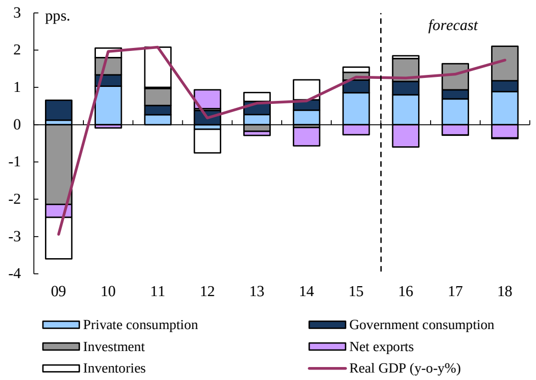
10. FRANCE

A prolonged period of moderate growth

Economic growth in France is forecast to continue at a moderate pace. The recovery in investment, particularly in the construction sector, is expected to rebalance growth, making it less dependent on private consumption. However, net exports are set to remain a significant drag on growth. The general government deficit is expected to fall from 3.3% of GDP in 2016 to 2.9% in 2017. Unemployment is set to continue its gradual decline. Inflation should pick-up to reach 1.4% in 2018.

After recording strong growth in the first quarter of this year, economic activity contracted slightly in the second quarter due to several temporary factors that affected growth negatively (backlash to Euro cup ticket sales and to the change in television standards, as well as strikes). In the third quarter of 2016, GDP grew modestly by 0.2%. Overall, in recent quarters, economic activity has been primarily driven by private consumption and investment. GDP growth is forecast at 1.3% in 2016 and 1.4% in 2017. In 2018, a pick-up in growth to 1.7% is expected under the no-policy-change assumption.

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



Growth mainly driven by domestic demand, while net exports remain a drag

Private consumption is set to remain sustained over the forecast horizon, as the purchasing power gains due to past oil price declines have not yet been spent entirely and labour market conditions continue to improve.

The recovery in investment is gaining momentum, particularly in the construction sector, which is forecast to recover after four years of contraction. At the same time, equipment investment has been boosted by the anticipation of the end of the over-amortisation scheme, a fiscal incentive for firms to invest. Rising profit margins and relatively easy financing conditions are expected to sustain robust growth rates.

After an exceptional performance in 2015, exports stalled in the first three quarters of 2016, in part due to delivery delays in the aircraft sector. Export growth is expected to normalise in 2017 and 2018, in line with the projected moderate recovery in French export market growth. However, as imports continue to be supported by strong domestic demand, net exports are set to remain a drag on growth throughout the forecast horizon.

Unemployment rate expected to decline while inflation picks up

Employment is projected to grow markedly in 2016 on the back of a strong increase in the first half of the year. Supported 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) and sustained economic activity, employment is expected to grow stronger than the labour force in the coming two years. Moreover, the emergency plan for employment announced in January is further decreasing the unemployment rate, by shifting a part of the labour force into training. Consequently, the unemployment rate is forecast to decline to 10.0% in 2016 and 9.9% in 2017 before dropping to 9.6% in 2018.

Inflation has started to recover in recent months and is expected to average 0.3% in 2016. With oil prices set to increase, inflation is forecast to pick up substantially to 1.3% in 2017 and to 1.4% in 2018 as the effect of rising oil prices gives way to pressures from rising wages.

Risks to the outlook

In addition to risks related to increased uncertainty to the global outlook, the effects of recent terrorist attacks, while expected to be short-lived, might affect certain sectors such as tourism for example in a more long-lasting manner. On the other hand, a stronger growth in employment or wages could boost private consumption.

The headline deficit is projected to decrease to 2.9% in 2017

The headline deficit is projected to decrease to 3.3% of GDP in 2016 (after 3.5% in 2015), on the back of better-than-expected budget execution. Public revenue growth is expected to slow somewhat this year, notably due to discretionary measures which are part of the Responsibility and Solidarity Pact (RSP). Public expenditure net of tax credits should increase by 1.2% compared to 0.9% in 2015 as inflation is low and interest payments continue to decline. Public investment is projected to rebound, albeit from low levels, in line with the local electoral cycle.

The government deficit is expected to further decrease to 2.9% of GDP in 2017. Revenue growth should be slightly more dynamic, reflecting higher GDP growth and the increase in local and green taxes. The draft budget for 2017 includes consolidation measures amounting to EUR 14 billion (0.6% of GDP) designed notably to offset the deficit-increasing impact of measures in favour of households, companies and local authorities announced since spring. The main measure was the replacement of the last phase of the RSP planning tax cuts of 0.2% of GDP in 2017 by tax credits and corporate tax cuts with a similar budgetary impact in 2018. Moreover, the forecast does not incorporate EUR 2.3 bn (0.1% of GDP) of these measures as they have not been sufficiently specified. Overall, public expenditure net of tax credits is expected to increase by 1.7%, reflecting 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 both 2016 and 2017.

Under the no-policy-change assumption, the deficit is forecast to reach 3.1% of GDP in 2018. The revenue-to-GDP ratio should decline by 0.2 pps. as the corporate income tax is cut and due to the temporary nature of the yield of some revenue measures in 2017. The expenditure-to-GDP ratio would stabilize. Public investment and interest charges would grow at a more dynamic pace than over 2013-2017. However, current expenditure net of tax credits and interest charges would grow at a somewhat slower pace than over 2013-2017 in volume terms as it is assumed that the expenditure containment strategy is continued. The structural balance is projected to fall by around ¼ pps. in 2018. The debt-to-GDP ratio is forecast to rise further and reach 97.1% 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	**1.3**	**1.4**	**1.7**
Private Consumption	1201.5	55.1	1.9	0.5	0.7	1.5	**1.5**	**1.3**	**1.6**
Public Consumption	521.8	23.9	1.4	1.5	1.2	1.4	**1.5**	**1.0**	**1.2**
Gross fixed capital formation	469.2	21.5	2.2	-0.8	-0.3	1.0	**2.9**	**3.2**	**4.2**
of which: equipment	103.2	4.7	2.6	-3.5	2.0	2.3	**6.2**	**4.2**	**5.1**
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	**2.8**	**3.8**	**4.9**
GNI (GDP deflator)	2216.5	101.6	1.7	0.6	0.6	1.6	**1.3**	**1.4**	**1.7**
Contribution to GDP growth: Domestic demand			1.8	0.4	0.6	1.4	**1.8**	**1.6**	**2.1**
Inventories			0.1	0.2	0.5	0.1	**0.1**	**0.0**	**0.0**
Net exports			-0.1	-0.1	-0.5	-0.3	**-0.6**	**-0.3**	**-0.4**
Employment			0.7	0.1	0.2	0.4	**1.1**	**0.7**	**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	**0.6**	**1.5**	**1.9**
Unit labour costs whole economy			1.6	1.1	0.8	0.2	**0.4**	**0.8**	**1.1**
Real unit labour cost			0.1	0.3	0.3	-0.4	**-0.4**	**0.0**	**-0.1**
Saving rate of households (b)			15.1	14.0	14.1	14.1	**14.3**	**14.1**	**14.1**
GDP deflator			1.5	0.8	0.5	0.6	**0.8**	**0.8**	**1.2**
Harmonised index of consumer prices			1.7	1.0	0.6	0.1	**0.3**	**1.3**	**1.4**
Terms of trade goods			-0.2	1.3	1.6	3.8	**1.9**	**-0.2**	**0.1**
Trade balance (goods) (c)			-0.5	-2.0	-1.7	-1.0	**-1.2**	**-1.5**	**-1.7**
Current-account balance (c)			0.1	-2.9	-3.2	-2.0	**-2.1**	**-2.3**	**-2.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			0.1	-2.8	-3.2	-2.0	**-1.8**	**-2.1**	**-2.3**
General government balance (c)			-3.5	-4.0	-4.0	-3.5	**-3.3**	**-2.9**	**-3.1**
Cyclically-adjusted budget balance (d)			-3.9	-3.2	-2.9	-2.6	**-2.5**	**-2.2**	**-2.6**
Structural budget balance (d)			-	-3.3	-2.9	-2.6	**-2.5**	**-2.3**	**-2.6**
General government gross debt (c)			68.0	92.3	95.3	96.2	**96.4**	**96.8**	**97.1**

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