France: Staff Concluding Statement of the 2024 Article IV Mission

May 23, 2024

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

Paris, France:

An International Monetary Fund (IMF) mission, led by Manuela Goretti and comprising Stephen Ayerst, Roberto Piazza, Iulia Teodoru, and Maryam Vaziri, conducted discussions during May 13-22 for the 2024 Article IV Consultation with France. At the end of the visit, the mission issued the following statement:

A strong and timely policy response helped cushion the impact of the pandemic and the energy crisis. Despite a recovery slowdown in 2023, the French economy has remained relatively resilient in the face of financial tightening and weaker euro area external demand. Nevertheless, the crisis response and slower-than-expected recovery have weighed on public finances, with a sizable fiscal underperformance in 2023, reducing fiscal space at a time of rising investment needs for the green and digital transformation. Labor market performance has remained robust, although labor productivity remains below its pre-COVID trend. Against this backdrop, the French authorities have appropriately shifted their focus towards rebuilding fiscal buffers and achieving a sustainable modernization of the economy. Nevertheless, substantial additional efforts, compared to staff's current policy baseline, will be needed over the medium term, starting in 2024, to strengthen public finance. The reforms of the pension and unemployment benefit systems have started to yield results. The authorities should continue to advance their ambitious structural agenda, supporting jobs and raisingproductivity . The authorities' proactive efforts to strengthen financial stability have helped support the resilience of the French banking system and should be sustained to mitigate systemic risks.

Economic Outlook

The economic recovery is expected to take hold in 2025, while the disinflationary process remains on track. Real GDP growth is projected to gradually reach 1.3 percent by 2025 from 0.8 percent in 2024, as financial conditions ease and investment starts recovering, while households' purchasing power and consumption improve. Over the medium term, potential growth is projected to reach 1.3 percent, before decelerating towards 1 percent in the long run as the population ages. Monetary policy tightening has supported the disinflationary process. Despite delayed wage adjustments, average

inflation is projected at 2.3 and 1.8 percent for 2024 and 2025, respectively, given favorable base effects and easing supply constraints. Core inflation will decline more slowly, as real wage growth remains positive in 2024-25.

While risks have become more balanced, the outlook remains subject to uncertainty. A measure of recession risk, based on financial conditions in France and abroad, has been receding over the past year. Still, risks might arise from escalating geopolitical fragmentation or an abrupt global slowdown. While faster structural reform momentum to support productivity and competitiveness in France and at the EU level, including through deeper integration, could help mitigate these risks, social tensions and political fragmentation could delay fiscal consolidation and reform efforts, weighing on confidence and the outlook. On the upside, consumption could be stronger if the household saving rate were to return more rapidly to its pre-pandemic level, as inflation recedes. Business investment, on the back of heightened demand from the digital and green transitions, and export performance could also surprise on the upside.

Fiscal Policy: Reducing Debt while Modernizing the Economy

The fiscal underperformance in 2023, weaker-than-expected growth, and new spending pressures are weighing on public finances, despite the unwinding of the crisis response measures. Under current policies, which incorporate only legislated and clearly specified measures, staff projects the overall deficit to remain elevated at 5.3 percent of GDP in 2024 and decline modestly to 4.5 percent in 2027. The latter is significantly higher than the 2.9 percent deficit level targeted by the authorities in their Stability Program, as key spending reforms and review measures underpinning the planned adjustment remain to be identified. Moreover, despite ongoing growth-enhancing structural efforts, the macroeconomic assumptions underlying the government's plan might prove somewhat optimistic over the adjustment period, an issue also raised by France's High Council of Public Finances. In the absence of further measures, debt would rise to 112 percent of GDP in 2024 and increase by about 1½ percentage points a year over the medium term. This relatively high level of debt is a source of fiscal risks, as it leaves the future evolution of public finances exposed to an unexpected increase in funding costs or a reduction in growth which would compound already existing long-term fiscal pressures from the green and demographic transitions. Nevertheless, France's commitment to undertake further fiscal consolidation, as per EU rules, and its liquid debt market are important mitigating factors.

Further consolidation measures are recommended overthe medium term, starting in 2024, to bring debt on a downward trajectory, while making space for targeted growth-enhancing spending. *For 2024*, additional new measures of about 0.4 percent of GDP will be needed to bring the deficit to 4.9 percent of GDP, compared to staff's current policy scenario, of which 0.3 percent of GDP have already been announced in the Stability Program (PSTAB). This would help improve debt dynamics while smoothing the adjustment in the outer years, reducing the potential negative effects on the economy. Improving financial conditions, as monetary policy eases, can also help mitigate the contractionary impact of fiscal tightening. *For the medium term*, the government's consolidation goal of bringing the deficit below 3 percent of GDP by 2027 remains appropriate to keep debt on a downward trajectory **.** It would strengthen France's resilience to shocks and help rebuild adequate buffers to meet new spending demands from ongoing structural transitions and long-term aging pressures. It would allow France to exit the Excessive Deficit Procedure (EDP), which is expected to be initiated later this year, by end-2027, as currently planned by the authorities. Meeting this goal would,

however, require a substantial structural primary effort of nearly 3 percent of GDP during 2025-27, on top of the recommended additional effort in 2024. Staff’s debt sustainability analysis indicates that the recommended fiscal path would significantly reduce medium-term risks, allowing France to reach its debt-stabilizing primary balance by 2027.

Building on recent reforms and ongoing spending reviews, the authorities should identify a well-specified and credible package of measures to underpin their fiscal consolidation plans . Given France’s already high levels of taxation, fiscal consolidation should continue to focus on targeted measures to lower current spending. The broad-based spending reviews are critical to target pockets of inefficiency while preserving room for growth-friendly investment. Specific measures such as better targeting unemployment benefits and support schemes for workers and enterprises could generate savings, while sustaining investment in both physical and human capital. Tax expenditure can also be redesigned to increase economic efficiency while reducing fiscal costs. The increase in the public sector salary bill can be contained by reducing the overlaps between different levels of government and through a greater reliance on automation and digitalization. Involving local governments more in the fiscal consolidation effort would help contain public spending. These structural fiscal efforts can also further lift potential growth, creating further space to support the digital and green transition s. The High Council of Public Finances should remain a building block of France’s fiscal framework, further supporting the authorities’ consolidation plans with its evaluation of the realism and internal consistency of the macroeconomic and budgetary forecasts, including vis-à-vis France’s commitments under the EU fiscal rules.

Maintaining Financial Sector Stability

The authorities’ proactive efforts to strengthen financial stability have helped support the resilience of the French banking system and mitigate systemic risks. Despite a marked credit slowdown, the preponderance of fixed-rate loans has shielded the non-financial corporate and housing mortgages segments from the impact of tighter financial conditions.While fixed-rate loans have prevented a deterioration in asset quality, French banks have not benefited from the record-high profits experienced by most European peers in the face of rising interest rates. Despite relatively lower profitability, French banks’ liquidity and solvency positions have remained robust, with adequate capital and liquidity buffers. The recent increase in the countercyclical buffer along with the implementation of the systemic risk buffer against highly indebted firms represent important steps to further mitigate systemic risks and strengthen the financial sector’s resilience. Looking forward, the authorities should continue to ensure that the *Haut Conseil de Stabilité Financière* (HCSF – High Council for Financial Stability) enjoys the operational independence needed to focus on financial stability issues and has sufficient and adequate legal powers to respond in a flexible, timely, and proportionate way to new risks that may arise.

The housing market is undergoing an orderly downward adjustment in response to rising interest rates, in the context of prudent lending standards. Higher mortgage rates have dampened housing affordability and demand, notwithstanding the downward correction in housing prices. Nevertheless, NPLs in housing mortgages have remained low, given the prevalence of fixed-rate mortgages (99 percent of total) at long maturity (23 years on average). France's implementation of prudent borrower-based lending standards has also helped mitigate insolvency risks for both borrowers and lenders.

While direct exposures to the commercial real estate (CRE) market are limited, vulnerabilities in real estate investment funds (REIFs) warrant continued close monitoring. The sharp decline in CRE prices has had a limited impact on the French banking system so far, as direct exposures are small. Nevertheless, the market for REIFs has grown significantly over the past decade and lower returns from declining CRE prices have heightened liquidity risks, although vulnerabilities appear contained given a stable investor base. In this context, the French supervisors' proactive work to close data gaps and establish relevant metrics for monitoring broader systemic risk stemming from indirect exposures via non-bank financial institutions (NBFIs) is welcome. The authorities should further advance these risk-monitoring efforts, also benefiting from the results of system-wide stress tests, while continuing to encourage use of liquidity management tools by investment funds. New European initiatives to develop appropriate macroprudential measures for REIFs and other NBFIs targeting build-up of risks in the CRE market are also welcome.

French banks should continue to mitigate climate transition risks by integrating them into their governance, strategy, and risk management processes. While the immediate impact on the banking sector appears to be contained, under staff's climate risk assessment simulating the Fit-for-55 scenario, key systemic banks may be exposed to rising credit losses, as these are estimated to significantly increase over the medium term for the energy-intensive mining, chemical, and manufacturing sectors. Results are broadly consistent with past state-of-the-art exercises by Banque de France and the ECB and underscore the importance for the authorities to work with the financial sector to expand its analytical capacity for assessing climate risks and enhance the resilience against future risks.

Accelerating the Green Transition: Price and Non-Price Sectoral Policies

France has taken a leadership role in global mitigation and made significant progress towards reducing greenhouse gas emissions, but further efforts will be needed to meet Fit-for-55 targets. France has been an integral part of the Conference of the Parties multilateral discussion framework and has also played a key role in promoting low carbon energy initiatives and contributing to climate financing for developing countries. Since 2005, France's own emissions have decreased by 23 percent, with reductions concentrated in power generation, industry, and buildings. Looking ahead, the authorities' green transition plan (*France Nation Verte)* and France 2030 identify new measures to meet key emission-reduction targets, including in the most polluting sectors with higher abatement costs.

Ongoing spending efforts to accelerate the green transformation, while mitigating its costs and dislocations, can be complemented by higher carbon pricing and other revenue-neutral schemes . Green spending is set to reach about 1.3 percent of GDP in 2024. Key sectoral policies include subsidies for the renovation of buildings (*MaPrimeRenov)*, the decarbonization of the industry, and for zero-emission passenger vehicles. Both renovation and vehicle schemes have means-tested aspects to support affordability and, in recent budgets, have been fine-tuned to address market failures and target the lowest abatement costs. Transitioning to revenue-neutral continuous feebate schemes for non-ETS1 sectors and further raising carbon pricing, including by gradually phasing out reduced rates and exemptions on fossil-fuel taxes, could further improve cost effectiveness and reduce fiscal costs. Additional revenues from higher carbon pricing could be recycled via cash transfers to offset the price impact on lower-income

households. Over the medium term, new charges for road transportation could also be considered to maintain an adequate coverage of road transport externalities, while helping offset declining fuel tax revenue and integrating equity and environmental considerations.

Supporting Employment and Productivity

Ongoing efforts to modernize the labor market can help integrate and requalify workers, further strengthening employment. Recent labor programs and reforms have successfully helped increase employment above its pre-pandemic trend and supported real GDP growth. *France Travail* registration efforts and job-seeking support can facilitate labor market integration, while ongoing efforts to strengthen targeting to lower skilled workers can raise the reskilling benefits of existing programs, such as *France Competences*. The recent pension and unemployment benefit reforms are also supporting labor force participation, by increasing work incentives. Further reforms could review the eligibility and duration of benefits to promote longer and less fragmented careers, while retaining adequate coverage against unemployment risk and protecting the vulnerable. The authorities' plans to revamp parental leave, while increasing provision of childcare facilities, addressing shortages of qualified staff, could further support labor force participation by women.

Education and training reforms can prepare workers for the green and digital transformations. The green transition is already having an impact on the labor market as demand for green jobs has steadily increased, benefiting high-skilled workers, while displacing low-skilled and more specialized workers in carbon-intensive occupations.8F While France ranks high in AI preparedness, AI adoption will also unequally impact the workforce. Addressing inefficiencies in education spending could help upskill the workforce and close the education attainment gaps with peer countries. Active labor market policies can help reduce recruitment tensions and skills mismatches. Ongoing initiatives by the authorities include the reform of vocational training (*lycée professionel*) as well as the introduction of training certification and professional qualification (as in *Qualiopi*). Programs should target workers that may face skill obsolescence or be displaced. Further efforts to address the low school enrolment in STEM fields of women, as envisaged in the authorities' digital strategy, and better integrate women in industry (*Industri'Elles*) are also welcome.

Complementary policies on firms' incentives are also needed to boost productivity. While important progress has been made in recent years, significant room still exists to reduce regulatory burden and barriers to entry, especially in some service sectors, to improve productivity and business dynamism. The Simplification Bill currently under discussion is a welcome step to streamline firms' authorization and reporting requirements, with a special focus on SMEs and greater digitalization of processes. Building on spending reviews, the authorities should also assess scope for rationalizing existing tax expenditure for R&D and innovation by focusing on the highest impact schemes.

Navigating Geoeconomic Fragmentation and Advancing the Single Market

Deepening geoeconomic fragmentation poses additional challenges to France's growth outlook . France can count on a well-diversified economy, as its more marked fall in manufacturing as a share of GDP compared to EU peers over the last decades has been balanced by dynamism in the services sector, more recently also in terms of exports.

Moreover, it is relatively less dependent than most EU peers on imports of critical intermediate goods from geopolitically distant countries. Nevertheless, it remains exposed directly and through key trading partners to the risk of supply disruptions as well as to technological and payments systems fragmentation from geopolitical tensions and the resulting reconfiguration of global trade and investment.

The authorities' plans to address structural growth challenges should continue to safeguard and deepen the European single market. While a complex balancing act, France should continue to foster an innovative domestic industry and rise to the challenge of climate transition, while remaining committed to multilateralism and fiscal discipline. Deepening the European single market by simplifying cross-border services and recognizing qualifications across member states would foster competition, lower costs, and enhance economic resilience. Renewed efforts at the EU and Member States level to deepen Europe's capital market integration and harmonize taxes and subsidies across countries are welcome. This would encourage cross-border access to finance and infrastructure investment, including in green technologies, and help preserve fiscal space. Industrial policies to support critical industries should be pursued cautiously and coordinated closely at the EU level. Limiting state intervention to address market failures and maintaining a level playing field across firms and sectors, in a non-discriminatory manner against trading partners, would support firms while driving innovation, productivity, and growth.

The mission thanks the French authorities and our other interlocutors in France for the productive collaboration and constructive policy dialogue.