumulative terms than in the baseline scenario (-1.8 percent). Unemployment is 0.6 percentage points higher and employment 0.6 percent lower than in the baseline by 2021. Alongside, inflation remains slightly positive but well below a rate consistent with the ECB's objective, increasing only very slowly to 1 percent by the end of the forecast horizon. The external environment outside the euro area is unchanged from the April 2016 WEO baseline of an uneven, fragile global recovery. The euro area environment, excluding France suffers similar stagnation as in France (with euro area GDP growth assumed to fall to an average of 1.1 percent over 2017–21) and is described in detail in the forthcoming Selected Issues Paper for the 2016 Euro Area Article IV.

- **Severe economic downturn in the short term followed by stagnation**. In a severe economic downturn, France's growth would fall slightly below one percent in the near term before recovering over the medium term. The scenario combines a near-term global slowdown with an investment demand shock in France, and in the euro area more generally, due to weaker confidence and financial stress. On the supply side, potential growth declines slightly as a result of lower investment and some financial disintermediation. Outside the euro area, real growth is lower by ½ percentage point each year in 2017, relative to the April 2016 WEO. The global slowdown and heightened risk aversion lead to a sharp drop in investor confidence in France and the euro area, reducing real investment in France by 2.2 percent on average, annually, during 2017–18 and by 6½ percent on average, annually, thereafter, also due to an increase in the real cost of capital. Inflation expectations and TFP are

[1] Prepared by Nicoletta Batini (EUR).

assumed to behave as in the stagnation scenario. By the end of the forecast period, real GDP is 3 percent lower in cumulative terms relative to baseline, and consumption and employment 2.9 and 7½ percent lower, and unemployment 1½ percentage points higher. Under this scenario, inflation falls to zero.

Appendix II. Debt Sustainability Analysis[1]

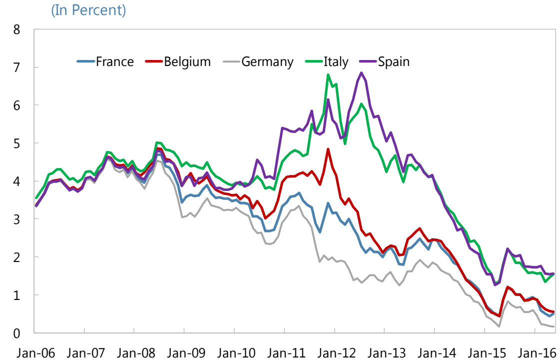
Under the baseline scenario, the debt-to-GDP ratio is projected to peak at 97.9 percent in 2017 and to decline to 94 percent by 2021 as economic recovery gains traction and the primary balance shifts to a surplus starting in 2020. Due to the maturity structure of the French debt, gross financing needs increase to about 9 percent of GDP in 2015–17 but would decline thereafter. The debt-to-GDP ratio in 2015 is expected to be better than forecast previously mainly due to the base effect of the revision of the 2014 debt ratio, high emission premium, a smaller primary deficit, and lower real interest rates. However, by the end of the projection period, the debt-to-GDP ratio is projected to be higher than was forecast previously due to weaker nominal GDP growth and slower pace of adjustment. Accordingly, public debt is expected to be at or above 94 percent of GDP throughout the projection period and presents vulnerabilities as illustrated by the stress scenarios. The debt ratio would be bumped up significantly in the event of a growth shock. The impact of lower fiscal consolidation and higher interest rate remains comparatively more limited.

Background. The combined effect of low growth over several years and the persistence of high fiscal deficits, augmented by the fiscal stimulus of 2009, have increased the debt-to-GDP ratio by 31.3 percentage points in eight years, to 96.1 percent in 2015. Despite ongoing fiscal consolidation, the debt ratio is projected to continue to increase in the short term, peaking at 97.9 percent of GDP in 2017, and decline thereafter.

Yields on French debt are at close to their historical low. The flattening of the yield curve that occurred in 2014 has been supported by QE. The benchmark yield (10 years) has declined from 4.7 percent in June 2008 to 0.5 percent end-May 2016. The spreads over German Bunds, which had increased to almost 190 basis points in November 2011, were at about 35 basis points end-May 2016.

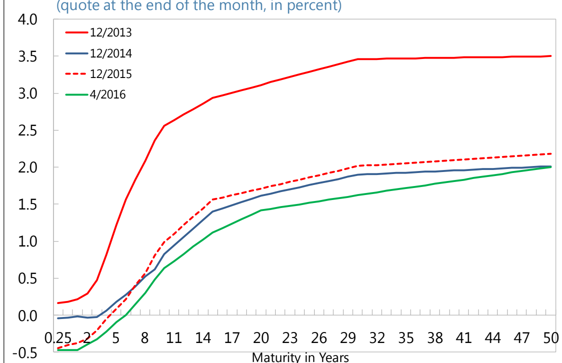
Owing to the sharp decline in interest rates and inflation,[2] the rising debt has had a limited impact on the debt service. Interest payments were at the historically low level of 2.0 percent of GDP in 2015[3] and are projected to be even lower during the projection period.

10 Year Sovereign Yields
(In Percent)



Source: Thomson Financial/Datastream.

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



Sources: French Authorities and Bloomberg.

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

[2] 11 percent of French debt is indexed on inflation.

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

Baseline. Staff projects that the debt-to-GDP ratio will peak at 97.9 percent in 2017 and then decline to 94 percent in 2021. Interest rates are projected to decline in 2016 before steadily increasing. As a result, interest payments would remain at a historically low level but are projected to decline to 1.7 percent of GDP in 2017 and 2018 before increasing to 2 percent of GDP in 2021.

- **Macroeconomic assumptions.** Recent growth performance has been affected by the weak external environment and the drag caused by large structural fiscal adjustment in 2011–13. After several years of near-stagnation, the economy grew by 1.3 percent in 2015, and growth is expected to rise steadily to 1.8 percent by the end of the projection period, with the output gap closed in 2021.

- **Fiscal outlook.** The pace of structural adjustment has slowed. Reaching 1 percentage point per year in 2011–13, it has slowed to 0.3 percentage point per year in 2014–15, and is projected, in the baseline, to average 0.1 percent during 2016–21. Primary balance would be above its debt stabilizing level starting in 2018 and shift to a surplus in 2020.

- **Debt levels and gross financing needs.** The gross financing needs remain below the 20 percent threshold even under the stress tests. Part of the increase in the debt ratio reflects financial support to other Euro area countries which grew from 0.2 percent of GDP in 2010 to 3.2 percent of GDP in 2014.[4] This support started to decline in 2015 (3.0 percent of GDP).

Realism of Projections. The median forecast error for real GDP growth during 2007–15 is -1.22 percent suggesting there is an upward bias in the staff projections. The median forecast bias for inflation stands at 0.18 percent suggesting again a slight downward bias in the staff projections. At -0.56 percent, the median forecast error for primary balance suggests that staff projections have proved slightly optimistic.

The debt-to-GDP ratio in 2015 is lower by 1.2 percentage point than forecast in the Staff report for the 2015 Article IV Consultation. Most of the impact is explained by high emission premium,[5] but also by the base effect of a downward revision of the debt ratio in 2014, lower primary deficit, and to a smaller extent by lower interest rates. However, at the end of the projection period, the debt-to-GDP ratio is projected to be higher than was forecast due to weaker nominal GDP growth and slower pace of fiscal adjustment.

The projected fiscal adjustment appears feasible. Cross-country experience also suggests that fiscal adjustment projections are realistic. The projected adjustment and level of the CAPB are below the thresholds that would cast doubt on the feasibility of the adjustment, based on high debt

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

[5] The interest rates on state auctioned debt were higher than the market rates. As a result, the debt was purchased at a higher value than its reimbursement value, which is used to calculate the debt under the Maastricht rules. The increase in debt was 1 percent of GDP lower than the state fiscal deficit. In contrast, in 2014, the increase in the state debt was broadly similar to the fiscal deficit.

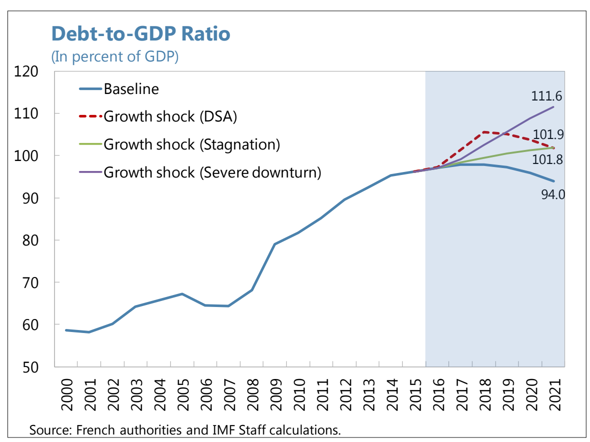
country experience. More specifically, at 1.2 percent of GDP, the largest projected adjustment over any three years during the projection is below the threshold of 3 percent of GDP. In addition, the maximum average level of the cyclically-adjusted primary deficit for any consecutive 3-year period during the projection horizon reaches is 0.3 percent of GDP, well below than the threshold of 3.5 percent of GDP.

Heat map. Risks levels from the debt level are deemed high given that the relevant threshold to which France's values are compared is 85 percent and this threshold is breached under baseline and all stress test scenarios. In contrast, France's gross financing needs remain below the benchmark of 20 percent of GDP in the baseline and all stress test scenarios. The debt profile remains below relevant thresholds except for the share of public debt held by foreigners. As of end-December 2015, foreigners held 61.9 percent of French debt, a level substantially lower than the peak of 70.6 percent reached in mid-2010.

Shocks and Stress Tests. The DSA framework suggests that France's government debt-to-GDP ratio would not exceed 106 percent and its gross financing needs would not exceed 12 percent of GDP under different standard macroeconomic and fiscal shocks.

- **Growth shocks.** Under this scenario, real output growth rates are lower by one standard deviation over 2017–18, i.e. 1.6 percentage points relative to the baseline scenario. The assumed decline in growth leads to lower inflation (0.25 percentage points per 1 percentage point decrease in GDP growth) and the interest rate is assumed to increase 25 basis points for every 1 percent of GDP worsening of primary balance. Under this scenario, the debt-to-GDP ratio would increases to 105.6 percent of GDP in 2018 and declines thereafter.

  In addition to this standard shock, staff undertook two alternative growth shocks described in Appendix I. In the "stagnation scenario," France real GDP growth would reduced on average by 0.3 percentage point each year over 2016–21. Under this scenario, the debt-to-GDP ratio would steadily increase reaching 101.9 percent of GDP in 2021. In the "severe downturn scenario," France real GDP growth would be reduced on average by 0.6 percentage point each year over 2016–21. Under this scenario, the debt-to-GDP ratio would steadily increase reaching 111.6 percent of GDP in 2021.



- **Primary balance shock.** This scenario examines the implications of a dual shock of lower revenues and rise in interest rate, leading to a cumulative 1.1 percent deterioration in the primary balance over 2017–21. Under this scenario, the debt-to-GDP ratio would increase to 100.1 percent of GDP in 2018 and declines thereafter.

- **Interest rate shock.** This scenario assumes an increase of 246 basis points increase in the cost of debt throughout the projection period. The deterioration of public debt and gross financing needs are back-loaded as old debt gradually matures[6] and new higher interest rate debt is contracted. In 2021, the impact on the gross financing needs is less than 1 percent of GDP and less than 2¼ percentage points for the debt-to-GDP ratio.

- **Real exchange rate shock.** This scenario assumes 13 percent devaluation of the real exchange rate in 2017 and examines the impact on debt through the inflation channel. Under this scenario, the debt-to-GDP ratio would be marginally larger (0.2 percentage point at most) than in the baseline.

- **Combined macro-fiscal shock.** This scenario aggregates shocks to real growth, the interest rate, the exchange rate, and the primary balance while taking care not to double-count the effects of individual shocks. Under this scenario, debt would reach 105.8 percent of GDP in 2018 and decline to 103.6 percent of GDP in 2021. The gross financing needs would peak at 11.7 percent of GDP in 2018, which remains below the 20 percent benchmark considered by the heat map.

Authorities' views. *The authorities project a debt profile similar to staff's with the debt ratio also starting to decline in 2018. However, they expect the debt-to-GDP ratio to be slightly lower and to decline faster than staff on account of faster nominal growth and fiscal consolidation in the second half of the projection period. They do not consider that relatively large share of public debt held by non-resident to be a vulnerability as investors in French debt are both institutionally and geographically diversified. The authorities noted that France benefits from a structural demand from central banks, which are net, stable, and recurrent purchasers with limited sensitivity to changes in interest rates.*

[6] As of end April 2016, the average maturity of debt is 7 years and 108 days.

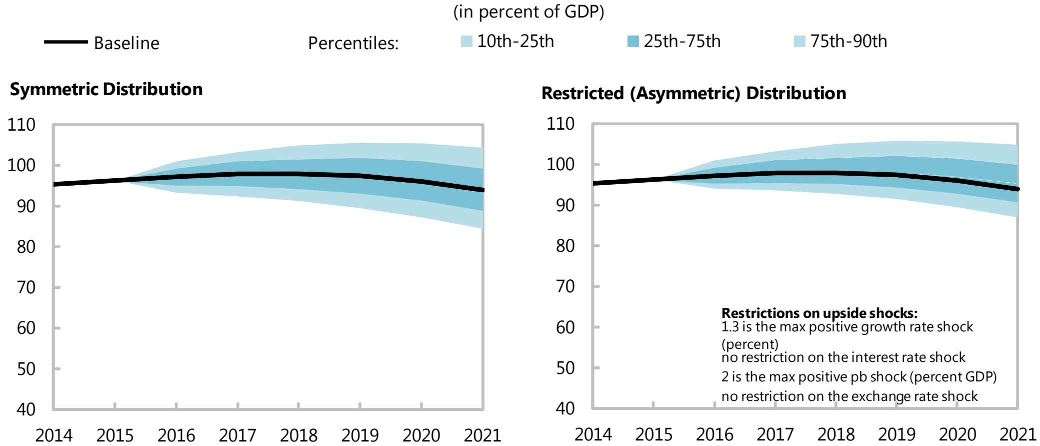
France: Public DSA Risk Assessment

Heat Map

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

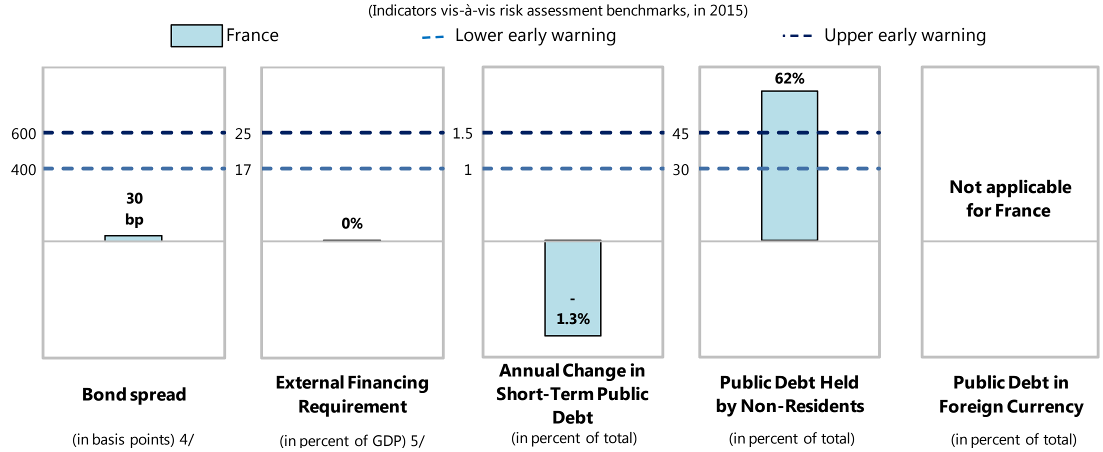
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



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.

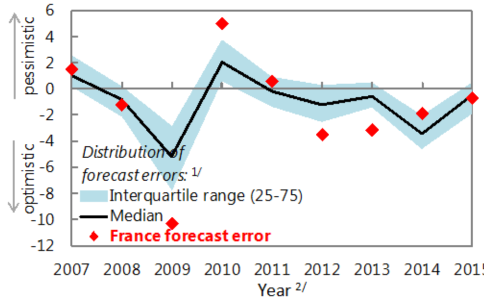
4/ Long-term bond spread over German bonds, an average over the last 3 months, 02-Mar-16 through 31-May-16.

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

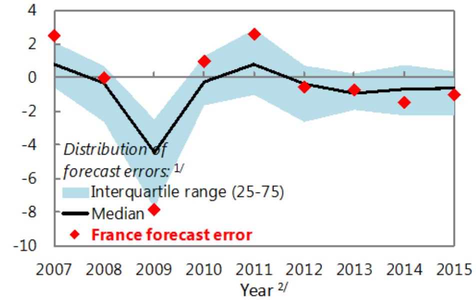
France: Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

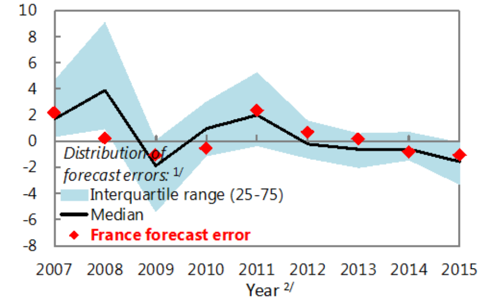
Real GDP Growth
(in percent, actual-projection)
France median forecast error, 2007-2015: -1.22
Has a percentile rank of: 20%



Primary Balance
(in percent of GDP, actual-projection)
France median forecast error, 2007-2015: -0.56
Has a percentile rank of: 51%

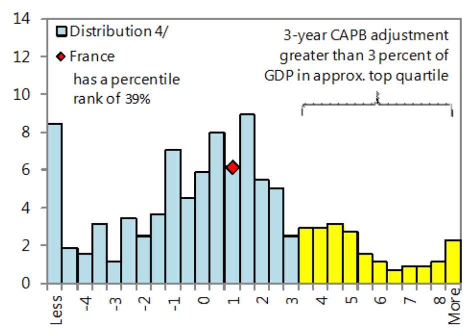


Inflation (Deflator)
(in percent, actual-projection)
France median forecast error, 2007-2015: 0.18
Has a percentile rank of: 51%

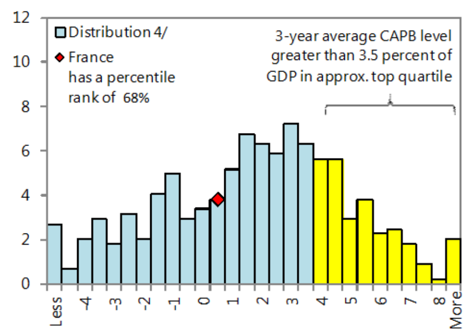


Assessing the Realism of Projected Fiscal Adjustment

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

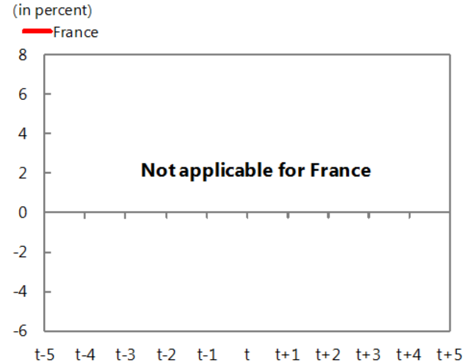


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



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

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

(In percent of GDP unless otherwise indicated)

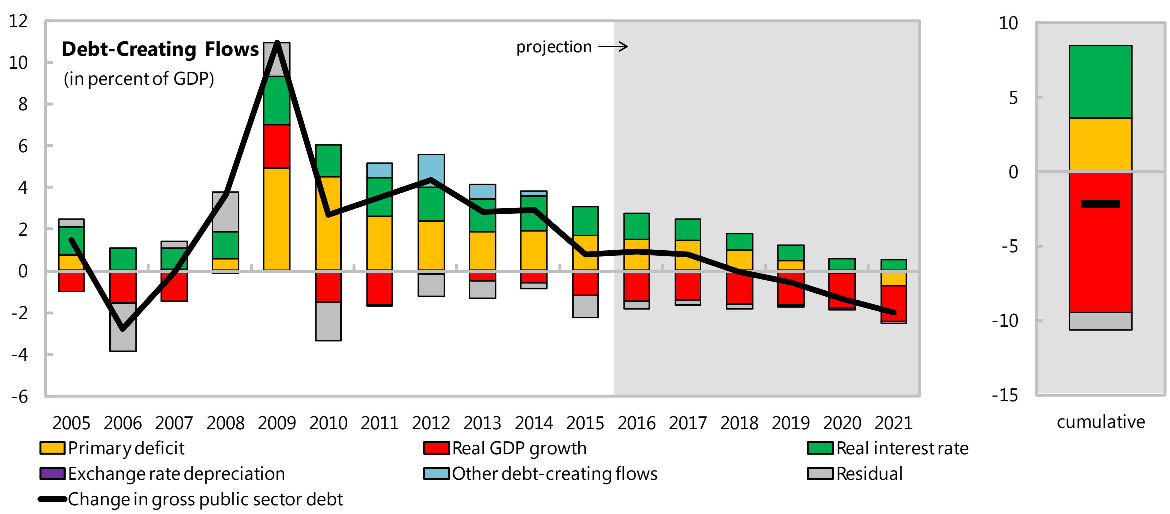
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	76.9	95.3	96.1	97.1	97.9	97.8	97.3	96.0	94.0
Public gross financing needs	8.4	8.1	8.9	8.9	9.2	8.7	7.9	6.8	4.4
Real GDP growth (in percent)	0.9	0.6	1.3	1.5	1.5	1.7	1.7	1.8	1.8
Inflation (GDP deflator, in percent)	1.5	0.5	0.6	0.7	0.7	1.0	1.1	1.3	1.5
Nominal GDP growth (in percent)	2.4	1.2	1.9	2.3	2.2	2.7	2.9	3.2	3.4
Effective interest rate (in percent) [4/]	3.6	2.4	2.1	2.0	1.8	1.8	1.9	2.0	2.1

As of May 31, 2016		
Sovereign Spreads		
EMBIG (bp) 3/		34
5Y CDS (bp)		37
Ratings	Foreign	Local
Moody's	Aa2	Aa2
S&Ps	AA	AA
Fitch	AA	AA

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing
Change in gross public sector debt	3.0	2.9	0.8	0.9	0.8	0.0	-0.5	-1.3	-2.0	-2.2	primary
Identified debt-creating flows	3.2	3.2	1.9	1.3	1.0	0.2	-0.4	-1.2	-1.9	-1.0	balance [9/]
Primary deficit	2.0	1.9	1.7	1.5	1.4	1.0	0.5	-0.1	-0.7	3.6	-1.2
Primary (noninterest) revenue and gra	50.3	53.3	53.3	53.1	53.0	52.9	52.9	52.9	52.9	317.7	
Primary (noninterest) expenditure	52.3	55.2	55.0	54.6	54.5	53.9	53.4	52.8	52.2	321.3	
Automatic debt dynamics [5/]	0.9	1.1	0.2	-0.2	-0.4	-0.8	-0.9	-1.1	-1.2	-4.7	
Interest rate/growth differential [6/]	0.9	1.1	0.2	-0.2	-0.4	-0.8	-0.9	-1.1	-1.2	-4.7	
Of which: real interest rate	1.5	1.7	1.4	1.2	1.0	0.8	0.7	0.6	0.5	4.8	
Of which: real GDP growth	-0.7	-0.6	-1.2	-1.4	-1.4	-1.6	-1.6	-1.7	-1.7	-9.5	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euro	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.2	-0.3	-1.1	-0.4	-0.3	-0.2	-0.1	-0.1	-0.1	-1.1	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

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

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

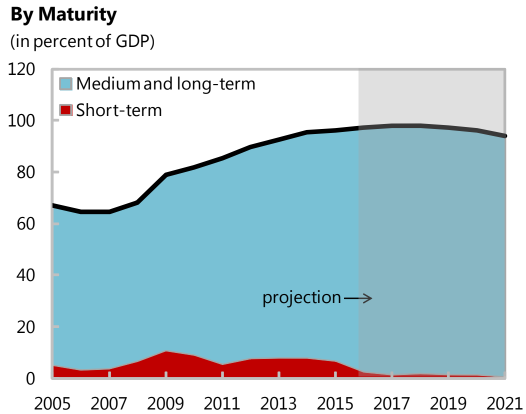
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

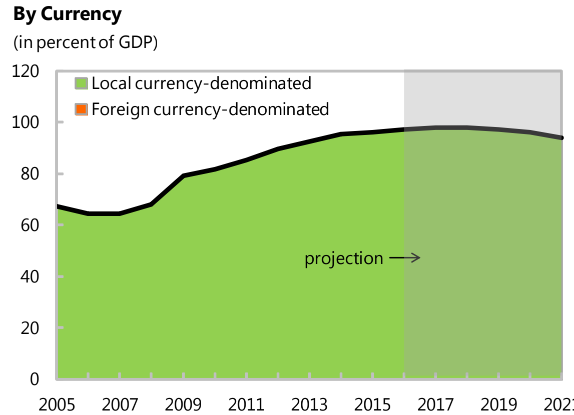
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

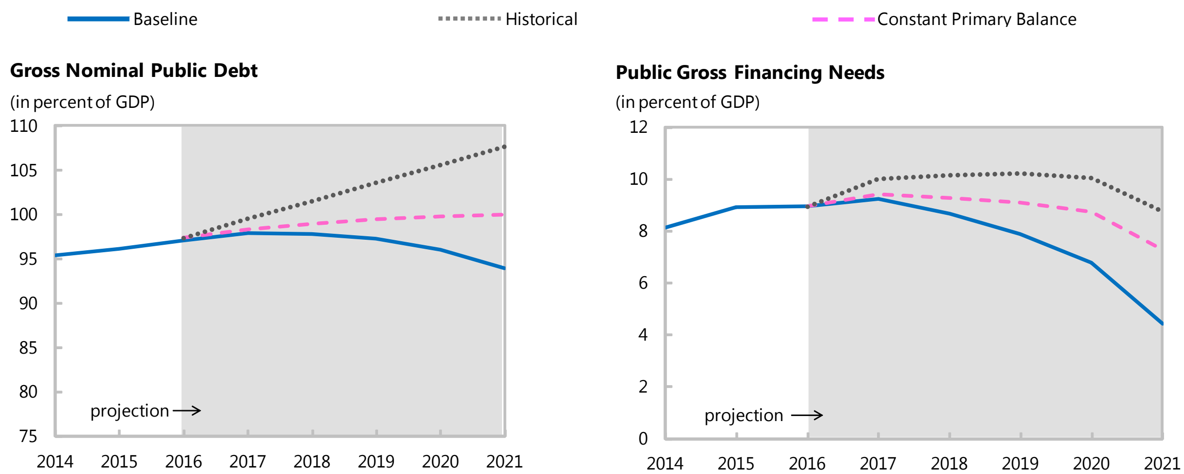
France: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt





Alternative Scenarios



Underlying Assumptions
(in percent)

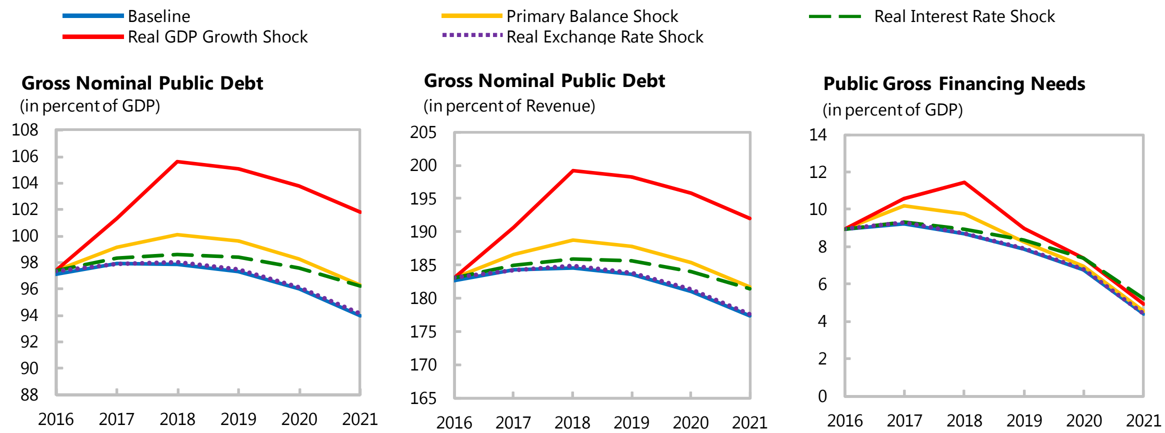
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	1.5	1.7	1.7	1.8	1.8
Inflation	0.7	0.7	1.0	1.1	1.3	1.5
Primary Balance	-1.5	-1.4	-1.0	-0.5	0.1	0.7
Effective interest rate	2.0	1.8	1.8	1.9	2.0	2.1
Constant Primary Balance Scenario						
Real GDP growth	1.5	1.5	1.7	1.7	1.8	1.8
Inflation	0.7	0.7	1.0	1.1	1.3	1.5
Primary Balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	2.0	1.8	1.8	1.9	2.0	2.2

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	0.9	0.9	0.9	0.9	0.9
Inflation	0.7	0.7	1.0	1.1	1.3	1.5
Primary Balance	-1.5	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.0	1.8	1.9	2.1	2.3	2.6

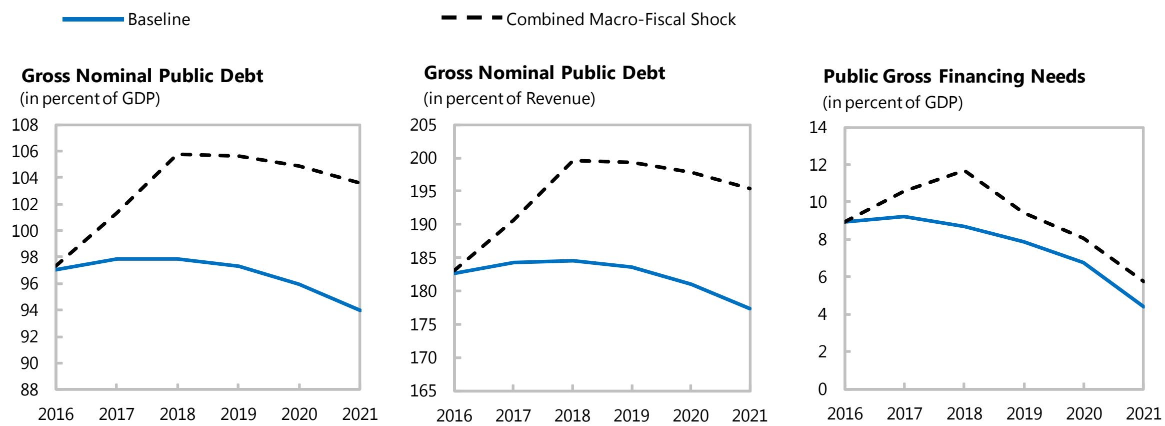
Source: IMF staff.

France: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	1.5	1.7	1.7	1.8	1.8
Inflation	0.7	0.7	1.0	1.1	1.3	1.5
Primary balance	-1.5	-2.3	-1.8	-0.5	0.1	0.7
Effective interest rate	2.0	1.8	1.9	1.9	2.0	2.2
Real Interest Rate Shock						
Real GDP growth	1.5	1.5	1.7	1.7	1.8	1.8
Inflation	0.7	0.7	1.0	1.1	1.3	1.5
Primary balance	-1.5	-1.4	-1.0	-0.5	0.1	0.7
Effective interest rate	2.0	1.8	2.0	2.3	2.5	2.8
Combined Shock						
Real GDP growth	1.5	-0.1	0.1	1.7	1.8	1.8
Inflation	0.7	0.3	0.6	1.1	1.3	1.5
Primary balance	-1.5	-2.5	-3.2	-0.5	0.1	0.7
Effective interest rate	2.0	1.8	2.1	2.4	2.6	2.9

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	1.5	-0.1	0.1	1.7	1.8	1.8
Inflation	0.7	0.3	0.6	1.1	1.3	1.5
Primary balance	-1.5	-2.5	-3.2	-0.5	0.1	0.7
Effective interest rate	2.0	1.8	1.9	2.0	2.1	2.2
Real Exchange Rate Shock						
Real GDP growth	1.5	1.5	1.7	1.7	1.8	1.8
Inflation	0.7	1.1	1.0	1.1	1.3	1.5
Primary balance	-1.5	-1.4	-1.0	-0.5	0.1	0.7
Effective interest rate	2.0	1.8	1.8	1.9	2.0	2.1

Source: IMF staff.

Appendix III. France: Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Impact on France if Realized	Policy response
Tighter or more volatile global financial conditions	**Medium** Investors reassess underlying risk and move to safe haven assets	**Medium** French banks are exposed to a globally systemic closure in funding markets. But inward spillovers from global financial market volatility have been limited in recent years	Ensure ex ante that banks reduce reliance on wholesale funding. The ex-post fiscal and monetary response depends on the nature of the shock
British voters choose to leave the EU	**High** A period of elevated financial volatility and heightened economic and political uncertainty could ensue, with potential for contagion.	**Medium** The main near-term channel would be financial spillovers. Political uncertainty across the EU could weaken confidence and the growth outlook.	Work with European partners to minimize disruption.
Structurally weak growth in key advanced and emerging economies	**High/ Medium** Weak advanced economy demand and persistently low inflation could take a toll through trade and investment links.	**Medium** Automatic stabilizers mitigate short-run impact. But entrenched unemployment and limited fiscal space would make it difficult to exit low growth trap	Continue with and deepen structural reforms to lift output growth and reduce structural unemployment
Weak implementation of fiscal and structural policy commitments	**Medium** Political resolve for reform may wane in the face of protracted low growth and popular discontent.	**Medium** Reversal of commitments could undermine investment and growth, adversely impact public debt dynamics, and eventually trigger adverse market reactions.	
Financial imbalances from protracted period of low interest rates	**Medium** Corporate borrowers may become excessively leveraged, while margins of life insurers and mortgage lenders get squeezed. Search for yield results in asset price bubbles.	**Medium (over medium term)** Large refinancing of mortgages poses medium-term risk for bank profitability, while impact on life insurers may build over time (mitigated by annual adjustment of guaranteed rates of return).	Monitor lending standards and risks Monitor life insurance sector and take policy action as needed
Changes in forthcoming regulatory landscape larger than expected	**Medium** Risks from regulatory uncertainty (e.g. on risk weighted assets, leverage ratio)	**Medium (over medium term)** Banks could be required to raise more capital, reducing their profitability and ability to provide credit to the economy	Promote continued restructuring and cost cutting efforts by banks
Dislocation in labor flows, sharp rise in migrant flows, with negative global spillovers	**High** Sharp rise in migrant flows, with negative global spillovers	**Low/Medium** The migrant crisis will have a relatively minor immediate fiscal impact, but the medium-term impact will depend on the speed of integration of migrants into the workforce	Adopt proactive policies to integrate migrants, including active labor market policies, strengthening language and skill training

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Appendix IV. External Sector Report

Foreign asset and liability position and trajectory	**Background**. After averaging near balance in the four years before the global crisis, the net international investment position (NIIP) deteriorated to around 17 percent of GDP in 2015Q3, reflecting current account deficits and valuation losses (the latter accounting for almost 20 percent of the deterioration in the NIIP since 2007). The deterioration in NIIP has been mainly driven by increases in public sector liabilities, reflecting rising public debt held by foreigners. However the net position masks large gross positions, particularly for banks, reflecting their global activities which grew steadily in the pre-crisis period. Since the crisis, the gross asset position has declined moderately and stood at 295 percent of GDP in 2015. More than three-quarters of French bank exposures are to advanced economies, with the share of major emerging market exposures now reaching 8 percent of total foreign claims. The value of emerging market exposures could fall in the medium-term, causing a moderate decline in the gross asset position and in the net IIP. Public external debt accounts for about 19 percent of the gross liability position. Stability of the French public debt market is an important element of euro-zone financial stability. **Assessment**. The NIIP is negative but its size and trajectory do not raise sustainability concerns. However, there are vulnerabilities due to the external public debt on the liability side.
Current account	**Background**. The current account has deteriorated from a surplus of almost 4 percent of GDP in the late 1990s to an estimated deficit of 0.2 percent in 2015, mostly due to structural factors (the cyclically-adjusted deficit is estimated at -0.8 percent of GDP). The deterioration originates from a worsening net saving position of the private sector and higher government deficits in equal proportions, but it has attenuated between 2014 and 2015 by virtue of positive shocks to the terms of trade (notably oil) and because of a weakening of the euro in real effective terms. The current account is projected to deteriorate marginally in 2016 to 0.5 percent of GDP, reflecting in part higher projected oil prices. **Assessment**. The staff assesses the 2015 cyclically-adjusted current account to be ½ to 2½ percent of GDP below its norm. This is consistent with the EBA model estimate that the cyclically-adjusted current account is about 1¾ percent of GDP weaker than the value consistent with medium-term fundamentals and desirable policy settings. Recent developments, including the depreciation of the euro and lower oil prices, suggest some strengthening of the external position in 2016. Over the medium term, the current account deficit is projected to remain closely around balance, as imports pick up in line with domestic demand. The gradual elimination of the fiscal deficit will help narrow the EBA-estimated gap.
Real exchange rate	**Background**. The trend deterioration in unit labor costs (9.3 percent cumulative appreciation of the ULC-based real effective exchange over the last 10 years) points to a loss of competitiveness consistent with the assessment of an imbalance in the current account. However, such loss of competitiveness is less evident based on relative price indicators, such as CPI-based real effective exchange rate (REER), as firms appear to have squeezed profit margins to retain price competitiveness. Compared to its average level in 2015, the ULC-based REER has appreciated by close to 2 percent as of June 2016. The CPI-based REER depreciated 4 percent in 2015 relative to its 2014 average level, but as of April 2016 had appreciated 1 percent relative to its 2015 average. **Assessment**. The EBA Level REER regression model estimates a 4.6 percent overvaluation, while the overvaluation suggested by the staff's assessment of the CA gap is a range of about 3 to 9 percent using standard trade elasticities. The EBA Index REER model on the other hand estimates an undervaluation of -5.4 percent. Taking into account the superior fit of the CA model for France, as well as the evidence from ULC and the Level regression model, the staff assessment is that the REER is 3–9 percent overvalued. 1/
Capital and financial accounts: flows and policy measures	**Background**. The current account deficit has been financed mostly by debt inflows (portfolio and other investment), while outward direct investment was generally higher than inward investment. Flows in financial derivatives have grown sizably on both the asset and liability side since 2008. The capital account is open. **Assessment**. France remains exposed to financial market risks but the structure of financial flows does not point to specific vulnerabilities.
FX intervention and reserves level	**Background**. The euro has the status of a global reserve currency. **Assessment**. Reserves held by the euro area are typically low relative to standard metrics, but the currency is free floating.
Technical Background Notes	1/ The ULC-based REER recent modest appreciation adds marginally to past competitive losses. Taking all these inputs into account, staff assesses the 2015 REER to be 3–9 percent overvalued.

Overall Assessment:

The external position in 2015 was moderately weaker than the level consistent with medium-term fundamentals and desirable policy settings. Recent developments, including the depreciation of the euro and lower oil prices, have helped strengthen the external position. However, it is still moderately weaker than implied by fundamentals, given high unit labor costs and fiscal deficits.

The labor tax wedge cuts undertaken since 2013 (equivalent to 3 percent of total labor costs, spanning 2014–17) have contributed somewhat to improve cost competitiveness. Efforts to improve non-cost competitiveness were reinforced by further labor and product market reforms (Macron and Rebsamen Law) in 2015.

Potential policy responses:

Continued wage moderation (especially of the minimum wage), continued reform of the labor market, and productivity-enhancing reforms (increasing competition in product markets and further regulatory simplification) would help restore competitiveness. Along with the planned gradual elimination of the fiscal deficit over the medium term, these measures should help correct the external imbalance (as well as promote growth).

Appendix V. Main Recommendations of the 2015 Article IV Consultation and Authorities' Actions

Fund Recommendations	Policy Actions
Fiscal Policy	
Follow an ambitious enough pace of fiscal adjustment to safely achieve the medium-term fiscal targets, including a firmly declining path for the debt ratio, without unduly detracting from the recovery.	The government continues to follow a fiscal adjustment strategy that is fully expenditure-based. However structural adjustment is slowing down to near zero in 2016.
Persevere with the efforts to rein in public spending. Underpin the adjustment by structural measures, identified through comprehensive expenditure reviews at all levels of government.	The annual targeted expenditure reviews initiated in 2015 are now fully integrated in budget preparation. Starting in 2016, the indicative targets for local governments' spending growth (*ODEDEL*), are specified for each level of local government. However, the bulk of spending control continues to rely on nominal spending growth containment measures.
Structural Reforms	
Allow more flexibility in firm-level agreements on hours and wages, reform the minimum wage, and strengthen job search incentives for those receiving unemployment or welfare benefits.	The *El Khomri* law, currently in parliament, would increase the scope for company-level labor agreements and reduce judicial uncertainty around dismissals.
Further liberalize regulated professions, dismantle bureaucratic hurdles to small enterprises, and remove barriers to competition in services	The *Macron* law was adopted in the summer of 2015, and the vast majority of measures has been implemented.
Financial sector	
Closely monitor financial risks and continue strengthening bank capital and liquidity buffers in line with evolving regulatory requirements.	The authorities are monitoring financial and regulatory risks in the context of the SSM. Banks have continued to adapt to evolving regulatory requirements.
Review guaranteed interest rates under the regulated savings schemes and tax incentives on financial savings products.	In August 2015, the *Livret A* savings rate was reduced to 0.75 percent. No further changes have been made since.

Source: IMF Staff.

INTERNATIONAL MONETARY FUND

FRANCE

June 24, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The European Department.

CONTENTS

FUND RELATIONS

(As of April 30, 2016)

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)	17,766.77	88.15
Reserve Tranche Position	2,388.46	11.85
Lending to the Fund		
New Arrangements to Borrow	1,695.42	

SDR Department:	SDR Million	Percent of Allocation
Net Cumulative Allocation	10,134.20	100.00
Holdings	7,318.80	72.22

Outstanding Purchases and Loans: None

Latest Financial Arrangements

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

Projected Payments to Fund

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

	Forthcoming				
	2016	**2017**	**2018**	**2019**	**2020**
Principal					
Charges/Interest	1.00	1.76	1.76	1.76	1.76
Total	**1.00**	**1.76**	**1.76**	**1.76**	**1.76**

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 major part of the past restrictions (those imposed by the European Union on a bilateral way: oil, gold, minerals…) has been dropped, in early 2016, due 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 8, 2015. The associated Executive Board assessment is available at http://www.imf.org/external/np/sec/pr/2015/pr15328.htm and the staff report at http://www.imf.org/external/pubs/ft/scr/2015/cr15178.pdf. France is on the standard 12-month consultation cycle.

FSAP Participation and ROSC:

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

Fiscal Transparency—Update — IMF Country Report No. 04/345, 11/03/04

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

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

France–Report on the Observance of Standards and Codes (ROSC): Module II–Transparency in Monetary and Financial Policies — October 2000, corrected: 2/15/01

Transparency in Monetary and Financial Policies—Update — IMF Country Report No. 01/197, 11/05/01

Transparency in Monetary and Financial Policies—Update — IMF Country Report No. 02/248, 11/13/02

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

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

France–Report on the Observance of Standards and Codes (ROSC): Data Module	IMF Country Report No. 03/339, 10/2903
Data Module—Update	IMF Country Report No. 04/345, 11/03/04
Data Module—Update	IMF Country Report No. 05/398, 11/07/05

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

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

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

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

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

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

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

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

STATISTICAL ISSUES

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. Country is currently working on implementing the transmission of data in electronic format using the Statistical Data and Metadata A data ROSC mission conducted an assessment of the statistical system in March 2003, and the report was published in October 2003. A factual update to the main report was published in November 2004.
National Accounts: France adopted the *European System of Accounts 2010* (*ESA 2010*) in May 2014. The transition from the *ESA 1995* (*ESA95*) entailed a revision of national accounts data. New data sources have been incorporated in the new estimates. As a result of these changes, the GDP level in 2010 has been revised 3.2 percent upward. Historical data series are available from 1949.
Government Finance Statistics: Starting from September 2014, government finance statistics (GFS) data will be based on *ESA 2010* methodology which is likely to include revisions of the general government deficit and debt levels from 1995 onwards. Revised data series will be published in October 2014. Although the source data are collected by the Ministry of Economy and Finance, INSEE is principally responsible for the compilation and dissemination of fiscal data in a framework that is consistent with ESA. **Monetary and Financial Statistics:** Monetary data reported for *International Financial Statistics* are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data.. Statistics for *International Financial Statistics* on banking institutions and monetary aggregates are prepared on a monthly basis and are timely. Monetary data are also disseminated in the quarterly *IFS Supplement* on monetary and financial statistics. **External Sector:** Starting in June 2014, monthly balance-of-payments statistics are published using the guidelines set out in the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*) . Back casting of previous periods started with the publication of the Annual report of the balance of payments and the international investment position end June 2014. It is expected that greater international consistency will be achieved once all EU members adopt the BPM6.

France: Table of Common Indicators Required for Surveillance
(As of May 2016)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	05/16	05/16	Monthly	Monthly	Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	04/16	05/16	Monthly	Monthly	Monthly
International Investment Position	Q4:2015	Q1:2016	Quarterly	Quarterly	Quarterly
Reserve/Base Money	03/16	05/16	Monthly	Monthly	Monthly
Broad Money	03/16	05/16	Monthly	Monthly	Monthly
Central Bank Balance Sheet	04/16	05/16	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	04/16	05/16	Monthly	Monthly	Monthly
Interest Rates[2]	05/16	05/16	Monthly	Monthly	Monthly
Consumer Price Index	04/16	05/16	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2015	05/16	Annual	Annual	Annual
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[5]	03/16	05/16	Monthly	Monthly	Monthly
Stock of Central Government Debt	04/16	05/16	Monthly	Monthly	Monthly
External Current Account Balance	03/16	05/16	Monthly	Monthly	Monthly
Exports and Imports of Goods and Services	03/16	05/16	Monthly	Monthly	Monthly
GDP/GNP	Q1:2016	05/16	Quarterly	Quarterly	Quarterly
Gross External Debt	Q4:2016	Q1:2016	Quarterly	Quarterly	Quarterly

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

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

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

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

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

Statement by the Staff Representative on France
July 11, 2016

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

On June 23, the people of the United Kingdom voted to exit the European Union. The referendum result surprised financial markets and triggered sharp currency movements and declines in equity valuations, especially in the euro area. Similar to the episode of financial volatility earlier this year, equity prices of France's banks declined broadly in line with those of other European banks, while credit default swap (CDS) spreads rose only modestly. The UK's prospective exit from the EU is expected to negatively affect euro area economies, including France, through trade, financial, and confidence channels.

As noted in the Statement by the Staff Representative on the Euro Area, IMF staff has revised its macroeconomic projections to take these recent developments into account. For France, staff's preliminary assessment is that real GDP growth will still be close to 1½ percent in 2016 and decelerate to about 1¼ percent in 2017, compared to 1½ percent projected in the staff report. The downward revision mainly reflects a slower pickup in business investment, on account of heightened uncertainty and financial market volatility, and lower import demand from the UK and other European countries. In line with recent episodes of financial stress, the impact on consumption is expected to be limited in the near term. The revised growth projection assumes that financial market conditions remain orderly and that any spillovers from France's banks' exposures to the UK are contained. Any further tightening of financial conditions would be an important source of downside risk.

With lower aggregate demand and inflation expectations, average annual inflation is now projected to come in just below 1 percent in 2017. The fiscal impact of these revisions is expected to be modest under baseline assumptions, as slower growth is partly offset by savings from lower interest rates. However, risks to achieving the near-term fiscal targets have increased.

The impact of these revisions on France's medium-term economic prospects would be relatively modest absent additional shocks. However, the risks to the outlook are now firmly on the downside, with much higher uncertainty around financial conditions and political developments in Europe.

The advice presented in the staff appraisal remains valid. With a subdued medium-term outlook and heightened downside risks, major efforts are needed to secure a durable reduction in unemployment and public debt. As discussed in the staff report, this will require further measures to boost job creation and private sector growth as well as deeper reforms to make public spending more efficient at all levels of government, which would help underpin sustainability and resilience against shocks.

Statement by Mr. de Villeroché, Executive Director for France
July 11, 2016

We thank staff for a thorough and detailed set of papers on the main challenges that the French economy is currently facing. Candid and open discussions during the Article IV mission led to a comprehensive and fruitful engagement with my authorities. We are pleased to note that staff is broadly in agreement with the authorities' overall strategy implemented since 2012.

Since the financial crisis, the French economy has shown its resilience. In 2015, the economic recovery accelerated, supported not only by external factors such as the decline in oil prices and a moderate depreciation of the real effective exchange rate but also domestic factors resulting from the implementation of reforms (in particular the reduction of the labor tax wedge, pro-competition measures, incentives for private investment) which are already bearing fruits. Going forward, my authorities remain committed to their economic strategy relying, in particular on ensuring the sustainability of public finances and structural reforms, particularly on the labor market.

1. Macroeconomic outlook

In 2015, the economic recovery accelerated with a pickup in growth to 1.3 percent (higher than the forecast of 1 percent in the 2015 Budgetary Plan) and after 0.6 percent in 2014. Economic growth was driven by households' spending, and corporate investment (+2 percent in 2015). Ongoing efforts to restore businesses' competitiveness have allowed France's share of export markets to stabilize (real exports grew by 6 percent in 2015) and contributed to lowering the country's trade deficit and almost balancing the current account.

Concerning the outlook for 2016 and 2017, the French economy is expected to gradually recover. Staff has revised its growth projections upward to 1.5 percent for both years, compared respectively with 1.1 percent and 1.3 percent in the last WEO. Staff growth forecasts are similar to the French authorities' projections as indicated in the Stability Program released last April, as well as to the latest *Consensus Forecasts*. Additionally, they are also in line with the forecasts of the OECD (1.4 percent in 2016 and 1.5 percent in 2017) and the European Commission (1.3 percent in 2016 and 1.7 percent in 2017).

The result of the United Kingdom's referendum on the EU Membership is expected to have a limited economic impact in France through trade channels whereas it is still difficult to assess how this outcome will affect the economic activity through the financial channels and the confidence effect on the United Kingdom and the Euro area.

In a medium and long term perspective, France's growth prospects should be supported by key factors, including its institutional framework, world-class infrastructure, sound financial system, well-educated workforce, positive demographic trends, and a high productivity rate in the world. Furthermore, the ambitious agenda of structural reforms currently implemented by the authorities will boost potential growth.

2. Fiscal policy

2015 execution

French public deficit stands at 3.6 percent of GDP in 2015 which has over-performed the objective set in the Budget bill passed in December 2015 (3.8 percent of GDP). This performance resulted from the containment of public spending following the first year of the saving plan's implementation. Additional saving measures were also taken during the year for EUR 4 billion in order to offset the negative impact of a lower-than-expected inflation. Indeed, nominal public spending excluding tax credits increased by only 0.9 percent in 2015, the lowest in decades. With the implementation of tax reduction measures targeting businesses (*Crédit d'Impôt Compétivitié Emploi*, *Pacte de responsabilité et de solidarité*) and private households, the tax-to-GDP ratio was reduced by 0.1 point to 44.7 percent of GDP.

We therefore do not share the findings of the staff report that the authorities' consolidation strategy "*has not delivered the hoped-for fiscal savings in the context of low growth and inflation*."

Fiscal medium-term consolidation path

As set out in the Stability Program published in April, France targets a 0.4 point of GDP structural adjustment of public balance in 2016 and 0.5 point of GDP in 2017 and 2018, which will allow under a prudent growth scenario (real GDP growth of 1.5 percent per year in 2016 and 2017) to bring back the headline deficit below 3 percent in 2017 with a safety margin (2.7 percent of GDP), a trajectory which is compliant with our European commitments. This target was restated by President Hollande at the end of June.

Recently announced measures will be financed to ensure that our headline deficit target of 2.7 percent of GDP will be met in 2017. This target has been confirmed and the compensations have been disclosed in the report published July 5th in order to prepare the draft budget bill discussions this autumn.

In this regard, we would like to underline that the report finding of a structural "*fiscal adjustment slowing to around zero*" is based on a scenario that does not fully take into account the measures set out in the Stability Program. Moreover, this difference of appreciation of our structural efforts is partly due to a lower estimate of potential growth by staff, compared to the Stability Program (1.1 percent for 2016 and 2017 compared to 1.5 percent).

From 2017 to 2019, we forecast that the growth of public expenditure will be close to inflation. The pace of consolidation strikes the right balance between the need to secure public finances' sustainability in the medium term, while reducing the tax burden, and avoiding a drag on growth in the short term.

Overall, given the strong commitment of the authorities to the consolidation path of the Stability Program, we consider that staff overestimates the implementation risks of a deviation.

Long term sustainability

Strong demographics, the improvement in its older workers' participation rate and the phasing-in of recent pension reforms, have placed France in a better position to deal with its aging population than most of its OECD partners. This long-term sustainable position has been reinforced by the latest pension reform adopted in 2014 as well as the new agreement signed in 2015 on the financing of the supplementary retirement scheme. According to the latest long term projections of the European Aging Report 2015, public pension spending is expected to decrease by 2.8 percent of GDP between 2013 and 2060. The financial position of France's pension system is no longer a major issue for the long-term sustainability of public finances.

3. **Structural reforms**

In order to reduce unemployment and foster potential growth, the French authorities are pursuing the implementation of a bold agenda of structural reforms aiming at improving cost competitiveness, enhancing the business environment, improving the functioning of product and services markets, improving the functioning of the labor market as well as promoting social inclusion and equal opportunities.

Improving cost competitiveness by cutting the labor tax wedge

The authorities remain fully committed to the implementation of the measures decided to foster job creation and improve business cost competitiveness by reducing the labor tax wedge.

The *Crédit d'Impôt Compétivitié Emploi* (CICE), which is a tax credit equivalent to 6 percent of gross wage targeted on lower wages than 2.5 times the minimum wage, has been fully implemented and will amount to EUR 19 billion labor cost reduction in 2017. The *Pacte de Responsabilité et de solidarité (*Responsibility and Solidarity Pact*)* amounts to EUR 20 billion and includes a reduction in social security contributions which has been implemented since April 2016.

These measures, which represent a positive supply shock of almost EUR 40 billion (close to 2 percent of GDP), are already bearing some concrete positive results: the growth of the unit labor cost in France has decelerated (+0.8 percent annually on average between 2013 and 2015 after +2 percent between 2000 and 2013 according to Eurostat) and has been lower than in Germany (+1.9 percent) and in the euro area on average (+1 percent).

To complement this labor cost reduction, a hiring bonus (so-called "*Embauche PME*"), targeted on lower wages less than 1.3 times the minimum wage, was created in January for new hires made in 2016 in SMEs, and was recently extended to next year hires. Furthermore, the President's recent announcements regarding the last phase of implementation of the *Responsibility and Solidarity Pact* in 2017 included the increase of the CICE to 7 percent of gross wage, corporate income tax cuts for SMEs, and EUR 150 million tax cuts for self-employed workers.

Enhancing the business environment and improving the functioning of goods and services markets

The government continues its efforts to reduce the red tape faced by businesses, through the so-called "*choc de simplification*," and thus improves the business environment. On February 3, 2016, the authorities announced new measures focused on jobs and innovation, notably the simplification of applications for the Research Tax Credit (*Crédit d'Impôt Recherche* - CIR).

The Growth, Economic Activity, Equal Economic Opportunity Act (so-called *Macron law)* adopted last summer has enhanced competition across the economy by opening-up various regulated professions, better aligning their fees with costs as well as extending the possibilities for Sunday and evening work hours. Since the adoption of this significant reform, its implementation has made tremendous progress since almost all the implementing decrees are published.

In the same vein, the transparency, anti-corruption and the Economic modernization Bill, which is currently before the Parliament, will ease the creation and growth trajectories of VSEs and SMEs, and the access to certain self-employed professions through a streamlining of qualification requirements.

Improving the functioning of the labor market

As indicated by staff in its report, several structural reforms (the 2013 Job Security Act, the 2015 Act on Labor-Management Dialogue and Employment – so-called *Rebsamen law* - and the *Macron law*) have been implemented over the last years to improve the functioning of the labor market. The overall objective is to give businesses more leeway to adapt to their environment while providing employees with greater protection during times of career change, particularly periods of unemployment.

Building on these achievements, the draft Labor Bill (so-called *El Khomri law*), which is currently before the Parliament, aims at modernizing the functioning of the labor market by promoting social dialogue, providing greater predictability to companies as well as making career paths more secure.

First, the *El Khomri law* will increase the decentralization of the labor market's functioning and expand the scope for negotiation between social partners at the firm level, notably by shifting the responsibility from the branch to the firm level on determining how work is organized and working hours. Collective bargaining rules will be reformed to make agreements more effective. The occupational sectors' contribution to regulating competition between businesses will be reasserted and the number of branches will be reduced from 700 to 200 over four years.

Second, the objective of the Bill is also to give greater visibility to companies in order to encourage hiring people on permanent contracts. Indeed, it identifies and spells out the economic difficulties faced by a company that can justify economic layoffs. In addition, a decree will set an indicative scale for compensations that labor tribunals can hand down for redundancies found to be without real and credible grounds, giving heightened visibility to both employers and employees.

Third, the Bill introduces new safeguards, particularly for employees with little job security and young people. The Personal activity account (CPA), that will enter into force on January 1, 2017, will allow all workers to accumulate entitlements throughout their career, regardless of their status (salaried employee, self-employed worker, civil servant, jobseeker), particularly for training or support in setting up a business.

The final adoption of this draft law by the Parliament is expected in the coming days.

4. Financial sector

Since the financial crisis, French banks have made significant progress in strengthening their balance sheets, in application of the new regulatory requirements. As indicated in the report, they have significantly increased their capital level and improved their liquidity position, as illustrated by the reduction of their dependence on short term wholesale funding and the decrease in their loan-to-deposit ratios. Compared to the European average, French banks appear relatively more profitable. The quality of their assets was confirmed by the AQR led by the ECB in 2014 and which has led to one of the smallest adjustments within the euro area. French banks have lower non-performing loans (NPL) ratios than the European average and their cost of risk remains under control.

Concerning the challenges facing the French banking system, we acknowledge that the current environment of low interest rates puts some pressures on banks' profitability, in particular in a context of regulatory uncertainties since there are still some ongoing discussions at the Basel committee on further reforms which could increase the capital requirements. However, it is important to underline that this challenge is not specific to the French banking sector and concerns all financial sectors in advanced economies. In fact, the model of universal banking of French banks contributes to their resilience thanks to a diversification of activities and could also ease the evolution of their business model.

In this context, the authorities remain vigilant that French banks strengthen their balance sheets as required by the regulation in order to preserve the financial stability and also that their adaption to this new environment does not negatively affect the economy's financing.

Last but not least, while we generally appreciate a more important focus on macrofinancial linkages in the Fund's surveillance activity, we note that the *Selected Issues Paper* on macrofinancial issues conducted for the Article IV consultation on France is quite detailed on the resilience of France's biggest banking institutions to market volatility. We consider that it could have been more interesting to focus on the interlinkages between financial developments and the real economy. We also believe that comparing France's biggest banking institutions with other G-SIBs is not the most relevant approach from a macrofinancial perspective, given the differences among G-SIBs (in particular but not only between European and US banks) in business models and their relative shares in the financing of their domestic economy, as well as regulatory environments (notably on housing loans). Going forward, we agree with staff that it should focus its follow-up work on having a better understanding regarding the transmission channels of financial conditions to economic activity.