MACROECONOMIC PROJECTIONS
FRANCE

BANQUE DE FRANCE
EUROSYSTÈME

December 2017

French GDP growth should increase markedly in 2017 to 1.8% (annual average, working-day adjusted) after 1.1% in 2016. It is then expected to remain at a broadly similar rate (1.7% in 2018, 1.8% in 2019 and 1.6% in 2020). Domestic demand, especially private investment, while remaining buoyant, is projected to slow slightly over the 2018-20 period. However, foreign trade should no longer weigh on GDP growth, after making an exceptionally negative contribution for several consecutive years. Unemployment is expected to decline over the projection horizon. The output gap, estimated by the Banque de France, should close in 2019. If the reforms being undertaken lead to an increase in potential growth over the projection horizon, growth could be stronger than currently projected. This would also lead to an improvement in public finances, which remain fragile: under the current scenario, public debt is only expected to stabilise in 2020.

Inflation strengthened substantially in 2017 to 1.2% (annual average) from 0.3% in 2016 due to the upturn in energy prices. It is then expected to fluctuate before accelerating more sharply in 2020 to an annual average of 1.6%. Inflation excluding energy and food will be dampened by various specific factors, and should thus only rise very gradually until 2020, in line with falling unemployment.

KEY PROJECTIONS FOR FRANCE

	2015	2016	2017	2018	2019	2020
HICP	**0.1**	**0.3**	**1.2**	**1.4**	**1.2**	**1.6**
HICP excluding energy and food	**0.6**	**0.6**	**0.6**	**0.8**	**0.9**	**1.2**
GDP deflator	1.1	0.4	0.6	0.9	1.3	1.5
Real GDP	**1.0**	**1.1**	**1.8**	**1.7**	**1.8**	**1.6**
Contributions to GDP growth (in percentage points):[a]						
Domestic demand (excluding changes in inventories)	*1.2*	*2.0*	*1.8*	*1.6*	*1.6*	*1.6*
Net exports	*-0.5*	*- 0.8*	*- 0.5*	*0.2*	*0.1*	*0.1*
Changes in inventories	*0.3*	*- 0.1*	*0.6*	*- 0.1*	*0.0*	*0.0*
Private consumption (53%)[b]	1.3	2.1	1.2	1.5	1.7	1.6
Government consumption (24%)	1.1	1.2	1.5	0.7	0.7	0.7
Total investment (22%)	0.9	2.7	3.5	2.8	2.4	2.3
Government investment (3%)	*-3.0*	*- 0.1*	*- 1.3*	*3.0*	*2.5*	*2.4*
Household investment (5%)	*-2.1*	*2.4*	*5.1*	*2.1*	*1.3*	*1.9*
Business investment (NFCs-FCs-IEs) (13%)	*3.1*	*3.6*	*4.1*	*3.0*	*2.8*	*2.4*
Exports (29%)	4.0	1.9	3.3	5.9	4.3	3.7
Imports (31%)	5.5	4.2	4.7	4.7	3.6	3.3
Real household gross disposable income	0.8	1.8	1.6	1.7	2.5	1.8
Net job creations (thousands)	60	197	281	147	184	192
ILO unemployment rate (France and overseas territories, % of labour force)	10.4	10.1	9.6	9.6	9.2	8.8

Sources: Insee data for 2015, 2016 and the first three quarters of 2017 (published on 29 November 2017). Blue-shaded columns show Banque de France projections. Annual percentage change except where otherwise indicated.
a) The sum of individual contributions may not add up to GDP growth as figures have been rounded.
b) Percentages in brackets refer to each item's share of GDP in 2016.

French growth is expected to be strong in 2017 (1.8%)

After three years of moderate growth (1.0% in 2014 and 2015, and 1.1% in 2016), French economic activity should accelerate in 2017, rising by 1.8% – the highest annual average growth rate since 2011. As in 2016, domestic demand is expected to continue to support growth, although its composition will be different, with more robust business and household investment and more moderate private consumption. Although exports should pick up again, driven by stronger growth in foreign demand for French goods and services (following the significant, though temporary, adverse impacts of certain exceptional events in 2016 and at the beginning of 2017), the annual average net contribution of foreign trade is expected to remain negative (see table), even though it has been neutral on a quarter-by-quarter basis since the second quarter. Lastly, the latest economic surveys point to a significant upturn in activity at end-2017, but also show signs of increasing supply constraints.

In the 2018-20 period, growth in economic activity is expected to remain at a broadly similar rate, and well above potential growth

Growth is expected to stabilise at an annual average rate of between 1.6% and 1.8% over the 2018-20 period, which should remain well above the estimated annual potential growth rate of 1.3% over the projection horizon. Consequently, the output gap is projected to close in 2019 and the possibility of sustaining a high growth rate in 2020 would also depend on potential growth trends.

These projections were finalised as at 30 November 2017 as part of the Eurosystem macroeconomic projection exercise. They are based on technical assumptions with a cut-off date of 22 November and Insee quarterly national accounts published on 29 November. They also take into consideration the measures announced in the budget laws. Beyond 2018, over the 2019-20 period, the recently undertaken reforms and the direction of economic policy over the coming years will also impact the growth rate.

The factors supporting this growth should become more balanced

In 2018, 2019 and 2020, exports are expected to accelerate sharply, particularly in 2018 when they should grow by 5.9%. Foreign demand for French goods and services should grow at a strong pace. In addition, the catch-up in exports following the disappointing performance observed in 2016 and at the beginning of 2017, should contribute to an improvement in export market shares in 2018, despite the lagged negative effects of this summer's appreciation of the euro. With imports remaining robust, the contribution of foreign trade is expected to be slightly positive.

Business investment should continue to be supported by the increase in economic activity as well as by low interest rates, and is expected to continue to grow more markedly than GDP. However, there is unlikely to be a repeat of the high growth rates witnessed in 2016 and 2017, which took the corporate investment rate to a higher level than the previous peak of 2008, but were also accompanied by significant net borrowing and high levels of debt.

Private consumption is projected to remain robust, with gains in purchasing power bolstered by the pick-up in wage income, while unemployment is expected to continue to decline. The tax measures set out in the budget laws should also help to lift household incomes from the end of 2018. Part of these gains should contribute to the increase in the saving ratio, towards 15.2% at end-2020, which is close to its long-term average (see section 2).

Household investment was exceptionally robust in 2017, rising by 5.1%, but is projected to slow considerably in 2018-20, to reach a similar pace of growth to household income, which is more sustainable in the long term.

Following the pick-up in 2017, inflation in France is expected to increase only slightly in 2018-19, but should rise again sharply in 2020 towards a rate of 1.7% at year-end

Inflation, as measured by the change in the harmonised index of consumer prices (HICP), is expected to remain at a broadly similar rate in 2018 (1.4%) and 2019 (1.2%) to that of 2017 (1.2%). The upturn in 2018 should be primarily related to tax measures impacting tobacco and energy. Inflation is then projected to rise more sharply in 2020 to an annual average rate of 1.6%. Inflation excluding energy and food should gradually rise from 0.6% in 2017 to 0.8% in 2018, 0.9% in 2019 and 1.2% in 2020, on the back of falling unemployment and the impact of various specific factors (see section 3).

Non-energy industrial goods inflation should remain contained until 2019 due to the effects of the recent appreciation of the euro. Service price inflation is also expected to be held back by the modest growth in labour costs (necessary to improve French competitiveness), and this effect should be accentuated in 2019 by the transformation of the Tax Credit for Competitiveness and Employment (CICE) into a direct reduction in employer social security contributions. The planned measures in the budget laws are expected to have an effect on the profile of inflation: service price inflation should fall each year as a result of the decrease in social housing rents, while increases in taxation on tobacco over a three-year period and on energy should sharpen the rise in headline inflation. In 2020, growth and the decline in unemployment should have a lagged positive impact, lending greater support to inflation.

A public deficit of just under 3% of GDP in 2017 and 2018, requiring tight spending control

The Banque de France projection incorporates the measures set out in the 2018 draft budget and the draft supplementary budget laws of 2 and 15 November 2017. Within this framework, the government deficit is projected to decline from 3.4% of GDP in 2016 to 2.9% in 2017, thanks primarily to the favourable macroeconomic environment. It should then stabilise at this level in 2018, below the Maastricht deficit ceiling. Constant monitoring and the ability to react rapidly to any sign of deteriorating public finances are therefore essential (see section 4).

In 2018, the aggregate tax ratio (ratio of taxes and social security receipts to GDP) is expected to fall by 0.3 percentage point to 44.3% of GDP from 44.6% in 2017 (excluding the temporary effect of the repayment of the dividend tax). The newly planned tax cuts, which will affect household taxation in particular, should then have a greater impact in 2019 and 2020. In real terms, primary public spending (excluding tax credits and adjusted for CPI excluding tobacco) is expected to continue to increase, by 1.0% in 2018 after 1.1% in 2017. The savings measures set out in the 2018 draft budget laws should limit growth in spending in 2018, but not enough to prevent a deterioration in the structural balance in 2018 in a context of declining tax receipts. The primary structural balance is thus projected to remain broadly stable in 2017, but should then deteriorate markedly by 0.4 percentage point of GDP in 2018. The debt-to-GDP ratio is expected to continue to increase until 2019, and is only projected to stabilise in 2020.

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1| Technical assumptions and the international environment: a pick-up in global demand, but appreciation of the euro

The Banque de France's economic scenario is based on the technical assumptions (exchange rates, interest rates, commodity prices) and international environment projections prepared by the Eurosystem (see notes to Table 1), with a cut-off date of 22 November 2017.

The euro nominal effective exchange rate appreciated strongly in the second quarter of 2017, particularly against the US dollar. Based on the trends observed up to 22 November 2017, then a stabilisation in the projections, it should rise significantly, by 2.2% and 2.9% in 2017 and 2018 respectively (annual averages). The price of oil in euro bounced back after the summer to EUR 53 in November (assumptions with a cut-off date of 22 November 2017), representing a EUR 10 increase since August. November's price is thus higher than the EUR 47 forecast for end-2017 included in the June projections. Oil futures suggest a slight subsequent downturn in oil prices over the projection horizon. The price of oil should therefore increase by an annual average of EUR 8 in 2017 and a further EUR 4 in 2018, before falling back by around EUR 4 in 2020 to EUR 49.

The accommodative monetary policy stance should continue to keep nominal interest rates at low levels. Markets are only pricing in a very gradual rise in yields on 10-year government bonds.

The international environment is expected to be much more favourable than predicted in June 2017, and foreign demand for French goods and services has been revised substantially upwards, particularly for 2017 and 2018. It is now expected to increase by 5.3% in 2017 (upward revision of 0.8 percentage point since June), which is well above the pace of growth seen in 2016 (2.6%). It should then lose momentum slightly, while nonetheless remaining robust, growing by 4.9% in 2018, 4.1% in 2019 and 3.7% in 2020. More specifically, extra-euro area demand, which was very weak in 2016, should pick up in 2017, but should continue to grow at a significantly slower pace than the average for 1995 to 2007 (7.5%). It is expected to be slightly less dynamic than intra-euro area demand.

Table 1: Technical assumptions and the international environment[a)]

	2016	2017	2018	2019	2020
Technical assumptions					
Brent oil price (USD/barrel)	44.0	54.3	61.6	58.9	57.3
Brent oil price (EUR/barrel)	39.8	48.2	52.5	50.2	48.9
Non-energy commodity prices in EUR (annual percentage change)	-3.6	5.9	-0.8	3.4	4.3
USD/EUR exchange rate	1.11	1.13	1.17	1.17	1.17
Euro nominal effective exchange rate (annual percentage change)[b)]	3.8	2.2	2.8	0.0	0.0
3-month Euribor[c)]	-0.3	-0.3	-0.3	-0.1	0.1
10-year French government bond yields[c)]	0.5	0.8	0.7	1.0	1.3
International environment, annual percentage change					
Extra-euro area competitors' prices on the export side (in EUR)	-4.8	2.4	-0.9	2.4	2.4
World real GDP	3.0	3.6	3.6	3.6	3.5
World (excluding euro area) real GDP	3.2	3.7	3.9	3.8	3.7
Global (excluding euro area) trade	1.2	5.6	4.5	4.2	3.7
Foreign demand for French goods and services	2.6	5.3	4.9	4.1	3.7
Intra-euro area	*4.4*	*5.2*	*5.0*	*4.4*	*3.9*
Extra-euro area	*1.1*	*5.4*	*4.8*	*3.9*	*3.4*

Sources: Eurosystem. Blue-shaded columns show Banque de France projections.
a) These technical assumptions and international environment projections were constructed on 22 November 2017 in accordance with principles set out in "*A guide to Eurosystem staff macroeconomic exercises*", ECB, June 2001, available at: *https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguideen.pdf*. Foreign demand corresponds to the weighted average imports of France's trading partners. The method of calculation is described in the Occasional Paper "*Trade consistency exercise in the context of the Eurosystem projection exercises – An overview*", available at: *https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp108.pdf*.
b) Calculated against 38 trading partners of the euro area.
c) The forecasts for interest rates were calculated using the yield curve.

Box 1

REVISIONS TO PROJECTIONS BETWEEN JUNE AND DECEMBER 2017

Annual GDP growth (working-day adjusted) is expected to average 1.8% in 2017, 1.7% in 2018 and 1.8% in 2019. **Growth has therefore been revised upwards compared with the June 2017 publication,[1] in particular for the current year, generating positive knock-on effects for subsequent years** (upward revisions of 0.5 percentage point for 2017, 0.2 percentage point for 2018 and 0.1 percentage point for 2019).[2] Compared with the June publication, the HICP inflation projection has been left unchanged for 2017, revised upwards by 0.2 percentage point for 2018, but revised downwards by 0.2 percentage point for 2019. Inflation excluding energy and food has been revised significantly downwards over the entire projection horizon (by 0.1 percentage point for 2017 and 0.4 percentage point for 2018 and 2019 respectively). For both economic activity and inflation, the revisions reflect the incorporation of new information since June (growth carry-over, budget law for 2018, technical assumptions and international environment) and the alteration of some of our assessments.

In 2017, the very sharp upward revision to GDP growth (0.5 percentage point) mainly reflects the 0.4 percentage point increase in the growth carry-over for the end of the third quarter and, more marginally, an upward revision to the projection for the final quarter of the year. In the second and third quarters of 2017, GDP growth was slightly higher than predicted in our June publication (an additional 0.1 percentage point in each quarter). Above all, **the growth estimate for the first quarter of 2017 has been revised significantly upwards (by 0.3 percentage point) since June, and this has had a substantial impact on the annual average.** For the full year 2017, household and business investment now appear to be much more robust than expected in the June projections, while export growth is slightly lower. Although final demand is proving strong on the whole, imports are less dynamic than expected and businesses are rebuilding inventories at a sharper pace, both of which have contributed to the upward revision to growth for the year.

For 2018 and 2019, three factors have affected the GDP growth projection: (i) the revisions to the international environment since June are broadly neutral because the sharper growth in global demand and the decline in interest rates are offset by the appreciation of the euro and the rise in oil prices; (ii) the incorporation of the 2018 draft budget law has given a slight boost to activity, particularly in 2019; (iii) our overall assessment of the trajectory for household investment has been revised upwards.

For 2018, GDP growth has been revised upwards by 0.2 percentage point compared with our previous projection, to 1.7%. This reflects the revision to the growth carry-over for the end of the last quarter of 2017, as the trends for 2018 are broadly unchanged. For the full year, domestic demand has been revised slightly upwards, mainly on account of a more optimistic assessment of household investment, and the usual acceleration effects on business investment stemming from the stronger recovery since 2017. The inclusion of the 2018 draft budget law has prompted a downward revision to government consumption but an upward revision to government investment, producing an overall neutral effect on economic activity for the year. The budget law measures are expected to have a rather negative impact on household purchasing power in 2018, in particular through the increase in indirect taxes. However, this is offset by more favourable employment growth in the private sector, driven by stronger-than-expected economic growth since 2017. The expected increase in private consumption has thus been left unchanged. With regard to foreign trade, given the sharp fluctuations in exports, imports and inventories up to the fourth quarter of 2017, it seems more relevant to examine the joint contribution of foreign trade and inventories to growth in 2018. This has been revised upwards by 0.1 percentage point, essentially reflecting the more favourable trends seen throughout 2017. During the opening quarters of 2018, despite the appreciation of the euro, exports are expected to be more dynamic than in the June projections. This stems from a more positive assessment of the ability of certain sectors to rebound from previous disappointing performances – notably transport equipment. However, this positive effect should be largely offset by the contribution from changes in inventories, which has been revised slightly downwards to reflect the usual cycles of deliveries and destocking in the sector.

For 2019, GDP growth has been revised upwards by 0.1 percentage point to 1.8%. As in 2018, these projections include a more positive assessment of the trajectory of household investment. Moreover, public finances are expected to provide a stronger boost to growth than in the June projections. Government consumption has been revised sharply downwards for 2019, but household purchasing power and consumption should be buoyed by the planned reductions in taxes and social security contributions. In addition, the transformation of the Tax Credit for Competitiveness and Employment (CICE) into a direct cut in employer social security contributions in 2019 should have a favourable impact on private sector employment (see Box 3) and should further increase household wage income compared to our June projection. However, it is likely that only part of this additional income will be consumed, and private consumption has therefore been revised upwards by just 0.2 percentage point, while the household saving rate is expected to rise by 0.6 percentage point in 2019 (in the June projection, it was already expected to increase, but only by 0.2 percentage point). Finally, the overall net contribution of foreign trade and changes in inventories is unchanged over the year.

Compared to our June projection, headline inflation is virtually unchanged for 2017 (at 1.2%), then revised upwards by 0.2 percentage point to 1.4% for 2018, and downwards by 0.2 percentage point to 1.2% for 2019. It is then expected to rise more sharply in 2020, which was not covered in the previous projections.

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1 See Table A1 in the appendix to this publication.
2 The revisions presented here are rounded off figures and not the differences between figures rounded off to one decimal place, resulting in possible variations of 0.1 percentage point.

The energy and food components of inflation have been revised upwards. In 2018, the increase observed at end-2017 in euro-denominated oil prices should be amplified by the tax hikes on tobacco and energy, which were not anticipated in June. These increases in indirect taxes account for 0.5 percentage point of the upward revision to HICP inflation. In 2019, the rise in the price of tobacco should continue to place upward pressure on inflation (accounting for 0.2 percentage point of the upward revision to headline inflation), but the increase in energy taxes should be offset by less dynamic oil prices.

Conversely, inflation excluding energy and food (which accounts for about 70% of headline inflation) has been revised sharply downwards, by 0.1 percentage point in 2017, and by 0.4 percentage point in 2018 and 2019 respectively. The appreciation of the euro since the summer of 2017 will feed through to manufactured goods prices with a lag of several quarters, and has thus contributed to a downward revision to this component for 2018 and 2019. Service price inflation has also been revised downwards for 2018 and 2019. This is due to two factors: (i) a tighter moderation of labour costs (needed to improve French competitiveness), which will be accentuated by the transformation of the CICE into a direct cut in employer social security contributions in 2019; and (ii) the incorporation into the projections of the expected fall in social housing rents.

2| Economic outlook: growth should be strong enough to close the output gap over the projection horizon

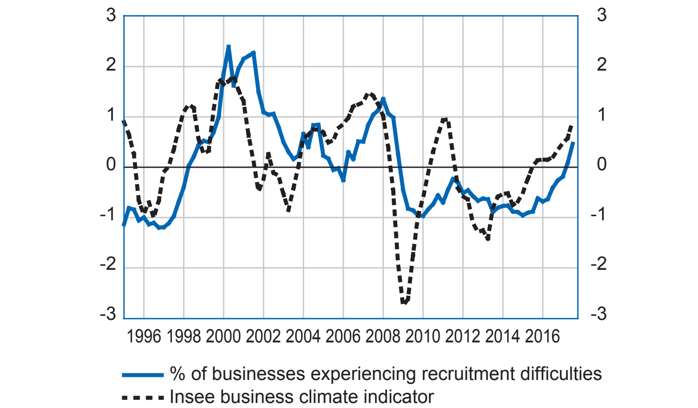
The current economic environment and business surveys

GDP growth is expected to remain robust in the fourth quarter of 2017. In the manufacturing industry, surveys show that the business climate index is at a historical high, while in market services, surveys also suggest the business climate is favourable. In the construction sector, however, indicators on housing starts as well as surveys on real estate and building crafts, all indicate that activity began to slow in the fourth quarter.

Despite the positive signs in the surveys, businesses have begun to report strains on production capacity, which could potentially hamper growth in the coming quarters. In the last Insee quarterly manufacturing survey, for example, the percentage of businesses citing supply difficulties exceeded those citing demand difficulties for the first time since 2008. In particular, a large number of businesses said they were struggling with recruitment (see Chart 1).

Chart 1: Indicator of business climate and recruitment difficulties (all sectors)

(quarterly data, normalised series)



Sources: Insee. Last graph data: Q3 2017.
Note: Series are normalised. Aggregate indicator compiled on the basis of the proportion of industrial, services and building sector businesses that said they had recruitment difficulties in Insee surveys (weighted moving average: share of nominal value added of each sector in total value added). In contrast to the business climate, the recruitment difficulty results do not take wholesale and retail trade into account.

Foreign trade should be supported by the acceleration in global demand, and should no longer drag on French growth

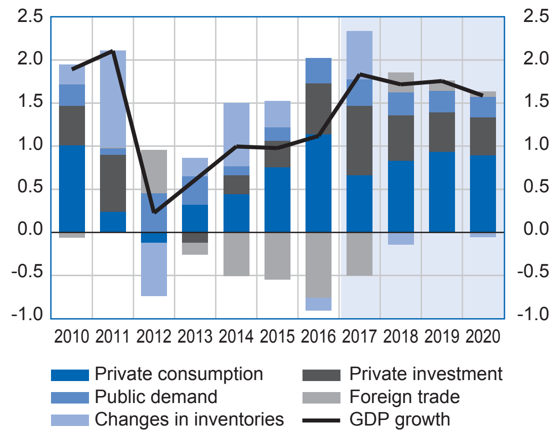
In 2016, foreign trade made a strong negative net contribution to GDP growth (weighing by 0.8 percentage point, see Chart 2), mainly as a result of slow export growth (1.9%) linked to sluggish foreign demand for French goods and services, but also due to unfavourable, and probably temporary, trends in certain sectors (tourism, agriculture and aeronautics). **Foreign trade should again make a firmly negative net contribution to GDP in 2017 (weighing by 0.5 percentage point) but this annual average masks the improvement that is already well underway.** France's export market shares have been recovering since hitting a low at the start of 2017. In addition, there have been marked swings in individual contributions from inventories and foreign trade over the year, owing to fluctuations in supply and deliveries in the transport equipment sector. Therefore the combined contribution of the two components probably better reflects the actual trends at play (see Chart 3). In 2017, this combined contribution is projected to be slightly positive, after remaining strongly negative in 2016.

After the temporary adverse shocks of 2016, the rebound in France's export market shares is expected to continue until early 2018. When combined with the renewed dynamism observed in global trade, this should lead to strong growth in exports over the year (5.9%), despite the appreciation of the euro. In 2019 and 2020, export growth should remain robust and similar to the pace of growth in foreign demand for French goods and services. As a consequence, France's export market shares are projected to remain fairly stable.

Imports are set to remain robust between 2018 and 2020, despite more subdued growth in domestic demand. Indeed, the penetration rate (measured as the ratio of imports to an import-adjusted measure of aggregate demand) should continue to rise over the projection horizon, moving back towards its historical trend.

Chart 2: Contributions to GDP growth

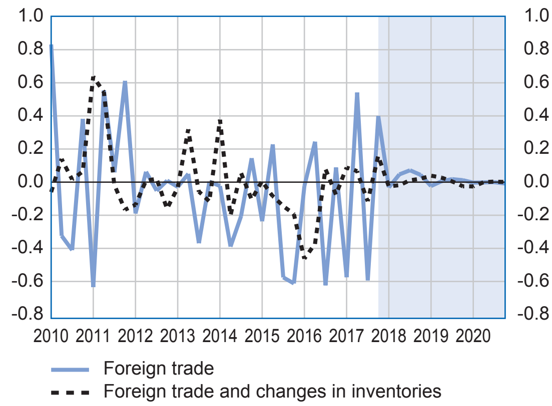
(growth in %, contributions in percentage points; annual averages)



Sources: Insee data up to 2016, Banque de France projections.
Note: Private investment groups together business and household investment. Public demand groups together government consumption and government investment.

Chart 3: Contributions to GDP growth of foreign trade and changes in inventories

(percentage points)



Sources: Insee data up to Q3 2017, Banque de France projections.

Overall, foreign trade should make a slightly positive net contribution to growth over the projection horizon.

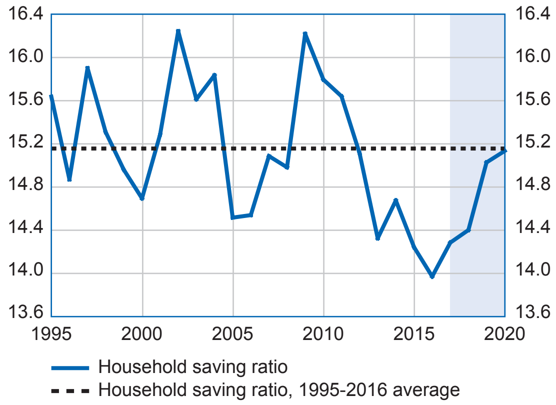
Strong gains in purchasing power should buoy consumption, but should also drive up the household saving ratio

Private consumption is projected to lose momentum in 2017 (annual average growth of 1.2%) after the strong growth seen in 2016 (annual average of 2.1%). Gains in household purchasing power should be smaller than in 2016 (annual average growth of 1.6% in 2017, down from 1.8%), as stronger growth in wage income is partially offset by the pick-up in energy inflation. The household saving ratio is also expected to increase slightly to 14.3% after hitting its lowest level in 2016 since the start of the 1990s (14.0%, see Chart 4).

Growth in household purchasing power should remain robust up to 2020, supported by a dynamic labour market. It should peak at 2.5% in 2019 owing to the cuts in taxes and social security contributions. However, in 2018, the average impact of the tax cuts set out in the budget laws (exemptions from the *taxe d'habitation* or housing tax,

Chart 4: Household saving ratio

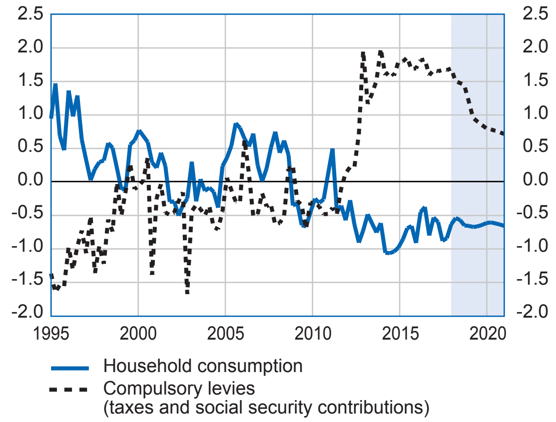
(% of gross disposable income)



Sources: Insee data up to 2016, Banque de France projections.

Chart 5: Consumption and compulsory levies

(in points)



Sources: Insee data up to Q2 2017, Banque de France projections.
Note: This chart shows the ratio between nominal household consumption and GDI before compulsory levies (i.e. before taxes and social security contributions), and the ratio between compulsory levies and GDI before compulsory levies. Variables are expressed as deviations from the long-term average (Q1 1995-Q2 2017).

conversion of the wealth tax into a tax on real estate assets, introduction of a flat tax on capital income) will be cancelled out to a large extent by the time lag between the rise in the general social security contribution or CSG and the cuts to employer payroll taxes. As a result, the full effect of the tax reductions on household income should only really be felt from the end of 2018, and in the annual average figures for 2019.

These tax cuts, coupled with an increase in financial income, should lead to a slight acceleration in private consumption in 2019, but should also help to drive the saving ratio back towards its long-term average (15.2% in the fourth quarter of 2020, see Chart 4). **This would be the inverse of the trend seen after the sharp increase in tax and social security contributions in 2012**: the latter effect was partially offset by a decline in the saving ratio, resulting in only a limited impact on consumer spending, in line with the idea that individuals have a lower marginal propensity to spend financial income (see Chart 5).

Table 2: Change in private consumption and in household gross disposable income (GDI)

(annual average percentage change)	2016	2017	2018	2019	2020
Real private consumption	2.1	1.2	1.5	1.7	1.6
Real GDI	1.8	1.6	1.7	2.5	1.8
Nominal GDI	1.7	2.5	2.9	3.5	3.2
Contributions to growth in nominal GDI					
Gross operating surplus	*0.4*	*0.4*	*0.4*	*0.6*	*0.5*
Gross wages	*1.3*	*2.0*	*1.6*	*1.7*	*1.8*
Net interest and property income	*-0.3*	*0.0*	*0.3*	*0.5*	*0.6*
Current transfers	*0.1*	*0.1*	*0.0*	*0.0*	*0.0*
Social security benefits	*0.6*	*0.6*	*0.8*	*0.8*	*0.9*
Direct taxes	*-0.2*	*-0.3*	*-1.3*	*-0.1*	*-0.4*
Social security contributions	*-0.2*	*-0.3*	*1.0*	*0.0*	*-0.2*

Source: Insee quarterly national accounts published on 29 November 2017. Blue-shaded columns show Banque de France projections.

Household investment should slow in 2018 after two consecutive years of strong growth, and then rise at a more sustainable pace

After dropping by 8% between 2011 and 2015, household investment has been picking up sharply over the past two years: it rose by 2.4% in 2016, and is projected to grow by 5.1% in 2017. As well as being underpinned by the improvement in the labour market and in household purchasing power, the rebound is also being spurred by the low interest rate environment and significant temporary stimulus policies (easing of conditions of eligibility for zero-interest loans, Pinel tax incentives for buy-to-let investments).

Since the first quarter of 2017, however, growth in household investment has been losing pace. The stabilisation of housing starts, and the drop in house sales and in monthly flows of mortgage lending (excluding renegotiations) since the summer suggest this slowdown could be amplified in the coming quarters. Growth in household investment is thus expected to decelerate to 2.1% in 2018, and again to 1.3% in 2019. **However, in 2020 it should pick up again (to 1.9%), rising at a similar pace to purchasing power, which is more sustainable in the long term. As a share of nominal disposable income, household investment should stabilise as of early 2019 at around 8.4%, close to the highs seen in 2017 and 2011.**

This should push the household financial saving ratio, calculated as net lending (after investment, therefore) as a percentage of gross disposable income, up from 4.5% in 2017 to 5.4% in 2020, leaving it still marginally short of the average since 1995.

Business investment should be held back by their self-financing capacity, but will still remain robust

The margin rate of non-financial corporations (NFCs) should remain more or less stable at 31.5% of value added, which is still below pre-crisis levels (it fluctuated between 32% and 33% between 1996 and 2008). After reaching a historical low in 2013, it recovered sharply up to the beginning of 2016. However, it has been shrinking again for the past few quarters, falling by 0.7 percentage point between the first quarter of 2016 and second quarter of 2017, notably because strong job creations are reducing gains in apparent labour productivity.

Table 3: Ratios of non-financial corporations

(annual average, in %)	2016	2017	2018	2019	2020
Margin rate	31.8	31.5	31.4	33.1	31.6
Investment ratio	23.3	23.9	24.1	24.1	24.2
Self-financing ratio	84.3	82.7	84.6	89.3	81.2
Saving ratio	19.7	19.8	20.4	21.6	19.7

Sources: Insee quarterly national accounts published on 29 November 2017. Blue-shaded columns show Banque de France projections.

Over the projection horizon, the recovery in productivity growth and acceleration in the value added deflator should help to stabilise the NFC margin rate. **It should rise sharply in 2019, albeit temporarily, as companies benefit from the overlap between the CICE credit received on wages paid in 2018 and the reduction in social security contributions on wages for 2019 (see Box 3). In our projections, this cash windfall is used by businesses to pay down debt and has no impact on real activity or prices.**

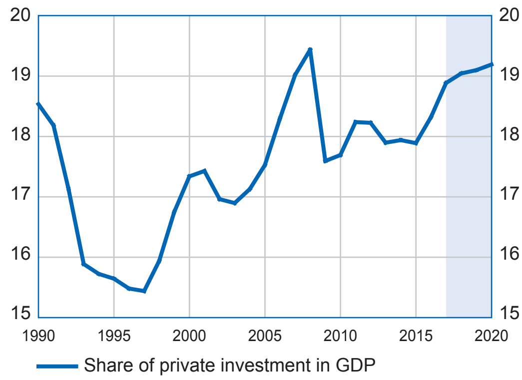
The corporate saving ratio is expected to remain stable over the projection horizon, but is nonetheless at a historical high owing to the low level of financial charges.

Business investment (for NFCs, FCs and IEs) increased at a strong pace in 2016 (annual average growth of 3.6%), and maintained this momentum over the first three quarters of 2017, despite the end of the extra depreciation allowance in mid-April 2017. **The sharp growth of the past two years is not expected to continue. However, business investment is still projected to be dynamic, growing by 3.0% in 2018, 2.5% in 2019 and 2.4% in 2020, after 4.1% in 2017. It should continue to outpace activity growth, as is usual in a period when the output gap is closing, but also thanks to additional support from very low interest rates.** The NFC investment rate, which measures investment as a share of value added, is expected to remain high: it has already exceeded the previous peak seen in 2008 and should continue to improve over the projection horizon, reaching 24.2% by end-2020.

Overall, the contribution of private investment (households and businesses) to GDP is currently high and, although growth in its individual components should moderate somewhat over the projection horizon, it should still continue to increase, moving towards its 2008 peak (see Chart 6).

Chart 6: Share of private investment in GDP

(% of GDP, annual nominal data)



Sources: Insee data up to 2016, Banque de France projections.
Note: Private investment groups together business and household investment.

Unemployment should continue to fall

The unemployment rate has shrunk by 0.8 percentage point over the past two years, from 10.5% of the labour force in the second quarter of 2015 to 9.7% in the third quarter of 2017. The improvement follows on from the sharp pick-up in growth in market sector salaried employment (190,000 net job creations in 2016 and a further 252,000 expected in 2017, see Box 2), which was offset slightly by slower growth in non-market sector employment and a decline in non-salaried employment. Market sector job creations were boosted by the measures to reduce labour costs – the CICE and PRS, and recruitment incentives for SMEs. The CICE in particular has taken longer than expected to feed through to employment, but ultimately appears to be having a significant effect (see Box 3). The acceleration in job creations stemming from these government policies has severely restricted private sector productivity growth (decline of 0.2% in productivity in 2016 followed by estimated growth of 0.2% in 2017).

Despite robust activity and strong job creations, the unemployment rate is not expected to fall in 2018 (forecast of 9.6%, unchanged versus 2017). The effects of the government's employment policies are projected to fade, and productivity should grow at a higher rate of 1.0% in 2018, as is usual during a period of economic recovery.

Box 2

STRONG NET JOB CREATION SINCE MID-2015

Following seven years of deterioration in the labour market, which took the unemployment rate in France to 10.5% of the labour force in the second quarter of 2015, since mid-2015 the rate of net job creation has picked up strongly (see chart). As an annual average, net salaried and non-salaried job creations reached 197,000 in 2016 and should increase to 281,000 in 2017 (the carry-over at the end of the third quarter of 2017 was already 273,000).

A substantial number of salaried jobs were created in the market sector, particularly services, in 2016 and 2017

The upturn in the labour market is essentially being driven by growth in market-sector salaried employment (firms and households). New job creations in the sector totalled 190,000 in 2016, and are expected to reach 252,000 in 2017 – the highest number seen since 2007. This surge is helping to offset the slowdown in non-salaried and non-market sector employment. Non-salaried employment has stalled since 2015, after being one of the main sources of job creation from 2010 to 2014 following the introduction of the *auto-entrepreneur* status in 2009. Non-market sector employment has settled into a trend of weak growth (with 14,000 jobs created in 2016 and 29,000 projected in 2017), and should slow even further in the coming years (see below).

The strong growth in market-sector salaried employment over the past two years has been concentrated in market services, with an additional 232,000 jobs created in this segment 2016 and a carry-over of 253,000 jobs at the end of the third quarter of 2017. By contrast, industrial employment is continuing to decline while employment in the construction sector only started to pick up slowly at the beginning of 2017.

Net job creation has been boosted by employment policies

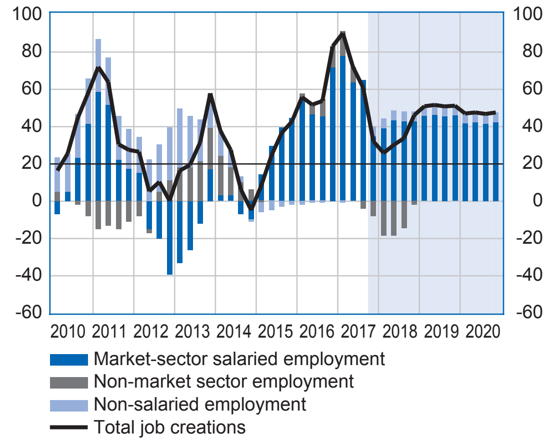
The upswing in market-sector salaried employment is all the more remarkable given that growth in activity in the sector was still muted in 2015 and 2016 (1.0% growth in real output in 2015 and 1.1% in 2016) and only really recovered durably at end-2016. As discussed in Box 3, this excellent performance can largely be attributed to employment policies (the Tax Credit for Competitiveness and Employment or CICE, the Responsibility and Solidarity Pact or PRS and recruitment incentives for SMEs) that have already helped to increase the employment content of growth by nearly 400,000 jobs. As a counterpart to this surge in job creation, however, gains in apparent labour productivity have been weak.

A slight slowdown is projected for net job creations (with stronger productivity gains than in 2017), but the unemployment rate should continue to fall markedly until the end of 2020

According to Banque de France projections, net job creations are expected to remain buoyant in the coming years due to robust economic activity. They should slow in 2018 before picking up again over the remainder of the projection horizon (an additional 147,000 jobs in 2018, then 184,000 in 2019 and 192,000 in 2020). The slowdown in 2018 is expected to be the result of two one-off factors: non-market sector employment is projected to be hit by the cut in subsidised jobs; and the effects of employment policies should gradually diminish while growth in apparent labour productivity should pick up to a more typical annual pace of 1%. From 2019 onwards, job creations are expected to gain momentum again as subsidised jobs stabilise (under a no-policy-change assumption). Furthermore, the transformation of the CICE into a reduction in social security contributions is expected to support market-sector salaried employment (see Box 3). As a consequence of all these components, unemployment should continue to fall, reaching 8.6% at end-2020, its lowest level since the beginning of 2009.

Chart: Quarterly changes in employment

(in thousands)



Sources: Insee, Banque de France projections.

Table: Net job creations

(annual average, in thousands)	2013	2014	2015	2016	2017	2018	2019	2020
Total job creations	**67**	**122**	**60**	**197**	**281**	**147**	**184**	**192**
Market-sector salaried employment	-97	-1	56	190	252	176	177	172
Non-market sector employment	58	70	12	14	29	-46	-13	0
Non-salaried employment	106	52	-8	-8	-1	16	20	20
Labour force	**228**	**129**	**98**	**120**	**163**	**147**	**74**	**68**
Unemployed	**162**	**7**	**37**	**-76**	**-118**	**0**	**-110**	**-124**
ILO unemployment rate (France and overseas territories, % of labour force)	**10.3**	**10.3**	**10.4**	**10.1**	**9.6**	**9.6**	**9.2**	**8.8**

Sources: Insee, Banque de France projections.
Note: "Market-sector salaried employment" here refers to paid employment in NFCs, FCs, IEs and households. "Non-market sector employment" refers to jobs in general government and non-profit institutions serving households (NPISH). The labour force projections from Q4 2017 onwards are based on Insee's baseline scenario projections for the labour force up to 2070.

Market sector job creations will thus be lower than in previous years, at a net total of 176,000, while the non-market sector should see net job losses of 46,000 in 2018, due to the cut in the number of subsidised contracts.

Unemployment should start to decline again in 2019 and 2020, and at a faster pace than previously, pushing the jobless rate down by 0.4 percentage point each year. Market sector employment should continue to be supported by the increase in economic activity. The transformation of the CICE into a reduction in employer social security contributions in 2019 should also gradually help to drive job creations upwards in the sector (see Box 3). In the non-market sector, meanwhile, employment should stabilise after the sharp drop expected in 2018.

Growth in real wages should fluctuate at around 1.0% per year, in line with productivity

As already seen in the Insee quarterly national accounts for the first and second quarters, growth in the average nominal per capita wage in the private sector (i.e. at NFCs, FCs and IEs) should accelerate sharply in 2017, to 1.9% after 1.2% in 2016, reflecting the fall in the rate of unemployment. However, real wage growth (i.e. adjusted for the consumption deflator) should moderate to 1.1% from 1.3% in 2016, as a result of the strong rebound in oil prices.

Table 4: Change in wages and productivity in the private sector

(annual average percentage change)	2016	2017	2018	2019	2020
Value added deflator	0.4	0.5	0.7	1.2	1.4
Unit labour costs	1.1	1.7	0.9	-1.8	1.5
Productivity per capita	-0.2	0.2	1.0	1.0	0.8
Per capita nominal wage	1.2	1.9	1.9	2.2	2.3
Per capita real wage[a)]	1.3	1.1	0.7	1.1	1.0

Source: Insee quarterly national accounts published on 29 November 2017. Blue-shaded columns show Banque de France projections.
Note: The private sector is defined as businesses (i.e. non-financial corporations or NFCs, financial corporations or FCs, and intermediate-sized enterprises or IEs).
a) Adjusted using the private consumption deflator.

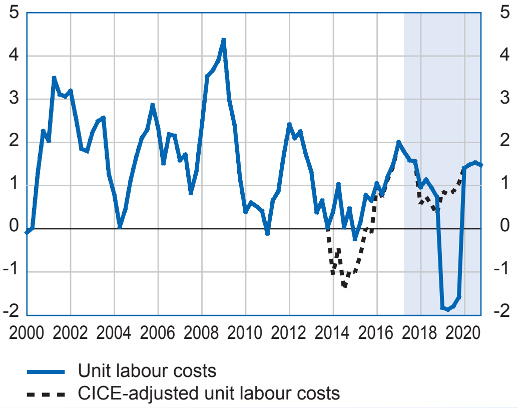
Over the remainder of the projection horizon, nominal wages should continue to be supported by improvements in the employment market, rising inflation and gains in productivity. The average wage per capita in the private sector should rise by 1.9% in 2018 then by 2.2% in 2019 and 2.3% in 2020. The minimum wage will grow in accordance with the revaluation rule, and as a result will increase at a more modest pace than private sector wages, despite rebounding in 2018 after several years of weak growth.

Real private sector wages (adjusted for the household consumption deflator) should be impacted by the spike in inflation in 2018 linked to the tax hikes on tobacco and energy. But they should then grow at a more sustained rate, close to trend growth in productivity.

With the transformation of the CICE into a reduction in employer social security contributions in 2019, unit labour costs measured according to national accounting methodology should drop sharply in the first quarter of 2019 (annual average decline of 1.8% in 2019 in the private sector), as this measure does not include the CICE for previous years. An alternative measure, taking into account the CICE for the 2014-18 period, shows unit labour costs following a smoother and more economically significant trajectory (see Chart 7). According to this measure, however, **unit labour costs should still only rise modestly in 2018 and 2019. Wage growth should remain subdued and productivity should rise. Meanwhile, companies will receive a higher CICE tax credit in 2018 (for 2017 wages), and its replacement in 2019 with a cut in charges will have a more significant downward impact on labour costs (excluding the *retour d'IS* – the increase in income subject to corporate income tax resulting from the direct reduction in contributions). This should temporarily curb growth in corrected unit labour costs. However, in 2020 they should rise more markedly.**

Chart 7: Change in private sector unit labour costs

(year-on-year percentage change – quarterly series)



Sources: Insee data up to Q2 2017, Banque de France projections.

Box 3

THE TRANSFORMATION OF THE CICE INTO A REDUCTION IN EMPLOYER SOCIAL SECURITY CONTRIBUTIONS IN 2019 IS EXPECTED TO BOLSTER THE CONTINUED UPSWING IN JOB CREATIONS

The Tax Credit for Competitiveness and Employment (CICE) came into force in 2013 and is calculated as a share of all wages paid during a calendar year that are less than 2.5 times the French minimum wage (SMIC). Its rate was increased from 4% in 2014 (applied to wages paid in 2013) to 6% in 2015, and is expected to reach 7% in 2018 before coming back down to 6% in 2019.

The 2018 *projet de loi de financement de la sécurité sociale* (PLFSS - draft Social Security Financing Act) provides for the transformation of the CICE into a permanent 6 point reduction in contributions on wages less than 2.5 times the SMIC. In addition, the general tax relief framework, which is concentrated on the lowest wages (with maximum relief at the level of the SMIC declining progressively up to 1.6 times the SMIC), will be topped up by approximately 10 additional points for wages equal to the SMIC. Overall, the CICE transformation will have almost no impact on the budget (in light of the *retour d'IS* – the increase in income subject to corporate income tax resulting from the direct reduction in contributions, see section 4), with the exception of the transitional year (2019) when businesses will benefit from both the CICE credit for wages paid in 2018 and the reductions in contributions for wages paid in 2019.

In view of this transformation, it seems opportune to consider the CICE's past impact on employment on the one hand, and on the other, the potential additional future impact of the reduction in contributions that will replace the CICE. This analysis only takes into consideration the medium-term effects of the measures, excluding the temporary overlap of benefits in 2019 and ignoring their financing.

The CICE's impact on unemployment to the present day

The creation of the CICE was intended to fulfil the threefold objective of encouraging competitiveness, investment and job creation. In terms of job creation specifically, its effect is still debatable. The CICE monitoring committee report published in October 2017[1] states that the impact on employment between 2013 and 2015 was uncertain, and broadly estimates the number of jobs created at between 10,000 and 200,000. However, due to the lack of available data, these microeconomic assessments have the disadvantage of only covering the three years following the reform, and therefore do not include the recent period that witnessed an upsurge in employment. Moreover, businesses only began to receive the tax credit in 2014. According to the national accounts, 450,000 jobs were created in the private sector (i.e. by NFCs, FCs and IEs) from the second quarter of 2015 to the second quarter of 2017. It is possible, therefore, that the complexity of the measure[2] meant that there were significant adjustment lags.

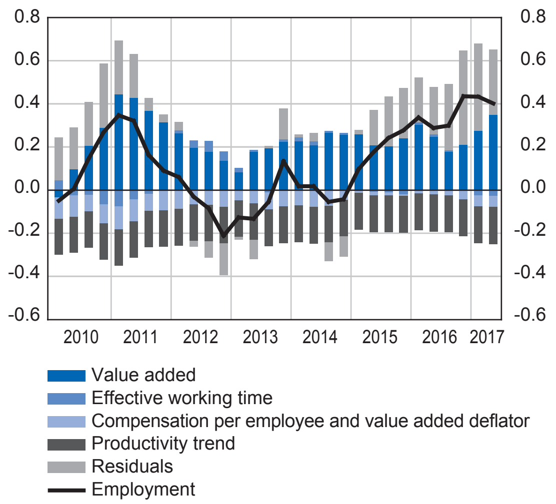
The macroeconomic projection equation used by the Banque de France for private-sector salaried employment demonstrates that job creation over the past two years has been substantially more dynamic than was expected based on traditional fundamentals,[3] with around 395,000 more jobs than anticipated since the introduction of the CICE in 2014. Taking into account Insee's assessment that 20,000 jobs were created as a result of the SME recruitment subsidy (*prime à l'embauche PME*) and a further 55,000 as a result of the targeted reduction in employer social security contributions under the Responsibility and Solidarity Pact (PRS), **this macroeconomic approach suggests that the CICE could have led to the creation of around 320,000 jobs up to the second quarter of 2017.**[4]

Will the labour cost reductions to be implemented in 2019 have an additional impact?

The reductions in contributions for 2019 are targeted more specifically towards low wages than the CICE, and greater elasticity of employment to labour costs is expected. The Treasury's

Chart: Contributions to quarterly changes in private sector employment

(employment in %, contributions in percentage points)



Sources: Insee, Banque de France calculations.

…/…

1 2017 report of the CICE monitoring committee, *France stratégie.*
2 *Particularly due to the fact that the CICE is a tax credit and its receipt is therefore deferred, notably for less profitable businesses.*
3 *Technically, as labour costs are not affected by the CICE, it has no impact on the determinants of the employment equation and its effect is therefore categorised under "residuals".*
4 *Using a macroeconomic approach for the 2014-Q2 2017 period, the French Economic Observatory (OFCE, 2017) found that the impact was particularly significant.*

estimates of elasticities of employment to labour costs by wage band[5] show that for a flat reduction in costs, concentrated on wages between 1 and 2.5 times the SMIC, the total average elasticity of employment to labour costs is 0.7, i.e. around 330,000 new jobs for a 6 point direct reduction in contributions on wages between 1 and 2.5 times the SMIC. In addition, for reductions with maximum relief at the level of the SMIC, declining progressively up to 1.6 times the SMIC, the average elasticity is 1.1. The additional relief, referred to as "zero charge", should therefore lead to the creation of 90,000 extra jobs.

In the long term, the measures to reduce social security contributions which will replace the CICE in 2019 should result in the creation of around 420,000 extra jobs. **As previously discussed, a proportion of these extra jobs have already been created as a result of the CICE, so an additional impact of around 100,000 jobs is therefore expected in the future.**

This leads to an expectation of moderate growth in productivity over the projection horizon.

5 See Bock (S.), Lissot (P.) and Ozil (S.) (2015), "Matis: une maquette d'évaluation des effets sur l'emploi de variations du coût du travail", Les Cahiers de la DG Trésor*, No. 2015-02, March.*

3| Headline inflation should rise to 1.7% at end-2020

Annual average headline inflation should rise to 1.6% in 2020, but its path is expected to be fairly uneven.

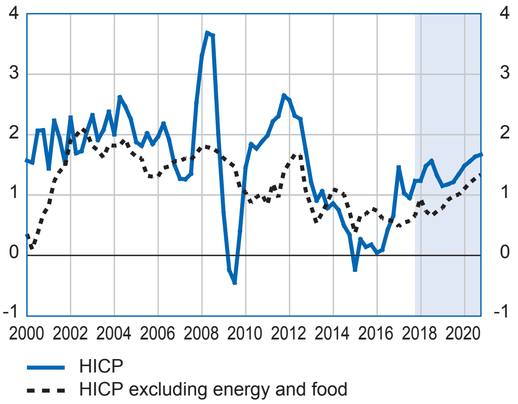
In 2017, annual HICP inflation is expected to average 1.2%, against 0.3% in 2016. Its path up to 2020 is projected to be fairly uneven, with annual average rates of 1.4% in 2018, followed by just 1.2% in 2019 and 1.6% in 2020. In year-on-year terms, HICP inflation should initially peak at 1.6% in the third quarter of 2018 before falling to 1.2% in mid-2019 then picking up to 1.7% at the end of the projection horizon (see Chart 8). This uneven path appears largely attributable to sharp and irregular tobacco tax hikes in 2018 which should then be more evenly spread over the following years. Growth in annual average HICP inflation excluding energy and food is expected to be more gradual. In 2017, the inflation rate should remain weak at 0.6%, as in 2016. It should then rise slightly, reaching 0.8% in 2018 and 0.9% in 2019. In 2020, it should increase more markedly to 1.2%, driven, among other factors, by the rise in import prices and the more marked increase in labour costs after a period of moderation.

In 2017, the recovery in headline inflation has been driven by energy inflation.

Headline HICP inflation should average 1.2% in 2017, up 0.9 percentage point compared with 2016. The rise in oil prices since the start of 2016 has strongly impacted the energy component of the HICP which is projected to jump by 6.0% in 2017, and should contribute 0.5 percentage point to headline inflation after making negative contributions from 2014 to 2016. Conversely, inflation excluding energy and food should remain low in 2017, at 0.6% – unchanged on 2016. Service price inflation should inch down to 0.9% from 1.0% in 2016, dampened by the decline in communications prices since the start of the year. Industrial goods inflation is expected to average –0.1%, due in particular to the fall in non-energy import prices in 2016.

Chart 8: HICP and HICP excluding energy and food

(year-on-year percentage change – quarterly series)



Sources: Insee data up to Q3 2017, Banque de France projections.

In 2018, headline inflation is expected to be strongly impacted by tobacco tax hikes. Inflation excluding energy and food should increase but only slightly.

In 2018, headline inflation is expected to be driven by the sharp rise in food inflation resulting from the significant tobacco tax hike included in the 2018 *projet de loi de financement de la sécurité sociale* (PLFSS – draft Social Security Financing Act). Food inflation is therefore expected to contribute 0.5 percentage point to headline inflation in 2018, of which 0.3 percentage point will stem from tobacco. Energy inflation should remain strong at 3.9%, driven by the rebound in oil prices at end-2017 and the rise in taxes on oil products set out in the budget laws.

Inflation excluding energy and food should nevertheless remain low in 2018, at 0.8%, only slightly higher than in 2017. Service price inflation is expected to pick up significantly, reaching 1.3% after 0.9% in 2017. The rise should be partly mechanical, as the sharp declines in communications prices observed at the start of 2017 drop out of the year-on-year comparison. However, it should also reflect the positive impact of the economic recovery and, notably, the acceleration in nominal wages in certain labour-intensive services – although higher labour costs should be mitigated to an extent by the rise in the CICE rate in 2018 (on 2017 wages). Service price inflation should nonetheless be temporarily curbed by the decrease in social housing rents provided for in the budget laws – the effect should be felt at the time the measure is implemented, in the second quarter of 2018.

In contrast, the slowdown and the subsequent decline in non-energy import prices caused by the appreciation in the exchange rate in mid-2017 should start to have a negative impact on industrial goods inflation as of the second quarter of 2018. Annual industrial goods inflation should therefore average –0.2% in 2018, down from –0.1% in 2017.

In 2019, headline inflation should come down a little, to 1.2%, due to the slowdown in its most volatile components (tobacco and energy). But inflation excluding energy and food should continue to increase.

Food price inflation should slow in 2019 as the tobacco tax hike of March 2018 drops out of the year-on-year comparison, and 2019 tax increases become more evenly spread. Energy inflation is also likely to come down sharply due to the decline (indicated by futures prices) in oil prices from their peak in early 2018. Energy prices should nevertheless be subject to more upward pressure from further energy tax hikes.

Inflation excluding energy and food should continue to increase very gradually to stand at 0.9%. Service price inflation should only rise slightly against a backdrop of contained labour costs, and this effect should be accentuated in 2019 by the transformation of the CICE into a reduction in employer social security contributions. Industrial goods inflation should gradually pick up in 2019, driven by the acceleration in non-energy import prices.

In 2020, all the components of the HICP should make a positive contribution to headline inflation, which is expected to end the year at 1.7%.

In 2020, food inflation should be underpinned by tobacco tax hikes in April and November 2020. According to futures markets, oil prices should continue to decline, but energy inflation is expected to be propped up by further energy tax hikes. Service price inflation should see a more significant rise, driven by higher wage increases and lower unemployment. Lastly, industrial goods prices are expected to increase further throughout the year as the impact of past decreases in import prices dissipates.

Over the projection horizon, French HICP inflation excluding energy and food is expected to remain lower than the forecast for the euro area, notably because France's labour market needs to improve more markedly if it is to catch up with conditions in the broader single currency bloc.[1]

1 *See also Eco Notepad blog post of 30 November 2017: The causes behind the France/euro area core inflation gap by De Charsonville (L.), Faubert (V.) et Sigwalt (A.)*

4| Public finances: the deficit should be just below 3% of GDP in 2017 and 2018, requiring tight spending control

Public finances are continuing to improve and the government deficit should be reined in to 2.9% of GDP in 2017, from 3.4% of GDP in 2016. In 2018, the deficit is expected to remain stable as a percentage of GDP, with the repayment of the dividend tax following a ruling by the Constitutional Council. The Banque de France's projections incorporate the assumption – also adopted by the French government – that EUR 5 billion will be repaid in 2017 (funded by an exceptional additional corporate income tax contribution this year) and another EUR 5 billion in 2018. Without this one-off repayment, the deficit would have narrowed by 0.2 percentage point of GDP in 2018, thanks primarily to the favourable macroeconomic environment. There is a slight possibility, however, that the entire repayment expected following the Constitutional Council's decision will be fully taken into account in the 2017 Maastricht deficit figure.[2] In this case, the 2017 Maastricht deficit will be 0.2 percentage point higher than in these projections.

Within the European framework, exiting the excessive deficit procedure will require close monitoring and the ability to react rapidly to any sign of a deterioration in public finances, irrespective of the causes. This is all the more important given the limited size of the structural adjustment. Indeed, in its press release of 22 November 2017, the European Commission stressed the risk that the trajectory of France's structural balance might fail to comply with EU requirements.

Two factors have an impact on the public balance: changes in tax and social security receipts on the one hand, and changes in public spending on the other.

In 2017, **tax and social security receipts** should rise at a stronger pace than nominal GDP, pushing the aggregate tax ratio (tax and social security receipts as a percentage of GDP) up from 44.4% to 44.6%. In 2018, however, the planned tax measures should have a downward impact on the tax ratio. These measures are projected to represent a net reduction of EUR 7 billion in tax receipts in 2018 (mainly the deferred effects of measures voted into law under the previous government, notably the increase in the CICE and the decrease in corporate income tax). The new tax cuts set out in the budget laws principally concern households, and include (i) the exemption of certain households from the *taxe d'habitation* (housing tax), (ii) the transformation of the wealth tax into a tax on real estate, and (iii) the introduction of a flat tax on capital income. However, on average during 2018, these cuts should be partially offset by the increase in the general social security contribution or CSG (while the counterpart to this – decreased social security contributions – is only expected in full at the end of the year), and by the increases in taxation on tobacco and energy. As a result of the time lag between the CSG increase and the decrease in social security contributions, the new tax reductions approved in the budget laws should have a stronger full-year impact in 2019, reducing the tax burden on households and thereby pushing up household gross disposable income. The repayment of the disputed dividend tax, which will have a neutral impact on the tax ratio in 2017 as it is financed by the exceptional additional corporate income tax contribution, should have a temporary negative impact of 0.2 percentage point on the aggregate tax ratio in 2018 (excluding this repayment, the tax ratio would be 44.3% of GDP).

Public spending excluding tax credits is projected to increase by 1.9% in nominal terms in 2017, after growth of 1.2% in 2016. The higher growth compared with 2016 should stem primarily from (i) a more substantial expansion of the public sector wage bill in 2017 following an upward revision to the index points in the pay grid after several years of freezes, (ii) exceptional government spending in respect of the Areva SA recapitalisation,[3] and (iii) the upswing in inflation, which drives up government consumption and social security benefits in nominal terms. Nevertheless, growth in social security benefits should be curbed by the fall in unemployment and a temporary slowdown in pension spending in 2017. Government investment, for its part, is expected to remain stable.

In 2018, our trajectory for public spending takes into account the savings measures set out in detail in the 2018 budget laws. These relate mainly to the public sector wage bill, the revaluation of pension benefits, *aides personnalisées au logement* (APL – personal housing subsidies) and cuts in subsidised jobs. In real terms and excluding interest payments, primary spending excluding tax credits should thus increase by 1.0% in 2018 (after 1.1% growth in 2017), which is in line with the rates observed over the fiscal consolidation period since 2010 (between 2010 and 2016, real primary public spending excluding tax credits increased on average by 0.9% each year). Despite the increase in

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2 The actual methodology used (under ESA 2010) will be decided by Insee in conjunction with Eurostat.

3 The French government provided EUR 4.5 billion of the Areva capital increase (EUR 2 billion for Areva SA and EUR 2.5 billion for Areva NewCo, which also received capital from private investors). It is still unclear how this operation will be classified in the national accounts – either as a financial transaction, in which case it will have no impact on the deficit, or as a capital transfer, in which case it will weigh on the deficit. For the purposes of these projections, the EUR 2 billion investment in Areva SA, which represents 0.1% of GDP, has been included within public spending as there is no prospect of a return on the investment (the EUR 2.5 billion capital injection in Areva NewCo alongside private investors has not been categorised as public spending).

market interest rates implicit in the current yield curve, the low interest rate environment is projected to continue to facilitate fiscal policy (as in 2017), as a significant proportion of new French treasury bonds (OATs) should be issued at lower rates than those they replace (for example, those issued ten years ago). Debt interest payments are therefore expected to continue to decline from 1.9% of GDP in 2016 to 1.8% in 2017 and 1.6% in 2018.

The structural adjustment,[4] calculated using the methodology and the potential growth figure of the European Commission, is estimated in these projections at 0.1 percentage point of GDP in 2017. This should mainly stem from lower interest payments, as the primary structural adjustment is expected to be close to zero. In 2018, the structural balance is expected to deteriorate by 0.2 percentage point of GDP, as cuts in taxes and social security contributions exceed the impact of savings measures. Excluding the decline in interest payments, the primary structural balance should deteriorate more markedly in 2018, falling by 0.4 percentage point.

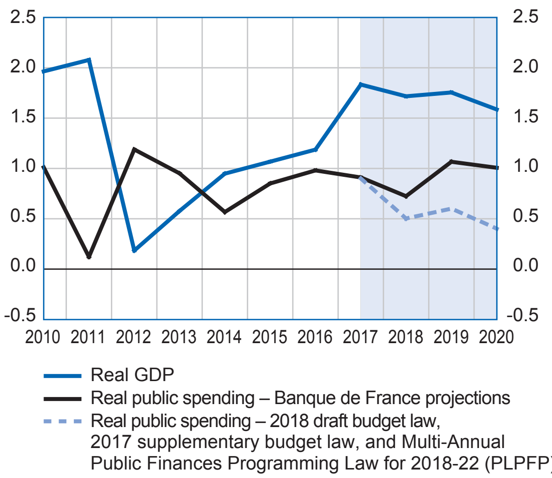
Over the entire projection horizon, **the effect of the government's strategy, which consists of lowering the tax ratio at the beginning of its five-year term and decreasing spending more gradually until 2022, is twofold: it has less of a negative impact on growth, but reduces the structural adjustment and pushes back the stabilisation of public debt levels.**

In line with the principle of prudence applied in Eurosystem projections, our projection incorporates less public spending restraint than anticipated by the government: only savings measures that have been set out in sufficient detail can be taken into account. Thus, in 2018, our projection is for a 0.7% rise in real public spending (excluding tax credits), compared with the 0.5% growth factored into the 2018 draft budget laws. Beyond 2018, the government's projection for 0.5% average public spending growth per year corresponds to an objective, to be met through additional savings that still need to be determined (notably as part of a spending review and through spending agreements with individual local authorities). These measures cannot be taken into account in our projections. As a result, over the medium term, growth in real public spending in our projection is expected to be in line with the trend seen over recent years, that is around 1% per year (see Chart 9).

In 2019, the transformation of the CICE into a cut in employer social security contributions is expected to have a temporary negative impact of 1 percentage point of GDP on the public balance, pushing the deficit up to 3.6% of GDP. In the medium term, however, the fiscal impact of this measure should be neutral (see Box 3).

Chart 9: Real public spending (excluding tax credits) and real GDP

(annual average percentage change)



Sources: Insee, 2017 supplementary budget law, 2018 budget law, 2018-22 PLPFP, and Banque de France projections.
Note: Real spending is adjusted for CPI excluding tobacco.

Overall, the public debt-to-GDP ratio should continue to rise over the projection horizon, reaching 97.0% in 2017, 97.6% in 2018 and 98.4% in 2019, and should then stabilise in 2020.[5]

4 *Change in the structural balance, excluding cyclical effects and exceptional measures. As the repayment of disputed dividend taxes is an exceptional measure, it has no impact on the assessment of the structural adjustment.*

5 *It is also important to analyse the longer term trajectory for France's public debt: for more on this, see forthcoming Eco Notepad blog posts which, on the one hand, will look at the conditions required, notably in terms of public spending growth, to achieve a lasting reduction in public debt beyond this projection horizon, and, on the other hand, will describe several possible scenarios for bringing France more in line with countries that have successfully cut their debt.*

5| The outlook for economic activity and inflation remains subject to risks

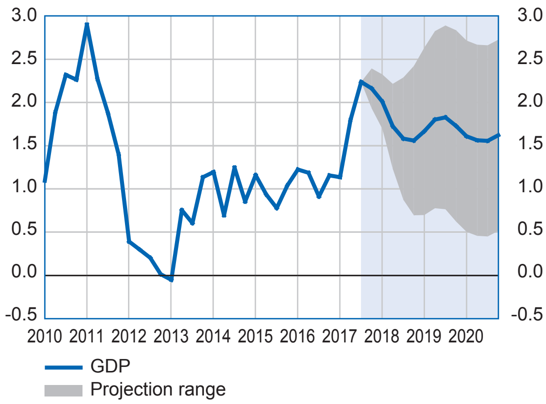
These projections are subject to a number of uncertainties regarding economic activity and the strengthening of inflation. These are illustrated in the fan charts below (estimated on the basis of historical projection errors).

The risks related to economic activity are on the whole balanced. First, if the **reforms** being undertaken lead to an increase in **potential growth** over the projection horizon, growth could be stronger than currently projected. Second, while there is ample evidence to suggest that **household investment** growth peaked in early 2017, the magnitude and duration of the slowdown are uncertain. The projection also assumes a sharp rise in the **household saving ratio** towards its long-term average by 2020 – the opposite equivalent of the decline that occurred in 2012. It is possible however that the rise in the ratio might not materialise on this scale or at this pace. Conversely, the projection for very robust exports, in particular in 2018, is linked, on the one hand, to the stabilisation of export market shares in 2018 at a higher level than in 2017, and, on the other, to a dynamic scenario for **global demand.** This represents a downside risk if the global recovery turns out to be less sustained than expected or if **export performances** prove to be disappointing.

Risks to the inflation outlook are rather on the upside. Oil futures point to a decline in prices from early 2018 that may not materialise. Our downward revision to inflation excluding energy and food largely reflects the assumption that the measures to reduce the **cost of labour** (the CICE until 2018 and lower social security contributions from 2019) will have a significant impact; however, in the context of a fairly pronounced drop in unemployment, inflation could bounce back faster than expected to a higher rate, as estimated with **Phillips curves.** The forecast also takes into account the decrease in social housing rents set out in the budget laws, although the timetable for applying this measure remains uncertain. Finally, the impact on inflation of **labour market reforms** is uncertain: they could lead to an improvement in the job market and generate productivity gains in the medium to long term, but could also weigh on certain wage negotiations and inflation in the short term.

Chart 10: Projection range for GDP growth

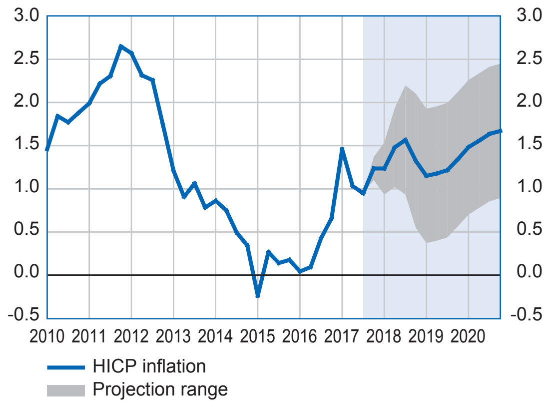
(year-on-year percentage change)



Sources: Insee for the 2000-Q3 2017 period, Banque de France projections.

Chart 11: Projection range for HICP inflation

(year-on-year percentage change)



Sources: Insee for the 2000-Q3 2017 period, Banque de France projections.

Appendix: Revisions to projections and technical assumptions since June 2017

Table A1: Revisions to projections since the June 2017 BMPE

	December 2017 BMPE					Revisions since June 2017 BMPE			
	2016	2017	2018	2019	2020	2016	2017	2018	2019
HICP	**0.3**	**1.2**	**1.4**	**1.2**	**1.6**	**0.0**	**0.0**	**0.2**	**-0.2**
HICP excluding energy and food	**0.6**	**0.6**	**0.8**	**0.9**	**1.2**	**0.0**	**-0.1**	**-0.4**	**-0.4**
GDP deflator	0.4	0.6	0.9	1.3	1.5	-0.4	-0.2	-0.2	0.0
Real GDP	**1.1**	**1.8**	**1.7**	**1.8**	**1.6**	**0.0**	**0.5**	**0.2**	**0.1**
Contributions to GDP growth (in percentage points):[a]									
Domestic demand (excluding changes in inventories)	*2.0*	*1.8*	*1.6*	*1.6*	*1.6*	*0.1*	*0.2*	*0.1*	*0.1*
Net exports	*-0.8*	*-0.5*	*0.2*	*0.1*	*0.1*	*0.0*	*0.0*	*0.1*	*0.0*
Changes in inventories	*-0.1*	*0.6*	*-0.1*	*0.0*	*0.0*	*-0.1*	*0.2*	*0.0*	*0.0*
Private consumption (53%)[b]	2.1	1.2	1.5	1.7	1.6	0.3	-0.1	0.0	0.2
Government consumption (24%)	1.2	1.5	0.7	0.7	0.7	-0.2	0.3	-0.2	-0.4
Total investment (22%)	2.7	3.5	2.8	2.4	2.3	0.0	0.9	0.7	0.4
Government investment (3%)	*-0.1*	*-1.3*	*3.0*	*2.5*	*2.4*	*0.6*	*-2.7*	*1.1*	*0.4*
Household investment (5%)	*2.4*	*5.1*	*2.1*	*1.3*	*1.9*	*0.3*	*2.0*	*0.9*	*0.9*
Business investment (NFCs-FCs-IEs) (13%)	*3.6*	*4.1*	*3.0*	*2.8*	*2.4*	*-0.3*	*1.5*	*0.5*	*0.2*
Exports (29%)	1.9	3.3	5.9	4.3	3.7	0.7	-0.1	0.8	0.0
Imports (31%)	4.2	4.7	4.7	3.6	3.3	0.7	-0.2	0.4	-0.2
Real household gross disposable income (GDI)	1.8	1.6	1.7	2.5	1.8	-0.1	0.5	0.1	0.7
Household saving ratio (% of GDI)	14.0	14.3	14.4	15.0	15.1	-0.6	-0.1	0.0	0.4
ILO unemployment rate (France and overseas territories, % of labour force)	10.1	9.6	9.6	9.2	8.8	0.0	-0.1	0.0	-0.1

Sources: Insee data for 2016 (published on 29 November 2017). Blue-shaded columns show Banque de France projections.
Annual percentage change except where otherwise indicated. Revisions are in percentage points.
a) The sum of individual contributions may not add up to GDP growth as figures have been rounded. This may also affect the calculation of revisions since the last BMPE.
b) Percentages in brackets refer to each item's share of GDP in 2016.

Table A2: Revisions to technical assumptions and the international environment[a]

	December 2017 BMPE					Revisions since June 2017 BMPE			
	2016	2017	2018	2019	2020	2016	2017	2018	2019
Technical assumptions									
Brent oil price (USD/barrel)	44.0	54.3	61.6	58.9	57.3	0.0	2.8	10.2	7.4
Brent oil price (EUR/barrel)	39.8	48.2	52.5	50.2	48.9	0.0	0.6	5.5	3.1
Non-energy commodity prices in EUR (annual percentage change)	-3.6	5.9	-0.8	3.4	4.3	0.0	-2.7	-2.0	-1.1
USD/EUR exchange rate	1.11	1.13	1.17	1.17	1.17	0.0%	4.1%	7.4%	7.4%
Euro nominal effective exchange rate (annual percentage change)[b]	3.8	2.2	2.8	0.0	0.0	0.1	2.6	2.5	0.0
3-month Euribor[c]	-0.3	-0.3	-0.3	-0.1	0.1	0.0	0.0	-0.1	-0.2
10-year French government bond yields[c]	0.5	0.8	0.7	1.0	1.3	0.0	-0.1	-0.4	-0.5
International environment, annual percentage change									
Extra euro-area competitors' prices on the export side (in EUR)	-4.8	2.4	-0.9	2.4	2.4	0.1	-3.1	-3.3	-0.2
World real GDP	3.0	3.6	3.6	3.6	3.5	0.1	0.2	0.1	0.0
World (excluding euro area) real GDP	3.2	3.7	3.9	3.8	3.7	0.1	0.2	0.1	0.0
Global (excluding euro area) trade	1.2	5.6	4.5	4.2	3.7	0.3	1.2	0.7	0.3
Foreign demand for French goods and services	2.6	5.3	4.9	4.1	3.7	0.5	0.8	1.0	0.3
Intra-euro area	*4.4*	*5.2*	*5.0*	*4.4*	*3.9*	*0.5*	*-0.3*	*0.5*	*0.2*
Extra-euro area	*1.1*	*5.4*	*4.8*	*3.9*	*3.4*	*0.5*	*1.7*	*1.5*	*0.4*

Sources: Eurosystem. Blue-shaded columns show Banque de France projections.
Revisions to the June BMPE are expressed as percentages for levels and as percentage points for rates of growth.
a) These technical assumptions and international environment projections were constructed on 22 November 2017 for market data and foreign demand for French goods and services, in accordance with the principles set out in "*A guide to Eurosystem staff macroeconomic exercises*", ECB, June 2001, available at: *https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguideen.pdf*. Foreign demand corresponds to the weighted average imports of France's trading partners. The method of calculation is described in the Occasional Paper "*Trade consistency exercise in the context of the Eurosystem projection exercises – An overview*", available at: *https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp108.pdf*.
b) Calculated against 38 trading partners of the euro area.
c) The forecasts for interest rates were calculated using the yield curve.