

2006

ANNUAL REPORT

BANQUE DE FRANCE

To
The President of the Republic
And Parliament

By Governor Christian Noyer



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The Banque de France's role is based on three main objectives:

- monetary stability;
- financial stability;
- the carrying out of public service and general interest tasks.

Within the framework of the Eurosystem, made up of the European Central Bank (ECB) and the national central banks (NCBs) of the euro area, the Banque de France's primary objective is maintaining price stability. By keeping inflation low, stable and predictable, the Eurosystem contributes to economic prosperity. Monetary stability underpins economic agents' confidence in the euro, our money: ensuring the former guarantees the stability of the latter. To this end, the Banque de France takes part, within the decentralised framework of the Eurosystem, in the preparation, implementation and explanation of the euro area's monetary policy. It also oversees the production and the quality of currency in circulation.

Monetary stability is a necessary, but not sufficient, prerequisite for financial stability. The latter also depends on the resilience of the financial sector and the smooth functioning of market infrastructures.

The Banque de France carries out regular assessments of the vulnerabilities of the financial system and endeavours to contribute to their alleviation. The objective of financial stability underpins several of the Bank's tasks at a national level, notably the authorisation and supervision of credit institutions and investment firms, the oversight of means of payment and payment

systems, and the assessment of the financial position of companies.

Within the framework of a public service contract, the State has entrusted the Banque de France with various specific tasks on behalf of private individuals, regional and local authorities, enterprises and banks.

The Banque de France's 2006 *Annual Report* comprises four chapters:

- The first is devoted to *Governance*.

It is the Banque de France's duty to act with maximum transparency and to communicate effectively, as an accountable institution of the French Republic. Its internal decision-making structures determine the Bank's strategic orientations in a collegial manner and are responsible for the institution's development over the medium term.

- The second, *The environment and implementation of monetary policy*, presents the main economic developments during the year under review, at a global level, in the euro area and in France, in order to put the monetary policy decisions and their implementation in context.

- The third, *The Banque de France, a key player in the economy*, describes the tasks the Bank carries out at the international, European and national levels. All of the different facets of its activities are illustrated in the light of the main events of 2006 and with the aid of some key data.

- The last chapter presents *The accounts of the Banque de France* for the year under review.

Within the European System of Central Banks (ESCB) the Banque de France is without doubt the national central bank (NCB) with the broadest range of responsibilities, stemming from both the European framework and national legal and regulatory provisions.

This wealth of tasks requires it to have in place decision-making structures that clearly define the responsibilities of each of its management bodies (see Section 1) and an operating mode that emphasises collegial decision-making at all levels of the institution.

This collegial approach to corporate governance plays a key role in its annual strategic planning. In these strategic discussions, the objectives for activities and projects are defined, costed and prioritised for the next financial year and over the medium term (see Section 2).

While the efficiency of the decision-making process is a permanent objective for all companies, the principle of prudence in risk management is even more essential for a central bank. It requires a clear definition and rigorous application of internal control mechanisms. The Banque de France has decided to set up a number

of structures that reflect the importance it attaches to risk monitoring and internal control (see Section 3).

The Banque de France, which is an institution of the French Republic, conducts its activities in a fully transparent manner. The Governor of the Bank appears regularly before Parliament and the Government to report on the tasks that the Bank carries out in the framework of the Treaty on European Union, those entrusted to it by French law, under the Public Service Contract and the various agreements signed with the State (see Section 4).

I | Management bodies

III | The Governors of the Banque de France

The Governor, Christian Noyer, assisted by two Deputy Governors, is responsible for managing the Banque de France. He chairs the General Council, and prepares and implements its decisions. He is in charge of appointments at the Bank and represents the institution in dealings with third parties.

The Governors of the Banque de France



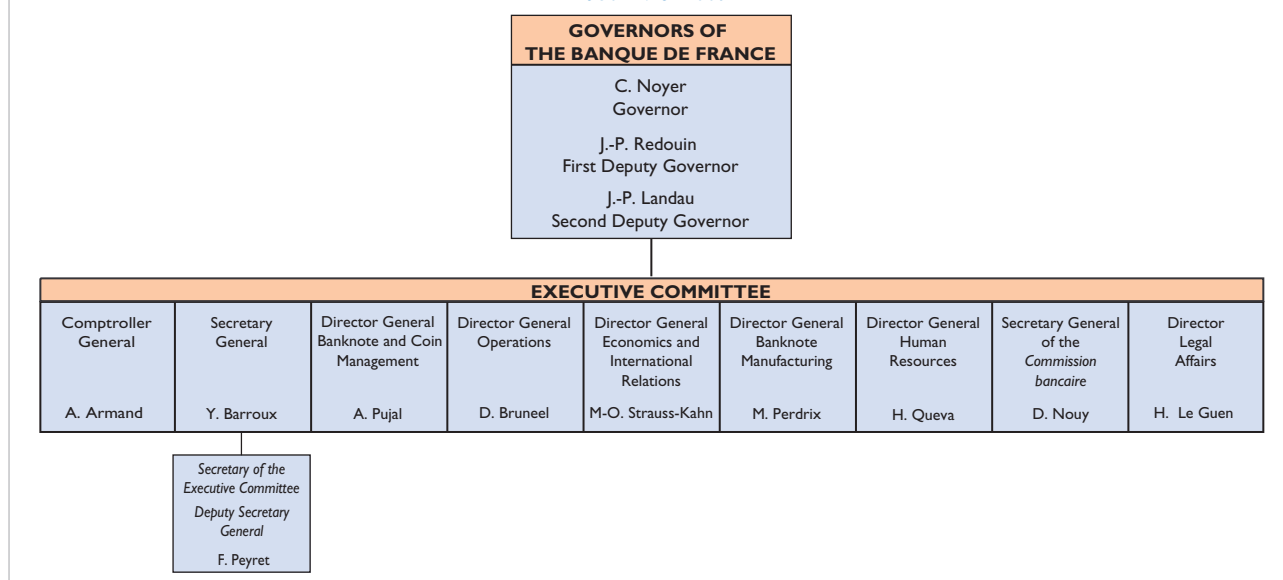
Jean-Paul Redouin

Christian Noyer

Jean-Pierre Landau

The Governors of the Banque de France and the Executive Committee

At 30 March 2007



The Governor and Deputy Governors are appointed by decree by the Council of Ministers for a six-year term, which may be renewed once.

The Governor has delegated his powers to the Directors General in order to ensure compliance with legal, regulatory and contractual provisions relating to staff relations and contracting.

The Deputy Governors have delegated to the Directors General their responsibility to sign, on behalf of the Governor and within the remit of the departments under their authority, all individual deeds and decisions, agreements and documents relating to the activities of their respective Directorates General.

1|2 The General Council

Pursuant to Act 2007-212 of 20 February 2007, the General Council comprises the Governor and the two Deputy Governors, two members appointed by the President of the Senate, two members appointed by the President of the National Assembly, and two members appointed in the Council of Ministers on the proposal of the Minister of the Economy and Finance and a representative of Banque de France staff. A Censor, or his/her alternate, appointed by the Minister of the Economy and Finance, represents the French State. The Censor attends the Council's meetings in possession

of all the necessary information and may submit proposals to the Council and veto any of its decisions.

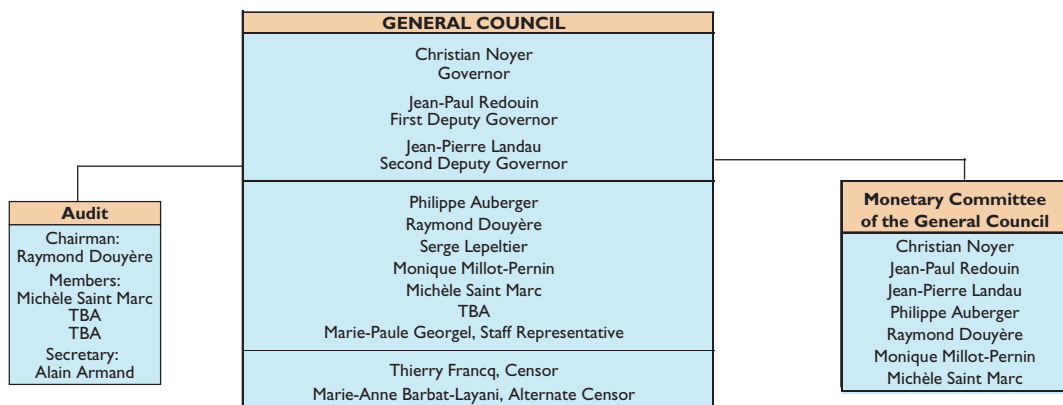
The General Council is in charge of administering the Bank. It examines issues relating to the terms of employment of the Bank's staff, which are submitted for approval to the relevant Ministers, and determines the rules applicable to the Bank's staff in areas where the provisions of the French Labour Code are incompatible with the statutes or public service tasks incumbent on it. The General Council decides on the use of the Bank's own funds. It draws up the Bank's expenditure estimates and annual accounts and makes proposals for the allocation of profits. In accordance with the above-mentioned principles, the General Council is, in particular, responsible for discussing the Banque de France's short and medium-term strategy. Each year, it therefore examines the business plan for the following year and reviews the progress of the projects underway. It also scrutinises the draft report on the implementation of the Public Service Contract. In 2006, within the framework of the previously-agreed real estate strategy, it took a series of decisions concerning the sale of a number of operational buildings.

The Monetary Committee of the General Council, created by the Act of 20 February 2007, comprises the Governor and the two Deputy Governors and the members of the General Council appointed by the Presidents of the Senate and the National

The General Council



Marie-Paule Georgel Serge Lepeltier Raymond Douyère Philippe Auberger Thierry Francq
Michèle Saint Marc Jean-Paul Redouin Christian Noyer Jean-Pierre Landau Monique Millot-Pernin



Assembly. It analyses monetary developments and the implications of the monetary policy conducted within the framework of the ESCB. It formulates the specific measures necessary to transpose into the national body of regulations the decisions adopted by the ECB Governing Council regarding monetary policy operations and to implement the Eurosystem's collateral and risk control framework.

In accordance with the provisions of Article L. 142-6 of the Monetary and Financial Code, the Head of the Treasury and Economic Policy or his/her representative may participate in meetings of the Committee and

may submit any proposals for consideration by the latter, but may not vote.

1|3 Independence of the Governor and the Banque de France's governing authorities

The independence of the Banque de France, as a member of the ESCB, implies the independence of the Governor, the Deputy Governors and the General Council, particularly the members of its Monetary Committee.

Box 1

Monetary Policy Council

The Act of 31 December 1993 entrusted the Monetary Policy Council with a major role in the setting of monetary policy and made it a key element of the Banque de France's independence. The members of the Monetary Policy Council were all appointed by joint agreement between the Parliament and Government. They provided the Governor with independent views on monetary policy, reflecting the diversity of their wealth of past experience. The members of the Monetary Policy Council moreover played an essential part in the dialogue with opinion leaders, business managers and bankers, in particular in the regions, where they were responsible for providing information and explanations about the Eurosystem's strategy and monetary policy decisions.

In 2006, the Council met 16 times and approved in particular the transposition into French law of a number of decisions relating to monetary policy instruments and procedures.

The Act of 20 February 2007 dissolved the Monetary Policy Council whose tasks had changed since 1 January 1999, when the Banque de France became part of the European System of Central Banks (ESCB).

In accordance with Article L 141-1 of the Monetary and Financial Code, the Banque de France, represented by its Governor, Deputy Governors or any other member of the Monetary Committee of the General Council, shall neither seek nor accept instructions from the Government nor any other body in the performance of the tasks arising from its participation in the ESCB. Furthermore, in accordance with Article L 142-6 of the said Code, the Monetary Committee of the General Council shall act with due regard to the principle of independence of its chairman, who is a member of the European Central Bank's Governing Council, and abide by the ECB's confidentiality rules. Lastly, Articles L 142-3 and L 142-7 stipulate that the Monetary Committee of the General Council shall ensure that the professional activities performed by their members comply with the principle of independence of the Banque de France.

1|4 The Audit Committee

Under the decision of 22 October 2004, the General Council set up an Audit Committee, made up of non-executive members of the General Council. Its chairman is appointed by the General Council, on the proposal of the Governor, and the Comptroller General of the Banque de France provides its secretariat. The composition of the Audit Committee will be reviewed after the new General Council has been

set up, in accordance with the above-mentioned Act of 20 February 2007.

The responsibilities and operating rules of the Audit Committee are specified in a charter annexed to the General Council Decision.¹ Its remit covers financial information, external and internal audit, internal control and risk control; in all these fields, the Audit Committee may examine any member of Banque de France management or auditors. It reports to the General Council.

In 2006, the chief task of the Audit Committee was to approve the 2005 annual accounts. In this regard, the Bank's auditors presented their report to the members of the Committee. The Committee was also informed of the main conclusions of the internal audit missions and the results of the work on operational risk management. Lastly, the Committee took part in the drawing up of the internal audit programme for 2007.

Furthermore, in 2006, the Banque de France renewed, following a tender procedure, the term of office of two of its statutory auditors.² The latter were appointed by the General Council of the Banque de France on the proposal of the Governor. In accordance with Article 27 of the Statute of the ESCB, external auditors shall be approved by the Council of the European Union and recommended by the ECB Governing Council. The Audit Committee ensured that the procedure

¹ Bulletin officiel de la Banque de France (Official Bulletin of the Banque de France), No. 74, February 2005.

² Mazars & Guérard and Deloitte & Associés.

carried out complied with the above. The existence of the Audit Committee strengthens the governance structure of the Banque de France by enhancing the already comprehensive internal control and risk management system, which is considered by the Bank's auditors to be "in line with best practices".

1|5 The Executive Committee

Both in its plenary and reduced form, the Executive Committee is at the heart of the operational functioning of the Banque de France. It constitutes the forum in which the Bank's managers exchange their viewpoints on a range of subjects of common interest in order to facilitate the collegial decision-making process.

The Executive Committee, which is chaired by the Governor, comprises the Deputy Governors, the Directors General, the Deputy Secretary General for Strategy and Planning and the Legal Affairs Director. The Committee examines issues relating to the the Bank's strategy and internal management. The meetings of the Executive Committee may be prepared, if necessary, by smaller committees involving the managerial staff directly concerned.

The Executive Committee met to discuss issues relating to the Bank's strategy, changes in its tasks, structures and working methods, human resource management (the introduction of performance-based bonuses, profit-sharing, business ethics, etc.), risk analysis and resource allocation.

The Executive Committee



1|6 The College of Regional Managers

The aim of the reform of the Banque de France's branch network, whose final stage was completed on 1 July 2006, was primarily to enable the Bank to better respond to the changes in its environment and activities and to better meet the expectations of its different partners. However, this reform also sets out to promote a new, more decentralised and more efficient operating mode on two levels:

- The region is a management level; the regional manager, i.e. the manager of the branch in the region's capital, co-ordinates and supervises the activity of the various branches throughout the region, and ensures the consistency and quality of the work carried out.
- The *département* is an operational level; it includes the *departmental* branch and, possibly, other associated specialised units, in charge of implementing the objectives assigned to the branch network in close contact with the Banque de France's usual partners (banks, companies, individuals, local authorities and administrative bodies).

Regional managers are responsible for fostering initiatives and promoting good practices in all operational fields. They are also in charge of allocating budget resources within the branch network, using financial control instruments, supervising and maintaining the Bank's property, staff training schemes and the various initiatives relating to risk control. In the performance of their different tasks, regional directors act on the opinions of the regional board of directors, which is a unique forum where regional heads of units can discuss the most important issues relating to the management of the region.

Regional managers are assisted by centres of expertise and a specific structure in charge of supervising operations and procedures: the "regional risk control unit". The role of this unit is to carry out second-level checks of the *departmental* control structures, and to organise and co-ordinate all control and security-related activities across the region.

In view of their responsibilities, the regional managers are the prime contacts of the Banque de France's Governors and Head Office managers for any questions relating to the branch network. The College of Regional Managers is chaired by the Secretary General and the Branch Network Manager; it also includes the five regional inspectors. Its meetings, which are held once every two months, are devoted to discussing the

projects of the heads of the business areas relating to the branch network and examining the activities carried out by the network. They also constitute a forum for sharing experience.

2| Strategic planning and management

2|1 Strategic plans

Every year, operational managers and support function managers are called upon to propose, in keeping with the general guidelines laid down by the Governor, a series of strategic plans to provide the basis for their activity during the following year within a medium-term perspective. These proposals, together with their implications in terms of financial and human resources, are examined during a special Executive Committee meeting. Following this meeting, the priorities of the Banque de France are subsequently decided on, prioritised and costed.

A progress report on the implementation of the initiatives laid down in this strategic plan is then presented to the Executive Committee during the year.

In this regard, the 2006 strategy continued to be based on the three main guidelines that have directed the implementation of the Bank's strategies for several years:

- The first gives concrete expression to the Banque de France's determination to take an active part in the smooth functioning of the Eurosystem. It involves:
 - the consolidation of all its operational capabilities;
 - the reinforcement of its centres of expertise, which is especially necessary since the organisation of the Eurosystem increasingly gives national central banks the opportunity to develop their fields of excellence.
- The second guideline illustrates the Banque de France's resolve to effectively carry out the wealth of challenging tasks entrusted to it by the law and the Public Service Contract.
- Against the backdrop of these twin objectives, the policy constantly reengineering operational processes and management constitutes the third guideline; it is the hallmark of the Bank's ability to organise changes based on the following basic principles: rationalising working methods, generating productivity gains,

and improving the quality and monitoring of performance.

2|2 Operational management

The strategic decisions concerning the implementation of the Bank's operations and the key support functions are formulated by internal advisory committees.

Two bodies play a crucial role in the conduct of investment policies and market operations: the "Assets-Liabilities" Committee and the Risk Committee.

The Assets-Liabilities Committee advises the Governor on the Bank's portfolio investment strategy (both for euro and foreign currency denominated portfolios). It issues opinions, in particular, on the volume of investment, its allocation by type of asset and its duration.

The Risk Committee, chaired by a Deputy Governor, lays down the conditions under which market operations should be conducted for the Bank's portfolios as a whole. In this regard, it draws up the list of authorised issuers, countries and instruments, validates the methodologies for measuring risk and the performance of market activities, sets the risk limits for these operations and examines the audit, control and activity reports relevant to its field of competence.

The Bank's support functions also operate on a collegial basis, through two committees placed under the authority of the Secretary General. The IT Strategy Group is responsible for defining the Bank's short- and medium-term policy with respect to IT investment, while the Real Estate Investment Committee is in charge of managing the Bank's real estate assets.

2|3 Internal organisation

With a view to improving the Bank's capacity to adjust to the changes in its tasks, a number of structural reforms of differing magnitudes continued to have an impact in 2006. The most significant, in terms of the number of employees or sites affected, concerned the Bank's branch network. On a smaller scale, all units

were invited to continue and renew the reorganisation of their operating processes.

Following numerous consultations, both internally and with local and regional representatives and the finance committees of the two Chambers of Parliament, the branch network restructuring project was adopted by a decision of the Banque de France's General Council on 5 December 2003. It takes into account, within the framework of the Eurosystem, the technological and economic changes in the Bank's activities, matters relating to regional development, the specific organisational features of the French administrative system and the particular nature of the services provided to users.

These reforms of the branch network enable the Banque de France to fully exercise all the tasks and responsibilities assigned to it by the Treaty on European Union and by French law, with a view to providing the best services at the lowest cost to the public. Furthermore, this reform allows the Banque de France to uphold a high-quality service to its users, in particular with regard to dealing with situations of overindebtedness and access to payment incident databases or basic banking services.

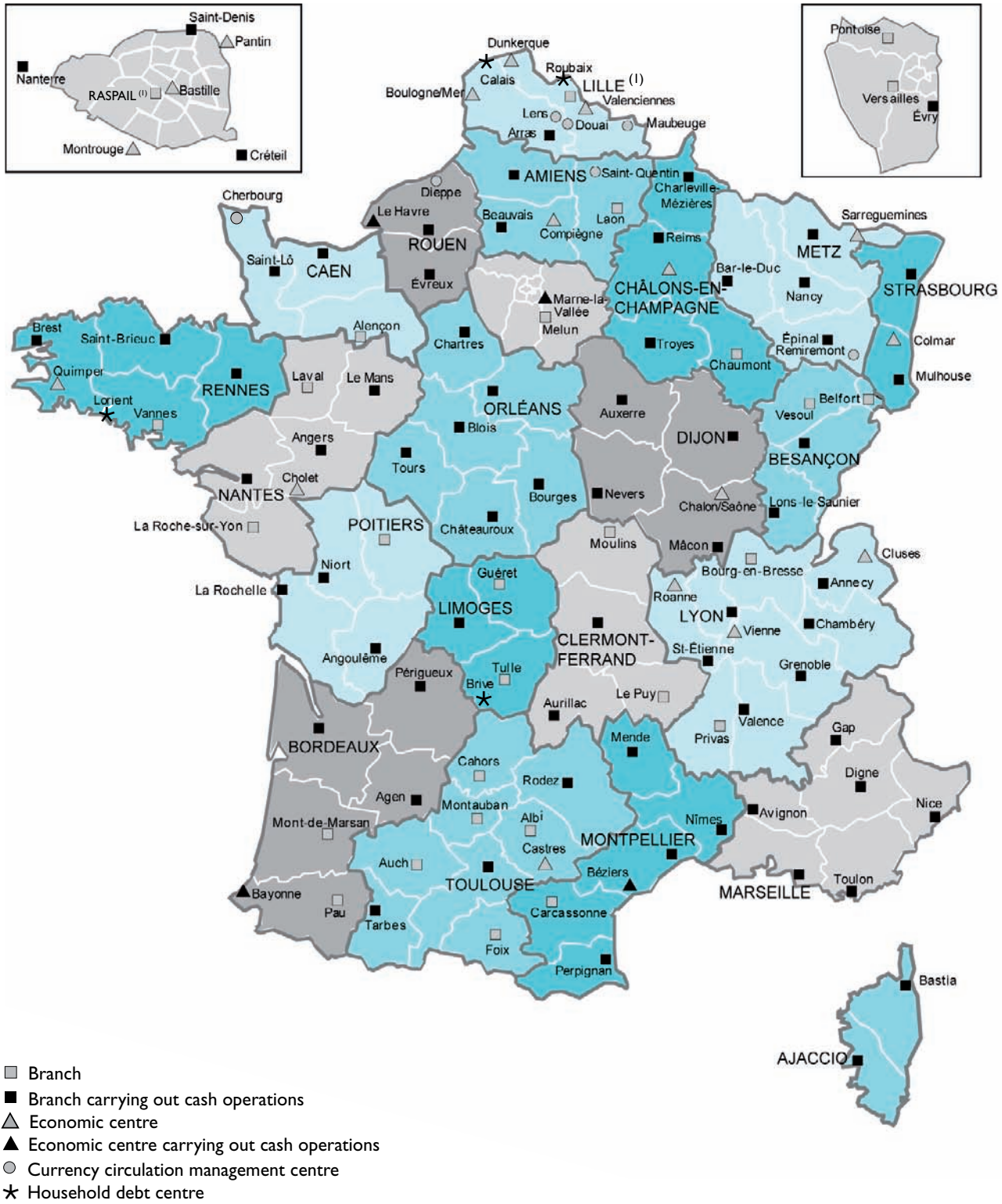
On 1 July 2006, which was the third and final stage of the network restructuring project, 20 branches and 13 cash centres were closed; 16 branches were converted into special units and 20 customer service and information offices were created.

Since then, the Bank's branch network has performed its tasks in its new configuration. The 211 branches – of which 131 offered cash facilities for institutional clients – that still existed at the start of 2004, were replaced by 96 departmental branches (68 of which carry out cash operations) (see map), supplemented by 32 other sites carrying out different tasks:

- 21 economic centres, four of which carry out cash operations;
- 7 household debt centres;
- 4 cash processing centres.

In order to ensure that the requirements of the users of public services provided by the Bank are met (household debt, access to payment incident databases and the right to basic banking services), and in accordance with the Public Service Contract concluded with the Government, 85 customer service and information offices have been set up in

The Banque de France network at end-2006



Cities where regional head offices are located are indicated in capitals (e.g. LILLE)
 (I) Branch carrying out private customers' cash activities

towns where the Banque de France, after closing its branches, retains neither an economic centre nor a centre for processing applications to the household debt commission. These non-permanent offices are located on the premises of other administrative bodies, such as town halls or *sous-préfectures*.

The activities in each of the regions are co-ordinated by the 22 Banque de France regional directorates located in each of the regional administrative centres.

2|4 Human resource management

2|4|1 Reform of the Banque de France pension scheme

The decree of 27 February 2007 concerning pensions resulted in major changes to the previous system. It was drawn up following an in-depth consultation throughout 2006 with the trade unions. It entered into force on 1 April 2007.

The main aim of the reform is to ensure the financial consolidation of the Banque de France pension scheme. This consolidation is to be achieved by:

- transposing the reforms implemented in 2003 in the civil service into the Bank's pension scheme;
- broadening the contribution base;
- introducing measures aimed at improving the financial robustness of the Employee Reserve Fund.

Transposing the civil service reforms

The main measure concerns the gradual increase in the maximum retirement age and the extension of the contribution period required to receive a full pension. Employees of the Banque de France will be able, with a few exceptions, to retire between 60 and 65 years old. To receive the full pension, they will have to have contributed to the Bank's scheme for 160 quarters, which may be extended to 164 by 2013.

If the number of quarters in which contributions are made is lower than that required for the full pension, the pension is reduced. This reduction mechanism will be progressively applied as of 1 January 2009. If the number of quarters exceeds that required, the pension is increased.

Furthermore, similarly to the solution adopted in most pension systems, including that of the civil service since 2004, pensions will henceforth be revalued according to expected changes in the price index excluding tobacco and no longer in relation to changes in the wages of the labour force.

Other measures aimed at transposing the civil service reforms into the Bank's pension system include: buying back periods spent in higher education, recognising periods of part-time work as periods of full-time work, aligning male employees' family benefits and rights to a survivor pension with those of female employees, retirement before 60 for disabled employees and those starting their career at a very early age. In the future, the Banque de France's pension scheme will reflect any changes in that of the civil service.

Broadening the contribution base

The contribution base now includes all the fixed elements of remuneration.

Measures aimed at improving the financial robustness of the Employee Reserve Fund

The Employee Reserve Fund henceforth receives, each year, an allocation that enables it to cover the new rights acquired over the year by current members of staff. Furthermore, the portion not covered at present of the liabilities in respect of past rights will be progressively funded by an allocation to a special Banque de France reserve fund, over the next eight to ten years, within the limits of the gross income of the Banque de France and the payment to the State of the predominant share incumbent on it.

2|4|2 Staff

On 31 December 2006, the Banque de France counted 12,998 full-time equivalent staff, down by 7% on the previous year. Between 1993 and 2006, staff numbers fell by 27.5%.

Statutory employees, whose male-female breakdown is roughly equal, are mainly in the 30-49 age bracket, even though this share is falling while that in the 50-54 age bracket is rising, with the average age standing at 45 in 2006.

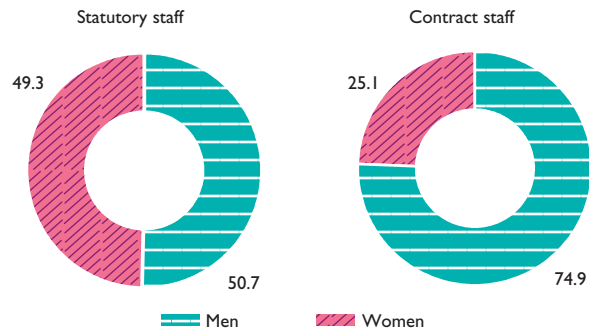
Staff levels

(Full-time equivalent positions at 31 December)

	2005	2006
STATUTORY STAFF	12,652	11,829
Male	6,282	6,001
Female	6,370	5,828
Head office	5,588	5,295
Management	1,518	1,487
Other categories	4,070	3,808
Branch network	6,199	5,745
Management	921	847
Other categories	5,278	4,898
Banknote manufacturing	865	789
Management	11	9
Other categories	854	780
CONTRACT STAFF	1,320	1,169
Specialy-recruited staff	342	374
Head office	218	231
Banknote manufacturing	124	143
Other staff (excluding occasional workers)	978	795
Security staff	758	601
Cleaning staff and others	220	194
TOTAL	13,972	12,998
Men	7,281	6,876
Women	6,691	6,122

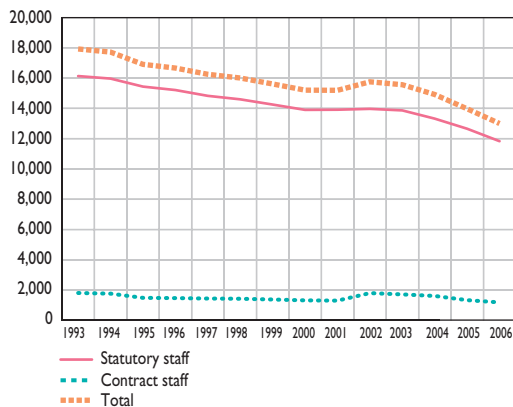
Male/female breakdown

(%)



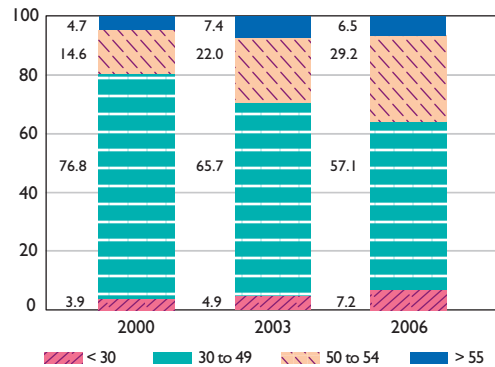
Staff numbers

(Full-time equivalent positions at 31 December)



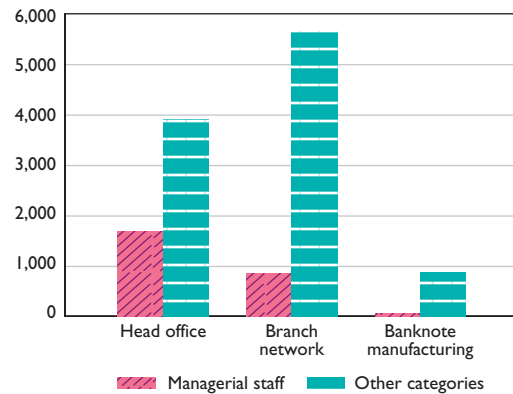
Breakdown of statutory staff by age bracket

(%)



Location of full-time staff

(Full-time equivalent positions)



Some 43% of staff members work at the Head Office, 50% in the branch network and 7% in banknote manufacturing.

2 | 4 | 3 Secondments of Banque de France staff to external organisations

In 2006, the Banque de France pursued its policy of seconding staff to external organisations. At end-2006, staff secondments were as follows:

- 52 members of the Bank's staff were seconded to various French organisations, including the Autorité des marchés financiers (AMF – Financial Markets Authority), the French overseas departments note-issuing bank (IEDOM) and a number of ministries;

- 87 members of staff were seconded abroad to European institutions, international organisations and embassies, and in particular to the European Central Bank (34 staff members), the International Monetary Fund and the Bank for International Settlements.

3 | Risk control, quality approach and sustainable development

3|1 Internal audit

The internal audit covers all of the Bank's operational units, processes and activities. It is conducted at the Head Office, the regional administrative centres and in the branch network; its organisation is therefore structured accordingly. The internal audit, whose work programme centres on a risk-based approach, aims to offer the Banque de France's managing authorities an objective and independent guarantee as to the quality of the management, risk control and internal audit processes. By helping the Bank to attain its objectives, the internal audit contributes to improving corporate governance. The international standards for the professional practice of internal auditing as defined by the Institute of Internal Auditors serve as a reference both with regard to the organisation and the conduct of audit missions; an internal assessment aiming to ensure that the organisation and practices of the internal audit comply with these standards was conducted in 2006 in preparation for the corresponding external assessment to be carried out at the end of 2008.

The work of the internal audit is clearly in line with the framework of the ESCB. The Comptroller General and the head of the Head Office Audit are permanent members of the ESCB Internal Auditors Committee that meets several times a year at the ECB. Together with their NCB and ECB counterparts, they are in charge of defining the ESCB's audit programme and overseeing the conduct of the audit missions. The committee then submits its conclusions to the Governing Council.

Representatives of the internal audit function take part in the methodological work conducted in the framework of the G10 conferences and working groups set up by the Bank for International Settlements. They also participate in benchmarking exercises to identify

best professional practices. Lastly, a large number of delegations of internal auditors from central banks in developing countries attend training courses in Paris, while Banque de France inspectors conduct on-site technical assistance missions abroad.

In 2005 the Head Office Audit undertook to implement a quality management system and was awarded, in July 2006, the certificate of compliance ISO 9001-2000 by Bureau Veritas Certification (formerly BVQI) for its provision of services in the areas of internal auditing, ESCB tasks and surveys.

3|2 Risk prevention

Since 2002, the Banque de France has implemented a risk management approach (the AMARIS method) in order to:

- strengthen the internal control function thanks to a common framework for operational risk control;
- promote the adoption of the best practices recommended by the Basel Committee in this area.

The following organisation was put in place:

- In each Directorate General, risk managers are in charge of mapping operational risks and assisting in the implementation of risk-reduction action plans; in addition, in each regional branch, a risk control unit is responsible for ensuring that the control mechanisms are properly implemented.
- Within the Risk Prevention Directorate, attached to the Comptroller General, a special unit is in charge of providing assessments, co-ordinating work and reporting its results to the Bank's top management, while another unit is responsible for information security.
- At the highest level, the report on risk analysis and the action plans based on an updated general risk map are presented to the Executive Committee. The Internal Control Co-ordination Committee (3CI) comprises the Directors General and risk managers and is chaired by the Comptroller General. It is charged with supervising the progress made towards tighter risk control in all of the Banque de France's fields of activity.

The security of information systems, which is an important component of operational risk, is constantly being improved. In 2006, against the backdrop of the increasing dematerialisation of financial

transactions, projects to improve the security of technical infrastructures focused on renewing and strengthening anti-virus systems, and commissioning digital certificate issuance systems and electronic signature management and control systems.

3|3 Quality approach and sustainable development

Above and beyond its risk management requirements, the Banque de France is developing a policy to enhance and reinforce the quality of services provided to its clients. In this respect, a large number of internal processes have been optimised and have benefited from external certification (ISO 9001-2000). This quality approach was extended in 2006, with the certification of all units of the Data Processing and Telecommunications Directorate and the quality management system of the Head Office Audit processes.

In addition to these certification procedures, a number of quality-related initiatives have been launched, in particular in the real-estate sector.

For instance, over and above its obligations in the area of regulatory environmental protection (asbestos, lead, energy performance assessments, etc.), the Banque de France has deliberately taken part in the national strategy to reduce greenhouse gas emissions. It commissioned, in partnership with the French Environment and Energy Management Agency (Ademe), the energy audit of the buildings of its Head Office and two of its branches, in order to identify potential sources of savings and to define and implement, in the first half of 2007, an action plan to reduce costs relating to its real estate stock.

The Banque de France has reaffirmed its intention to become involved in sustainable development by discussing ways to more largely integrate corporate social responsibility into its strategy (decision from the business plan review of October 2006).

New concrete initiatives have already been taken:

- The two banknote production sites (the printing works and the paper mill) obtained environmental certification ISO 14001 in 2002 and participate in the national programme to reduce greenhouse gas emissions (application of the CO₂ emission quotas).

- The new building for the Avignon branch will be constructed to high environmental quality (HEQ) standards. Work will start in 2007.

- An “environmental quality” strategy, based on the HEQ approach, was incorporated into the plan to improve the premises of the Head Office and annexes (SALSA project).

4| Transparency and responsibility

4|1 Relations with Parliament and the Government

Annual report and hearings of the Governor

The independence of the Banque de France within the framework of the ESCB requires total transparency in terms of the way in which it carries out its tasks. This transparency is achieved, in particular, through the publication of an Annual Report submitted to the French President and Parliament and the regular hearings of the Governor organised by the specialised committees of the National Assembly and the Senate. In 2006, the Governor appeared before the Finance, Economics and Planning Committee of the National Assembly on 8 February, and then before the Finance, Budgetary Control and National Economic Accounts Committee of the Senate on 28 March to comment on the economic and financial environment and the internal functioning of the Banque de France.

Censor to the General Council and reports by the Court of Auditors

The Censor, the Government representative on the General Council, is responsible for supervising the Banque de France's internal management. In this respect, he/she is authorised to give an opinion on, and even oppose, any of the Banque de France's decisions. The Bank's internal management is also regularly audited by the Court of Auditors, which examines the manner in which the Bank performs its tasks and activities, in particular in terms of their financial implications. As is the case for the other public bodies subject to supervision by the Court of Auditors, the results of these investigations are published in a report available to the public. The last public report was published in March 2005 with a follow-up report

in January 2007 that highlighted the fact that the recommendations of the Court of Auditors had been closely followed and that the Banque de France had “resolutely stepped up the reform process”.

Special agreements with the State

In order to properly assess the efficiency of the Banque de France in the light of the national and international provisions governing its activity, it is important that the means by which it provides services to the national community be clearly specified. This is the purpose of the agreements that define the nature of the services that the Banque de France provides on behalf of the State as well as the conditions under which it receives compensation. The main agreements between the Banque de France and the State concern the processing of household debt, the issuance of coins, the management of the Central Cheque Register and the Treasury’s account, and the management of debt consolidation agreements with foreign countries.

4|2 The application of the Act on data processing, computer records and civil liberties

The Governor decided, in accordance with the provisions of the amended Act 78-17, to appoint a correspondent for the protection of personal data. The latter is charged with ensuring, in an independent manner, compliance with the obligations of the aforementioned Act for all the Banque de France’s automated data processing functions. To this end, the correspondent may make any recommendation that he/she considers appropriate to the data processing managers. The correspondent shall be consulted, prior to their implementation, regarding new processes or changes to existing applications. Where necessary, he/she assists and advises the administrative units on their duties vis-à-vis the French Data Protection Authority (CNIL).

The correspondent shall not be given instructions as to the exercise of his/her functions. He/she may consult the Bank’s governing authorities, who are

responsible for all processing functions, regarding any difficulties encountered in the conduct of his/her duties that cannot be resolved following discussions with the managers in question.

The correspondent shall also carry out the tasks previously entrusted to the data protection officer, which is a post that was created in 2003 following the publication of the CNIL report on “Cybersurveillance in the workplace”. In this capacity, he/she is charged in particular with enforcing and updating the provisions of the “Charter for the use of information and communication technologies” and with ensuring the protection of personal data regarding Banque de France staff.

4|3 Specific rules applicable to Banque de France staff

Code of Financial Ethics

Banque de France employees are bound by the confidentiality obligations laid down in Article L142-9 of the French Monetary and Financial Code. They may not take or accept any holding or interest in, or remuneration from another company, unless a derogation is granted by the Governor.

These provisions do not apply to scientific, literary or artistic work.

Derogation requests are examined by a committee, chaired by the Professional Ethics Officer, which issues a reasoned opinion; they are then transferred to the Governor for a decision.

Banque de France employees are also subject to a Code of Financial Ethics. Compliance with this Code is ensured by the Professional Ethics Officer. The Code’s provisions aim to prevent any behaviour that might be detrimental to the Bank or situations of conflicts of interest. The strictest provisions apply to employees whose duties in any way involve the negotiation of procurement contracts on the Bank’s behalf or employees liable to hold non-public information.

4|4 Communication

The Banque de France's communication strategy vis-à-vis the general public, the media and professionals contributes to fostering greater transparency. Its main aim is to inform these players about the Bank's mission within the Eurosystem. The latter co-ordinates its communication activities to make them as clear and effective as possible. In order to facilitate access to the Eurosystem's documentation, the Banque de France translates into French and disseminates the ECB's press releases and major publications.

In addition to press releases and the usual relations with the press, the Banque de France uses various other vehicles of communication to convey its messages and make its tasks known to the public. These include notably: the *Rapport annuel de la Banque de France* (Annual Report), the *Bulletin de la Banque de France* (Banque de France Bulletin) (monthly) and the *Revue de la Stabilité financière* (Financial Stability Review) (biannual). New publications such as the *Rapport sur la surveillance des moyens de paiement et des systèmes d'échange* (Report on the oversight of payment media and exchange systems)³ and one-off studies such as the *Rapport au Parlement sur les incidences de la réforme de l'usure sur les modalités de financement des petites et moyennes entreprises* (Report to Parliament on the impact of the "usury reform" on the financing of SMEs)⁴ contribute to improving the knowledge of the general public and professionals of the Bank's activities.

In accordance with the law, the *Rapport annuel de la Banque de France* is submitted to the President of the French Republic and Parliament. It presents the Banque de France's operations, monetary policy and its outlook. It is accompanied by a letter from the Governor, which gives the Bank's main views on economic and monetary issues.

In order to make its communication more readily available, the Banque de France regularly posts its publications, reports and other information on its website, *www.banque-france.fr*. Since 2006, a new collection of on-line economic publications, *Débats économiques* (Economic debates), presents subjects of interest to a wide audience, including economic policymakers, academics, the media and the general public. Working papers are posted in order to contribute to on-going economic debates and benefit from external comments.

In order to ensure consistency and better visibility, the Banque de France has extended its publication layout guide to the reports and studies published by the bodies and institutions for which it provides the secretariat.

The Bank's publications and part of its website are translated into English so as to convey its economic message to an international audience.

³ Available of the Bank's website (http://www.banque-france.fr/fr/sys_mone_fin/rapports/page5.htm).

⁴ Available on the Bank's website (http://www.banque-france.fr/fr/stat_conjoncture/telechar/stat_mone/rapport_bdf_28_12_2006.pdf).

THE ENVIRONMENT AND IMPLEMENTATION OF MONETARY POLICY

In 2006, growth in the economies of the euro area's main trading partners was robust and financial markets proved resilient to a number of bouts of turbulence and persistent international imbalances (Section 1).

In the context of this favourable international environment, growth in the euro area firmed and became more broadly based (domestic demand, including investment, and exports to the main trading partners). In the first part of 2006, euro area inflation remained above 2%, fuelled by high energy prices, before falling below this mark at the end of the year. The ongoing rapid expansion of money supply and credit aggregates contributed to ample liquidity, posing a potential risk to price stability in the longer run. The Governing Council of the European Central Bank (ECB) reviewed the short-and long-term determinants of future inflation and continued to adjust its accommodative monetary policy stance, raising its key rate five times over the year from 2.25% to 3.5% (Section 2).

The Banque de France's implementation of the single monetary policy at the national level was marked in 2006 by a decline in French banks' participation in the Eurosystem refinancing operations, in contrast to 2005, while the liquidity requirements of euro area banks generally increased (Section 3).

I | The international environment

I | Economic growth in countries outside the euro area

The United States

The US economy grew at a robust pace in 2006 (3.3%, compared with 3.2% in 2005). Nevertheless, GDP growth fell off sharply in the second half of the year, with the slowdown coming mainly from the drop in the residential property sector: in 2006, sales of new homes declined by 18% and housing investment by 4%. Corporate investment also contracted slightly at the end of 2006 (3.1% in Q4 quarter-on-quarter, annualised, after +10%), due to cyclical factors (e.g. transport regulations) as well as perhaps some structural factors (e.g. downward revision of earnings expectations). Household consumption posted only a

NB: Data are as at 1 June 2007.

Main economic indicators for the United States and Japan

(%)

	United States		Japan	
	2005	2006	2005	2006
Gross domestic product (a)	3.2	3.3	1.9	2.2
Industrial production(a)	3.2	4.0	1.1	4.6
Consumer prices (a)	3.4	3.2	-0.3	0.2
Unemployment rate (b)	5.1	4.6	4.4	4.0
General government deficit (c)	-3.7	-2.3	-5.3	-4.6
General government debt (c)	60.5	60.3	173.1	176.2
Current account balance(c)	-6.4	-6.5	3.7	3.8

(a) Annual average change.

(b) In level form.

(c) As a % of GDP.

Sources: national and OECD.

moderate decline thanks to the strength of the labour market: high net job creation and the downward trend in the unemployment rate since 2003 (from 5.1% in 2005, to 4.6% in 2006). In the second half of the year, the negative impact of house price depreciation on household consumption was partially offset by the growth in compensation driven by a catch-up with past productivity gains, lower energy prices and higher stock prices. Corporate investment expanded before contracting in the last quarter.

Inflation, as measured by the Consumer Price Index (CPI), decreased from 3.4% in 2005 to 3.2% in 2006, mainly due to the slowdown in energy goods prices. Excluding volatile energy and food prices, the inflation rate rose from 2.2% in 2005 to 2.5% in 2006. Unit labour cost growth increased in 2006 (3.2%, after 2.0% in 2005) due to both the continued slowdown in hourly productivity growth (1.6%, after 2.1% in 2005) and the faster compensation growth (4.8%, after 4.1% in 2005), stemming from tightness on certain segments of the labour market.

Despite some improvement, persistent macro-financial imbalances continue to undermine the sustainability of the United States' economic performance. The current account deficit widened from 6.4% of GDP in 2005, to 6.5% in 2006. This broadly unchanged figure largely reflects the decline in oil imports in value terms in Q4, as well as the slowdown in import growth of goods and services other than oil (9.0% in 2006, after 9.7% in 2005), in line with weaker domestic demand (3.1% in 2006, after 3.3% in 2005).

Box 2

Is corporate investment behaviour in the United States “normal”?

Given the strong earnings growth of companies in the G7 countries, firms’ business investment behaviour reveals a major “global imbalance”.

Companies as net lenders

According to a study in the IMF World Economic Outlook¹, in 2003 and 2004, corporates in G7 countries accumulated USD 1,300 billion in financial assets, which was more than twice the size of the current account surpluses of emerging markets and developing countries. This atypical situation can be ascribed to both the historically high share of profits in GDP and to fixed capital investment trends. Although the level of the latter has been high, its share in value added has nevertheless remained for a long time below its long-term average: 12.2% in 2006 for US non-financial corporations, i.e. more than 2 percentage points below its 20-year average.

So how are businesses using their profits?

First, they are accumulating considerable amounts of liquidity. For instance, in 2004-2005, liquid assets accounted for 10% of US firms’ balance sheet total and 9% in 2006, a level that is difficult to explain by a historical precedent or a standard economic approach. Second, they indirectly redistribute a large amount of these profits to shareholders. In the United States, net equity issuance by non-financial corporations amounted to a negative total of USD 600 billion in 2006 (excluding dividends). Third, companies have been engaged in significant merger and acquisition activity, financed in part through cash financing, but also through debt financing.

Does corporate investment behaviour appear to be “normal”?

On the one hand, this situation can be explained by the fact that the excess capital accumulation observed over the past decade is still being absorbed, which considerably slows fixed capital formation. The capacity utilisation rate of US manufacturers only returned to its long-term level at end-2005. On the other hand, corporate investment behaviour may be conditioned, at least partly, by very high risk aversion to new investment. A number of reasons could explain why risk premia on physical investment are very high relative to those on financial assets:

- geopolitical uncertainties, which affect investment decisions;
- global current account imbalances are likely to fuel expectations of exchange rate adjustments, causing firms to postpone their decisions;
- extreme caution on the part of managers, who have learnt lessons from the market’s reaction during the previous period of over-investment.

In the course of the economic cycle the financial position of companies should return to normal. In the United States, wage growth should eventually catch up with current productivity gains, meaning that the share of corporate profits in GDP should decline. At the same time, investment rates should continue to rise, in particular given that capacity utilisation rates have recently returned to levels above their long-term average, which should help reduce excess corporate savings. However, a less optimistic scenario cannot be ruled out, i.e. risk premia on financial assets eventually rising to the levels of those on physical investment, as such differences in risk premia cannot last.

¹ “Awash with Cash: Why Are Corporate Savings So High?”, World Economic Outlook – Prospects and Policy Issues, Chapter IV, April 2006.

The general government deficit narrowed in 2006 from 3.7% to 2.3% of GDP, thanks to exceptional revenue growth, which more than offset the high level of spending. Reforms nevertheless remain necessary to ensure the sustainability of public finances in the medium term. Household debt rose from 116% of GDP in 2005 to 120% in 2006, despite the slowdown in mortgage loans. The debt-to-GDP ratio of non-financial corporations remained stable in 2006. It nevertheless increased in Q4 due to the sharp rise in net bond issues.

Japan and emerging Asian economies

In Q4 2006, Japan put in its eighth consecutive quarter of growth. Over the year as a whole, growth reached 2.2%, compared with 1.9% in 2005. This good performance can essentially be ascribed to a strengthening of domestic demand in Q4 2006. Employment conditions improved substantially, as reflected in the fall in the unemployment rate (from 4.4% in January 2006 to 4.0% at the end of

the year), and the record level of the vacancies to unemployment ratio. Against this backdrop, wage growth remained relatively subdued in 2006 at 0.3% (after 0.6% in 2005), but the buoyancy of the labour market gives grounds for optimism. Japan's economic environment has improved: companies have been reducing their debt and bolstering their finances since the start of the 1990s and the restructuring of the balance sheets of banks and the financial sector has moderated the systemic risk in these activities. Japan's current account balance rose slightly in 2006. In particular, exports to Asia remained robust.

The recovery in growth should put an end to deflation, allowing a gradual normalisation of monetary policy. Inflation, as measured by the Consumer Price Index (CPI), increased up to August 2006 (0.9% year-on-year), and then slowed due to the fall in oil prices, to stand at 0.2% as an annual average in 2006. The Bank of Japan ended its quantitative easing and zero-rate policies, with an initial quarter-point hike on 14 July 2006.

Box 3

Globalisation, inflation and financial markets

Over the past two decades, inflation has fallen sharply in all developed and emerging countries. This slowdown has coincided with the acceleration of globalisation. Naturally, this raises the question of a possible link between these two phenomena.

Indeed, globalisation has helped to reduce inflation through a number of channels:

- *The growing openness and interdependence of economies has boosted competition, making it riskier for companies to raise prices and more difficult for employees to obtain wage increases over and above productivity gains.*
- *The entry into the world market of countries with an abundant low-wage workforce has upped the pressure on tradable goods prices, in particular those of industrial goods.*
- *The decoupling of pressures on domestic production factors and the level of prices has also played a role: domestic demand growth in a country no longer affects as directly as in the past the domestic demand and supply equilibrium because products can be acquired on the global market. Inflation in each country therefore depends less on domestic supply pressures.*

It remains to be seen whether this deflationary phenomenon is stable and permanent. In the long term, inflation is chiefly determined by the monetary conditions of the economy, and the increased credibility of central banks should help to stabilise inflation. However, in the short and medium term, shocks appear likely to result in renewed inflationary pressures:

- *Increases in commodity prices, largely underpinned by strong demand (actual and expected) from emerging economies, offset the decline in industrial prices.*
- *The high economic growth rates of the past few years in all areas of the world have led to upward pressure on production factors (including in emerging countries), which tend to result in higher inflation.*
- *The increase in the market share of low-cost countries, which have generated sizable deflationary effects, could slow down.*

Owing to a combination of these different factors, uncertainties remain as to how quickly inflation will return to its long-term trend.

The strong GDP growth of all Asian emerging economies was particularly driven by India and China (9.2% and 10.7% respectively), despite the measures to stop the economy from overheating taken by both countries' monetary authorities.

The euro area's partners inside the European Union

Growth in the United Kingdom came to 2.8%, up considerably on 2005 (1.9%), thanks to robust household consumption, which was underpinned by a solid labour market and further rises in house prices. But the high capacity utilisation rate and energy price growth resulted in a sharp increase in the CPI (3% in December).

GDP growth in the New Member States (NMS) of the European Union (excluding Slovenia) rose from 4.8% on average in 2005, to 6.3% in 2006, which is the highest rate since start of the transition process. All countries registered strong growth, except Hungary following its fiscal consolidation plan. Poland recorded the fastest economic growth, which jumped from 3.5% in 2005 to 6.1% in 2006. Inflation picked up across the NMS, with the exception of Poland, where it slowed from 2.2% in 2005 to 1.3% in 2006. The general government deficit of the NMS widened from 3.1% of GDP to 3.5% on average in 2006 and in particular in Hungary, from 6.5% of GDP in 2005 to 8.5% in 2006.

I|2 Capital and commodities markets

Capital markets

In 2006, the increased risk appetite of most investors resulted in a rise in stock prices and an upturn in bond yields as of mid-2006. European, US and Japanese bond yields firmed on the back of interest rate hikes by the corresponding central banks. Yield curves flattened across the board.

Spreads between corporate and government bonds continued to narrow to reach historically low levels, reflecting a strong appetite for more risky bond investments.

At the same time, the main equity markets rose sharply, returning to their highs of a few years

Bond yields
(change in basis points, level as a %)

Maturity	Change 2006		Level end-2006	
	2-year	10-year	2-year	10-year
United States	41	30	4.86	4.74
France	103	67	3.91	3.98
Japan	49	19	0.82	1.67

previously. This trend was underpinned by the ongoing favourable outlook for companies and strong earnings growth. The CAC 40 gained 17.5 %, to stand at 5,540 at the end of December. After a sluggish start to the year, the Dow Jones climbed significantly in the second half of the year, putting on 16.2% to close at a historical high of 12,460. The Nikkei also gained ground but to a lesser extent (6.9%).

Volatility reached historically low levels on the main market segments: foreign exchange, money, bond and equity markets. Following an upward spike in May-June, volatility on the German DAX and American SP 500 returned in H2 to levels observed in H1 (see Chart 1). On foreign exchange markets, one-month euro-dollar volatility continued to decline from 9% to 6.8%.

The euro's nominal effective exchange rate against the area's main trading partners appreciated by 4.4% in 2006, following a 6.6% depreciation in 2005. In bilateral terms, the euro rose by 11.4% against the dollar and 12.5% against the yen, but fell by 2.0%

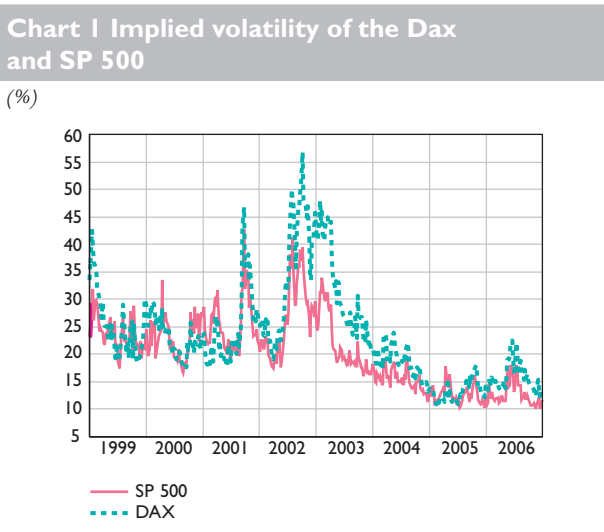
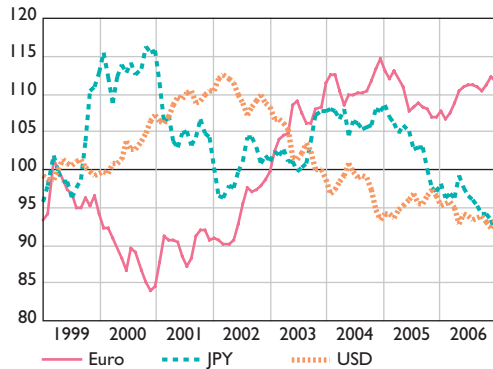


Chart 2 The nominal effective exchange rate of the main currencies against 56 countries (a)

(100 = Q1 1999)

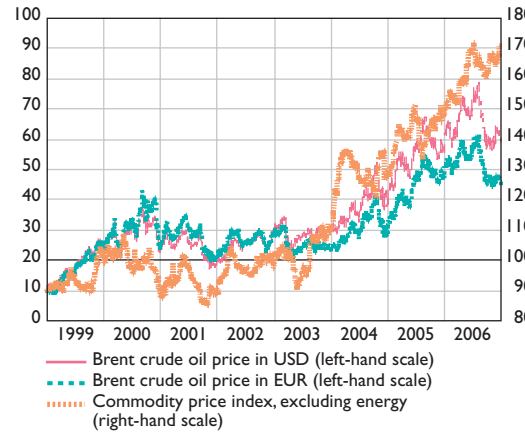


(a) The list of the 56 countries can be consulted in the methodological note of the statistics section in the Bulletin de la Banque de France. Sources: Datastream, IMF, BIS, ECB. Calculations: Banque de France.

Chart 3 Brent crude oil prices and commodity price index

(USD and EUR)

(100 = 2000)



Sources: Datastream, Banque de France.

against sterling. The dollar declined, not only against the euro and sterling, but also against a number of Asian currencies (the Thai baht, the Philippine peso, etc.). In Japan, the central bank's change of monetary strategy and key rate hike did not bolster the yen. The latter continued to fall (by 2.8% in effective terms in 2006), partly due to the carry trades implemented by certain investors taking advantage of the low interest rates to borrow in yen and purchase assets in higher-yielding currencies.

Rising oil and commodity prices

Oil prices continued to climb in 2006, with the price of a barrel of Brent crude gaining 19.7% on 2005 (as an annual average). More precisely, international oil prices peaked at USD 78.7 in August, reflecting structural pressures (rising demand, in particular from North America and China, and the lack of responsiveness of supply capacity) as well as a number of one-off factors (geopolitical uncertainty in the Middle East, hurricanes in the United States, etc.). Nevertheless, oil prices eased at the end of the year, falling below the 60-dollar mark, corresponding to levels observed at end-2005. The prices of many non-energy commodities also rose. The Banque de France index of imported commodity prices showed a 13.8%-increase on average in 2006, compared with 10.5% in 2005. Metal prices rocketed by 18.0%. These developments may potentially have a recessionary and inflationary impact, even though the euro area benefits more than other industrialised

regions from an increase in demand stemming from oil-exporting countries' surplus income.

2 | Eurosysteem monetary policy decisions

The decisions to raise key rates (2|1) are explained by economic (2|2) and monetary (2|3) analysis, with developments in interest rates and financing conditions (2|4) reflecting these decisions.

2|1 Key interest rates raised five times in 2006

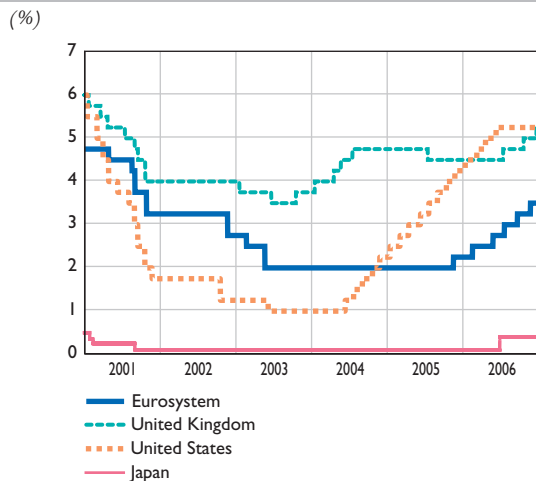
In 2006, the ECB Governing Council successively increased its key rate by 25 basis points (bp) at its meetings of March, June, August, October and December 2006, after the initial 25bp hike in December 2005. This followed on from a two-and-a-half year period where rates were left on hold at the historically low level of 2%. This 125bp rise brought the minimum bid rate on the Eurosysteem's main refinancing operations to 3.5% at end-2006. These decisions reflect the Council's determination to adjust the accommodative monetary policy stance and to take account of the risks to price stability identified by the economic analysis and confirmed by cross-checking its findings with the monetary

analysis (see Box 3 on the monetary policy strategy of the Eurosystem). Economic activity picked up significantly, with inflation remaining above 2% in the first half of 2006.

At the end of the year, despite the decline in actual and expected inflation, due in particular to the fall in energy prices, the continued expansion of liquidity in the euro area indicates ongoing inflationary risks in the medium and long term. The gradual tightening of monetary policy, accompanied by effective communication of the decisions and their underlying economic rationale nevertheless ensured that longer-term inflation expectations in the euro area remained anchored at levels consistent with the Eurosystem's price stability objective.

Both nominal and real interest rates were still at low levels at the end of 2006, in the case of both market interest rates and the lending rates applied by euro area credit institutions. Despite higher interest rates and the rise in the euro's real effective exchange rate in 2006, monetary policy continued to be accommodative at the end of 2006.

Chart 4 Key interest rates of the ECB and other major central banks



Sources: ECB, national central banks.

In the next section, the salient developments observed in 2006, presented first from an economic analysis perspective and then from a monetary analysis angle, are considered in greater depth.

Box 4

The monetary policy strategy of the Eurosystem

In accordance with the 1993 Treaty on European Union, the primary objective of the Eurosystem's monetary policy is to ensure price stability. The Eurosystem's monetary policy can best contribute to sustainable and balanced growth in the euro area by anchoring inflation expectations at a low and stable level. In order to achieve maximum transparency, which is a prerequisite for aligning private agents' inflation expectations with its objective, the Eurosystem has implemented, from the outset, an explicit monetary policy strategy. This strategy offers a consistent framework for communicating and explaining to the public the Eurosystem's key rate decisions and their rationale.

The Eurosystem's strategy starts with a quantitative definition of price stability, i.e. an annual increase in the Harmonised Index of Consumer Prices (HICP) below, but close to, 2% in the euro area over the medium term. The Eurosystem's strategy also calls for an assessment of risks to price stability based on a broadly-based analysis of available economic information organised around two "pillars", corresponding to two complementary approaches to inflation and its causes. The first pillar is the "economic" analysis based on tracking a wide range of economic and financial indicators likely to provide information about inflationary pressures in the short and medium term, such as data on real growth, prices and costs, the labour market, foreign exchange rates and fiscal policies. The second pillar is the "monetary" analysis, which focuses more on the outlook for the longer term, cross-checking the findings of the economic analysis against developments in money supply and credit aggregates.

2|2 Economic review of the euro area

Economic activity

Euro area economic activity strengthened substantially in 2006: GDP grew by 2.9% as an annual average (quarterly accounts at chain-linked prices, adjusted for seasonal and working-day variations) compared with 1.6% in 2005. Such a rate of growth had not been recorded since 2000. Furthermore, GDP firmed in all euro area countries. As in previous years, the services sector was the main driver for growth in 2006. Its contribution stood at 1.5 percentage points, compared with 0.8 percentage point for industry (excluding agribusiness and construction). Services also made the biggest contribution in Italy and France. However, industry predominated in Germany (1.3 percentage points, compared with 1.2 percentage points for services) for the second consecutive year.

In 2006, there was a marked readjustment of euro area demand between its different components, whereas GDP had been mainly consumption-led in 2005. Investment strengthened substantially and the contribution of foreign trade returned to positive territory.

Private consumption remains the main driver of activity in the euro area, expanding by 1.8% in 2006 compared with 1.6% in 2005. Households' gross disposable income increased by 1.6% in 2006 thanks to the 0.2% rise in compensation per employee and, above all, the creation of a little over 2 million jobs between end-2005 and end-2006. Lastly, the household savings rate declined from 8.9 as an annual average in 2005 to 8.6% in 2006.

Investment growth (5.1% after 2.8% in 2005) outstripped consumer spending growth in the euro area. Investment was mainly underpinned by pressure on productive capacity: in the manufacturing industry, the capacity utilisation rate, which rose from 80.9% as an annual average in 2005 to 82.5% in 2006, is now above its long-term average (81.6%). Moreover, despite the rise in short-term interest rates and the appreciation of the effective exchange rate of the euro, monetary and financial conditions remained favourable in the euro area, in particular thanks to the relative stickiness of long-term interest rates. Moreover, in Germany, the construction sector appears to have recovered from its crisis in 2006; investment in this sector rose by 4.3%, compared with a decline of 3.6% in 2005.

Foreign trade was a driver for euro area growth in 2006. Underpinned by very strong world demand, exports of goods and services recorded significant growth in volume terms (8.5%), while imports expanded by 8.0% on the back of the recovery in domestic demand. The euro area benefited in particular from strong net export growth in Germany. Nevertheless, the external trade of the euro area recorded a deficit of EUR 9.0 billion in value terms, compared with a surplus of EUR 14.8 billion in 2005. This decline in the trade balance in value terms stems from higher commodities prices, in particular energy prices, relative to the previous year. Thus, excluding commodities, the trade balance improved, rising from EUR 237.4 billion in 2005 to EUR 260.8 billion in 2006.

Lastly, the contribution of inventory changes to GDP growth was almost nil in 2006 (0.1 percentage point), as in 2005.

Overall, the increase in euro area GDP growth can be ascribed in almost equal measure to the improvement in domestic demand excluding inventories (contribution of 2.5 percentage points in 2006, compared with 1.8 percentage points in 2005) and to that of external trade (0.3 percentage point, after -0.3 percentage point in 2005). Among the components of domestic demand, private consumption and investment were the two main engines of growth; investment almost caught up with private consumption, with the two components contributing 1.1 and 1.0 percentage point to growth respectively.

Euro area GDP growth was not only more broadly based in terms of the different components, but also more equally balanced between its major countries, thanks to the particularly strong improvement in economic activity in Germany and Italy.

In Germany, GDP grew by 3.0% in 2006, after 1.1% in 2005, thanks to the sharp rise in the contributions of investment (1.2 percentage points in 2006 after 0.2 percentage point in 2005) and external trade (1.2 percentage points, compared with 0.4 percentage point in 2005).

In France, growth came out at 2.2%, after 1.7% in 2005. Contrary to previous years, growth was less strong in France than in Germany or than the euro area average. While external trade largely contributed to the

Growth in France and the euro area

(contribution to GDP growth as a %)

	Euro area		France	
	2005	2006	2005	2006
GDP	1.6	2.9	1.7	2.2
Domestic demand excluding inventories	1.8	2.5	2.2	2.4
Change in inventories	0.1	0.1	0.0	0.1
Net exports	-0.3	0.3	-0.6	-0.3

Sources: Eurostat, INSEE.

upsurge in growth in Germany, it continued to dampen growth in France, by 0.3 percentage point, after a 0.6 percentage point negative contribution in 2005. French growth was once again mainly underpinned by the strength of household consumption, which rose by 2.3% in 2006, as in the previous year.

Thanks to its economic recovery (1.9%, after 0.2% in 2005), Italy came closer to the euro area average. This recovery can be attributed to the simultaneous improvement in the contribution of domestic demand (from 0.5 percentage point in 2005 to 1.7 percentage points in 2006) and external trade (from -0.3 to 0.2 percentage point). Lastly, domestic demand remained strong in Spain, where GDP growth rose from 3.5% to 3.9%.

The strong growth in the euro area led to a fall in the Eurostat unemployment rate, which declined from 8.4% of the labour force in December 2005 to 7.5% in December 2006 (in seasonally adjusted

terms). The unemployment rate dropped in all euro area countries except Ireland, Luxemburg and Portugal. Among the large countries, the fall in the unemployment rate was particularly marked in Germany (7.8% in December 2006, compared with 9.2% in December 2005), France (9.0% in December 2006, compared with 9.7% one year earlier) and Italy (6.5% end-2006, against 7.5% end-2005).¹

Inflation

Annual average headline inflation in the euro area has hovered between 2.1% and 2.3% since 2000. In 2006, it remained within this range (2.2%). However, following diverging trends in headline inflation and core inflation excluding energy prices in 2005, these different measures started to converge again at the end of 2006.

The transmission of the oil shock into inflation, excluding energy prices, was limited and offset

Box 5

Current account flows in France's balance of payments

In value terms, France's current account balance shifted into deficit in 2005 (15.7 billion), widening to 22.5 billion in 2006, or around 1.3% of GDP.

This further decline is chiefly due to the EUR 7 billion-rise in the goods deficit, whose high level (EUR 30 billion) can still be attributed to the higher energy bill.

In value terms, French exports grew by 9.1%, compared with 10.6% for euro area countries as a whole (including intra-euro area trade). This means that France lost further market share in 2006.

The services trade balance remained in surplus but also continued the decline that began at the start of the decade, decreasing by EUR 2.3 billion in 2006, to EUR 8.3 billion.

.../...

¹ Eurostat is the source for all data in this paragraph.

.../...

The travel surplus grew thanks to the surge in tourist receipts and stood at EUR 12.1 billion in 2006. But it did not offset the EUR 4.4 billion drop in the services balance excluding travel and transport, which moved into negative territory in 2006 (EUR -1.2 billion).

Around one-third of this decline can be ascribed to that of the research and technical assistance costs of ten or so major groups in the aircraft, automobile, electronics and pharmaceutical sectors. It can also be explained by the increase in the financial services deficit. The latter is however linked to the increase in fees paid by French banks to their foreign subsidiaries for their portfolio transactions with non-residents. These costs are matched by receipts in the financial account.

Due to the sharp rise in reinvested earnings abroad by residents, the income account surplus grew by EUR 2.3 billion in 2006, to reach EUR 21 billion.

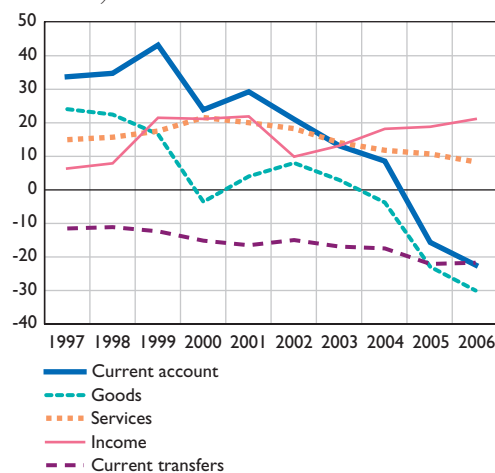
The current transfers deficit narrowed slightly by EUR 0.4 billion in 2006 to stand at EUR 21.7 billion

NB: For more information about trade in goods, see the report on external trade published (in French) in the Bulletin de la Banque de France No. 146 (February 2006).

Current account

Non-seasonally-adjusted data

(in EUR billions)

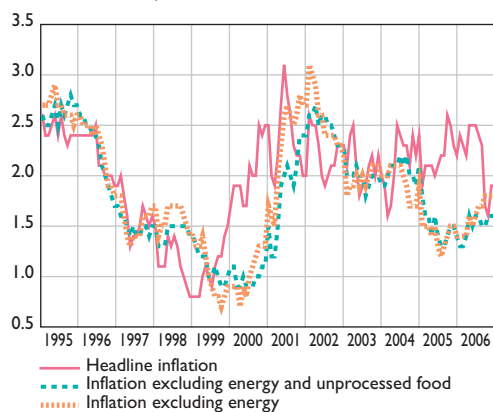


by other factors. Inflation excluding such volatile components as unprocessed food and energy prices remained stable at a moderate level (1.5% as an annual average in 2005 and 2006). This development can be attributed to a number of factors.

First, the increase in pressures resulting from the economic recovery did not impact consumer prices

Chart 5 Measures of euro area inflation

(year-on-year, as a %)



Source: Eurostat.

in the euro area as unit labour costs were stable throughout the year (0.0% year-on-year in Q4 2006), with the rise in per capita wages (1.8%) being offset by productivity gains, as is often the case at this stage of the cycle. On product and services markets, the recovery led to an increase in the capacity utilisation rate, which at end-2006 reached levels equivalent to those observed during the previous business cycle peak in 2000. At the same time, on the labour market, the unemployment rate continued to decline from its last peak in December 2003.

Second, government measures to hold down consumer prices made a smaller contribution to the core inflation rate than in 2005 and especially in 2004. Indirect taxes, especially on tobacco, were raised in 2004, and many measures were introduced that reduced healthcare coverage, in particular in France and Germany. These measures had a large impact on the HICP, because the index covers healthcare spending by households. In December 2006, the contribution of all such measures to the inflation rate fell below the average observed since 2000, and decreased by 0.2 percentage point year-on-year.

Box 6

Is the euro inflationary?

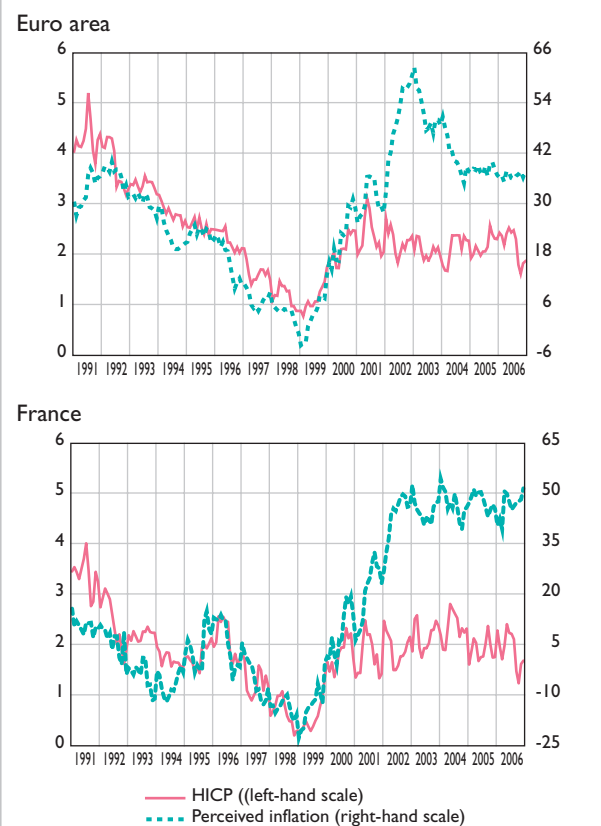
In 2002, following the introduction of the euro, prices rose by around 0.2% in France. Low-price products recorded the largest increases due to rounding effects: 6% on average for coffee served at tables in cafés between August 2001 and April 2002. All countries in the euro area experienced a similar surge in prices. But in all countries it was temporary and inflation quickly returned to its previous rate. However, this diverged with the perception of households throughout the euro area, who perceived a sharp increase in inflation. This divergence was somewhat less significant in France but also much more enduring.

This difference can be attributed to psychological factors as well as economic reasons unrelated to the introduction of the euro. First, it is very difficult to assess prices in euro for many consumers who still think in francs. Naturally it is more difficult for agents to establish a scale of values in France where the conversion is complicated (EUR 1 = FRF 6.56) than in Germany for example, where consumers calculate EUR 1 to be DEM 2.00. The second effect is more significant. Consumers are above all sensitive to the prices of the products they purchase frequently such as food and fuel. Yet the prices of these products are those that rise the most rapidly. For other goods such as automobiles, household appliances, computer and hi-fi equipment, etc., prices fall or rise less quickly. The gain in purchasing power, which is nevertheless very real, is not directly perceptible: consumers do not remember prices from the distant past, especially if they were expressed in a different currency.

Perception of inflation in the euro area and France

(year-on-year and as a %)

(balance of opinions)



Factors unrelated to the introduction of the euro also played a role and relative price movements were unusually divergent. First, business legislation limited competition and, as a result, large price rises were observed in the supermarket sector at the time of the euro changeover. Some observers highlight the fact that the “products” whose prices rose the most rapidly include services provided by employees who are mainly paid the minimum wage. This is the case of over 50% of workers in the hotel and restaurant industry. While the minimum wage was raised a number of times from 2001 (“discretionary increases” and catch-ups resulting from the reduction in working time), social contributions were nevertheless reduced. Overall, even though it is difficult to come to a conclusion, this suggests that the increase in the prices of some goods may be influenced by public policies. Second, certain administered prices, i.e. those fixed by the government, have also risen by more than average in recent years: tobacco, rail transport (overground and underground trains), etc. Lastly, the prices of some consumer goods fluctuated substantially, mainly upwards but sometimes downwards, due to largely external factors: higher oil prices in the case of fuel, and extreme climatic conditions for fruit and vegetables. The succession of visible rises in the price of different products naturally influenced inflation perceptions. The increased divergence in relative price movements has other consequences: all French citizens are not subject to the same inflation. These differences may make general inflation seem higher.

Box 7

Public finances in France in 2006

Like most other European countries, France's public finances benefited from both a relatively favourable macroeconomic environment and revenue windfalls. The latter are mainly attributable to the strength of financial and housing markets and robust corporate earnings. These windfall receipts contributed to the improvement in the general government deficit, which stood at 2.5% of GDP in 2006, compared with 3% in 2005. In particular, the social security fund deficit declined, excluding compensation payments, thanks to high level of social contributions and tax receipts allocated to it. However, social security benefits continued to rise fairly rapidly in 2006. At 53.4%, the France's public expenditure-to-GDP ratio, despite having decreased by 0.3 percentage point relative to 2005, remains the highest in the euro area.

The government debt ratio fell from 66.2% to 63.9% of GDP. This decline can be ascribed to the fact that the general government budget balance returned, for the first time since 2001, to a level below that required to stabilise the debt ratio as well as to major stock-flow adjustments, in particular relating to the allocation of receipts from privatisations to reducing debt and increasing cash holdings.

Conversely, the weaker euro in 2005 had a slight upward impact on final prices, as changes in the exchange rate pass through to inflation with a lag, offsetting the impact of the stronger euro in 2006.

Public finances

In 2006, according to the data reported by the different countries to Eurostat, the average general government budget deficit ratio of the euro area narrowed for the third consecutive year, reaching 1.6% of GDP, after 2.5% in 2005 and 2.8% in 2004. With the exception of Italy, all euro area countries improved their fiscal position in 2006. Italy and Portugal remain the only countries with an excessive deficit. The three other countries (France, Germany and Greece) that were still subject to the excessive deficit procedure have reduced their deficit to below 3% of GDP.

However, the improvement in the euro area budget deficit is primarily linked to the surge in the revenue-to-GDP ratio to 45.8%, compared with 45.1% in 2005, due to stronger-than-expected economic growth and revenue windfalls. Nevertheless, the euro area public expenditure-to-GDP ratio only stabilised at 47.4%, compared with 47.5% in 2005. This appears especially disappointing since only structural reforms based on expenditure restraint will allow countries with fiscal imbalances to achieve sufficient flexibility in the medium term.

The euro area's public debt profile is directly determined by that of government deficits.² The public debt-to-GDP ratio narrowed by 1.5 percentage points in 2006 to reach 69%. All countries, with the exception of Italy and Portugal, reduced their debt ratio, with that of Germany remaining stable. Admittedly, as in 2005, the public debt of seven countries³ exceeded 60% of GDP in 2006. However, a number of countries pursued their efforts to consolidate public finances and achieved both a budget surplus and a debt-to-GDP ratio of below 60% (Spain, Finland, Ireland and the Netherlands).

2|3 Monetary analysis

In the euro area, the growth rate of M3, which had moderated in Q2 2006, started to increase again in summer to stand at 9.7% year-on-year in December – the highest level since the creation of Monetary Union. This surge in the broad monetary aggregate was fuelled by further strong growth in loans to the private sector, against the backdrop of growing economic activity and the continued low level of interest rates, despite the key interest rate rises in 2006.

The increase in the cost of borrowing nevertheless started to affect monetary developments by prompting

² The stock-flow adjustment is the difference between the change in government debt and the general government deficit/surplus over a given period. In 2006, at the euro area level, stock-flow adjustments played a marginal role in the change in debt.

³ Germany, Austria, Belgium, France, Greece, Italy, Portugal.

Monetary developments in France and the euro area

(outstanding amounts in EUR billions, year-on-year % changes)

Monetary aggregates (seasonally adjusted)	Euro area (a)				France			
	Amount outstanding at 31 December 2006	Growth rate (b)			Amount outstanding at 31 December 2006	Growth rate (b)		
		2004	2005	2006		2004	2005	2006
Currency in circulation	579.0	17.0	13.8	11.0				
Overnight deposits	3,095.1	7.5	10.9	6.7	448.4	5.8	10.9	5.2
= M1	3,674.1	8.9	11.3	7.4				
+ Other monetary deposits (M2 – M1)	2,953.9	4.3	5.4	11.7	497.1	5.5	5.3	7.9
= M2	6,628.0	6.6	8.5	9.3				
+ Marketable instruments (M3 – M2)	1,079.0	6.2	0.8	11.5	470.3	12.0	6.8	10.4
= M3	7,718.7	6.6	7.3	9.7				
French contribution to M3 (excluding banknotes)					1,432.0	7.6	8.2	10.3
Credit to the private sector (unadjusted data)	9,160.1	7.2	9.2	10.7	1,542.7	8.4	9.0	11.4
<i>o/w: Loans to NFCs</i>	3,846.7	5.4	8.3	13.0	630.4	6.0	7.2	9.3
<i>Consumer loans</i>	586.8	5.7	7.9	7.8	144.9	4.4	6.8	4.3
<i>Housing loans to households</i>	3,209.6	10.1	11.5	9.5	577.8	12.2	14.8	15.0

(a) Transactions of euro area monetary financial institutions (MFIs) with other euro area residents.

(b) Data adjusted for reclassifications and valuation effects.

shifts within M3 from overnight deposits into other short-term deposits and marketable instruments. Turning to the main counterparts of M3, growth in loans to households, while remaining buoyant, eased from 9.4% at end-2005 to 8.2% at end-2006, while that of loans to non-financial corporations steadily increased until the end of the year, from 8.3% to 13%. These credit developments largely contributed to the abundance of liquidity in circulation in the euro area.

In France, shifts from overnight deposits into other short-term deposits were relatively marked. France's

contribution to M3 nevertheless increased at a more rapid pace than that of the euro area monetary aggregate. The upsurge in loans to the private sector was also more substantial in France than in the euro area as a whole (11.4% and 10.7% respectively). Annual growth in housing loans, which was already brisk in 2005 (14.8%), gained further momentum in 2006, before falling back to 15.0% at the end of the year. This growth rate far exceeds that of the euro area as a whole (9.5%). Similarly, the strong growth in loans to non-financial corporations continued throughout the year, rising from 7.2% at end-2005 to 9.3% at end-2006.

Box 8

Challenges currently facing euro area monetary analysis

The monetary policy strategy of the Eurosystem assigns a prominent role to monetary indicators. While it is undeniable, for the Banque de France and the Eurosystem as a whole, that monetary developments are important, some remain difficult to explain:¹

First, the relationship between monetary aggregates and inflation is increasingly hard to assess. In particular, the decline in the income velocity of M3 has gathered pace significantly since 2001; it now appears that this break in the trend is long-standing and cannot be ascribed solely to temporary shocks. A more in-depth analysis is particularly necessary to confirm this break and identify the possible causes for it. An accurate estimate of the trend of M3 income velocity is indeed essential for measuring excess liquidity in the euro area.

In practice, the performance of M3 as a leading indicator of inflation has deteriorated since 2001. Furthermore, the instability of money demand models, in the prevailing low interest rate environment, raises the question as to whether the sensitivity of money to its opportunity cost is changing. How, in concrete terms, can these changes be incorporated?

Lastly, the most frequently used methods to take account of this trend break in monetary analysis are not entirely convincing. For instance, the mere correction of M3 for the estimated impact of portfolio shifts over the period 2001-2002 only results in a lag in the perception of the break. Moreover, a correction of this nature does not allow for a transparent and robust methodology, which is a prerequisite for the credibility of monetary analysis. Furthermore, very marked recent trends in certain sectoral components of M3, such as other financial intermediaries' holdings² or the residual component of M3, blur the perception of inflationary pressures and require a more detailed study.

In order to enhance the usefulness of monetary analysis, it must be constantly adapted to prevailing developments. Refining this analysis, by taking into account the far-reaching changes of the past years, will increase the relevance of monetary indicators.

¹ See two speeches by Christian Noyer "Does money matter? A European perspective" – November 2006 and "Financial innovation, monetary policy and financial stability" – April 2007. These speeches are available on the Bank's website: <http://www.banque-france.fr/egl/instit/discours/discours.htm>.

² In the euro area, the other financial intermediaries sector is very heterogeneous; it comprises four main sub-sectors: non-money market funds, securitisation funds, investment firms and different undertakings engaged in lending activities.

Box 9

Changes in the balance sheet structure of French MFIs

In 2006, a marked change was observed in the longer-term liabilities of French monetary financial institutions (MFIs). Home savings plan outstandings held by MFIs declined sharply due to large-scale withdrawals following a change in tax rules applicable to the interest accruing on plans held for over 10 years that came into force on 1 January 2006.¹ At the same time, their extension of long-term credit, in particular housing loans, remained very buoyant (see table on the page 30). These two developments boosted their maturity transformation activity relating to the maturity mismatch between assets and liabilities vis-à-vis residents, bringing it to levels close to those of the euro area (Chart A).

Over the period, MFIs substantially increased their longer-term liabilities. This was achieved through the issuance of debt securities, whose annual flow reached its highest level since the start of the 1980s, and loans from non-resident MFIs (Chart B). The latter resulted in flows in the French component of the external counterpart of euro area M3 becoming strongly negative, thus reducing France's contribution to this aggregate (Chart C).

Chart A Transformation ratio
Long-term deposits/long-term loans

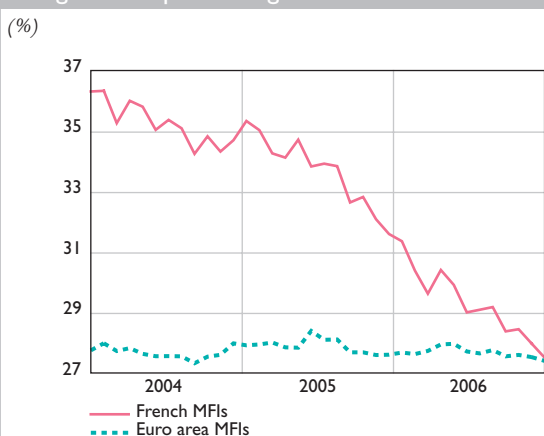


Chart B Longer-term liabilities of MFIs

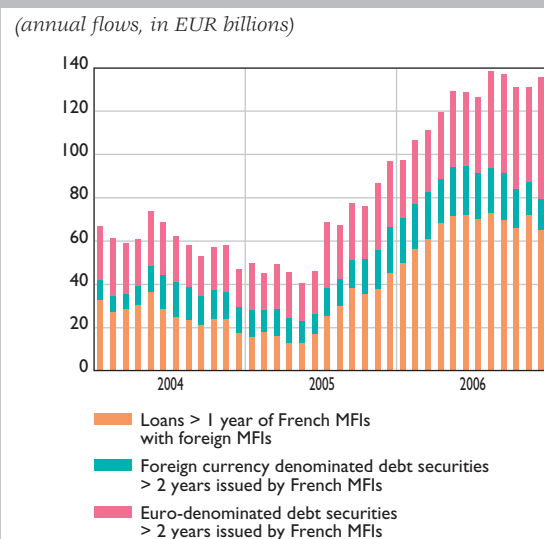
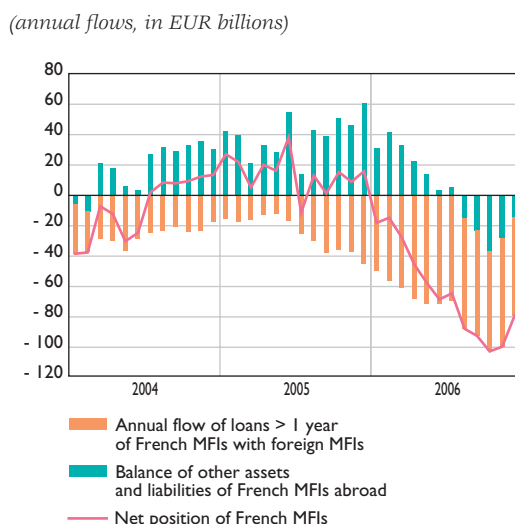


Chart C French contribution to the net external asset position of euro area MFIs



¹ See "Les conséquences du changement de régime fiscal et social des PEL sur l'épargne logement" ("The impact on home savings plans of the change in the tax and social regime covering PEL home savings account"), Bulletin de la Banque de France, No. 153

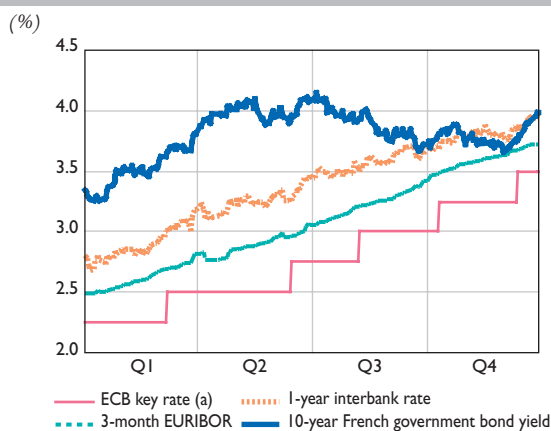
2|4 Interest rates and financing conditions

Market rates

The five hikes in the Eurosystem's key interest rate in 2006 were reflected in money market yields. EURIBOR interest rates rose almost continually over the period under review across all maturities. The one-month EURIBOR increased from 2.40% on 2 January 2006 to 3.63% on 29 December 2006. At the same time, the one-year EURIBOR rose from 2.86% to 4.03%. The slope of the money market yield curve was constantly positive, with the spread between the one-year and the one-month EURIBOR remaining most of the time between 40 and 60bp.

On bond markets, 10-year government bond yields gained around 70bp between December 2005 and December 2006 in the euro area,⁴ to reach around 4.0%. This rebound can be explained by the renewed optimism on the part of market participants about the euro area's growth prospects, as indicated by the concomitant rise in yields on index-linked bonds of the same maturity. It also reflects the impact of US long-term bond yields on those of the euro area, with 10-year US Treasury yields having risen by around 80bp in the first half of the year. Overall, the spread between the average 10-year government bond yield in the euro area and the 3-month EURIBOR narrowed to reach the relatively low level of 30bp at the end of the year.

Chart 6 Key rate, one-year rate and long-term rate in the euro area in 2006



(a) The minimum bid rate in the main refinancing operations of the Eurosystem.

Sources: ECB, Banque de France.

Bank lending rates

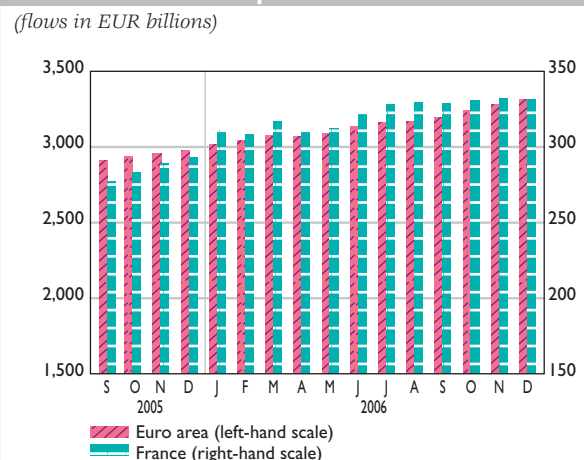
In 2006, bank lending rates continued to rise in France and the euro area. This uptrend started at the end of 2005 and reflects the successive increases in key ECB interest rates. However, lending rates to households and non-financial corporations in France remained, overall, lower than the average corresponding rates in the euro area.

The rise in bank lending rates was relatively marked for new floating rate loans to non-financial corporations and loans with an initial rate fixation period (IRFP) of up to one year (120bp over the year in both France and the euro area). The increase was nevertheless more moderate for new loans to non-financial corporations with an IRFP of over five years (around 70bp in both France and the euro area).

The higher lending rates did not have a significant impact on corporate loan demand, which continued to grow throughout the year, underpinned by the improvement in the economic environment. Relative to 2005, new lending flows to non-financial corporations (excluding overdrafts) for 2006 as a whole increased more strongly in France (13.4%) than in the euro area (11.3%).

Lending rates to households also went up sharply, in particular in the case of floating rate housing loans

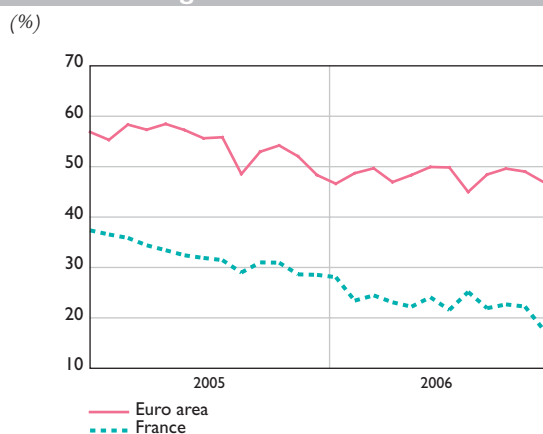
Chart 7 New loans to non-financial corporations



Sources: ECB, Banque de France.

⁴ Ten-year euro area government bond yields are calculated by the ECB using the harmonised yields of domestic government bonds with the same maturity weighted by their nominal outstanding amounts.

Chart 8 Share of floating rate loans in new housing loans



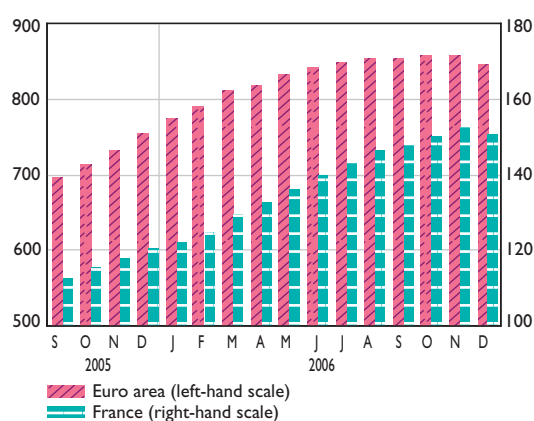
Sources: ECB, Banque de France.

and loans with an IRFP of up to one year. The latter put on around 100bp in 2006 in the euro area and a lending rates for over 70bp in France. However, the increase in lending rates for house purchase with an IRFP of more than 10 years was much smaller (just under 50bp in France and the euro area).

In view of the different trends in lending rates, household demand for housing loans centred even more than in the previous year on fixed-rate loans, in particular in France where the share of new floating rate loans, or loans with an IFRP of up to one year in total housing loans has fallen steadily: at end-2006 it stood at around 18%, compared with 28% at end-2005

Chart 9 New housing loans

(12-month cumulative flows in EUR billions)



Sources: ECB, Banque de France.

(46% and 48% respectively for the euro area). In this context, French household demand for housing loans remained buoyant and started to moderate only at the very end of the year: relative to 2005, new flows of housing loans to households increased more strongly in France (14.2%) than in the euro area as a whole (9.4%).

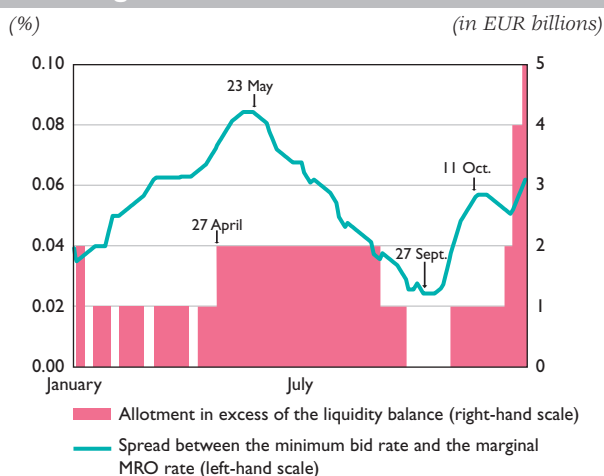
3 | Implementation of monetary policy by the Banque de France

3|1 Refinancing of the banking system

In 2006, the liquidity requirements of euro area banks vis-à-vis the Eurosystem continued to expand by EUR 45 billion, to reach EUR 422.4 billion on average (up by 11.9% on 2005). This can chiefly be attributed to the growth of currency in circulation (11.3%), even though this expansion has slowed since the first years following the cash euro changeover.

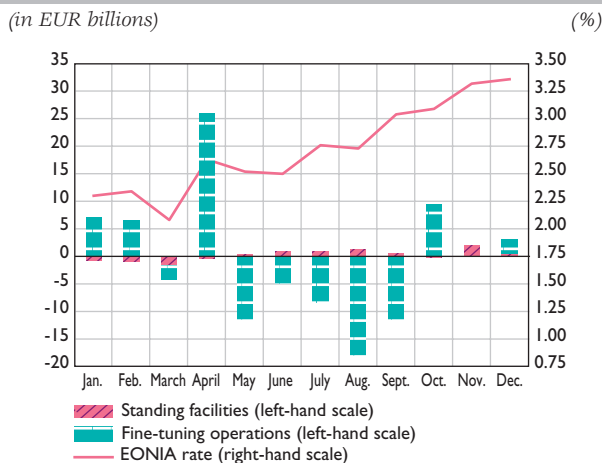
The share of monthly longer-term refinancing operations (i.e. with a maturity of three months) in total refinancing rose in 2006 to 27.3%, compared with 23.2% in 2005. This trend reflects the decision by the Governing Council of the ECB to increase the allotment amount for each of these operations from EUR 30 billion to EUR 40 billion.

Chart 10 Main refinancing operations and marginal allocation rate in 2006



Source: ECB.

Chart 11 Eurosystem fine-tuning operations and the EONIA in 2006



Source: ECB.

The participation of French banks in refinancing operations decreased significantly. They obtained on average EUR 16.5 billion via the main refinancing operations (MROs), compared with EUR 18.9 billion in 2005, representing a 12.7% decline. However, French banks' average participation in longer-term refinancing operations rose slightly from EUR 1.5 billion in 2005 to EUR 1.7 billion in 2006.

Overall, the share of French banks in total euro area refinancing fell. In 2006, it stood at 4.3% on average, compared with 5.3% in 2005.

The spread between the minimum bid rate of the MROs (key rate) and the marginal MRO rate, which was 4bp at the start of the year, reached 8bp in April. This prompted the ECB to conduct a more expansive liquidity allotment policy as of 27 April, bringing the spread to 2bp in September. In 2006 as a whole, it stood at an average level of 5bp, identical to 2005.

In 2006, the ECB conducted 11 fine-tuning operations (6 fixed-rate liquidity absorbing and 5 variable-rate liquidity providing operations), compared with 9 in 2005 and 3 in 2004, enabling a reduction in money market rate volatility at the end of the maintenance period.

Consequently, net recourse to standing facilities on the last day of the reserve maintenance period

declined significantly, to EUR 0.8 billion in 2006, against EUR 1.6 billion in 2005.

The amount of collateral used for monetary policy operations in France declined by 17.8%, due to the fall in the share of French banks in euro area refinancing. However, the amount of collateral used for intra-day operations increased by 9%. Overall, the amount of capital used for monetary policy operations rose by 3%, to EUR 58.1 billion on average.

In 2006, assets used as collateral include: government bonds (44%), credit claims (26%) and bank bonds (11%).

In relation to 2005, the share of government securities and asset-backed securities (ABS) declined by 8% and 22% respectively, in favour of credit claims and bank bonds, which increased by 13% and 41% respectively.

Cross-border collateral accounted for over half of the assets pledged by French banks: 60.2% of total collateral, compared with 39.8% for domestic collateral. The former has been rising constantly since 2004. Sixty-five percent of cross-border collateral consists of government securities from other countries.

3|2 Reserve requirements

The number of credit institutions in France subject to minimum reserves fell by 3.2%, from 865 in December 2005 to 837 in December 2006, as a result of consolidation in the banking sector.

The average amount of required reserves to be held by French banks increased from EUR 28 billion in 2005 to EUR 33 billion in 2006 (18%). The reserve requirement of euro area banks rose less substantially (13%). In 2006, it stood at an average of EUR 172 billion, compared with EUR 152 billion in 2005. The share of French banks in total reserve requirements has therefore risen slightly, representing 19.2%, compared with 18.4% in 2005.

The number of breaches remained very small and has steadily decreased over the past few years. Eleven breaches were observed, triggering penalties of around EUR 85,000.

THE BANQUE DE FRANCE, A KEY PLAYER IN THE ECONOMY

The two major aspects of the Banque de France's role testify to its position in the financial and economic landscape:

- an active contribution to the decisions taken within the framework of numerous European and international bodies and working groups, as well as the exercise of key responsibilities in all national financial supervision structures and representation at the local and regional levels, formalised in the Public Service Contract concluded with the State;
- a concrete contribution to the national economy via its core monetary, financial and general interest tasks.

I | An institution at the centre of the economic and financial sphere

The Banque de France's place in the economic and financial sphere derives above all from its status as member of the European System of Central Banks (ESCB), instituted by Article 8 of the Treaty on European Union (the Treaty). In this capacity, the Banque de France participates in performing the tasks and meeting the objectives assigned to the ESCB by the Treaty.

The diversity of the Banque de France's tasks also derives from a substantial legislative framework which is partially set out in France's Monetary and Financial Code and from specific provisions such as the procedure for dealing with overindebtedness.

Some of the Bank's activities are performed within the framework of agreements with the State among which the Public Service Contract may be highlighted, which sets out both tasks and objectives for the Bank.

I | Relations with the ESCB

I | I | I | Governing Council of the ECB

As a euro area Member State central bank, the Banque de France is part both of the European System of Central Banks (ESCB), which comprises the 27 national central banks (NCBs) of the European Union (EU)¹ and the European Central Bank (ECB),

and of the Eurosystem, a term referring to the ECB and the 13 euro area NCBs.² Since 1999, the Eurosystem has carried out the main tasks related to the single monetary policy of the euro area.

The ECB's Governing Council is the supreme decision-making body of the ESCB. It comprises the Governors of the euro area countries, including the Governor of the Banque de France, and the six members of the ECB's Executive Board, including the ECB President and Vice-President. The Governing Council defines monetary policy for the euro area and establishes guidelines for its implementation. It takes the decisions necessary for conducting foreign exchange operations, holding and managing the ECB's official foreign exchange reserves, and promoting the smooth operation of payment systems. The Governing Council also adopts the ECB's budget.

The Eurosystem is a decentralised system. Monetary policy decisions are taken by the Governing Council on the basis of information that has been collected and previously analysed by the NCBs and the ECB. Domestic credit institutions have access to central bank money in euro via NCBs, i.e. the Banque de France in the case of France. Each NCB implements the single monetary policy in a decentralised manner in its own economy, in accordance with the rules laid down by the Governing Council and the Executive Board of the ECB.

On 5 October 2006, the Banque de France hosted one of the two meetings of the Governing Council that were held outside Frankfurt.

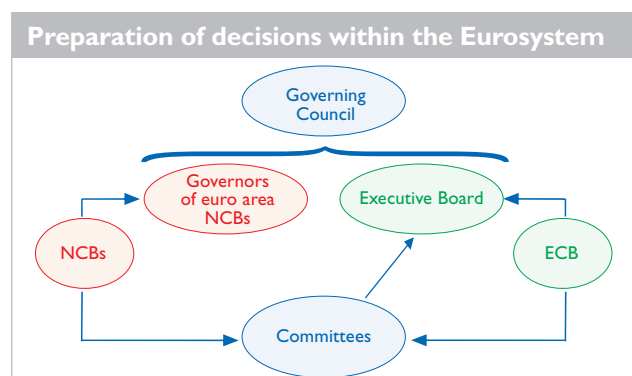
I | I | I | 2 ESCB Committees and decisions in the Eurosystem

The ESCB has set up a network of 13 committees, made up of representatives from the NCBs and the ECB, which provide assistance to the ECB's decision-making bodies. These committees are chaired by high-ranking officials from the ECB or NCBs. They play an important role in preparing the decisions of the Governing Council and greatly contribute to the co-operation between central banks in their respective fields of responsibility, as defined by the Governing Council: internal audit, banknotes, budgetary matters, communication, accounting and monetary income, legal issues, market operations, monetary

¹ 27 since Bulgaria and Romania joined the European Union on 1 January 2007.

² 13 since Slovenia joined the euro area on 1 January 2007.

policy, international relations, statistics, banking supervision, information systems, and payment and settlement systems. In addition, a conference on human resources brings together specialists from NCBs and the ECB on a regular basis.



1|2 International and bilateral relations

The Banque de France takes part in the major international discussions within various bodies.

- The Governor of the Banque de France is Alternate Governor for France at the International Monetary Fund (IMF). In this capacity, he participates in meetings of the International Monetary and Financial Committee (IMFC) as well as in the IMF's Annual Meeting.
- The Banque de France participates in the work of the Group of Seven (G7), which comprises France, the United States, Canada, the United Kingdom, Germany, Italy and Japan. The Governor of the Banque de France is also a member of the G10, which consists of members of the G7 and Belgium, the Netherlands, Sweden and Switzerland.
- The Banque de France takes part in meetings of the G20, which brings together the G7 and major emerging countries.
- The Banque de France is a founder member of the Bank for International Settlements (BIS).

It participates in the bi-monthly meetings in Basel that bring together the main central banks and, as part of G10 central bank activities, it contributes to the work of the different committees, notably the Basel Committee on Banking Supervision.

- The Governor of the Banque de France or its representatives and experts participate in the work carried out by the economic and financial bodies of the European Union, in particular in the framework of the informal meetings of the ECOFIN Council and the meetings of the Economic and Financial Committee.

- The Banque de France also takes part in the discussions and tasks of many international and regional institutions such as the Financial Stability Forum (FSF), the Organisation for Economic Cooperation and Development (OECD) and the multilateral development banks. It manages the debt agreements reached within the framework of the Paris Club.

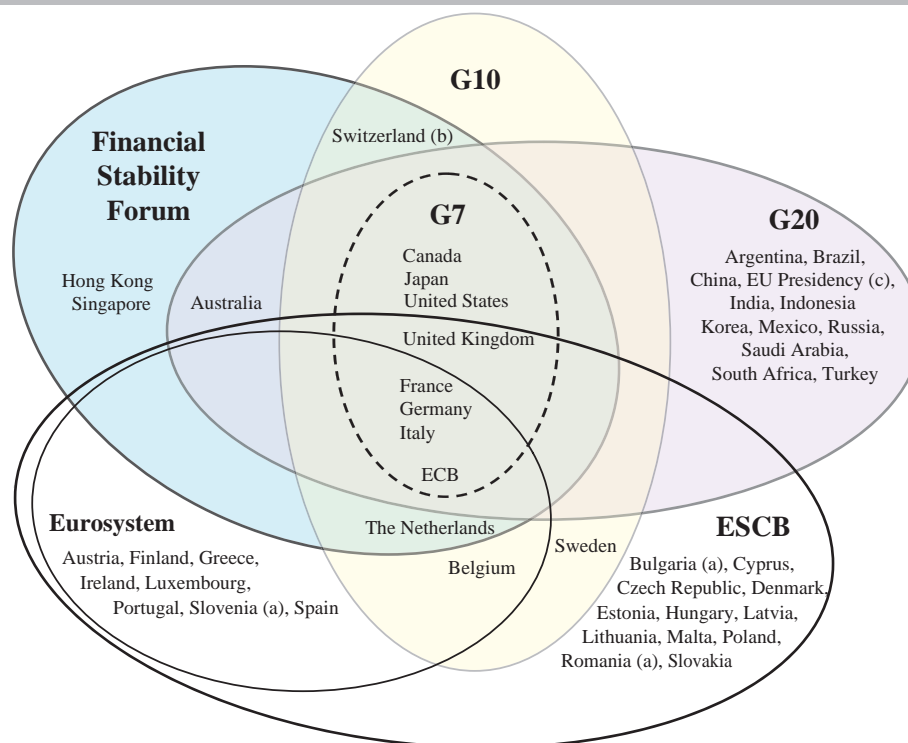
- The Governor of the Banque de France participates in the meetings of the Franc Area Ministers of Finance and Governors for which the Banque de France provides the secretariat. In this capacity, it provided support to the working groups that meet alongside these ministerial meetings.

The twinning arrangement agreed between the Banque de France and the National Bank of Romania in spring 2005, in partnership with the Nederlandsche Bank and the Banca d'Italia, came to an end as planned in September 2006. In October 2006, the Banque de France, as lead institution, signed a second twinning agreement with the National Bank of Bulgaria with the same partners for a two-year period.

Key data for 2006

- 23 meetings of the ECB Governing Council
- Some 20 other European meetings (Economic and Financial Committee, Informal ECOFIN and the French-German Economic and Financial Council)
- Some 20 meetings of international (IMF, BIS, G7, G10, G20, OECD, FSF) and regional (e.g. the Franc Area) organisations or bodies
- 12 bilateral debt agreements signed
- 115 short-term assignments and 7 long-term secondments in the framework of technical co-operation
- 52 training seminars and 28 study visits arranged for over 1,560 trainees from foreign central banks

The Banque de France's participation in European and international groupings



NB: Basel Committee = G10 + Spain.

(a) Since January 2007.

(b) Switzerland has been a member of the G10 since the 1980s and began participating in the FSF in 2007.

(c) The European Union presidency participates in the G7 when it is held by a country that does not belong to the G7.

In addition, the Banque de France offers training programmes and technical assistance to the central banks of European Union accession countries and of Franc Area, Francophone, Middle Eastern, CIS and some Asian countries.

control, the fight against money laundering and the financing of terrorism, etc).

1|3 The role of the Banque de France in financial sector supervisory bodies

The CCLRf, the CCSF and the other French financial market authorities

The CECEI and the Commission bancaire

The Banque de France is a member of the other French financial market authorities, which comprise the *Autorité de contrôle des assurances et des mutuelles* (ACAM – Insurance Supervisory Authority), the *Autorité des marchés financiers* (AMF – Financial Markets Authority) and the *Conseil consultatif de la législation et de la réglementation financières* (CCLRf – Advisory Committee on Financial Legislation and Regulation). The Banque de France's regional managers are the AMF's representatives in the regions. The Banque de France provides the secretariat for the CECEI, the General Secretariat of the Commission bancaire, the CCLRf and the *Comité consultatif du secteur financier* (CCSF – Advisory Committee on the Financial Sector).

The Governor of the Banque de France chairs the *Comité des établissements de crédit et des entreprises d'investissement* (CECEI – Credit Institutions and Investment Firms Committee) – which delivers the necessary authorisations for the setting up, development and restructuring of these institutions, and the *Commission bancaire*, which is in charge of prudential supervision (solvency, liquidity, internal

1|4 The Advisory Council (Conseil consultatif)

The role of the Advisory Council is to provide the Banque de France's governing authorities with information and advice regarding the state and outlook of the various sectors of the economy.

The members,³ appointed for three years by the General Council on the proposal of the Governor, are selected among leading figures from different sectors of the economy. The Advisory Council met 11 times in 2006.

1|5 Local economic relations in the framework of the Public Service Contract

The Public Service Contract concluded with the State on 10 June 2003 sets out the duties incumbent on the Banque de France with respect to the public and general interest services it provides. It lays down the conditions of access to the services the Bank offers and the commitments to improving the quality of the services provided to users in the context of its work relating to household overindebtedness and to the monitoring of economic developments and labour pools in the regions.

The contract was the subject of a review by a commission bringing together the different signatories in order to examine how it is implemented, on the basis of reports drawn up by the Banque de France for each *département* after consultation with local elected representatives and regional administrative officials.

A new Public Service Contract for the period 2007-2009, approved by the General Council, is expected to be signed, after consultation with the Banque de France's Central Works Council and associations representing regional and local authorities. While resembling the previous contract in most respects, the draft version submitted as part of this consultation contains several new elements aimed firstly at gaining a better understanding of the process of overindebtedness and increasing the range of training offered to those involved in this area, and secondly at making new commitments designed to improve private individuals' access to the services and information provided by the Banque de France.

³ At 31 December 2006, they numbered 26 (see Appendix).

2| The tasks and activities of the Banque de France

Most of the Banque de France's tasks are directly linked to the functioning of the Eurosystem, while others relate to specific responsibilities that in most cases have been entrusted to it by law. They contribute to three major objectives that underpin the legitimacy of its actions:

- monetary stability;
- financial stability both in respect of its participation in the Eurosystem and its responsibility as a national central bank;
- the provision of specific services to public administrations, enterprises, private individuals and the banking and financial sector.

2|1 The Banque de France and monetary stability

Tasks conducted within the framework of monetary policy

The Banque de France performs its central banking tasks within the framework of the Eurosystem, which is made up of the European Central Bank (ECB) and the euro area national central banks. The primary objective of monetary policy – as laid down in the Maastricht Treaty – is to ensure price stability.

The Banque de France provides the Eurosystem with an array of business analyses, statistics and studies on the French economy, which are used to define monetary policy. It makes an assessment of the economic situation across the euro area for the Governor of the Banque de France, who participates in the meetings of the ECB Governing Council, which is responsible for interest rate policy. The Banque de France, which is charged with the implementation of the single monetary policy in France, refinances credit institutions established in France by supplying them with the liquidity they require.

2|1|1 Preparation and implementation of monetary policy

The year 2006 was mainly devoted to the drawing-up of a single list of assets eligible as collateral in the Eurosystem's refinancing operations. This

The single list: a framework for assessing credit quality

The harmonised framework for assessing credit quality is based on a minimum level of quality required by the Eurosystem, assessed by one of the four following sources, chosen by the credit institution concerned:

- *authorised external credit assessment institutions; up to now, these have comprised three major international rating agencies (Fitch, Standard and Poor's and Moody's). Other bodies may be added to this category at a later date;*
- *internal rating systems developed by some euro area national central banks;*
- *the internal risk assessment methods developed by credit institutions themselves as part of the implementation of "Basel II", provided they are approved by the relevant banking supervisor;*
- *rating tools developed and managed by authorised third-parties.*

There is no hierarchy between these four sources, which are considered equally valid. Credit institutions are free to choose one or more sources depending on their particular needs. The choice of source must be maintained for a minimum period of one year; it is renewed by tacit agreement.

work resulted, on 1 January 2007, in the introduction of an updated framework for the implementation of monetary policy common to all euro area countries; this replaced the previous collateral framework put in place at the start of Economic and Monetary Union (EMU), which varied across member countries. The new operational framework, referred to as the "single list", includes in particular:

- the acceptance as eligible assets of loans extended by credit institutions to enterprises, provided that the borrowers meet the eligibility and creditworthiness criteria common to the Eurosystem as a whole; debt securities issued with an agreed maturity of over two years and loans granted to the public sector, which the Banque de France did not accept as collateral prior to January 2007, are now eligible provided they meet the general conditions laid down;
- implementation of a single and pragmatic framework for valuing assets in order to ensure that the risk borne by the Eurosystem in its monetary policy operations is kept at an appropriate level, whatever the technical means used (see box).

The French project known as "LIST1" enabled credit institutions to prepare as well as possible for the changes, notably to IT systems, brought about by this development.

The Banque de France also launched a project for overall collateral management. Thanks to this framework that uses the legal technique of pledging, credit institutions will be able to manage their liquidity in the form of a "pool" of assets that may be used as collateral for the refinancing obtained: domestic securities, foreign securities received notably via the CCBM (Correspondent Central Banking Model) system for the cross-border use of assets within the euro area, and credit claims on the private and public sectors. They will also be able to follow in real time the overall state of their refinancing. This project is scheduled to be implemented in the first quarter of 2008, to coincide with France's changeover to TARGET2.

2 | 1 | 2 The management of foreign exchange reserves

Tasks carried out in the management of foreign exchange reserves

The Banque de France holds and manages the country's gold and foreign exchange reserves; it also manages part of the ECB's foreign exchange reserves. In the framework of the decisions taken by the ECB Governing Council, it may be required to intervene on foreign exchange markets.

Key data at end-2006

*EUR 73.8 billion in foreign exchange reserves
2,719 tonnes of gold, worth EUR 42.2 billion
EUR 31.6 billion in foreign currency holdings*

Foreign exchange assets diversified and actively managed

In 2006, the diversification of the foreign exchange investment strategy continued, with a view to optimising the risk/return profile of these assets.

Foreign exchange assets are managed in the trading book, which does not rule out holding a proportion of them to maturity.

Services offered for the management of foreign exchange reserves in euro

Since 1 January 2005, the Banque de France has contributed to the provision of services offered by the Eurosystem for the management of foreign exchange reserves in euro of non-euro area central banks and international organisations. This activity expanded substantially during the year, both in terms of strengthening ties with existing clients and developing and diversifying new contacts. Assets held enjoy legal immunity.

The Banque de France is now one of the main players providing these services in the Eurosystem. In this way, it helps promote the euro as a reserve currency and facilitates the placement of French government securities.

Further gold sales in the framework of the central bank agreement

In 2006, the Banque de France sold 105 tonnes of gold. These sales reflect market transactions within the framework of the agreement reached between 15 European central banks to limit overall gold sales to a maximum of 500 tonnes per year over a five-year period commencing on 27 September 2004.

At the end of 2006, the Banque de France's gold reserves stood at 2,719 tonnes.

The management of ECB foreign reserve assets

In the framework of the decentralised management of the ECB's foreign reserve assets, the Banque de France manages dollar and yen reserves proportionate to its share in the subscribed capital of the ECB. In the same way as national foreign exchange reserves, these portfolios are actively managed, relative to the investment benchmarks defined by the ECB.

2 | 1 | 3 Statistics and research

The operational participation in the implementation of monetary policy and the explanation of this policy are inconceivable without the basis provided by in-depth research and the compilation and analysis of economic, monetary and financial statistics.

Tasks carried out in the area of statistics and research

In this area, the Banque de France:

- draws up the French components of the monetary, financial and balance of payments statistics that the ECB then aggregates for the whole of the euro area;
- produces a large body of financial statistics pertaining to national accounting;
- compiles France's balance of payments and international investment position;
- conducts a "monthly business survey";
- analyses France's international economic environment and makes growth and inflation projections within the framework of the Eurosystem;
- produces a large range of publications, including the Banque de France Bulletin and the Financial Stability Review;
- contributes to economic and financial research through its own studies, retranscribed and published, notably in the Notes d'études et de recherche (NER) series, and through the work of the Fondation Banque de France and the organisation of or participation in symposia.

Active participation in tasks relating to official French and European statistics

As regards monetary, financial and bank interest rate statistics, the Banque de France has implemented ECB regulations on the reporting requirements of monetary financial institutions (MFIs) and has also participated in work concerning the drafting of the ECB regulation on the expansion of statistical data collected on investment funds (other than money market funds).

Key data for 2006

28,500 statistical series published in French by the Banque des séries monétaires et économiques (BSME – Monetary and Economic Statistics Data Bank) and 3,000 series in English
3,100 statistical series relating to the euro area and Member States were posted online as part of the Banque de France's contribution to the ESCB's joint publication system
13,000 companies surveyed to produce the monthly business survey
2,100 companies reporting monthly and 19.5 million items of information processed to compile the balance of payments
23 Notes d'études et de recherche, 56 articles in the Bulletin de la Banque de France and 13 articles in the Financial Stability Review

In accordance with the ECB's amended Guideline of 21 November 2002 on quarterly financial accounts, the time period within which national data must be submitted to the ECB has been reduced from 130 to 110 days. The Banque de France also communicated the quarterly financial accounts for the general government sector to the European institutions, ensuring their consistency with the public debt data reported by INSEE, in accordance with the provisions of a Memorandum of Understanding concluded with the national statistics institute on 22 August 2006.

In addition, the estimation of certain lines of the current account of the balance of payments was substantially revised, notably the "income" item as part of the changeover to the accruals principle and "travel" on account of the use of new surveys. In the financial account, bank balance sheets continued to be favoured as a source of balance of payments data together with a corresponding reduction in the use of specific data on "other investment" (deposits and loans).

Work continued on modernising the processing of business surveys. Two one-off surveys were conducted on representative samples of SMEs and bank branches as part of the Banque de France's report to Parliament on the impact of the "usury reform" on the financing of SMEs.

Lastly, the Banque de France undertook the technical consolidation of its internal and external statistical information system by participating in the ESCB's joint publication project. This consists in posting on the websites of the ECB and Eurosystem NCBs, in their respective languages, several thousand homogeneous statistical series for the Member States and the euro area.

Refining analyses and developing the "studies and research" function

The Banque de France continued its research in different areas of the monetary economy, such as

the assessment of business cycles and monetary policy, price setting, money demand, the formation of interest rates, and the links between labour market structural reforms and the effectiveness of monetary policy. This work draws in particular on quantitative models of structural macroeconometrics, microeconometrics and applied finance.

It contributed to the forecasting exercises conducted by the Eurosystem and carried out macroeconomic analyses, notably of productivity and potential output growth, globalisation and inflation, global imbalances and emerging economies. This research gave rise to the publication of studies,⁴ more specialised working papers⁵ and articles in international scientific journals.

The Banque de France organised a number of symposia and seminars that brought together renowned researchers from central banks and French and foreign universities. These included events held in June 2006 in Paris, in collaboration with INSEE's Center for Research in Economics and Statistics (CREST) and the Europlace Institute of Finance, and in September with French and US universities.

The *Fondation de la Banque de France pour la Recherche en économie monétaire, financière et bancaire* (Banque de France Foundation for Monetary, Financial and Banking Economic Research) put out its eleventh request for proposals for research projects, which it funds via grants. In the framework of its new guest researcher programme, it received several academics from France and other countries wishing to collaborate on studies with Banque de France teams. It organised its fourth "*Journées*" in June 2006 and awarded its prize for a doctoral thesis on a monetary and banking topic. With a view to broadening its activity, a Scientific Council for the Foundation, made up of representatives from French and international academia, was set up. The Council is a forum for the exchange of views and discussion of the Foundation's strategic orientations.

⁴ The Banque de France Bulletin Digest and the Financial Stability Review, available on the Banque de France website (www.banque-france.fr).

⁵ Notes d'études et de recherche, available on the Banque de France website (www.banque-france.fr).

2 | 1 | 4 Production and management of banknotes and coins

Tasks carried out in the production and management of banknotes and coins

The Banque de France's tasks in the area of banknotes and coins consist in:

- banknote printing. It operates a paper-mill at Vic-le-Comte and printing works at Chamalières, both in the Auvergne. Both industrial sites have received a quality and environment certification. While it focuses on the production of euro banknotes, the Banque de France also supplies banknotes to foreign central banks in the framework of institutional partnerships and the provision of specialised engineering services;
- putting into circulation euro banknotes and coins. Through its branch network throughout France, it supplies cash to credit institutions, which then distribute it to the public;
- maintenance of banknotes and coins. The Bank is charged with ensuring the quality of all banknotes in circulation in France and sorts the notes in order to identify and remove from circulation all counterfeit, worn, torn and stained bills;
- supervision of the cash industry within the framework laid down by Decree 2005-487 of 18 May 2005 on the recycling of euro coins and banknotes.

Key data for 2006

- 2.1 billion banknotes delivered by the banknote production facilities, including 1,350 million in euro
- 6.9 billion banknotes sorted annually
- 7.4 billion banknotes distributed by the Banque de France
- 7.1 billion banknotes received at the Banque de France
- 1.1 billion coins put into circulation

Banknote manufacturing

Following a decade of restructuring, on 31 December 2006 the Directorate General Banknote Manufacturing of the Banque de France (hereafter "Banknote Manufacturing") completed the second phase of its recovery plan (2001-2006) and posted results that were in accordance with the objectives it had set itself (see table).

Since the launch of the first phase of the plan in 1995, overstaffing at the two sites (the Chamalières printing works and Vic-le-Comte paper-mill) has been entirely eliminated. Productivity at both sites has greatly improved, especially at the printing works where it increased five-fold. With 2.97 million banknotes

Banknote Manufacturing			
Objectives and results 2006			
<i>(annual volumes in billion banknotes, result in EUR millions)</i>			
	Annual volumes manufactured and delivered	Staff	Result
Objectives under second Plan (end-2006)	1.7	950	Balance
Result for 2006	2.1	949	Profit = 7

produced and delivered a year per employee, the Banque de France's Banknote Manufacturing is one of the most productive public printing facilities in the euro area.

Once the latest recruitments have been completed in the first half of 2007, Banknote Manufacturing will have reached the target of 950 full-time equivalent staff set for both its sites and, in respect of the age structure of staff, recruited 136 new employees. Given the productivity improvements achieved, this staffing level is now compatible with the expected annual production objectives for the coming years.

With 2.1 billion banknotes produced and delivered in 2006, Banknote Manufacturing reached a level of production that was up by 75% on 2005, primarily owing to the large rise in the quota of banknotes (1,350 million compared with 748 million in 2005) assigned to the Banque de France, within the framework of the pooling system, resulting from the increase in euro banknotes in circulation.⁶ With the export market amounting to an average 500 million banknotes annually, the Banque de France will be required to produce between 1.8 billion and 2.2 billion banknotes a year over the 2007-2012 period.

With regard to its industrial capacity, a complete overhaul of the Bank's production facilities was carried out in the second phase of the plan, with very substantial efforts to update the equipment used. The production facilities, which are now stable, are state-of-the-art in terms of industrial standards for the sector and include, at the printing works, a continuous printing line, two sheet-fed printing lines and five automatic banknote checking machines (quality control); and, at the paper-mill, high-performance equipment making it possible to satisfy the annual requirement of two billion banknotes at the printing works.

⁶ A pooling system was set up in 2002 among NCBs for the production of euro banknotes in the Eurosystem: each NCB specialises in the production of different denominations, which are partly exchanged with the other 12 Eurosystem members.

At the European level, the Banque de France is taking an active part in the programme to prepare the second series of euro banknotes as leader of a co-operative public group (Belgium, Spain, France, Italy and Austria) to which the ECB has entrusted the design of four of the denominations in the future series.

The results achieved in 2006 thus confirm the Banque de France's Banknote Manufacturing in its position as leader among European public-sector printing works. Building on this, its strategy for the coming years is to consolidate the financial equilibrium reached in 2006 and to create the necessary leeway to ensure it can rise to the industrial and economic challenge it has set itself, i.e. being ready to participate in the Eurosystem's centralised system of tenders in 2012.

Managing currency in circulation

In 2006, there was a very substantial increase in the volume of banknotes and coins handled by the Banque de France, this being the short-term consequence of the entry into force on 17 January 2006 of Decree 2005-487 of 18 May 2005 on the recycling of euro coins and banknotes. The Banque de France is responsible for monitoring – by means of on-site and documentary inspections – of operators who decide to recycle their

own banknotes and who sign an agreement with the Bank to that effect (see Box).

As part of the decentralised pooling system and the adjustment of banknote stocks between euro area national central banks, the Banque de France supplied foreign central banks with 165 million banknotes and imported 216 million.

At end-2006, banknote circulation in the Eurosystem amounted to EUR 628.2 billion, of which EUR 120.2 billion (19.14 %)⁷ was recorded on the balance sheet of the Banque de France.

The net issuance of euro banknotes⁸ in France stood at EUR 57.2 billion at end-2006, i.e. a 12.5% increase compared with end-2005. It now substantially exceeds the volume of circulation of French francs reached at the end of 2000 prior to the dishoarding that occurred in the run-up to the euro cash changeover. Thus at end-2006, France continued to rank fourth within the Eurosystem,⁹ behind Germany (EUR 255.2 billion), Italy (EUR 119.7 billion) and Spain (EUR 87.0 billion).

This growth stems mainly from transaction banknotes (EUR 5, 10, 20 and 50 notes), whose net issuance

Box 10

Implementation of the Decree on the recycling of banknotes and coins in 2006

Decree 2005-487 of 18 May 2005 on the recycling of euro coins and banknotes (codified in Articles R121-3 to R123-3 of the regulatory part of the Monetary and Financial Code), which supplements Article 6 of Council Regulation (EC) 1338/2001 of 28 June 2001, came into force on 17 January 2006.

In accordance with Article 14 of the Decree, the Banque de France shall draw up an annual assessment of its application in its Annual Report to the President of the Republic.

Main provisions of the Decree

Concerning the processing of coins

The Decree stipulates that credit institutions that process and package coins for delivery to the Banque de France must conclude an agreement with the Bank regarding the processing of coins for delivery to the Banque de France or use the services of an operator that has concluded such an agreement.

.../...

⁷ Pursuant to the ECB's Decision of 6 December 2001 on the issue of euro banknotes, 8% of the total value of euro banknotes is allocated to the ECB, while the remainder is allotted to the NCBs in proportion to their paid-up shares in the ECB's capital.

⁸ Since 1 January 2002, currency in circulation designates all euro banknotes issued in the Eurosystem. National Statistics now use the concept "net currency in circulation", defined as the difference between withdrawals and deposits at the counters of the NCB in question.

⁹ Outstandings excluding national currencies.

.../...

These agreements specify the measures to be implemented by operators (equipment, procedures, etc.) and provides for on-site and documentary inspections by the central bank.

Concerning the delivery of banknotes to automated teller machines (ATMs)

The Decree stipulates that operators that replenish self-service ATMs with banknotes that are not directly drawn from a Eurosystem central bank must conclude an agreement with the Banque de France or use the services of an operator that has concluded such an agreement.

These agreements, approved by the ministerial order of 20 June 2005, stipulate the resources to be put in place by operators, particularly in terms of equipment. They provide for on-site and documentary inspections by the central bank. They require operators to draw up written operating and control procedures and to provide specific information to the Banque de France.

Concerning the manual distribution of banknotes by credit institutions

Regarding the manual distribution of banknotes in bank branches, the Decree stipulates that credit institutions must use staff that have received appropriate training, with the Banque de France supporting the training activities carried out by banks.

Assessment of the Decree's application in 2006

Agreements regarding the processing of coins; inspections carried out by the Banque de France

With the Banque de France and operators having concluded agreements before they became obligatory under the Decree, the system of inspections was rapidly put in place and may be regarded as fully operational.

At end-2006, 43 processing agreements were in force, concluded between the Banque de France and credit institutions, cash-in-transit and cash-processing companies and companies operating coin-processing equipment. In total, there were 209 sites in France handling coins for delivery to the Banque de France.

In 2006, 109 sites were the subject of on-site inspections by Banque de France teams. The inspections carried out by the Bank identified a number of malfunctions (inadequacy of equipment or procedures) that were swiftly rectified by the operators concerned. It nonetheless proved necessary to carry out two follow-up inspections at sites where serious shortcomings were identified.

Agreements regarding the automatic distribution of banknotes not drawn from a central bank; inspections carried out by the Banque de France

The Decree's entry into force led many banks to review their practices concerning the replenishment of their ATMs. Some of them decided to stop recycling banknotes, while others chose to take advantage of the transitional period provided for in the standard agreements. Only a few credit institutions embarked on recycling activities compliant with the target system laid down by the standard agreements.

The main purpose of the agreements so far concluded is therefore to allow the recycling practices using the mechanical equipment in place to continue during a three-year transition period. At end-2006, 40 agreements concerning "the distribution by ATMs of banknotes not directly drawn from a Eurosystem central bank" had been signed or were pending signature by the Banque de France and the credit institutions concerned. The agreements covered around a thousand bank branches and 300 so-called remote sites, which under the system of agreements benefit from special conditions.

In this context, the Banque de France's main objective has been to provide support to banks during this process. On-site inspection activities have been scaled back: four on-site inspections were carried out with a view to developing an efficient system scheduled to come into operation during 2007.

.../...

.../...

Training bank employees in the authentication of banknotes

In accordance with the Decree's provisions, the Bank gave support to banks that requested it in training staff charged with the manual distribution of banknotes in bank branches.

In total, the Banque de France trained:

- in 2005, 3,100 trainers in credit institutions;
- in 2005 and 2006, 5,800 bank counter clerks directly.

Implementation of the Decree in overseas departments

The Banque de France has charged the French overseas departments note-issuing bank (IEDOM) with the administration of the system with regard to credit institutions whose headquarters are located in the overseas departments, or in Mayotte or Saint-Pierre and Miquelon.

Six agreements covering the automatic processing of euro coins were signed in respect of nine production sites. The IEDOM conducted 16 on-site inspections.

At end-December 2006, an agreement concerning the delivery by ATMs of recycled banknotes was concluded with a credit institution.

The IEDOM also participated in the training of 510 bank employees in banknote authentication.

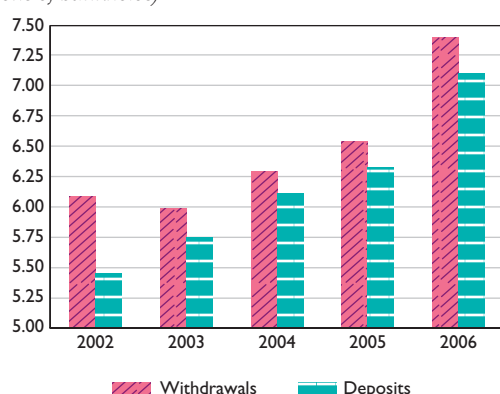
increased in value terms by 18.2%, compared with 11.2% in the Eurosystem as a whole. Indeed, France stands out in using a greater number of medium-value denominations. Conversely, net issuance in France of denominations used for hoarding purposes (EUR 100, EUR 200, EUR 500 notes) recorded the slowest growth in the area. Under these circumstances, there was a mechanical reduction in the average value of euro banknotes issued in France: it fell from EUR 27.7 at

end-2005 to EUR 26.9 at end-2006. It may be noted, by way of comparison, that more than one out of every three EUR 20 banknotes, but less than one out of every ten EUR 500 notes circulating in the euro area is withdrawn in France.

As a result of the Decree on the recycling of euro banknotes and coins, there was strong growth in the volumes of banknotes handled by the Banque de France.

Volumes of euro banknotes handled by the Banque de France

(billions of banknotes)



Deposits (7.1 billion banknotes with a value of EUR 165 billion) and withdrawals (7.4 billion banknotes with a value of EUR 172 billion) increased by 12.3% and 13.1% in volume terms.

As a consequence, banknote sorting activity was extremely sustained (an additional 518.1 million banknotes sorted in 2006).

The growth rate of net issuance of coins in France abated slightly in value terms, standing at 5.9% at end-2006, after 6.4% at end-2005. It amounted to 11.5% for net issuance in volume terms, after 13.2% at end-2005.

At the end of 2006, 77.3% of total net currency outflows (sum of withdrawals – sum of deposits) consisted of copper coins, due to the continuing very low rate of return of these coins.

2|2 The Banque de France and financial stability

2|2|1 Banking supervision and financial stability

Work on the convergence of national supervisory practices within the European Union

The General Secretariat of the *Commission bancaire* contributed, in consultation with the Paris financial centre, to the drafting of the legislation transposing the European capital adequacy directive into French law.¹⁰ The draft text was submitted to the CCLRF. The General Secretariat continued with its assessments of the systems put in place by credit institutions that had made known their intention to use the internal ratings-based approach to credit risk, which requires prior authorisation from the *Commission bancaire*.

Work to harmonise reporting was carried out by the Committee of European Banking Supervisors (CEBS), the Chair of which is the Secretary General of the *Commission bancaire*. Within this framework, in 2006 the *Commission bancaire* (CB) adopted the principle of consolidated financial reporting based on the International Financial Reporting Standards (IFRS) – FINREP – and common prudential reporting for the Basel II solvency ratio – COREP. These two types of reporting, the format for which was the subject of in-depth consultation with the profession, will be communicated to the General Secretariat of the CB in XML/XBRL format. The first submissions under FINREP and COREP will take place for the period ending 30 June 2007. In parallel and also within the framework of the CEBS, the CB's General Secretariat participated in the introduction of the supervision of major cross-border European banking groups (the "operational networking" project) and the provision of information to the new CEBS server that gives access to the regulations in force in each member country (the "supervisory disclosure" project).

Tasks carried out with regard to banking supervision and financial stability

The Banque de France, either directly or via its administration of the general secretariats of the Comité des établissements de crédit et des entreprises d'investissement (CECEI – Credit Institutions and Investment Firms Committee), the Comité consultatif sur la législation et la réglementation financière (CCLRF – Advisory Committee on Financial Legislation and Regulation, which also works in the field of insurance) and the Commission bancaire (CB), contributes to the smooth functioning of the banking sector and the financial system. Within this framework, it carries out or participates in the following tasks:

- delivering the authorisations and licences required for credit institutions and investment firms to carry out their activities;
- ensuring these institutions' compliance with the banking and financial regulations in force through off-site monitoring and on-site inspections; supervising the negotiable debt securities market;
- drafting and implementing the legal texts governing the banking and financial sector and analysing regulatory issues relating to the functioning of financial markets, in the context of the harmonisation of European and international rules;
- identifying the risk factors underlying financial developments and assessing the strategic issues linked to financial stability;
- contributing, within financial bodies or international organisations, to strengthening financial stability and the robustness of the financial system, particularly through co-operation between central banks, financial sector supervisory authorities and government agencies.

The criteria and methodology used by the Commission bancaire to implement Pillar 2 of the Basel II framework were made public. A study on this topic was published in the Banque de France's *Financial Stability Review* (FSR) in December 2006.

Work on financial stability

The Financial Stability Committee, an internal body within the Banque de France that brings together

¹⁰ Order 2007-571 of 19 April 2007 on credit institutions, investment firms and mortgage credit institutions; Decree 2007-745 of 9 May 2007 on the solvency of credit institutions, investment firms and mortgage credit institutions; Order of 20 February 2007 on the capital requirements applied to credit institutions and investment firms; Order of 20 February 2007 amending the regulations of the Comité de la réglementation bancaire et financière (CRBF – Banking and Financial Regulations Committee) and Order of 7 May 2007 updating the regime for mortgage credit institutions.

the two Deputy Governors and representatives of the Directorate General Operations, the general secretariats of the *Commission bancaire* and the CECEI, the Directorate General Economics and International Relations and, when necessary, the Banque de France's General Secretariat, notably examined the issues relating to accounting standards, the securitisation of insurance risk, the reform of the rules covering public offerings and the processing of post-trade transactions on credit derivatives.

The *Financial Stability Review* analysed developments in the vulnerabilities of the financial system, in particular the low level of risk premia and the considerable growth in risk transfer mechanisms. Among the topics addressed in 2006, special emphasis was placed on investors' appetite for emerging financial and commodity-related assets, market liquidity and its incorporation into risk management, and the measurement and supervision of risks in the trading book of banks.

In the area of market supervision, implementation of the NORIA information system made possible the collection and compilation of data on negotiable debt securities issued by credit institutions and industrial and commercial companies (certificates of deposits, commercial paper and negotiable medium-term notes). The year 2006 also saw the official launch of the STEP (Short-Term European Paper) label, promoted by the ACI-The Financial Markets Association and the European Banking Federation (EBF), in order to foster the integration, recognition and quality of European short-term securities markets. The Banque de France plays an important supporting role in the labelling process, while the ECB is in charge of publishing the statistics for issues that have received the label. The outstandings of French negotiable debt securities that have been given the STEP label currently account for around 90% of total euro area outstandings.

Regarding the resilience of the financial system, the Banque de France led a group made up notably of representatives of the major credit institutions and payment systems, as well as the various supervisory and regulatory authorities. A report setting out concrete recommendations to strengthen the operational continuity of the French financial centre is being finalised. The progress thus brought about will contribute to the indispensable robustness of financial circuits in the event of shocks, especially exogenous ones.

Key data for 2006

Number of institutions subject to supervision: 993
848 credit institutions and 145 investment firms

Commission bancaire

139 on-site inspections; 128 individual letters requesting improvements or letters of injunction; 11 proceedings leading to penalties

CECEI

356 individual cases examined, of which 26 authorisations and 63 revocations of authorisation

Financial stability co-ordinating bodies

11 meetings

Financial Stability

11 meetings of the Financial Stability Committee and the group on resilience made up of representatives from the financial sector

13 articles published in the *Financial Stability Review (FSR)*

Supervision and development of the negotiable debt securities market

340 financial memoranda analysed and posted on the Banque de France's website

Relations between the financial market authorities

Within the framework of the provisions laid down by the law, the Banque de France and the *Commission bancaire* co-operate closely with the other financial market authorities.

The first Deputy Governor of the Banque de France, who generally chairs the *Commission bancaire* on behalf of the Governor, sits on the Board of the *Autorité des marchés financiers* (AMF – Financial Markets Authority) as well as its Audit Committee and one of the specialised commissions that decide on the referral of individual cases to the disciplinary commission. The personnel of the two institutions also collaborate actively. The Banque de France's Regional Directors thus represent the AMF in the regions. At the AMF's request, the Banque de France's Inspectorate carries out inspections in credit institutions and investment firms, as well as in specific entities such as Euronext and the clearing house LCH.Clearnet. In addition, the secretariats of

the two institutions exchange views in the course of regular meetings on numerous regulatory issues and individual cases. They also formulate common positions on specific subjects (e.g. recently on the issue of hedge funds) in order to present co-ordinated points of view in international fora. Exchanges of staff between the general secretariats of the AMF and the *Commission bancaire* take place on a regular basis and the on-site inspection programmes of the two boards are harmonised where necessary.

There is also close co-operation with the *Autorité de contrôle des assurances et des mutuelles* (ACAM – the Insurance Supervisory Authority) given that the first Deputy Governor is a member of this body. A charter sets out the terms of the co-operation between the two authorities and their general secretariats. The very close working relations between the latter take the form of joint meetings, joint on-site inspections of financial groups that engage in both banking and insurance activities, and exchanges of staff. The Governor of the Banque de France and the Chairman of the ACAM take turns in chairing the joint ACAM-*Commission bancaire* sessions, during which subjects of common interest that come within the competence of the two bodies are discussed, notably the identification of bancassurance financial conglomerates and the terms of their supervision.

The Governor of the Banque de France, as Chairman of the *Commission bancaire*, also sits on the *Collège des autorités de contrôle des entreprises du secteur financier* (Caces – Board of supervisory authorities for companies in the financial sector), chaired by the Minister in charge of economic affairs, in which cross-sector issues concerning all three supervisory authorities are discussed.

2 | 2 | 2 The Banque de France and the security of means of payment and exchange systems

Management of exchange systems and main projects related to payment systems and media

TARGET2

In 2006, the Banque de France, in a joint project with the Deutsche Bundesbank and the Banca d'Italia, pursued the creation of the European single shared platform that will constitute the core of the common

Tasks carried out in respect of means of payment and exchange systems

The Banque de France keeps the accounts of credit institutions and manages the French component of the European TARGET system, which ensures the secure settlement of large-value payments and thereby the smooth functioning of the euro area interbank market.

The Banque de France also actively participates in European reforms regarding means of payment and payment systems.

Lastly, the Banque de France is charged with ensuring the security of means of payment and exchange systems.

Key data for 2006

950 accounts of credit institutions and investment firms (of which roughly 140 accounts in the TBF system, France's real-time gross settlement system)

EUR 480 billion worth of payments processed daily in TBF
25% of TARGET traffic transits via TBF

settlement system using central bank money, TARGET2. This project will increase the efficiency of large-value euro transactions, primarily by means of the TARGET2 platform, which will replace the current national systems, a single system of pricing and substantial harmonisation of the services provided.

The internal programme of developments and tests was implemented in accordance with the published schedule and part of the central platform was delivered to the Eurosystem in January 2007 for acceptance testing at end-November. The ECB's Governing Council published the third TARGET2 progress report, containing information about the pricing policy of the services provided and about the legal framework within which TARGET2 will operate.

France's migration to TARGET2 is scheduled to take place on 18 February 2008. In order to prepare for this deadline, a committee bringing together credit institutions and payment systems in the Paris financial centre meets frequently under the Banque de France's chairmanship. In addition, the French

banking community is informed about TARGET2 by various means: topic-specific workshops, information bulletins and a dedicated interactive section on the Banque de France's website.¹¹

SEPA

The Single Euro Payments Area (SEPA) launched by the banking community within the framework of the European Payment Council aims to create a Europe-wide system for payments, notably via the introduction of harmonised payment instruments. The Banque de France participates actively in these discussions and preparations and in 2006 set up, in collaboration with the *Fédération bancaire française* (French Banking Federation), a national SEPA implementation committee bringing together all of the stakeholders, whose work led in October to the adoption of the first version of France's national migration plan.¹²

Oversight of means of payment and exchange systems

In 2006, for the first time the Banque de France published a report on the oversight of means of payment and exchange systems.¹³ This document, which contains a detailed description of means of payment and payment systems and presents the Banque de France's assessment of their functioning and security, provides transparent and extensive information of a technical and general nature on this area, which plays an increasingly important role in today's economy.

Oversight of means of payment

In the above-mentioned report, the Banque de France recalls the need to continually adapt systems to combat fraud, notwithstanding its current low level. Several recommendations were drawn up regarding dynamic authentication for payment cards, verification of security features on cheques, verification of authorisations for direct debits and the reinforcement of authentication techniques for on-line payments.

The Banque de France, which in 2005 was charged with overseeing the security of the new *chèque emploi service universel* (CESU), the all-purpose employment service cheque instituted by Act 2005-841 of 26 July 2005, drew up a draft security framework for the CESU, which is currently the subject of consultation with the relevant professionals.

Lastly, the fraud statistics compiled by the Observatory for Payment Card Security,¹⁴ which is chaired by the Governor of the Banque de France and whose secretariat is administered by the Bank, confirmed the downward trend observed in 2005 regarding both domestic and cross-border transactions. The only rise in fraud was seen in remote payments. This increase is difficult to measure given the absence of exact figures and the overall growth of this type of payment.

Oversight of exchange systems

The report on the oversight of means of payment and exchange systems highlights the high degree of compliance of the exchange systems assessed by the Banque de France, but underscores the need to strengthen operational continuity in the event of exogenous shocks. In a more general way, the Banque de France continued to monitor the action plans drawn up by the operators of the different systems in order to ensure their total compliance with the oversight standards in place.

In 2006, the Banque de France also pursued its co-operation with central banks and regulatory authorities in other European countries, in the framework of memoranda of understanding on the co-ordination of the oversight and supervision of the post-trading infrastructures LCH.Clearnet and Euroclear.

The report on the oversight of means of payment and exchange systems also sets out the Banque de France's view of the issues at stake and outlook for oversight activities in a context marked by growing European integration, of which TARGET2 is the main example, and the need to reduce operational risks as far as possible.

¹¹ Available on the Bank's website (http://www.banque-france.fr/fr/sys_mone_fin/target2/target2.htm).

¹² Available on the Bank's website (http://www.banque-france.fr/fr/sys_mone_fin/telechar/rapports/sepa_27102006.pdf).

¹³ Available on the Bank's website (http://www.banque-france.fr/fr/sys_mone_fin/target2/rapports/page5.htm).

¹⁴ The Observatory for Card Payment Security annual reports are available in English on the Observatory's website at <http://www.observatoire-cartes.fr>.

2|3 Other tasks specific to the Banque de France

2|3|1 The management of an account and of payment media on behalf of the Treasury

Tasks carried out in the management of the Treasury's account

In accordance with the agreement of April 2002 between the State and the Banque de France, the latter:

- manages the Treasury's central account;
- implements the national and international settlement and collection circuits in euro and foreign currency that make it possible to carry out flow transactions on behalf of Treasury accountants;
- manages all these services, while complying with the quality and risk control indicators laid down in the agreement.

Key data for 2006

Transactions performed on behalf of the State:

- 159 million cheques collected
- 285 million direct debits presented
- 250 million credit transfers initiated

In 2006, the EVCLI project to update the management of institutional clients' accounts, designed to equip the Bank with a high-performance and advanced tool, entered the acceptance testing phase. This project, which is scheduled to become operational in mid-2007, is especially important as it is coupled with the provision to the Public Accounts Directorate of a similar application (ALTAIR) for managing the 140,000 accounts of local authorities and public institutions.

2|3|2 Services to public administrations

The Banque de France responds positively to the growing requests for its economic expertise from local and regional authorities as long as its intervention does not call either its neutrality or its obligation to respect confidentiality into question and it is appropriately compensated for its services.

Alongside the continuation of activities aimed at promoting the use by companies of the GEODE economic and financial assessment service, in co-operation with regional and departmental councils, in 2006 emphasis was mainly placed on developing and expanding the ACSEL service providing assessments of the economic and financial position of specific geographical areas.

Tasks carried out in the context of relations with public administrations

In accordance with the Public Service Contract signed with the State, the support the Banque de France offers to public administrations in the execution of their economic activities is two-fold:

- its representatives serve as experts on committees charged with monitoring and addressing the main economic issues (Comité interministériel de restructuration industrielle – CIRI, Comité départemental d'examen des problèmes de financement des entreprises – CODEFI), as well as on committees that give their opinion on requests for government assistance;
- it monitors economic developments and labour pools in the regions. In accordance with various agreements and contracts, it provides public administrations with services that enable them to support local companies (GEODE), to assess the economic and financial position of a specific geographical area or sector (Localised Cyclical and Structural Economic Analysis – ACSEL) or to monitor a specific group of companies, for example those that have received assistance in previous years.

Key data for 2006

In accordance with the 2003-2006 Public Service Contract concluded between the Banque de France and the State:

- 45,000 technical opinions delivered by commissions for monitoring and granting assistance to companies;
- 2,150 GEODE economic and financial assessments performed in collaboration with business leaders. This included 277 assessments carried out within the framework of 53 agreements and contracts with public administrations and 27 ACSEL analyses conducted and presented to officials from these administrations.

2|3|3 Data on non-financial corporations

Tasks carried out in respect of company data

The Banque de France has managed the FIBEN company database since 1982 to cater for its own needs, those of the Commission bancaire and the banking industry, and to provide company managers with an external assessment of their company's financial position relative to that of other firms.

Key data for 2006

5.2 million entities listed in FIBEN
228,000 companies rated on the basis of tax or consolidated statements
44,000 meetings with company managers

FIBEN and the Banque de France rating

The Banque de France rating is a reference for the banking industry in two respects. First, within the context of refinancing operations, it is used by the Eurosystem to assess the quality of assets pledged by banks as collateral for their monetary policy operations. Moreover, FIBEN and the Banque de France rating provide credit institutions with a database that helps them to refine their decision-making, monitor their risks over time and supplement their own information and rating systems, without however replacing their own risk analysis.

In view of this dual role, the Banque de France has made a submission to the General Secretariat of the Commission bancaire to be recognised as an external credit assessment institution (ECAI) within the framework of the reform of solvency ratios known as Basel II. Credit institutions will thus be able to draw on the Banque de France's expertise in order to calculate their regulatory capital requirements.

Through FIBEN, the Banque de France contributes to the quality of financial reporting, which is a prerequisite for smooth relations between banks and companies and fosters financial stability.

In parallel, the Banque de France carries out studies on the analysis of companies' financial behaviour, giving priority, on the one hand, to monetary policy concerns and, on the other, to financial stability and risk analysis. In order to promote wider use of the FIBEN database, it is developing external partnerships, notably with the ECB, regarding risk contagion and, more generally, the analysis of companies' financial behaviour.

The Banque de France is continuing the overhaul of its rating process with the aim of reinforcing the quality of its database while at the same time reducing its cost. In particular, in 2006 it implemented the experimental phase of an expert system to assist in the rating process (ASCOT), prior to its roll-out in 2007.

Trade Credit Observatory

In 2006, the Banque de France was charged with the secretariat of the *Observatoire des délais de paiement* (Trade Credit Observatory), a body that was reactivated by an Order published in the *Journal officiel* of 29 June 2006. Set up in September 2006, the new Observatory's task is to draw up a detailed assessment of the situation regarding payment periods and to analyse the economic impact of the developments observed. It brings together players from the economic sphere, administrations with competence in economic and statistical areas, and prominent experts. The Observatory's first report¹⁵ was submitted to the Minister for Industry on 19 December 2006. Having analysed the situation in France, highlighting in particular the importance of the issue for SMEs and making a number of international comparisons, it endeavours to identify the benefits, limitations and risks relating to trade credit. It sets out a series of positions and proposals based on the latter.

2|3|4 Services provided in the area of relations between private individuals and the financial sphere

National payment incident databases

In 2006, the improvement in the processes for sharing information with the banking profession continued, with the generalised implementation of the system for entering and consulting data via internet.

The management and promotion of the National Register of Irregular Cheques (FNCCI), which have

¹⁵ Available on the Bank's website (<http://www.banque-france.fr/fr/publications/catalogue/eco-3k.htm>).

Tasks carried out in database management

The Banque de France manages the household payment incident databases:

- the Fichier national des incidents de remboursement des crédits aux particuliers (FICP – National Register of Household Credit Repayment Incidents), which records clear-cut payment incidents related to credit granted to natural persons as well as measures for handling cases of household overindebtedness;
- the Fichier central des chèques (FCC – Central Cheque Register) records clear-cut payment incidents related to the use of cheques, with the aim of improving the security of payment instruments; within the framework of an agreement with the bank card consortium, the Banque de France also manages the database of bank card incidents;
- the Fichier national des chèques irréguliers (FNCI – National Register of Irregular Cheques), which compiles and disseminates data, particularly on stolen or lost cheques, to merchants and service providers seeking to verify the validity of cheques.

Key data for 2006

70 million consultations of the FCC
2.3 million individuals registered in the FICP
175 million consultations of the FNCI

been outsourced to an external company following a European tender procedure, was to take place under the new designation Vérifiance-FNCI-Banque de France (to replace Resist) from 1 January 2007 onwards.

Overindebtedness

At end-2006, the Banque de France published the first overindebtedness barometer, thus fulfilling a commitment made as part of the Public Service Contract concluded with the State. This barometer, developed within the framework of a consultation process conducted in collaboration with the Comité consultatif du secteur financier (CCSF – Advisory Committee on the Financial Sector), consists of a set of representative indicators enabling developments regarding overindebtedness to be measured.

The project to overhaul the application for processing cases of overindebtedness used by the Banque de France's branch network units was also ongoing.

The new application was due to be implemented in the first half of 2007, thus providing the commission secretariats with a more ergonomic and effective tool with which to process cases.

Access to banking services

As part of measures aimed at combating exclusion from banking services and following on from the work carried out under the aegis of the CCSF, a modification to the "access to banking services" arrangement was introduced in April 2006. Private individuals may now authorise the credit institution that has turned down their application to communicate to the Banque de France their request for access to banking services.

Other tasks carried out in respect of relations with private individuals

The Banque de France carries out a number of tasks that are entrusted to it for the most part by law:

- it has provided the secretariat for the household debt commissions since the set-up of the mechanism for dealing with situations of household overindebtedness;
- it processes requests to allow individuals to exercise their right of access to banking services, which entitles all persons domiciled in France without a deposit account to open such an account;
- it provides the secretariat for the Banking Mediation Committee, which is chaired by the Governor, and is responsible for supervising the mechanism set up in 2003 and drafting an annual report on mediation;
- it helps to inform private individuals about banking regulations and practices via its Infobanque service;
- it manages the database on banking and financial sales activities on behalf of the Autorité des marchés financiers (AMF – Financial Markets Authority), the Comité des établissements de crédit et des entreprises d'investissement (CECEI – Credit Institutions and Investment Firms Committee) and the Autorité de contrôle des assurances et des mutuelles (ACAM – Insurance Supervisory Authority);
- it has taken on the secretariat of the Observatory for Micro-Finance, recently set up by the public authorities.

Key data for 2006

185,000 cases submitted to household debt commissions
30,500 applications for access to banking services

This enhanced access to the procedure goes hand in hand with the commitment made by the Banque de France to designate – within the space of a working day – the credit institution that should open the account.

Informing private individuals and banking mediation

Efforts to improve the quality of information provided to private individuals, which in 2005 resulted in the creation of a database on sales activities, which may be consulted on the website www.demarcheurs-financiers.fr, have continued. The work carried out in 2006 to extend the Banque de France's role as regards informing the public about banking and credit regulations and overindebtedness led to the setting-up of an information helpline.¹⁶

As part of the supervision of the banking mediation framework, the Banque de France organised an

information day for mediators, an account of which is featured in the third report on banking mediation, which was published in November 2006. At this event, the question of extending the mediators' field of competence, which is one of the main concerns of the players involved, was discussed. The current legal framework confines the intervention of mediators to disputes relating to the functioning of deposit accounts and to tied- and commission-based sales. The Governor of the Banque de France has highlighted that the positive results obtained by mediation are an argument in favour of extending the competence of mediators to other categories of dispute that arise in respect of the contractual relations between a bank and its customers.

The *Bilan de la médiation bancaire* (report on banking mediation) as well as a directory of contact addresses for mediators, which is regularly updated, can be consulted on the Banque de France's website.¹⁷

¹⁶ As of the start of 2007, this helpline can be reached on 0811 901 801.

¹⁷ Available in French on the Banque de France's website (<http://www.banque-france.fr>, section entitled organisation et activités/services rendus/protection du consommateur/médiation bancaire).

THE ACCOUNTS OF THE BANQUE DE FRANCE

I | Report on assets, liabilities and results

The accounts for the year ended 31 December 2006 were approved by the General Council at its meeting of 10 April 2007. With a net profit of EUR 1,246 million, the Banque de France more than doubled that of the previous year, thereby marking a return to the exceptional levels recorded in 1989 and 1990. This improvement results from efforts to control operating costs, on the one hand, and the sharp increase in monetary income resulting from strong growth in banknote circulation within the Eurosystem and a better return on investments, on the other.

In the interests of clarity, this section discusses aggregated balance sheet and profit and loss items extracted from the published accounts, which are presented in accordance with the Order of the Minister of Economy, Finance and Industry of 7 February 2000 (see below). Details of the accounting principles applied by the Banque de France are provided in the notes to the annual accounts.

I | Assets and liabilities

In 2006, the financial position of the Banque de France improved significantly thanks to the strong increase in net sources of funds from banknote operations, which were up by EUR 11.5 billion year-on-year. Changes in other sources of funds were relatively marginal.

Financial position			
<i>(year-end amounts, EUR millions)</i>			
	Outstanding amounts at 31/12		Change 2006/2005
	2006	2005	
Net sources of funds from banknote operations	118,431	106,942	11,489
Gold and foreign exchange assets	-29,384	-25,138	-4,246
Net position with credit institutions, the ESCB and the ECB	-72,029	-73,631	1,601
Euro-denominated portfolios	-29,491	-18,088	-11,403
Net position with customers	7,304	5,773	1,531
Other transactions	5,169	4,142	1,027
Total	0	0	0

No sign: net source of funds (liability); minus sign: net asset position.

These additional sources of funds contributed to raising the amount of euro-denominated assets, which rose year-on-year from 72% to 74% of net interest-bearing assets on average. Gold and foreign exchange assets (net of revaluation accounts) also increased, but to a lesser extent, on account of purchases of foreign currency, partly offset by further sales of gold and a reduction in the SDR position vis-à-vis the IMF.

I | Net sources of funds from banknote operations

Net sources of funds from banknote operations			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Banknotes issued by the Banque de France	57,182	50,841	6,341
Adjustment to the allocation mechanism based on the ECB's capital key	73,502	66,733	6,769
Allocation of 8% of banknotes to the ECB	-10,455	-9,406	-1,049
Banknotes in circulation allocated to the Banque de France (balance sheet item P1)	120,229	108,168	12,061
Advance to the IEDOM	-3,066	-2,576	-490
Net sources of funds from banknote operations (euro banknotes)	117,163	105,593	11,571
French franc banknotes	1,267	1,349	-82

Euro banknotes

Since the introduction of euro banknotes at the start of 2002, 92% of the total amount of euro banknotes in circulation has been allocated at each month-end between the National Central Banks (NCBs) in the Eurosystem in proportion to their subscription to the capital of the European Central Bank (ECB). The remaining 8% is allocated to the ECB.

Having rapidly returned to the levels seen prior to the introduction of euro banknotes, the amount issued by the Eurosystem has grown at a pace which is gradually declining but is nonetheless still sustained (annual average of 11.2% in 2006, compared with 15.3% in 2005). Under the formula for allocating banknotes between euro area NCBs, this growth was reflected in a year-on-year increase of EUR 12.1 billion in net sources of funds from euro banknote operations in the accounts of the Banque de France.

The share of euro banknotes allocated to the Banque de France is substantially higher than net issues of euro banknotes carried out by the Bank. The difference constitutes a claim on the ESCB (balance sheet item A8.3), which bears interest at the marginal rate applied to main refinancing operations. The size of this adjustment reflects a number of factors, including the inflow of banknotes into France as a result of tourism and the fact that demand from outside the euro area is to a fairly large extent met by other NCBs in the Eurosystem.

The IEDOM is the Banque de France's correspondent responsible for managing banknote circulation in the overseas departments and in the departmental unit of Mayotte and the territorial unit of Saint Pierre and Miquelon. It receives a non-interest-bearing advance in return for the notes it distributes in the name of and on behalf of the Banque de France. The advance corresponds to 3% of France's euro banknote allocation. As a result of the increase in banknotes in circulation, it rose by EUR 490 million from one year-end to the next. This advance is eliminated in the Banque de France/IEDOM combined accounts.

French franc banknotes

French franc banknotes not yet handed in to the Banque de France constitute a purely domestic source of funds, classified as a miscellaneous liability (balance sheet item P11). At end-December, French franc banknotes represented a liability of EUR 1.27 billion, EUR 82 million lower than at end-2005 due to notes handed in to the Banque de France.

1 | 1 | 2 Gold and foreign exchange transactions

The balance sheet items used to record gold and foreign exchange transactions were affected by the large fluctuations in exchange rates from one year-end to the next.

Year-end revaluation rates			
	Gold (per kg)	US Dollar (EUR/USD)	Special Drawing Rights (EUR/SDR)
End December 2005	13,980.9	1.1797	0.8265
End December 2006	15,518.8	1.3170	0.8760

Gold and foreign exchange transactions			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Assets	82,404	69,863	12,542
Gold	42,210	39,511	2,698
Foreign exchange assets and investments	38,391	27,156	11,235
Relations with the IMF	1,804	3,196	-1,392
Liabilities	53,021	44,724	8,296
External liabilities			
Foreign exchange liabilities	7,580	1,362	6,218
Counterpart to SDR allocations	1,241	1,313	-72
Revaluation reserves			
Revaluation accounts (gold, foreign exchange assets and securities denominated in foreign currencies)	21,117	19,866	1,251
Revaluation reserve of State gold reserves	20,034	19,239	794
Revaluation reserve of State foreign exchange reserves	3,049	2,944	105
Gold and foreign exchange	-29,384	-25,138	-4,246

Gold reserves

Against a backdrop of high gold prices, the Banque de France's gold reserves decreased by 105 tonnes, and at year-end stood at 2,719 tonnes. This reduction reflects the sales carried out in accordance with the agreement reached between 15 European central banks to limit overall gold sales to a maximum of 500 tonnes per year over a five-year period commencing on 27 September 2004. Despite these sales, the sharp rise in gold prices increased the value of Banque de France gold reserves by EUR 2.7 billion from one year-end to the next.

Realised foreign exchange gains during the year ended 31 December 2006 of EUR 794 million were allocated to the "Revaluation reserve of State gold reserves". The gold revaluation account opened on 1 January 1999, which tracks unrealised capital gains from that date, stood at EUR 20.6 billion at year-end.

Foreign exchange assets and operations with the International Monetary Fund

Net foreign exchange assets increased by EUR 5 billion from one year-end to the next owing to the further

purchase of foreign exchange assets, notwithstanding the depreciation of the US dollar against the euro.

The claim on the IMF fell by 44% to EUR 1.8 billion as a result of reimbursements by third countries of financing provided by the IMF on the one hand, and a fall in the exchange rate of Special Drawing Rights (SDRs) against the euro on the other.

Inter-currency arbitrage and reimbursements of SDRs generated EUR 134 million of net foreign exchange gains, taken to the "Revaluation reserve of State foreign exchange reserves". Unrealised losses on the yen and SDRs (EUR 29 million) were taken to the profit and loss account and covered by drawing on the "Revaluation reserve of State foreign exchange reserves".

1 | 1 | 3 Net position with euro area credit institutions and with the ESCB

Net position with euro area credit institutions and with the ESCB			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Assets	26,497	33,428	-6,930
Loans granted in the framework of monetary policy operations	13,695	20,576	-6,881
Other euro-denominated loans to euro area credit institutions	2,149	1,385	764
Intra-ESCB TARGET accounts	10,653	11,467	-814
Liabilities	26,396	25,745	651
Current accounts of banks with minimum reserve obligations	26,378	25,730	649
Other deposits from euro area credit institutions	18	15	2
Net position with credit institutions	-101	-7,683	7,581
Claim on the Eurosystem for banknotes in circulation	63,452	57,525	5,927
Claim on the ECB for foreign exchange assets transferred	8,476	8,423	53
Other net positions with the ESCB	-71,928	-65,948	-5,980
Net position	-72,029	-73,631	1,601

Net position with credit institutions

From one year-end to the next, refinancing obtained by credit institutions from the Banque de France declined by EUR 6.9 billion, while refinancing obtained from the rest of the euro area (reflected in intra-ESCB accounts used to record transactions processed through TARGET) fell by EUR 0.8 billion. As minimum reserve deposits increased slightly, the net lending position with credit institutions dropped by EUR 7.6 billion.

Other claims on the Eurosystem

This comprises (i) the claim arising on the ESCB for the difference between banknotes issued by the Banque de France and the banknotes allocated to the Banque de France under the mechanism described above (see "Net sources of funds from banknote operations") and (ii) the claim arising from foreign exchange assets transferred to the ECB, which is denominated in euros and of which 85% bears interest (to take account of the non-interest bearing 15% corresponding to a gold transfer). Both claims are remunerated at the marginal rate applied to Eurosystem main refinancing operations.

1 | 1 | 4 The Banque de France's euro-denominated portfolios

Euro-denominated portfolios			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Euro-denominated monetary portfolios	25,773	14,480	11,293
Available-for-sale	8,222	6,933	1,288
Held-to-maturity	17,552	7,547	10,005
Own funds investment portfolio	3,717	3,607	110
Available-for-sale	1,644	1,599	45
Held-to-maturity	832	768	65
Participating interest in the ECB	835	835	0
Other participating interests	405	405	0
Euro-denominated securities	29,491	18,088	11,403

Euro-denominated monetary portfolios¹

The increase of EUR 11.3 billion in 2006 reflects the management framework adopted by the Eurosystem in 2003, which allows NCBs to build up their portfolios within annually-reviewed limits.

Own funds investment portfolios

These portfolios, which stood at EUR 3.7 billion at end-December showed a slight increase on account of the investments carried out over the year.

1 | 1 | 5 Operations with institutional customers

Operations with the French Treasury

The advance in respect of coins remained stable from one year-end to the next at EUR 82 million. However, the balance on the Treasury's account dropped to EUR 235 million at end-December.

Other operations with institutional customers

Operations with institutional customers			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Assets	13,746	13,835	-89
Advance in respect of coins	82	82	0
Other advances to the French Treasury	0	0	0
Euro-denominated claims on non-euro area residents	2,303	122	2,181
Other banking operations	11,361	13,631	-2,270
Liabilities	21,050	19,608	1,442
French Treasury current account	235	320	-86
Euro-denominated deposits from euro area residents (other than the French Treasury)	8,175	6,975	1,200
Euro-denominated deposits from non-euro area residents	4,263	3,660	603
Other banking operations	8,377	8,653	-276
Net position with customers	7,304	5,773	1,531

Operations with institutional customers, primarily central banks from outside the euro area who use the Banque de France to invest some of their foreign exchange reserves, which had already increased markedly in 2005, continued to grow in 2006, as shown by the rise in euro-denominated deposits held by non-residents. These transactions are matched by market investments recorded in dedicated accounts in the form of claims on non-residents or other bank transactions.

1 | 1 | 6 Other transactions

Other transactions			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Assets	4,512	4,137	375
Other claims on the Eurosystem	31	18	13
Miscellaneous assets	3,618	3,269	350
Fixed assets	863	850	13
Liabilities	9,682	8,279	1,403
Other liabilities to the Eurosystem	0	132	-132
Items in course of settlement	364	244	120
Miscellaneous liabilities	3,698	3,221	477
Other provisions for liabilities and charges	577	535	41
Accelerated tax depreciation	48	28	20
Fund for general risks	550	410	140
Capital, reserves and retained earnings	3,198	3,186	12
Net profit for the year	1,246	522	725
Net balance of other transactions	5,169	4,142	1,027

The net balance on other transactions at 31 December 2006 was EUR 5,169 million. The year-on-year increase of EUR 1,027 million can largely be attributed to:

- the EUR 725 million rise in profit;
- the increase in other provisions for liabilities and charges resulting essentially from an allocation to a provision for tax exposures;
- the additional contribution of EUR 140 million made to the fund for general risks in the light of the rise in the euro-denominated and foreign currency securities portfolios held by the Banque de France.

¹ From an accounting standpoint, this aggregate item comprises balance sheet item A7 "Euro-denominated fixed-income securities" which consists of the Bank's available-for-sale portfolios and the portion of A11 "Other euro and foreign currency denominated financial assets" consisting of the euro-denominated held-to-maturity portfolio. Available-for-sale portfolios are stated net of revaluation accounts, which are shown on the liabilities side of the balance sheet in item P13.2.

1|2 Results

Net profit for the year ended 31 December 2006 was EUR 1,246 million, the highest level since 1990.

1|2|1 Net income on activities

Net income on activities			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Net income on activities of the Banque de France	3,937	2,659	1,277
Euro monetary income	2,021	1,222	799
Income from refinancing of the banking system	814	588	226
Pooling of monetary income	1,335	737	598
Income from available-for-sale and held-to-maturity portfolios	685	392	293
Interest on claims arising on transfer of reserve assets to the ECB	201	148	53
Interest paid on minimum reserves	-904	-574	-330
Other interest-bearing accounts	-109	69	-41
Foreign currency monetary income	1,339	905	435
ECB and IEDOM dividends	28	20	8
Net profit from non-monetary activities	548	513	35

Monetary income on euro and foreign exchange transactions accounts for 85% of net income on activities of the Banque de France, which amounted to a total of EUR 3,937 million in 2006. Overall, it rose by EUR 1,234 million to reach EUR 3,360 million. Non-monetary income increased by EUR 35 million to EUR 548 million.

Euro monetary income

Monetary income from euro transactions is the biggest component of income for the Banque de France. It represents the excess of income derived from euro monetary assets (refinancing of the banking system,

securities portfolios, pooling of Eurosystem monetary income) over the interest paid on deposits from credit institutions, mainly comprising minimum reserves. Net monetary income rose by EUR 799 million to EUR 2,021 million.

This marked increase was due to a rise in income from the allocation of monetary income by the Eurosystem (interest on intra-ESCB balances corresponding to adjustments to banknotes in circulation – see above – and the net result of pooling of monetary income²) to bank refinancing and to extra income generated by the available-for-sale and the held-to-maturity portfolios. These good performances reflect a combination of larger volumes of interest-bearing investments and higher euro area interest rates, particularly in the short run; over 2006 as a whole, the average interest rate on main refinancing operations was 2.82%, compared with 2.08% in 2005.

Foreign currency monetary income

Foreign currency monetary portfolios generated income of EUR 1,339 million, an increase of EUR 435 million over the 2006 figure.

This increase was attributable partly to the expansion and diversification of the Bank's portfolios, but also to a better rate of return on those assets, with short-term investments denominated in US dollars benefiting from the ongoing rise in American interest rates. On average over the year, the rate of return on foreign currency assets was 4.4%, against 3.3% in 2005.

ECB and IEDOM dividends

The ECB used the total profit generated in 2005 and 2006 to reconstitute its provision for currency and interest rate risks. Consequently, no dividend was paid in 2006 and no interim dividend in respect of ECB seigniorage income was paid to the Banque de France.

The dividend paid by the IEDOM in 2006 in respect of the year ended 31 December 2005 was EUR 28 million, an increase of EUR 8 million.

² The net result of the pooling of monetary income is the final component of the mechanism for the monthly adjustment of the claim arising on the Eurosystem for banknotes issued; it takes account of intra-month trends in banknote circulation, deposits made by credit institutions, and income actually derived from monetary policy operations. In the case of the Banque de France, the pooling of monetary income generated additional income of EUR 31 million, an increase of EUR 13 million relative to 2005.

Net profit from non-monetary activities

Non-monetary activities generated a net profit of EUR 548 million, an increase of EUR 35 million compared to the previous year.

The rise was due to:

- income from the provision of services to the State, which rose by EUR 6 million;
- other income from services (up by EUR 29 million), including the sale of goods to other central banks (banknote exports), financial intermediation services for international institutions, and provision of services to commercial banks (including management of payment media and databases).

Income from the portfolios in which the Bank's own funds and the Employee Reserve Fund are invested was unchanged overall at EUR 205 million.

1 | 2 | 2 Operating expenses

Operating expenses			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Operating expenses	-1,776	-1,735	-41
Provision for tax exposures	-61	0	-61
Personnel and related expenses	-1,341	-1,310	-31
Taxes other than income tax	-31	-27	-4
Provisions, depreciation and amortisation	-115	-152	37
Capitalised production	50	19	31
Other operating expenses	-279	-266	-13

Note: Figures are calculated by aggregating amounts expressed in thousands of euros in the detailed accounts, and rounding the aggregate to the nearest million.

If one excludes the exceptional expense related to the provision for tax exposures of EUR 61 million, operating expenses were down by 1.2% on the previous year and stood at EUR 1,715 million.

The rise in personnel expenses mainly reflects the increase in expenses related to severance schemes,

covered by provisions, and higher pension-related expenses. Conversely, personnel expenses related to working employees declined by EUR 14 million, the headcount reductions having largely offset the 0.23% general pay rise and the payment of an exceptional bonus.

Depreciation and amortisation expenses declined by EUR 37 million in 2006 following the introduction of new rules for assessing the useful lives of assets in 2005.

Production costs continued to be capitalised on account of major IT projects and the development of new project valuation methods defined in the framework of a methodology common to the Eurosystem.

Other operating expenses were up by EUR 13 million mainly as a result of an increase in IT spending and a rise in commodity purchases for banknote production. On a more structural level, the closure of sites as part of the reform of the Banque de France's branch network (29 in 2004, 34 in 2005 and 20 in 2006) is making a significant contribution to reducing overheads.

1 | 2 | 3 Profit for the year

Main profit and loss account balances			
<i>(year-end amounts, EUR millions)</i>			
	2006	2005	Change 2006/2005
Net income on activities of the Banque de France	3,937	2,659	1,277
Operating expenses	-1,776	-1,735	-41
Profit before tax and exceptional items	2,160	924	1,236
Net transfer to fund for general risks and accelerated tax depreciation	-160	-93	-67
Exceptional items	53	66	-13
Corporate income tax	-807	-375	-432
Profit for the year	1,246	522	725

Note: Figures are calculated by aggregating amounts expressed in thousands of euros in the detailed accounts, and rounding the aggregate to the nearest million.

An exceptional gain of EUR 53 million was recorded in 2006. As in 2005, it comprises gains on the disposal of property vacated as a result of the reform of the Bank's branch network.

After an additional contribution of EUR 140 million made to the fund for general risks (see above) and an accelerated tax depreciation charge of EUR 20 million, and after a corporate income tax charge of EUR 807 million, net profit for the year ended 31 December 2006 amounted to EUR 1,246 million.

After retained earnings of EUR 2.5 million, the profit available for appropriation was EUR 1,249 million.

At its meeting of 10 April 2007, the General Council of the Banque de France examined the accounts for 2006 and decided on the appropriation of profits. One such appropriation is automatic, as it results from the legal requirements applying to the Banque de France: 5% of net profit, i.e. EUR 62.3 million, to the reserve set up by Article 28 of the Decree of 3 December 1993.

In accordance with the methods for financing the pension obligations defined in the framework of the reform of the Banque de France pension scheme, the General Council decided, on the one hand, to appropriate EUR 155 million to the Employee Reserve Fund in order to cover the pension entitlements acquired by employees over the past two years,³ and, on the other, to allocate EUR 109 million to a special reserve fund. To ensure that the uncovered portion of the liabilities in respect of past rights is progressively covered, this special reserve fund will be regularly replenished over the next 8 to 10 years, within the limits permitted by the Bank's gross profit and the payment to the State of the predominant share incumbent on it.

The dividend paid to the State amounted to EUR 922 million.

The remaining EUR 0.6 million was carried forward as retained earnings.

³ The amount of EUR 155 million includes EUR 30 million in respect of the adjustment of pension entitlements for 2005 and EUR 125 million for 2006.

2 | Annual accounts

2|1 Balance sheet and profit and loss account

Balance sheet at 31 December 2006

(EUR thousands)

Notes	Item	ASSETS	2006	2005
1	A1	Gold	42,209,552	39,507,645
2	A2	Foreign exchange assets (excl. relations with the IMF)	36,001,855	24,687,349
		2.1 Foreign exchange assets held with non-euro area residents	28,605,877	18,291,833
		2.2 Foreign exchange assets held with euro area residents	7,395,978	6,395,517
3	A3	Relations with the IMF	1,803,876	3,195,523
		3.1 Financing provided to the IMF	1,079,928	2,448,475
		3.2 Acquisitions of Special Drawing Rights	723,948	747,048
5	A4	Euro-denominated claims on non-euro area residents	2,303,479	122,290
4	A5	Euro-denominated loans to euro area credit institutions in the framework of monetary policy operations	13,694,879	20,575,924
5	A6	Other euro-denominated loans to euro area credit institutions	2,149,264	1,384,866
6	A7	Euro-denominated fixed-income securities	8,221,830	6,933,578
	A8	Relations within the Eurosystem	83,447,295	78,268,292
		8.1 Participating interest in the ECB	835,280	835,280
		8.2 Claims arising on the transfer of reserve assets to the ECB	8,476,135	8,423,055
8		8.3 Claims on the Eurosystem for euro banknotes in circulation	63,452,088	57,525,285
9		8.4 Other claims on the Eurosystem	10,683,792	11,484,671
10	A9	Advances to the IEDOM	3,065,952	2,575,561
11	A10	Claims on the French Treasury	81,555	81,555
12	A11	Other euro-and foreign currency denominated financial assets	34,540,586	26,707,357
13	A12	Miscellaneous	3,372,615	3,006,174
14	A13	Fixed assets	1,268,840	1,255,776
		13.1 Tangible and intangible assets	863,487	850,417
		13.2 Participating interests (other than interest in the ECB)	405,352	405,358
TOTAL ASSETS			232,161,577	208,301,890

Notes	Item	LIABILITIES	2006	2005
15	P1	Banknotes in circulation	120,229,430	108,168,212
4	P2	Euro-denominated liabilities to euro area credit institutions in the framework of monetary policy operations	26,378,440	25,729,808
		2.1 Current accounts	26,377,230	25,729,808
		2.2 Other liabilities	1,210	–
	P3	Other euro-denominated liabilities to euro area credit institutions	17,649	15,245
16	P4	Euro-denominated liabilities to non-euro area residents	8,174,734	6,974,567
2	P5	Foreign exchange liabilities	7,580,280	1,362,175
3	P6	Counterpart to SDR allocations	1,241,115	1,313,052
	P7	Relations within the Eurosystem		131,980
17	P8	Euro-denominated liabilities to other euro area residents	4,497,996	3,980,370
		8.1 Treasury's account	234,723	320,452
		8.2 Other liabilities	4,263,273	3,659,918
18	P9	Items in course of settlement	364,247	244,188
19	P10	Banking transactions	8,376,869	8,653,076
20	P11	Miscellaneous	4,965,440	4,569,928
21	P12	Provisions for liabilities and charges	576,642	535,362
22	P13	Revaluation accounts	21,633,347	20,294,455
	P14	Fund for general risks and accelerated tax depreciation	598,384	438,265
	P15	Revaluation reserve of State gold reserves	20,033,633	19,239,149
	P16	Revaluation reserve of State foreign exchange reserves	3,048,883	2,943,893
23	P17	Capital, reserves and retained earnings	3,198,131	3,186,372
	P18	Profit for the year	1,246,357	521,794
TOTAL LIABILITIES			232,161,577	208,301,890

2006 profit and loss account				
(EUR thousands)				
Notes	Item		2006	2005
	1.	Net income on activities of the Banque de France	3,936,611	2,659,355
28	1.1.	Net interest income	3,501,321	2,220,412
		1.1.1 Interest and related income	5,293,356	3,170,359
		1.1.2 Interest and related expenses	- 1,792,035	- 949,947
29	1.2.	Net income/loss on financial transactions	- 94,300	- 36,279
		1.2.1 Net of realised gains/losses and unrealised losses on foreign exchange	899,473	918,836
		1.2.2 Net of charges to/releases from foreign exchange revaluation reserves	- 899,473	- 918,836
		1.2.3 Net of other income and expenses on financial transactions	- 94,300	- 36,279
	1.3.	Commission	4,178	5,655
		1.3.1 Commission (income)	48,851	47,823
		1.3.2 Commission (expense)	- 44,673	- 42,169
30	1.4.	Income from equity securities and participating interests	69,463	51,987
31	1.5.	Net result of pooling of monetary income	30,634	17,883
32	1.6.	Net of other income and expenses	425,315	399,698
	2.	Operating expenses	- 1,776,290	- 1,735,432
33	2.1.	Personnel and related expenses	- 1,340,937	- 1,310,275
	2.2.	Taxes other than income tax	- 30,562	- 26,500
	2.3.	Provisions, depreciation and amortisation	- 114,843	- 151,529
	2.4.	Net of other operating income and expenses	- 289,948	- 247,128
		Profit before tax and exceptional items (1 + 2)	2,160,321	923,923
	3.	Net charge to the fund for general risks and accelerated tax depreciation	- 160,119	- 93,265
34	4.	Extraordinary items	53,448	66,436
		4.1 Extraordinary income	53,448	66,436
		4.2 Extraordinary charges	-	-
35	5.	Corporate income tax	- 807,293	- 375,299
		Profit for the year (1 + 2 + 3 + 4 + 5)	1,246,357	521,794

2|2 Notes to the annual accounts

2|2|1 Accounting principles and valuation methods

Legal framework

The annual accounts of the Banque de France are presented in accordance with the Order of the Minister of the Economy, Finance and Industry of 7 February 2000. Their structure is designed to reflect the specific nature of the tasks carried out by the Bank within the framework of the ESCB and its diverse range of activities. The accounts are expressed in thousands of euro.

The accounting and valuation methods applied by the Banque de France are defined in Article R 144-6 of the Monetary and Financial Code, which specifies that:

- The Banque de France must comply with the accounting and valuation methods laid down by the Governing Council of the ECB in its 5 December 2002 Guideline for all activities carried out within the

framework of the ESCB. This Guideline establishes in particular the accounting rules applicable to refinancing operations for the banking sector, securities, foreign currency transactions carried out in the course of foreign exchange reserve management, and the issue of banknotes.

- The accounting rules established by the Accounting Regulations Committee (CRC) apply to all the other activities of the Bank. However, the Bank's General Council may, after consulting with the Monetary Policy Council (*Conseil de la politique monétaire* – CPM), also decide to apply the accounting and valuation rules recommended by the ECB to its other activities.

Until 2002, the Banque de France applied the accounting rules set by the Accounting Regulations Committee to all of its non-ESCB activities. With effect from 1 January 2003, the Banque de France has extended the accounting methods laid down by the Governing Council of the ECB in its 5 December 2002 Guideline to cover the securities portfolios recorded in asset item A11.

Valuation methods

Foreign exchange gains/losses

Spot and forward purchases and sales of foreign currencies are recorded in off-balance sheet accounts at the trade date. They are recognised in the balance sheet at the settlement date.

Foreign exchange gains/losses on State gold and currency reserves

Realised gains/losses are computed for each currency. Every day, a weighted average price is calculated, firstly on inflows (spot or forward purchases on the trade date and income in foreign currencies, in particular daily accrued interest), and secondly on outflows (spot or forward sales on the trade date and expenses in foreign currencies, in particular accrued interest in foreign currencies). The realised gain/loss is calculated by applying the difference between these average prices to the lower of the day's inflows or outflows.

Where outflows exceed inflows, a second realised gain/loss is calculated, equating to the difference between the net outflows of the day valued at the average outflow price on the one hand, and at the average price of the day's opening position on the other. Where inflows exceed outflows, the net inflow is added to the assets held at the beginning of the day, thus changing the average price of the position.

Gold and foreign exchange positions are valued at year-end on the basis of the rates/prices prevailing on the last business day of the year. Unrealised gains are recorded as liabilities in revaluation accounts (item P13). Unrealised losses are taken to the profit and loss account in item 1.2.1. Unrealised gains and losses are not netted.

Revaluation reserve of State gold reserves and revaluation reserves of State foreign exchange reserves

In order to neutralise the impact on the Bank's profit and loss account of realised gains and losses and of unrealised losses at year-end, the 31 March 1999 agreement between the State and the Banque de France on the management of and accounting for State foreign exchange reserves (as supplemented by the rider dated 26 November 2002) requires the impact to be cancelled out by debiting

or crediting the profit and loss account, with the matching entry posted to the revaluation reserve of State foreign exchange reserves or the revaluation reserve of State gold reserves. However, the amount of net foreign exchange gains taken to the revaluation reserves is limited to the net profit for the year before the transfer to the reserves.

Other foreign exchange gains/losses

The Banque de France applies Regulation 89-01 of the *Comité de la réglementation bancaire et financière* (CRBF – Banking and Financial Regulation Committee) to foreign exchange operations that are not connected to its main responsibilities. Foreign currency deposits and investments are marked to market on the last business day of the year. Realised and unrealised foreign exchange gains and losses are posted to the profit and loss account in item 1.2.3 “Net of other income and expenses on financial transactions”. Accrued income and expenses are translated into euro at the rate prevailing on the day the transaction is recorded. Forward foreign exchange hedges are valued at the closing date exchange rate.

Securities portfolio (excluding pension fund)

The Banque de France holds held-to-maturity securities, shown in asset item A11. These are fixed-income securities which the Banque de France has decided to retain to maturity, and which it is able to retain to maturity. Unrealised gains and losses on these securities are not recognised in the accounts.

Other fixed-income securities are shown in either asset item A2 or asset item A7, depending on whether they are (i) securities denominated in foreign currencies held in connection with foreign exchange reserve management, or (ii) euro-denominated securities. The only exception concerns securities linked to the Bank's own funds, included in asset item A11.

Variable-yield securities are recorded in item A11.

Gains and losses on disposals of fixed-income securities not held to maturity, and on variable-yield securities, are calculated on the basis of the weighted average cost of each line of securities. At the end of the year, securities are marked to market line-by-line on the last business day of the year. Unrealised gains are recorded as liabilities in revaluation accounts (item P13). Unrealised losses are booked as expenses on financial

transactions (profit and loss account item 1.2.3). Unrealised gains and losses are not netted.

For all fixed-income securities, differences between the acquisition and redemption price are spread over the remaining life of the securities on a discounted basis.

The valuation methods used for securities held in connection with the pension reserve fund of Banque de France employees are described in the section on the pension scheme below.

Forward financial instruments

In connection with the management of its portfolios of euro-denominated and foreign currency denominated securities, the Banque de France may use interest rate futures traded on organised markets. These transactions are recorded off-balance sheet at the notional amount, while daily margin calls paid or received are recognised in the profit and loss account.

Tangible and intangible fixed assets

Tangible and intangible fixed assets are accounted for and valued in accordance with CRC regulations.

Land is valued at acquisition cost. Buildings and equipment are carried at historical cost, less depreciation or provisions for impairment set up since they were brought into service. Costs incurred in developing computer applications intended to be used over a number of years are capitalised using the following method: project management and ownership costs are recorded in the profit and loss account as operating expenses; an intangible asset of the same amount is recognised in the balance sheet, but cancelled out by a matching credit recorded under profit and loss item 2.4 "Net of other operating income and expenses".

In accordance with Article 322-1 of the French National Accounting Code (*Plan comptable général* – PCG), the depreciation period for each asset is determined on the basis of its probable useful life. Components of the Bank's property assets are depreciated over 50, 33, 20 or 10 years, depending on the type of asset. Computer equipment is depreciated over 4, 5 or 10 years, and most other equipment over periods ranging from 2 to 10 years. Purchased software is amortised over 3 or 5 years. All fixed assets are depreciated using the straight line method.

The Banque de France records accelerated tax depreciation for assets that can be depreciated more rapidly for tax purposes than for accounting purposes.

Fund for general risks

In 1998, the Banque de France set up a fund for general risks to cover any general risks inherent in the activities of a central bank. Charges to and releases from this fund are recorded in the profit and loss account.

Pension scheme

Banque de France employees are entitled to a special pension scheme. Their pensions, paid out by the reserve fund of Banque de France employees, are partly funded by the income from a dedicated securities portfolio set up over time.

Securities purchased by the Bank to this end are segregated assets and are recorded under balance sheet item A12 "Miscellaneous". The capital of the reserve fund is recorded in liability item P11 "Miscellaneous". Securities purchased are recorded in accordance with CRBF Regulation 90-01 as available-for-sale and held-to-maturity securities. Differences between acquisition and redemption prices are amortised over the residual life of the securities on a straight-line basis for bonds and annual-interest Treasury notes (BTANs), and on a discounted basis for other securities. Unrealised losses on available-for-sale securities are provided for on a line-by-line basis. However, under the rules of the reserve fund, realised gains and losses and unrealised losses recognised in the profit and loss account require a matching charge to or withdrawal from the capital of the reserve fund.

Retirement expenses are included in the profit and loss account item 2.1 "Personnel and related expenses". The proceeds of the reserve fund's securities portfolios are recorded in profit and loss account item 1.6 "Net of other income and expenses".

Post balance sheet events

Reform of the Banque de France pension scheme

At the close of a consultation with all the parties concerned on the reform of the Banque de France pension scheme, a set of conclusions were signed on 24 November 2006 by

the Banque de France staff representative and six out of the seven trade union organisations. The proposed reform was then approved by the General Council at its meeting on 19 January 2007. This led to the adoption of the Decree of 27 February 2007 which introduces major changes to the Banque de France pension scheme as from 1 April 2007.

The main aspects of this reform are described in section 2.4 of Chapter 1 of the Annual Report concerning human resource management. At the accounting level, the impact of this reform on the assessment of provisions for restructuring has been taken into account.

Employees benefiting from the early retirement incentive programme at 31 December 2006 in the framework of restructuring plans (see note 21) who retire after 1 April 2007 will continue to benefit from the pension scheme in place prior to the reform; the offsetting of the effects of the reform (in terms of additional seniority) represents an expense for which provisions have been made by the Bank. The broader contribution base – the cost of which will continue to be borne by the Bank in the case of these early retirees – should also be taken into account.

The impact of these two effects amounts to EUR 36 million. It was entirely provisioned for in the 2006 accounts.

In the absence of essential new data and parameters (career path, new behavioural hypotheses, hypotheses on the repurchase of pension rights, etc.), it is not possible to measure the exact effect of the pension reform on the amount of pension obligations. Given the time needed to obtain, analyse and check this information, the net amount of the Bank's pension obligations at 31 December 2006, as mentioned in note 27 of the Notes to the annual accounts, was determined on the basis of the pension scheme in force at that date. This estimate does not therefore take account of the expected reduction in pension obligations that will result from the reform's entry into force.

Change in the tax regime of the Banque de France

According to Article 8 of Act 2007-212 of 20 February 2007 on various measures concerning the Banque de France, the taxable profit or loss of the Banque de France is calculated using accounting

rules defined in accordance with Article L144-4 of the Monetary and Financial Code and the agreement in Article L141-2 of the same Code.

These new measures, which will come into effect in 2007, take into account the impact of the Bank's being subject to a specific accounting framework as part of its membership of the ESCB (see § of the Notes to the annual accounts on accounting principles and valuation methods) on the determination of corporate income tax for which it is liable.

Change in the Banque de France's share in the capital key of the ECB as of 1 January 2007

On 1 January 2007, the ECB's capital key was changed on account of Bulgaria and Romania joining the EU, in accordance with Council Decision of 15 July 2003 (2003/517/EC).

The share of the Banque de France in the ECB's capital key declined from 14.8712% at 31 December 2006 to 14.3875% at 1 January 2007.

Slovenia's adoption of the euro also had an impact on the Bank's share of subscribed and paid-up capital: this amount edged down from 20.80% on 31 December 2006 to 20.70% on 1 January 2007.

2 | 2 | 2 Information on balance sheet, off-balance sheet and profit and loss items

A certain amount of confidential information relating to operations carried out in the exercise of the Banque de France's core tasks is not disclosed, in accordance with decisions taken by the General Council following recommendations by the Monetary Policy Council and pursuant to Article R144-6 of the Monetary and Financial Code.

Balance sheet

Note 1: Gold

In 2004, the Eurosystem central banks, the Swiss National Bank and the Sveriges Riksbank renewed the agreement capping their sales of gold. Under the new agreement, entered into for a five-year period commencing on 27 September 2004, annual sales by the 15 central banks may not exceed 500 tonnes.

Note 2: Foreign exchange assets and liabilities

Foreign exchange reserves are invested in overnight deposits, fixed-term deposits, reverse repo transactions with delivery of securities, and fixed-income securities. The Banque de France may also borrow foreign currencies in the form of repurchase agreements with delivery of securities, recorded in liability item P5.

Foreign exchange assets and liabilities (excluding relations with the IMF)		
Asset item A2 and liability item P5 (EUR thousands)		
	2006	2005
ASSETS		
Foreign exchange assets		
Overnight deposits	28,216	142,811
Fixed-term deposits	6,373,599	5,949,319
Securities received under repurchase agreements	6,416,349	651,583
Fixed-income securities	22,870,422	17,785,616
Accrued interest receivable	313,268	158,020
Total	36,001,855	24,687,349
LIABILITIES		
Foreign exchange liabilities		
Securities delivered under repurchase agreements	7,565,439	1,361,648
Accrued interest payable	14,841	527
Total	7,580,280	1,362,175

The Banque de France also owns fixed-income held-to-maturity securities denominated in foreign currencies. In accordance with standardised Eurosystem accounting rules, these securities are classified in asset item A11.

Note 3: Relations with the IMF

The amount of financing provided to the IMF is equivalent to the euro value of:

- the portion of France's share in the capital of the IMF settled in gold and other foreign exchange assets, uplifted for net euro usage by the IMF, in particular euro-denominated drawings and repayments by member countries vis-à-vis France;

- drawings made within the framework of the General Arrangements to Borrow and the New Arrangements to Borrow.

Relations with the IMF		
Asset item A3 and liability item P6 (EUR thousands)		
	2006	2005
ASSETS		
Financing provided to the IMF	1,075,286	2,436,655
Acquisitions of SDRs	719,086	743,340
Accrued interest receivable	9,504	15,528
Total	1,803,876	3,195,523
LIABILITIES		
Counterpart to SDR allocations	1,232,780	1,306,535
Accrued interest payable	8,335	6,517
Total	1,241,115	1,313,052

The item "Acquisitions of SDRs" (Special Drawing Rights) includes the euro equivalent of the SDRs held by France. The amount shown here should be taken together with that recorded in liability item P6 "Counterpart to SDR allocations" to determine France's net SDR position.

Note 4: Monetary policy operations

Asset item A5 and liability item P2.2 show operations carried out by the Banque de France within the framework of the single monetary policy of the Eurosystem.

Liability item P2.1 comprises the current accounts opened by credit institutions in the books of the Banque de France. These accounts mainly comprise minimum reserves. The minimum reserve build-up period begins on the main refinancing operation settlement date following the Governing Council meeting at which the monthly assessment of the monetary policy stance is made (Article 7 of EC Regulation 1745/2003 of the ECB, dated 12 September 2003). Minimum reserves are remunerated at the marginal rate applied to main refinancing operations.

Euro-denominated loans to euro area credit institutions within the framework of monetary policy operations

Asset item A5

(EUR thousands)

	2006	2005
Main refinancing operations	12,037,289	19,048,000
Longer-term refinancing operations	1,646,615	1,521,479
Fine-tuning operations	–	–
Structural operations	–	–
Marginal lending facility	–	–
Margin calls paid	–	–
Accrued interest receivable	10,975	6,445
Total	13,694,879	20,575,924

Euro-denominated liabilities to euro area credit institutions within the framework of monetary policy operations

Liability item P2

(EUR thousands)

	2006	2005
Current accounts	26,310,392	25,681,411
Other liabilities	1,210	–
Deposit facilities	–	–
Collection of fixed-term deposits	–	–
Repurchase agreements	–	–
Margin calls received	1,210	–
Accrued interest payable	66,838	48,397
Total	26,378,440	25,729,808

Note 5: Items A4 “Euro-denominated claims on non-euro area residents” and A6 “Other euro-denominated loans to euro area credit institutions”

These items include euro-denominated investments linked to euro-denominated deposits recorded in liability item P4 (see note 16). These claims and loans, which do not relate to monetary policy operations, are split between these two asset items according to whether the counterparty is located within or outside the euro area.

Note 6: Euro-denominated securities

These securities are valued using the weighted average cost method and may be sold prior to maturity. At the end of the year, unrealised losses are written-off and unrealised gains are recorded in the balance sheet in “Revaluation accounts”.

Euro-denominated fixed-income securities

Asset item A7

(EUR thousands)

	2006			Total	2005
	< 3 months	3 - 12 months	> 1 year		
Securities	358,970	4,299,293	3,461,454	8,119,717	6,794,235
Accrued interest receivable	na	na	na	102,113	139,343
Total	–	–	–	8,221,830	6,933,578

na: not available

Note 7: Claims arising on the transfer of reserve assets to the ECB

This claim held by the Banque de France results from the transfer of foreign exchange reserves to the ECB. The claim is denominated in euro and is equivalent to the euro value of the transferred foreign exchange reserves as at the date of the transfer. It is remunerated at the marginal rate applied to main refinancing operations, adjusted to reflect the fact that the gold component of the transferred reserve assets is not remunerated.

Claims arising on the transfer of reserve assets to the ECB

Asset item A8.2

(EUR thousands)

	2006	2005
Claims arising on the transfer of reserve assets to the ECB	8,275,331	8,275,331
Accrued interest receivable	200,804	147,724
Total	8,476,135	8,423,055

Note 8: Claims on the Eurosystem for euro banknotes in circulation

The intra-ESCB claim arising from the allocation of euro banknotes within the Eurosystem and the liability to the ECB relating to the 8% share of euro banknotes in circulation are shown as a net amount in item A8.3 “Claims on the Eurosystem for euro banknotes in circulation”, along with accrued interest receivable as at 31 December 2006. The remuneration of this net claim, and the related adjustments over the 2002-2007 period are shown in profit and loss item 1.1.1 “Interest and related income” (see note 15 “Banknotes in circulation”).

Note 9: Other claims on the Eurosystem

Asset item A8.4 mainly reflects France's net claim arising on cross-border transfers via TARGET with other NCBs in the ESCB. This position is remunerated at the marginal rate applied to main refinancing operations. The interest is paid monthly on the second business day of the month to which it relates. This item also includes any income receivable from the ECB in respect of the distribution of the balance of monetary income (see note 31 to the profit and loss account).

Other claims on the Eurosystem Asset item A8.4		
(EUR thousands)		
	2006	2005
TARGET and lori/nostri claim of Eurosystem NCBs	10,603,656	11,448,348
Accrued interest receivable	49,502	18,440
Other claims on the Eurosystem	30,634	17,883
Total	10,683,792	11,484,671

Note 10: Advances to the IEDOM

The circulation of banknotes in the overseas departments, the territorial unit of Saint Pierre and Miquelon and the departmental unit of Mayotte is managed by the *Institut d'émission des départements d'outre-mer* (IEDOM) – the French overseas departments note-issuing bank – in the name of, on behalf of and under the authority of the Banque de France.

To this end, the Banque de France grants the IEDOM a non-interest-bearing advance for an amount corresponding to an estimate of the value of the banknotes in circulation in the territories concerned.

Note 11: Claims on the French Treasury in respect of coins

Article L141-3 of the Monetary and Financial Code prohibits the Banque de France from advancing funds to the Treasury or any other public body or State-owned corporation. However, Article 6 of EU Council Regulation 3603/93 authorises national central banks to advance funds to the public sector in respect of coins, provided that the advance represents less than 10% of coins in circulation.

The claim of the Banque de France on the French Treasury in respect of coins is non-interest-bearing.

Note 12: Other euro-and foreign currency denominated financial assets

Other euro-and foreign currency denominated financial assets

Asset item A11

(EUR thousands)

	2006	2005
Fixed-income securities held to maturity (a) (b)	28,187,887	10,576,552
Other fixed-income securities and variable-yield securities	2,977,904	2,026,426
Advances against securities (c)	5,204	5,673
Other transactions	2,848,718	13,868,227
Accrued interest receivable	520,873	230,479
Total euro-and foreign currency denominated financial assets	34,540,586	26,707,357

(a) In 2006, none of these securities was transferred to any other or sold prior to maturity.

(b) Of which foreign currency denominated securities: EUR 10,253,770 thousand.

(c) Advances against securities are customer loans guaranteed by pledged securities.

Fixed-income securities

Asset item A11

(EUR thousands)

	2006	2005
Unamortised premium	102,024	368,028
Unamortised discount	705,383	45,203

Securities portfolios

Asset item A11

(EUR thousands)

	2006			2005
	Fixed-income securities held to maturity	Other securities	Total	Total
Fixed-income securities				
Government securities	24,223,526	120,894	24,344,420	8,177,639
Securities issued by public bodies	2,031,006	–	2,031,006	1,191,493
Other issuers	1,933,355	–	1,933,355	1,356,050
Accrued interest receivable	490,804	–	490,804	207,387
Net balance sheet value	28,678,691	120,894	28,799,585	10,932,569
Equities and other variable-yield securities				
French and foreign mutual funds	985,840	–	985,840	873,649
Capitalisation mutual funds	973,934	–	973,934	932,160
Other variable-yield securities	79,845	–	79,845	71,987
Net balance sheet value	2,039,619	2,039,619	2,039,619	1,877,796

Note 13: Miscellaneous

Miscellaneous Asset item A12		
(EUR thousands)		
	2006	2005
Accrued income, prepaid expenses, etc.	356,453	102,071
Accrued income	113,675	89,916
Prepaid expenses	9,948	10,399
Other items	232,830	1,756
Miscellaneous	3,016,162	2,904,103
Total	3,372,615	3,006,174

Note 14: Fixed assets

Fixed assets Asset item A8.1 and A13				
(EUR thousands)				
	31 Dec. 2006	Increases (a)	Decreases (a)	31 Dec. 2005
Participating interest in the ECB (gross value)	829,874			829,874
Translation difference on participating interest in the ECB	5,406			5,406
Participating interest in the ECB (balance sheet value)	835,280			835,280
Participating interests other than the ECB (gross value)	405,352		6	405,358
<i>Intangible fixed assets (gross value)</i>	<i>381,447</i>	<i>71,153</i>	<i>79,138</i>	<i>389,432</i>
<i>Amortisation</i>	<i>246,473</i>	<i>26,282</i>	<i>71,265</i>	<i>291,456</i>
Net value of intangible fixed assets	134,974	44,871	7,873	97,976
<i>Tangible fixed assets (gross value)</i>	<i>2,085,727</i>	<i>257,190</i>	<i>284,054</i>	<i>2,112,591</i>
<i>Depreciation and provisions</i>	<i>1,357,214</i>	<i>88,679</i>	<i>91,614</i>	<i>1,360,149</i>
Net value of tangible fixed assets	728,513	168,511	192,440	752,442
Total tangible and intangible fixed assets (net value)	863,487	213,382	200,313	850,417

(a) Increases and decreases also include transfers between fixed asset accounts.

Information relating to subsidiaries and participating interests at 31 December 2006
Asset item A8.1 and A13.2

(EUR thousands, % share)

	Asset item	Listed	% share capital held	2006 Shareholders' equity	2006 profit/loss equity	2006 book value
BIS	A13.2	No	9.16	13,081,191	684,049	405,261
ECB	A8.1	No	20.80	12,038,723	0	829,874
La Prévoyance immobilière Banque de France Gestion	A13.2	No	98.20	3,673	93	ns
	A13.2	No	99.99	2,133	4,437	ns

ns: not significant

Participating interest in the ECB

Under article 28 of the ESCB Statute, the capital of the ECB is held solely by the NCBs of the ESCB. The formula for determining the capital subscription of each NCB to the ECB (the "capital key") is defined in article 29.3 of the ESCB Statute and adjusted every five years. The first five-yearly adjustment was made on 1 January 2004. On 1 May 2004, a second adjustment to the key was made as a result of the accession of ten new Member States.

Interest held by the Banque de France in the capital of the ECB

(%)

To 31 December 2003	From 1 January 2004 to 30 April 2004	From 1 May 2004
16.8337	16.5175	14.8712

Since 1 May 2004 and until 31 December 2006, the interest held by the Banque de France in the subscribed capital of the ECB has been EUR 827,533 thousand, representing 20.8% of the capital.

As a result of the aforementioned change in the capital key, each NCB's share in the shareholders' equity of the ECB also changed on 31 December 2003 and 30 April 2004. This change is also incorporated in asset item A8.1 "Participating interest in the ECB".

Note 15: Banknotes in circulation

The ECB and the 12 euro area NCBs, which together make up the Eurosystem, have issued euro banknotes since 1 January 2002. The total value of euro banknotes in circulation in the Eurosystem is allocated on the last working day of each month in accordance with the banknote allocation key.⁴

The ECB has been allocated an 8% share of the total value of euro banknotes in circulation; the remaining 92% has been allocated to euro area NCBs according to their weightings in the ECB's capital key. The share of banknotes in circulation allocated to each NCB is disclosed in the liability item "Banknotes in circulation".

The difference between the value of euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation also gives rise to remunerated intra-Eurosystem balances (see asset item A8.3).

From 2002 to 2007, the intra-Eurosystem balances arising from euro banknote allocation are being adjusted in order to avoid significant changes in the NCBs' income positions as compared with previous years.⁵ The adjustments are effected by taking into account the differences between, on the one hand, the average value of banknotes in circulation of each NCB in the period between July 1999 and June 2001 and, on the other hand, the average value of banknotes that would have been allocated to them during that period under the ECB's banknote allocation key. The adjustments will be reduced in annual stages until the end of 2007, after which income on banknotes will be allocated fully between the NCBs in proportion to their paid-up share in the ECB's capital.

Interest income and expense on these balances are cleared through the accounts of the ECB and included in "Net interest income" in the profit and loss account.

The ECB Governing Council has decided that the ECB's seigniorage income arising from the 8% share of euro banknotes in circulation allocated to it is due to the NCBs in the same year it accrues and distributed to them on the second working day of the following year in the form of an interim distribution of profit.⁶ This income is distributed in full unless the ECB's net profit for the year is less than the income earned on euro banknotes in circulation and unless the Governing Council decides to reduce this income by the amount of the costs incurred by the ECB on the issuance and storage of euro banknotes. The Governing Council may also decide to transfer all or part of the ECB's seigniorage income to a provision for foreign exchange rate, interest rate and gold price risks. The amount distributed to NCBs is included in item 1.4 "Income from equity securities and participating interests".

With respect to 2006, the ECB Governing Council decided that the seigniorage income would be retained in full by the ECB.

French franc banknotes, which ceased to be legal tender on 17 February 2002, may still be exchanged until 17 February 2012. Prior to that date, French franc banknotes in circulation but not yet remitted to the Treasury will continue to be recorded as a liability of the Banque de France. This liability has since 1 January 2003 been included in balance sheet item P11 "Miscellaneous".

Note 16: Euro-denominated liabilities to non-euro area residents

This item comprises credit balances in euro (excluding TARGET) with central banks, commercial banks and non-financial customers in non-Eurosystem member countries. In most cases, the assets matching these liabilities are included in asset items A4 or A6 (see note 5) or asset item A11 (see note 12), depending on whether they are invested in the same currency or are covered by cross-currency swaps (see note 26).

⁴ ECB decision of 6 December 2001 on the issue of euro banknotes (ECB/2001/15).

⁵ ECB decision of 6 December 2001 on the allocation of monetary income from 2002 (ECB/2001/16).

⁶ ECB decision of 17 November 2005 (ECB/2005/11) on the distribution of the income of the ECB on euro banknotes in circulation to the NCBs of participating Member States.

**Euro-denominated liabilities
to non-euro area residents**

Liability item P4

(EUR thousands)

	2006	2005
Euro-denominated liabilities to non-euro area residents	8,130,544	6,955,285
Accrued interest payable	44,190	19,282
Total	8,174,734	6,974,567

Note 17: Euro-denominated liabilities to other euro area residents

Liability item P8.1 comprises the Treasury's account, which since 1 May 2002 has been remunerated at the marginal rate applied to main refinancing operations up to EUR 300 million; above this amount, it is remunerated at the deposit facility rate. Interest is credited to the Treasury's account on the last business day of the month.

Liability item P8.2, "Other liabilities", mainly comprises:

- the current account with the IEDOM, the assets matching this liability being mainly recorded in asset item A9 "Advances to the IEDOM" (see note 10); and
- guarantee deposits (mutual funds and individual guarantees) set up since February 2005 by participants in the RELIT+ system (the irrevocable deferred securities settlement system of Euroclear France).

Euro-denominated liabilities to other euro area residents

Liability item P8

(EUR thousands)

	2006	2005
Treasury's account	234,639	320,221
Other liabilities	4,253,498	3,654,786
Accrued interest payable	9,859	5,363
Total	4,497,996	3,980,370

Note 18: Items in course of settlement

In compliance with banking rules, balance sheet item P9 "Items in course of settlement" includes only items (primarily cheques) debited or credited to a customer's account but not yet credited or debited to a credit institution's account, and vice versa.

Note 19: Banking transactions

This item mainly comprises overnight and fixed-term deposits denominated in foreign currencies constituted by French or foreign public bodies. The management of such foreign currency transactions is totally separate from the management of the State's foreign exchange reserves. The assets matching these liabilities, which may be covered by cross-currency swaps, are included either in asset item A11 (see note 12) or in item A4 or A6 (see note 5), depending on whether they are invested in a foreign currency or in euro.

Banking transactions

Liability item P10

(EUR thousands)

	2006	2005
Overnight deposits	550,478	579,660
Other banking transactions	7,738,293	8,035,949
Accrued interest payable	88,098	37,467
Total	8,376,869	8,653,076

Euro-denominated deposits made by institutional customers (other than monetary financial institutions) and private customers are recorded in liability item P8.2.

Note 20: Miscellaneous

This item includes in particular the capital of the reserve fund of Banque de France employees (see below, "Pension obligations") and French franc banknotes still in circulation (see note 15).

Miscellaneous

Liability item P11

(EUR thousands)

	2006	2005
Deferred income, accrued expenses, etc	268,239	330,715
Accrued expenses	268,239	266,215
Deferred income, etc.	0	64,500
French franc banknotes in circulation	1,267,479	1,349,053
Miscellaneous	3,429,722	2,890,160
Total	4,965,440	4,569,928

Note 21: Provisions for liabilities and charges

Provisions for liabilities and charges mainly comprise:

- provisions for restructuring relating to the “cash activities” and “banknote printing” plans, the plan to adapt the Banque de France’s branch network, and the plan to discontinue retail banking activities;
- provisions relating to the early retirement incentive plan for employees reaching the end of their career;
- provisions for retirement benefits;
- provisions for various social liabilities (death benefits, long-service medals, extended sick leave, pensions for industrial injuries);
- provisions for major repairs.

Provisions for liabilities and charges				
Liability item P12				
<i>(EUR thousands)</i>				
	2006	Increase	Decrease	2005
Provisions for restructuring	315,039	6,216	21,085	329,908
Provisions for changing the age pyramid	25,891		2,734	28,625
Provisions for retirement benefits	99,266	411		98,855
Other	136,446	66,098	7,626	77,974
Total	576,642	72,725	31,445	535,362

In 2006, the Bank also made a provision for tax exposures.

Note 22: Revaluation accounts

Gold and foreign exchange assets and liabilities are revalued at the reference prices indicated by the ECB on 31 December 2006. The unrealised gain on gold was calculated using a price of EUR 15,519 per kilogram of fine gold, compared with EUR 13,980.9 at end 2005.

Revaluation accounts		
Liability item P13		
<i>(EUR thousands)</i>		
	2006	2005
Revaluation account – gold	20,646,493	17,110,745
Revaluation account – foreign exchange	464,151	2,752,060
Revaluation account – securities	522,703	431,650
Total	21,633,347	20,294,455

The revaluation rates used for the main currencies are the following:

- 1 euro = 1.3170 US dollars (compared with 1.1797 at end-2005)
- 1 euro = 0.8760 SDRs (compared with 0.8265 at end-2005)

Note 23: Capital, reserves and retained earnings

Capital, reserves and retained earnings		
Liability item P17		
<i>(EUR thousands)</i>		
	2006	2005
Capital	457,347	457,347
Reserves	2,738,240	2,712,184
Statutory reserves	230,206	204,116
Long-term capital gains	100,324	100,323
Other reserves (a)	2,407,710	2,407,745
Retained earnings	2,544	16,841
Total	3,198,131	3,186,372

(a) Under the Decree of 3 December 1993, the Bank must maintain reserves to finance its investments. The Bank is also its own insurer with respect to civil liability risks, claims on property it owns and damage to this property by third parties. The “Other reserves” item chiefly comprises these two types of reserves.

Off-balance sheet items

Note 24: Securities commitments

Off-balance sheet items		
<i>(EUR thousands)</i>		
	2006	2005
Securities receivable	513,416	988,710
Securities deliverable	1,418,519	41,806

Note 25: Forward contract commitments

Forward contract commitments		
<i>(EUR thousands)</i>		
	2006	2005
Foreign currency-denominated forward contracts		
Purchases	3,297,791	ns
Sales	641,847	ns
Euro-denominated forward contracts		
Purchases	269,500	ns
Sales	15,773,600	ns

ns: non significant

Note 26: Forward foreign exchange transactions with customers

The Banque de France collects euro-denominated deposits from non-euro area residents, in particular foreign central banks and international bodies; these deposits are recorded in liability item P4. The Banque de France also collects foreign currency denominated deposits, mainly from non-resident institutions; these deposits are recorded in liability item P10.

These euro-denominated or foreign currency denominated deposits are invested either in the same currency or in a different currency (euro-denominated investments are recorded in asset items A4 or A6 depending on the area of residence of the counterpart, while foreign currency investments are recorded in item A11); if need be, the foreign exchange risk is neutralised by cross-currency swaps of the same amount and maturity as the deposit. These foreign-currency deposits and investments, and the related spot and forward foreign exchange transactions, form part of an activity that is totally separate and independent from the management of foreign exchange reserves. Consequently, they are recorded in dedicated accounts separate from those used for the management of foreign exchange reserves, and are valued in accordance with the standards issued by the CRC (see Other foreign exchange gains/losses in section 2|2 "Valuation methods", and note 19).

The table below shows amounts of foreign currency receivable and deliverable in respect of these transactions carried out independently of the management of foreign exchange reserves.

Forward foreign exchange transactions with customers				
<i>(EUR thousands)</i>				
	2006		2005	
	Foreign currency receivable	Foreign currency deliverable	Foreign currency receivable	Foreign currency deliverable
EUR	4,504,144	8,017	5,239,264	120,051
Foreign currencies	6,017,172	10,121,972	6,738,995	11,883,197
Total	10,521,316	10,129,989	11,978,259	12,003,248

Note 27: Pension obligations

Banque de France employees benefit from a pension scheme set up by an Imperial Decree of 16 January 1808 and currently governed by the amended Decree 68-300 of 29 March 1968. The Banque de France pension scheme belongs to the category of "special" schemes. Like the general and supplementary retirement benefit plans (AGIRC and ARRCO) which pay the pensions of employees in industry, business and the service sector, the Banque de France's special pension scheme pays Bank retirees all the pension benefits acquired in the course of their career at the Bank.

The pension scheme is therefore a fully-fledged component of the mandatory old-age insurance scheme, like the other special schemes and the general and supplementary schemes.

At 31 December 2006, the net amount of the Bank's pension obligations to its staff stood at EUR 6,858,102 thousand, after deducting the book value of the securities portfolio of the reserve fund of the Bank's employees.

These obligations were calculated taking into account all working employees and retirees, and their dependants. The amount of the liabilities to working employees was determined using a prospective method with career-end salaries on the basis of a retirement age of 60. A discount rate of 4.5% and an inflation rate of 2.0% were applied to the calculations.

Pension obligations		
<i>(EUR thousands)</i>		
	2006	2005
Obligations to retirees	3,578,536	3,465,258
Obligations to current workforce	3,279,566	3,337,910
Total	6,858,102	6,803,168

No provisions have been made for these obligations in the balance sheet.

However, benefits payable upon retirement (not included in the obligations shown above) are provided for in the Bank's balance sheet (see note 21).

Decree No. 2007-262 of 27 February 2007 reformed the pension scheme of Banque de France employees. The nature of this reform and its accounting impacts are described in the § on post balance sheet events (see above).

Profit and loss account

Note 28: Net interest income

Net interest income Profit and loss item P1.1		
(EUR thousands)		
	2006	2005
Interest on foreign exchange assets	1,464,263	873,467
Interest on claims on the IMF	56,773	92,946
Interest on euro-denominated claims on non-residents	7	
Interest on lending to credit institutions	520,996	432,002
Interest on euro-denominated securities	234,861	153,272
Interest on claims arising on transfer of reserve assets to the ECB	200,804	147,724
Interest on net claims on the Eurosystem	296,231	157,395
Interest on the net euro banknote position	1,304,665	719,112
Interest on euro-and foreign currency denominated financial assets	1,214,755	594,441
of which: Interest on available-for-sale securities	243	981
Interest on held-to-maturity securities	647,243	375,723
Other interest	567,123	217,737
Total interest and related income (A)	5,293,356	3,170,359
Interest on euro-denominated liabilities to monetary financial institutions in the euro area	-1,002,221	-634,261
of which: Interest paid on minimum reserves	-903,505	-573,929
Interest on euro-denominated liabilities to non-euro area residents	-1	-
Interest on foreign exchange liabilities	-166,068	-68,464
Interest on counterpart to SDR allocations	-46,178	-33,684
Interest paid on the Treasury account	-3,600	-2,669
Other interests	-573,967	-210,869
Total interest and related expenses (B)	-1,792,035	-949,947
Net interest income (C = A + B)	3,501,321	2,220,412

Note 29: Net income/loss on financial transactions

In 2006, the net balance of realised gold and foreign exchange gains and losses was a gain of EUR 899,473 thousand.

In accordance with the agreement of 31 March 1999 between the State and the Banque de France on management of and accounting for State foreign exchange reserves, supplemented by a rider dated 26 November 2002, the realised gains on gold and foreign

exchange were allocated, respectively, to the "Revaluation reserve of State gold reserves" or the "Revaluation reserve of State foreign exchange reserves", with the matching entry taken to the profit and loss account (item 1.2.2):

- EUR 794,483 thousand was allocated to the "Revaluation reserve of State gold reserves";
- EUR 104,990 thousand was allocated to the "Revaluation reserve of State foreign exchange reserves".

Net of other income and expenses on financial transactions

Extract from profit and loss item P1.2.3

(EUR thousands)		
	2006	2005
Net gain/loss on foreign currency denominated securities (a) (b) (c)	-66,703	-49,626
Net gain/loss on euro-denominated securities included in item A7 (b) (c)	-46,874	-11,319
Net gain/loss on available-for-sale securities included in item A11 (b)	7,293	15,419
Net foreign exchange gain/loss (excluding foreign exchange reserves management)	11,354	9,247
Total	-94,300	-36,279

(a) Excluding the impact of foreign exchange fluctuations, shown in profit and loss item 1.2.1.

(b) These items include realised gains and losses, and unrealised losses at year-end.

(c) These items also include margin calls on interest rate futures and forwards.

Note 30: Income from equity securities and participating interests

In 2006, the ECB did not pay a dividend in respect of the 2005 financial year. In addition, the ECB retained its 2006 seigniorage income in full following the Governing Council's decision based on the ECB's forecast results. Consequently, in 2006 the Banque de France did not receive its share, amounting to EUR 274,343 thousand in the form of an interim dividend (see note 15).

Income from equity securities and participating interests

Profit and loss item P1.4

(EUR thousands)		
	2006	2005
ECB dividend	-	-
Dividends from other participating interests	46,676	34,211
Dividends from available-for-sale securities	20,286	17,776
Other income	2,501	-
Total	69,463	51,987

Note 31: Net result of pooling of monetary income

The monetary income of each NCB is determined by measuring the actual annual income derived from the earmarkable assets held against its liability base.

The liability base is composed of the following items: banknotes in circulation; liabilities to credit institutions in connection with euro-denominated monetary policy operations; intra-Eurosystem liabilities arising from TARGET transactions; and net intra-Eurosystem liabilities arising from the allocation of euro banknotes within the Eurosystem. Any interest accruing on liabilities included in the liability base is deducted from the monetary income to be pooled.

Earmarkable assets consist of the following items: euro-denominated loans to euro area credit institutions in the framework of monetary policy operations; claims arising on the transfer of reserve assets to the ECB; the net intra-Eurosystem claim arising from TARGET transactions; the net intra-Eurosystem claim arising from the allocation of euro banknotes within the Eurosystem; and a limited amount of gold in proportion to each NCB's interest in the ECB's capital under the capital key. Gold is deemed not to generate any income. Where the value of an NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference is offset by applying to the value of the difference the average rate of return on the earmarkable assets of all the NCBs taken together.

The monetary income pooled by the Eurosystem is allocated between NCBs according to their share in the ECB's capital. The difference between the monetary income pooled by the Banque de France (EUR 3,078,392 thousand) and that reallocated to the Bank (EUR 3,109,026 thousand) constitutes the net result arising from the calculation of monetary income recorded in profit and loss item 1.5.

Note 32: Net of other income and expenses

Net of other income and expenses		
Profit and loss item P1.6		
<i>(EUR thousands)</i>		
	2006	2005
Remuneration for services rendered to the State	167,853	162,339
Other income (a)	263,977	243,660
Total other income (A)	431,830	405,999
Total other expenses (B)	-6,515	-6,301
Net of other income and expenses (C = A + B)	425,315	399,698

(a) Includes fees charged for use of the databases managed by the Banque de France (FNCI, FICP, FCC, FIBEN).

Note 33: Personnel and related expenses

Personnel and related expenses		
Profit and loss item P2.1		
<i>(EUR thousands)</i>		
	2006	2005
Salaries, wages and related taxes	-753,043	-729,439
Social security expenses	-149,361	-145,694
Retirement expenses	-403,648	-400,156
Profit-sharing and incentive plans	-34,885	-34,986
Total personnel expenses	-1,340,937	-1,310,275

Note 34: Extraordinary items

Extraordinary items for the year ended 31 December 2006 comprise net gains arising on the sale of some of the branches closed as part of the reform of the Banque de France regional network.

Note 35: Corporate income tax

Corporate income tax		
Profit and loss item P5		
<i>(EUR thousands)</i>		
	2006	2005
Income taxes for the year	807,293	375,299
On recurring income	788,889	352,091
On exceptional items	18,404	23,208

All expenses and income covered by the agreement of 31 March 1999 between the State and the Banque de France on the management of and accounting for State foreign exchange reserves, supplemented by a rider dated 26 November 2002 (see section 9.3.1.2.), the impact of which on the Banque de France's profits is cancelled out by an equivalent reduction or increase in the "Revaluation reserve of State gold reserves" or the "Revaluation reserve of State foreign exchange reserves" as the case may be, fall outside the scope of corporate income tax. For 2006, this applies to the net realised gains on gold and foreign exchange allocated to the "Revaluation reserve of State gold reserves" and the "Revaluation reserve of State foreign exchange reserves", respectively.

Other information

Remuneration of management bodies

(EUR thousands)

	2006	2005
Total remuneration paid to management bodies (a)	2,300	2,280

(a) The members of the Monetary Policy Council and the Directors General constitute the management bodies of the Bank.

2|3 Auditors' report on the annual accounts of the Banque de France

Mazars & Guérard
61 rue Henri Régnauld
92400 Courbevoie

Deloitte & associés
185 avenue Charles de Gaulle
92524 Neuilly-sur-Seine Cedex

BANQUE DE FRANCE
39 rue Croix des Petits Champs
75001 Paris
RCS Paris B 572 104 891

REPORT OF THE AUDITORS ON THE ANNUAL ACCOUNTS

Year ended 31 December 2006

In accordance with assignment entrusted to us by the General Council, we hereby report to you for the year ended 31 December 2006 on:

- the audit of the accompanying annual accounts of the Banque de France;
- the basis for our assessments;
- the specific procedures required by Article R 144-8 of the Monetary and Financial Code.

The annual accounts have been approved by the Governor. Our role is to express an opinion on these annual accounts, based on our audit.

(I) Opinion on the annual accounts

We conducted our audit in accordance with professional standards applicable in France; these standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. It also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the annual accounts give a true and fair view of the results of its operations for the year to 31 December 2006, and of the financial position and the assets and liabilities of the Banque de France at that date, in compliance with the accounting rules and principles set out by the European System of Central Banks for central banking activities and securities portfolios (other than those of the Employee Reserve Fund), and with French accounting rules and principles for other activities.

Without qualifying our opinion, we draw your attention to the following matters:

- The Notes to the annual accounts provide a detailed description of the presentation and accounting principles applied by the Banque de France, a number of which are specific to the European System of Central Banks (ESCB).
- As explained in the Notes to the annual accounts, the General Council, exercising the right provided for in Article R144-6 of the Monetary and Financial Code, assessed the level of detail of the financial information published.
- In respect of post balance sheet events, the Notes to the annual accounts set forth the main features of the reform of the pension scheme and point out that, owing to the lateness of this event, it was not

possible to finalise the estimate of the reduction in the amount of pension obligations. As a result, the pension obligations described in note 27 were determined without taking account of this reform.

(2) Basis for our assessments

As required by Article L.823-9 of the Commercial Code relating to the basis for our assessments, we draw your attention to the following:

- The Banque de France books provisions for risks and charges to cover risks such as those detailed in note 21 of the Notes to the annual accounts. Our work consisted in evaluating the data and assumptions on which these estimates are based, checking the Banque de France's calculations, comparing the accounting estimates in previous periods with the corresponding actual figures, and examining the procedures in place for the validation of these estimates by the Bank's management. We used these elements to carry out an assessment of the reasonableness of these estimates.
- Note 27 to the annual accounts sets out the method for assessing pension obligations and other related liabilities. These obligations have been assessed by actuaries. Our work consisted in examining the data used, evaluating the assumptions utilised, checking the calculations and verifying that note 27 provides appropriate information. We carried out an assessment of the reasonableness of these estimates, taking into account the observations set out in paragraph (1) above.
- As indicated in Note 35 to the annual accounts, the Banque de France believes that all expenses and

income covered by the agreement of 31 March 1999 between the State and the Banque de France on the management of and accounting for State foreign exchange reserves, supplemented by a rider dated 26 November 2002, the impact of which on profits is cancelled out by an equivalent reduction or increase in the "Revaluation reserve of State gold reserves" or the "Revaluation reserve of State foreign exchange reserves" as the case may be, fall outside the scope of corporate income tax. In 2005, this applied in particular to net gains on sales of gold.

As part of our assessment, we reviewed documentation supplied by the Banque de France in support of these positions, and satisfied ourselves as to their reasonableness.

Our assessment of these issues was made within the context of our audit approach to the annual accounts taken as a whole, and contributed to our opinion as expressed in the first part of this report.

(3) Specific procedures and disclosures

We have also performed the other procedures required by the law, in accordance with professional standards applicable in France.

We have no comment to make as to the fair presentation and consistency with the annual accounts of the information given in the report on the Bank's assets, liabilities and results.

Courbevoie and Neuilly-sur-Seine, 16 April 2007

The Auditors

Mazars & Guérard
Patrick de Cambourg
Charles de Boisriou

Deloitte & associés
Thierry Aubertin

3 | Combined accounts

3|I Combined balance sheet and profit and loss account

Combined balance sheet at 31 December 2006

Notes	Item	ASSETS	2006	2005
	A1	Gold	42,209,552	39,507,645
		Foreign exchange assets (excl. relations with the IMF)	36,001,855	24,687,349
	A2	2.1 Foreign exchange assets held with non-euro area residents	28,605,877	18,291,833
		2.2 Foreign exchange assets held with euro area residents	7,395,978	6,395,517
		Relations with the IMF	1,803,876	3,195,523
	A3	3.1 Financing provided to the IMF	1,079,928	2,448,475
		3.2 Acquisitions of Special Drawing Rights	723,948	747,048
	A4	Euro-denominated claims on non-euro area residents	2,303,479	122,290
	A5	Euro-denominated loans to euro area credit institutions in the framework of monetary policy operations	13,694,879	20,575,924
	A6	Other euro-denominated loans to euro area credit institutions	2,149,490	1,385,050
	A7	Euro-denominated securities	8,221,830	6,933,578
	A8	Relations within the Eurosystem	83,447,295	78,268,292
		8.1 Participating interest in the ECB	835,280	835,280
		8.2 Claims arising on the transfer of reserve assets to the ECB	8,476,135	8,423,055
		8.3 Claim on the Eurosystem for euro banknotes in circulation	63,452,088	57,525,285
		8.4 Other claims on the Eurosystem	10,683,792	11,484,671
2	A9	Claims on the French Treasury for coins	81,555	81,555
	A10	Other euro-and foreign currency denominated financial assets	34,543,181	26,710,082
1	A11	Miscellaneous	3,612,015	3,250,665
	A12	Fixed assets	1,288,366	1,273,325
		12.1 Tangible and intangible assets	874,618	859,725
		12.2 Participating interests (other than interest in the ECB)	413,748	413,600
		TOTAL ASSETS	229,357,373	205,991,279

Notes	Item	LIABILITIES	2006	2005
	P1	Banknotes in circulation	120,229,430	108,168,212
	P2	Euro-denominated liabilities to euro area credit institutions in the framework of monetary policy operations	26,378,440	25,729,808
		2.1 Current accounts	26,377,230	25,729,808
		2.2 Other liabilities	1,210	0
	P3	Other euro-denominated liabilities to euro area credit institutions	17,649	15,245
	P4	Euro-denominated liabilities to non-euro area residents	8,174,734	6,974,567
	P5	Foreign exchange liabilities	7,580,280	1,362,175
	P6	Counterpart to SDR allocations	1,241,115	1,313,052
	P7	Relations within the Eurosystem	0	131,980
	P8	Euro-denominated liabilities to other euro area residents	1,229,478	1,246,093
		8.1 Treasury's account	433,364	452,471
		8.2 Other liabilities	796,114	793,622
2	P9	Items in course of settlement	377,051	247,182
	P10	Banking transactions	8,376,869	8,653,076
	P11	Miscellaneous	4,986,065	4,577,969
	P12	Provisions for liabilities and charges	591,861	549,800
	P13	Revaluation accounts	21,633,347	20,294,455
	P14	Fund for general risks	550,000	410,000
	P15	Revaluation reserve of State gold reserves	20,033,633	19,239,149
	P16	Revaluation reserve of State foreign exchange reserves	3,048,883	2,943,893
1	P17	Capital, reserves and retained earnings	3,624,881	3,570,572
		17.1 IEDOM capital grant, reserves and retained earnings	136,578	135,487
		17.2 Banque de France capital, reserves and retained earnings	3,488,303	3,435,085
	P18	Profit for the year	1,283,658	564,050
		TOTAL LIABILITIES	229,357,373	205,991,279

2006 Combined profit and loss account

(EUR thousands)

	Item		2006	2005
	1.	Net income on activities of the Banque de France	4,005,312	2,717,039
2	1.1.	Net interest income	3,590,076	2,274,932
		1.1.1 Interest and related income	5,293,733	3,170,699
		1.1.2 Interest and related expenses	-1,703,657	-895,766
	1.2.	Net income/loss on financial transactions	-94,300	-36,279
		1.2.1 Net of realised gains/losses and unrealised losses on foreign exchange	899,473	918,836
		1.2.2 Net of charges to/releases from foreign exchange revaluation reserves	-899,473	-918,836
		1.2.3 Net of other income and expenses on financial transactions	-94,300	-36,279
	1.3.	Commission	4,180	5,657
		1.3.1 Commission (income)	48,854	47,826
		1.3.2 Commission (expense)	-44,673	-42,169
2	1.4.	Income from equity securities and participating interests	41,463	31,987
	1.5.	Net result of pooling of monetary income	30,634	17,883
	1.6.	Net of other income and expenses	433,259	422,860
	2.	Operating expenses	-1,810,667	-1,782,914
	2.1.	Personnel and related expenses	-1,354,989	-1,333,816
	2.2.	Taxes other than income tax	-27,837	-27,993
	2.3.	Provisions, depreciation and amortisation	-116,599	-153,084
	2.4.	Other operating expenses	-311,242	-268,021
		Profit before tax and exceptional items (1 + 2)	2,194,645	934,125
	3.	Net charge to the fund for general risks	-140,000	-65,000
	4.	Extraordinary items	53,448	66,436
	4.1.	Extraordinary income	53,448	66,436
	4.2.	Extraordinary charges	0	0
1	5.	Corporate income tax	-824,435	-371,511
		PROFIT FOR THE YEAR (1 + 2 + 3 + 4 + 5)	1,283,658	564,050

3|2 Notes to the combined annual accounts

Consolidation of the Institut d'émission des départements d'outre-mer (IEDOM)

3|2|1 Scope of consolidation

Undertakings excluded from the consolidation

At 31 December 2006, the Banque de France held a participating interest in four undertakings (see Note 14 to the balance sheet of the Banque de France).

The Banque de France holds an interest of over 20% in three of these undertakings.

The interests in *Banque de France Gestion* and *La Prévoyance immobilière* are excluded from the consolidation on grounds of immateriality.

Under the Statute of the ESCB and ECB, the ECB Governing Council functions in such a way that the Banque de France does not exert control or significant influence over the ECB. Monetary policy is defined by the Governing Council, composed of seventeen members, on the basis of the "one man, one vote" principle, in compliance with Article 10.2 of the Statute.

In compliance with Order No. 2000-347 of 19 April 2000, amending Order No. 59-74 of 7 January 1959 reforming issuance arrangements in the overseas departments of Guadeloupe, French Guiana, Martinique and Réunion, the French overseas departments note-issuing bank (IEDOM) came under the control of the Banque de France as from 1 July 2000. The Banque de France does not, however, hold an equity interest in the IEDOM.

The IEDOM is a national, financially autonomous, public institution with legal personality. It receives a capital grant from the State.

It is administered by a supervisory board composed of 15 members, seven of whom are appointed by the Governor of the Banque de France for a four-year term. The Governor, or his representative, chairs the supervisory board.

The Director General of the IEDOM is appointed by the chairman of the supervisory board.

The IEDOM pays the balance of its net profits, after the constitution of reserves, to the Banque de France. Any losses are borne by the Banque de France.

Article 9 of the aforementioned Order states that the accounts of the IEDOM are to be consolidated with those of the Banque de France.

3|2|2 Activities of the IEDOM

The IEDOM's catchment area is the four overseas departments of Guadeloupe, French Guiana, Martinique and Réunion, the territorial unit of Saint Pierre and Miquelon and the departmental unit of Mayotte.

Its tasks are:

- tasks carried out within the framework of the ESCB (putting banknotes into circulation, and implementing the minimum reserve system);
- relations with the Treasury (keeping current accounts of paymasters-general and their accredited representatives, and centralising transactions);
- executing transfers of public and private funds between metropolitan France and the territorial units in its catchment area;
- providing services to the banking community and the public (keeping of data files, economic and monetary studies, processing of household debt files) within the framework of legal, regulatory and contractual provisions.

3|2|3 Accounting principles and valuation methods used in the combined accounts

The same accounting principles and valuation methods apply to both the combined accounts and the individual annual accounts of the Banque de France, except in the computation of corporate income tax which, in the combined accounts, takes into account all temporary timing differences arising for tax purposes.

3|2|4 Information on individual items in the combined balance sheet and profit and loss account

Note 1: Deferred taxes

A net deferred tax asset of EUR 233,732 thousand is included in item A11 "Miscellaneous" in the combined balance sheet. It arises solely on temporary timing differences between the recognition of expenses and income for accounting purposes and their recognition for tax purposes. This asset is made up of the items shown in the table below.

Deferred tax assets and liabilities		
<i>(EUR thousands)</i>		
	Deferred tax assets	Deferred tax liabilities
Income temporarily exempted from taxation		24,398
Tax on unrealised gains and losses on mutual funds	73,436	
Other deferred tax relating to securities	18,056	
Provisions not deductible for tax purposes	175,196	
Charges deducted for tax purposes but not yet recognised in the accounts	8,612	
Other recurring timing differences		17,169
Total	275,300	41,567

The matching entry for this deferred tax asset is split between:

- the tax charge for the year, which in 2006 is EUR 5,148 thousand higher than in the individual annual accounts for fiscal 2005;
- liability item P17 "Capital, reserves and retained earnings", which includes the balance of EUR 238,880 thousand, representing the net deferred tax asset at the start of fiscal 2005.

Apart from the recognition of deferred taxes, the principal consolidation adjustments are (i) the elimination of inter-institutional transactions with the IEDOM and (ii) the elimination of tax-regulated provisions from the balance sheet and of charges to/releases from the profit and loss account.

Note 2: Elimination of inter-institutional transactions

Eliminations of inter-institutional transactions relate to:

- the advance to the IEDOM (asset item A9 in the individual balance sheet of the Banque de France);
- the IEDOM's current account with the Banque de France (included in liability item P8.2 in the individual balance sheet);

- interest paid on the IEDOM current account (included in item 1.1.2 "Interest and related expenses" in the individual profit and loss account);
- and the dividend paid by the IEDOM (included in item 1.4 "Income from equity securities and participating interests" in the individual profit and loss account).

3|3 Auditors' report on the combined annual accounts

Mazars & Guérard
61 rue Henri Régnault
92400 Courbevoie

Deloitte & associés
185 avenue Charles de Gaulle
92524 Neuilly-sur-Seine Cedex

BANQUE DE FRANCE
39 rue Croix des Petits Champs
75001 Paris
RCS Paris B 572 104 891

REPORT OF THE AUDITORS ON THE COMBINED ANNUAL ACCOUNTS

Year ended 31 December 2006

In accordance with the assignment entrusted to us by the General Council, we have audited the accompanying combined annual accounts of the Banque de France and the *Institut d'émission des départements d'outre-mer* – IEDOM (French overseas departments note-issuing bank), expressed in euro, for the year ended 31 December 2006.

The combined annual accounts have been approved by the Governor. Our role is to express an opinion on these annual accounts, based on our audit.

(I) Opinion on the combined accounts

We conducted our audit in accordance with professional standards applicable in France; these standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. It also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined annual accounts, prepared in accordance with article 9 of Order no. 2000-347 of 19 April 2000, give a true and fair view of the results of the operations of the Banque de France and the IEDOM

for the year to 31 December 2006, and of the financial position and the assets and liabilities of combined as at that date, in compliance with the accounting rules and principles set out by the European System of Central Banks for central banking activities and securities portfolios (other than those of the Employee Reserve Fund), and with French accounting rules and principles for other activities.

Without qualifying our opinion, we draw your attention to the following matters:

- (a) In establishing the combined annual accounts of the Banque de France and the IEDOM, inter-institutional transactions have been eliminated and deferred taxation has been recognised. These adjustments are described in the summary notes to the combined annual accounts. With the exception of deferred taxes, the impact of which is described in the notes to the combined annual accounts, these adjustments do not materially affect the overall annual accounts.
- (b) The notes to the annual accounts and to the combined annual accounts provide a detailed description of the presentation and accounting principles applied in the combined annual accounts, a number of which are specific to the European System of Central Banks (ESCB).
- (c) As explained in the notes to the annual accounts, the General Council, exercising the right provided for in article R144-6 of the Monetary and Financial Code, assessed the level of detail of the financial information published.

- (d) For reasons described above, the combined annual accounts are not specifically commented on in the report on the Bank's assets, liabilities and results.
- (e) In respect of post balance sheet events, the Notes to the annual accounts set forth the main features of the reform of the pension scheme and point out that, owing to the lateness of this event, it was not possible to finalise the estimate of the reduction in the amount of pension obligations. As a result, the pension obligations described in note 27 were determined without taking account of this reform.

(2) Basis for our assessments

As required by Article L.823-9 of the Commercial Code relating to the basis for our assessments, we draw your attention to the following:

- The Banque de France books provisions for risks and charges to cover risks such as those detailed in note 21 of the Notes to the annual accounts. Our work consisted in evaluating the data and assumptions on which these estimates are based, checking the Banque de France's calculations, comparing the accounting estimates in previous periods with the corresponding actual figures, and examining the procedures in place for the validation of these estimates by the Bank's management. We used these elements to carry out an assessment of the reasonableness of these estimates.
- Note 27 to the annual accounts sets out the method for assessing pension obligations and other related liabilities. These obligations have been assessed by actuaries. Our work consisted in examining the data used, evaluating the assumptions used, checking the calculations and verifying that note 27 provides appropriate information. We carried out an assessment

of the reasonableness of these estimates, taking into account of the observations set out in paragraph (1e) above.

- As indicated in Note 35 to the annual accounts, the Banque de France believes that all expenses and income covered by the agreement of 31 March 1999 between the State and the Banque de France on management of and accounting for State foreign exchange reserves, supplemented by a rider dated 26 November 2002, the impact of which on profits is cancelled out by an equivalent reduction or increase in the "Revaluation reserve of State gold reserves" or the "Revaluation reserve of State foreign exchange reserves" as the case may be, fall outside the scope of corporate income tax. In 2005, this applied in particular to net gains on sales of gold.

As part of our assessment, we reviewed documentation supplied by the Banque de France in support of these positions, and satisfied ourselves as to their reasonableness.

- As indicated in the notes to the combined accounts, the Banque de France shows a net deferred tax asset of EUR 234 million as at 31 December 2006. The Bank believes that profits earned in future periods will enable this asset to be recovered.

As part of our assessment, we reviewed documentation supplied by the Bank in support of this position, and satisfied ourselves as to its reasonableness.

Our assessment of these issues was made within the context of our audit approach to the combined accounts taken as a whole, and contributed to our opinion as expressed in the first part of this report.

Courbevoie and Neuilly-sur-Seine, 16 April 2007

The Auditors

Mazars & Guérard
Patrick de Cambourg
Charles de Boisriou

Deloitte & associés
Thierry Aubertin

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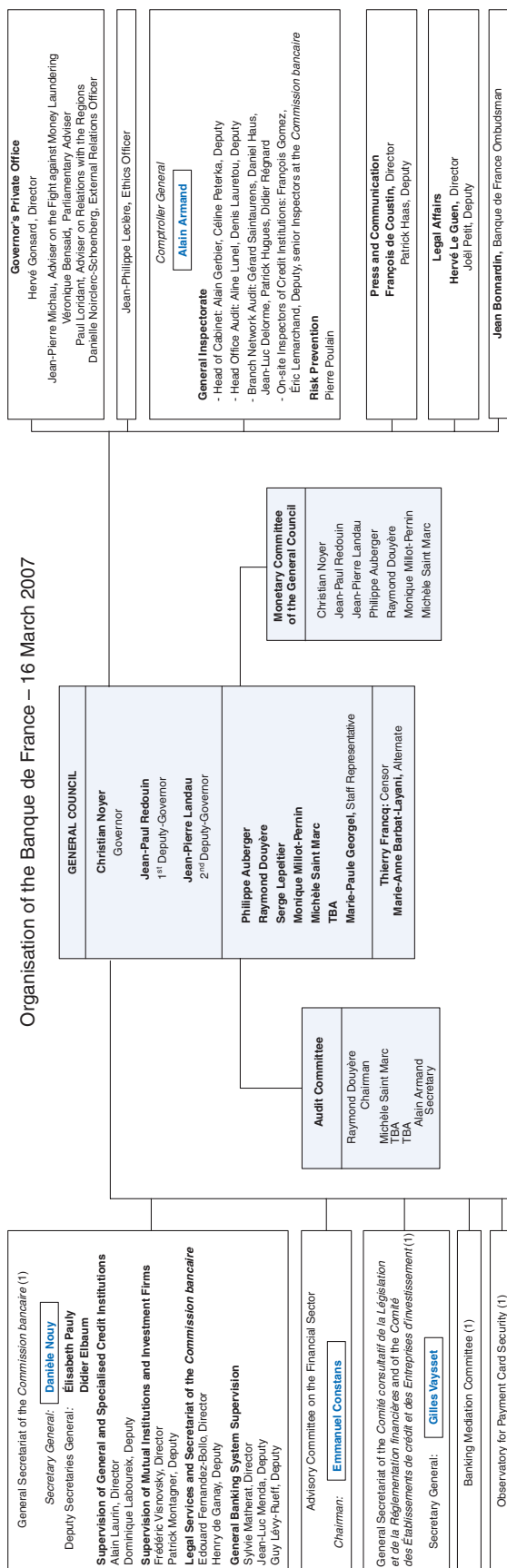
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The Banque de France's Advisory Council at 31 December 2006

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Jean-Paul Bechat	Chairman of the Executive Board of the SAFRAN group
Jean-Louis Beffa	Chairman and CEO of Compagnie de Saint-Gobain
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Organisation of the Banque de France – 16 March 2007



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96 branches, 21 economic centres, 7 household debt centres et 4 currency circulation management centres.

22 Regional Directorates

(1) The Governor chairs the Comité des établissements de crédit et des entreprises d'investissement, the Commission bancaire, the Banking Mediation Committee and the Observatory for Payment Card Security.

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