10. FRANCE

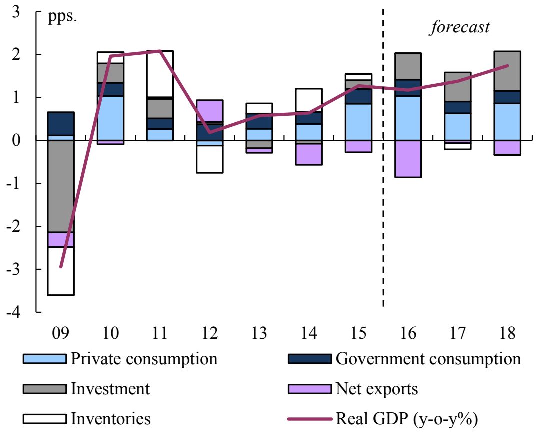
The recovery holds up despite uncertainties

Economic activity in France is forecast to gently accelerate. Business and consumer confidence improved and growth picked up in the fourth quarter. The recovery in exports is expected to rebalance growth away from private consumption and help sustain the recovery, although net exports are forecast to continue to be a drag on growth. Unemployment is set to continue its gradual decline. The general government deficit is expected to fall from 3.3% of GDP in 2016 to 2.9% in 2017.

Net exports weighed on GDP growth in 2016

GDP growth declined slightly to 1.2% in 2016 from 1.3% in 2015, despite growth reaching 0.4% in the fourth quarter. Private consumption accelerated on the back of dynamic household purchasing power, while investment growth has been boosted by anticipation of the end of the over-amortisation scheme, a fiscal incentive for firms to invest. However, after an exceptional performance in 2015, export growth fell to 1.0% in 2016, due to several temporary factors, while imports remained relatively dynamic. As a result, net exports represented a drag on growth of almost 1 pp. of GDP growth in 2016.

Graph II.10.1: **France - Real GDP growth and contributions**



The recovery of exports is expected to rebalance growth away from consumption

GDP growth is forecast to pick up to 1.4% in 2017 and 1.7% in 2018 under the usual no-policy-change assumption. Private consumption is expected to decelerate in line with purchasing power, as the tailwinds from lower oil prices fade out. Also, the recovery in investment is gaining momentum, particularly in the construction sector. After the strong growth observed in 2016, equipment investment growth is set to moderate somewhat. However, the prolongation of the over-amortisation scheme until 14 April 2017, rising profit margins and easy financing conditions are expected to sustain robust growth rates.

Export growth is expected to gradually normalise in 2017 and 2018, in line with the moderate recovery projected in French export markets. Meanwhile, imports are forecast to moderate somewhat in 2017, in a context of decelerating domestic demand, allowing for a more balanced contribution of net exports to GDP growth.

Unemployment expected to fall further while inflation picks up

Employment is forecast to continue growing at a sustained pace, supported by the ongoing economic recovery and by policy measures to encourage job creation by reducing the labour tax wedge (the Tax Credit for Competitiveness and Employment, the Responsibility and Solidarity Pact, and the Hiring Subsidy). Moreover, the emergency plan for employment announced in January 2016 is further decreasing the unemployment rate by providing training to unemployed people who subsequently do not appear as unemployed any more. Consequently, the unemployment rate is forecast to decline to 9.9% in 2017 and 9.6% in 2018.

Inflation rose sharply to 1.6% in January 2017, from 0.8% in December 2016. Overall, HICP is expected to average 1.5% in 2017, before declining slightly to 1.3%, as the strong positive contribution from recent oil price increases fades out and domestic price pressures increase only gradually.

Risks are more balanced

Despite continued global uncertainty, risks to the forecast for France are less tilted to the downside than in the autumn. The improvement of labour market conditions could allow for a more significant drop in the household saving rate on average and thus stronger private consumption.

Public deficit below 3% in 2017

The headline deficit likely fell to 3.3% of GDP in 2016 (from 3.5% in 2015), on the back of better-than-expected budget execution. Discretionary measures, part of the Responsibility and Solidarity Pact (RSP), are set to weigh on public revenues. In turn, public expenditure net of tax credits is forecast to increase moderately, by 1.0% in 2016 compared to 0.8% the previous year, helped by low inflation and the continued decline in interest payments. After two years of sharp falls, public investment is projected to be broadly flat as the local investment cycle has bottomed out.

The government deficit is expected to decrease further to 2.9% of GDP in 2017. Revenues are set to pick up thanks to higher GDP growth and the increase in local and green taxes. Apart from the consolidation measures contained in the draft budget, the finally adopted budget includes an additional increase in public spending by EUR 0.8 bn. to be financed by budgetary reallocations, which are not specified. Moreover, as negotiations on the new unemployment benefit agreement have not concluded yet, the expected yield thereof, amounting to EUR 1.6 bn, is not taken into account. All in all, public expenditure net of tax credits is expected to increase by 1.8%, as a result of higher wages for civil servants following the end of the wage freeze in 2016 and the increase of the healthcare spending norm compared to 2016. The structural balance is projected to improve by around ¼ pps. in 2016 and 2017. However, the planned recapitalisation of the state-owned company AREVA with a public capital injection of EUR 4.5 bn. entails a negative risk for the 2017 deficit amounting to 0.2% of GDP.

Assuming no policy change, the deficit is forecast to rise again to 3.1% of GDP in 2018. While the revenue-to-GDP ratio is projected to decline by 0.2 pps. due to the corporate income tax cut and some temporary revenue measures in 2017, the expenditure-to-GDP ratio is set to broadly stabilise. Although spending growth is expected to remain moderate, primary current expenditure net of tax credits in volume terms is projected to accelerate slightly with respect to 2013-2017. Public investment and interest payments are also projected to gain momentum with respect to the same period. The structural balance is projected to deteriorate by close to ½ pps. in 2018. The debt-to-GDP ratio is forecast to rise further from 96.4% in 2016 to 97.0% of GDP in 2018.

Table II.10.1:

Main features of country forecast - FRANCE

		2015			Annual percentage change					
		bn EUR Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		2181.1	100.0	1.7	0.6	0.6	1.3	**1.2**	**1.4**	**1.7**
Private Consumption		1201.5	55.1	1.9	0.5	0.7	1.5	**1.9**	**1.2**	**1.6**
Public Consumption		521.8	23.9	1.4	1.5	1.2	1.4	**1.6**	**1.2**	**1.2**
Gross fixed capital formation		469.2	21.5	2.2	-0.8	-0.3	1.0	**2.8**	**3.1**	**4.1**
of which: equipment		103.2	4.7	2.6	-3.5	2.0	2.3	**6.0**	**4.1**	**5.0**
Exports (goods and services)		654.9	30.0	4.1	1.9	3.3	6.1	**1.0**	**3.1**	**4.0**
Imports (goods and services)		685.0	31.4	4.8	2.1	4.7	6.6	**3.7**	**3.1**	**4.8**
GNI (GDP deflator)		2216.5	101.6	1.7	0.6	0.6	1.6	**1.2**	**1.4**	**1.7**
Contribution to GDP growth:	Domestic demand			1.8	0.4	0.6	1.4	**2.0**	**1.6**	**2.1**
	Inventories			0.1	0.2	0.5	0.1	**0.0**	**-0.1**	**0.0**
	Net exports			-0.1	-0.1	-0.5	-0.3	**-0.9**	**-0.1**	**-0.3**
Employment				0.7	0.1	0.2	0.4	**0.8**	**0.6**	**0.9**
Unemployment rate (a)				9.0	10.3	10.3	10.4	**10.0**	**9.9**	**9.6**
Compensation of employees / f.t.e.				2.5	1.6	1.2	1.1	**0.9**	**1.5**	**1.9**
Unit labour costs whole economy				1.6	1.1	0.8	0.2	**0.5**	**0.7**	**1.1**
Real unit labour cost				0.1	0.3	0.3	-0.4	**-0.4**	**-0.2**	**-0.2**
Saving rate of households (b)				15.1	14.0	14.1	14.1	**14.2**	**14.0**	**14.1**
GDP deflator				1.5	0.8	0.5	0.6	**0.8**	**0.9**	**1.2**
Harmonised index of consumer prices				1.7	1.0	0.6	0.1	**0.3**	**1.5**	**1.3**
Terms of trade goods				-0.2	1.3	1.6	3.8	**1.7**	**-1.2**	**0.5**
Trade balance (goods) (c)				-0.5	-2.0	-1.7	-1.0	**-1.3**	**-1.5**	**-1.6**
Current-account balance (c)				0.1	-2.9	-3.2	-2.0	**-2.3**	**-2.6**	**-2.7**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				0.1	-2.8	-3.2	-2.0	**-2.1**	**-2.4**	**-2.4**
General government balance (c)				-3.5	-4.0	-4.0	-3.5	**-3.3**	**-2.9**	**-3.1**
Cyclically-adjusted budget balance (d)				-3.8	-3.2	-2.9	-2.7	**-2.6**	**-2.3**	**-2.7**
Structural budget balance (d)				-	-3.4	-3.0	-2.7	**-2.5**	**-2.3**	**-2.7**
General government gross debt (c)				68.0	92.3	95.3	96.2	**96.4**	**96.7**	**97.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.