IMF Executive Board Concludes 2016 Article IV Consultation with France

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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.

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.

France: Selected Economic Indicators

	2014	2015	2016	2017
			(Proj.)	(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.				

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

[2] 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.