MACROECONOMIC PROJECTIONS
FRANCE

BANQUE DE FRANCE
EUROSYSTÈME

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According to the Banque de France's macroeconomic projections for France – constructed as part of the Eurosystem projection exercise – after three years of tepid growth, GDP will expand at an annual average rate of 1.2% in 2015. The economic recovery should then be confirmed in subsequent years, but growth will only accelerate to a modest extent: GDP is projected to rise by 1.4% in 2016 and 1.6% in 2017.

With the ECB maintaining an accommodative monetary policy stance, French activity should benefit from the return to growth in the broader euro area, where GDP is expected to increase by 1.5% in 2015, 1.7% in 2016 and 1.9% in 2017. French growth should also be supported by favourable domestic dynamics, with a gradual recovery in business investment and an increase in private consumption.

As a result of the fall in oil prices, HICP inflation is expected to remain very low in France in 2015, averaging 0.1% over the year, before rising again to 1.5% in 2017. Euro area HICP inflation is projected to average 0.1% in 2015, accelerating to 1.0% in 2016 and 1.6% in 2017.

KEY PROJECTIONS FOR FRANCE

	2014	2015	2016	2017
HICP	**0.6**	**0.1**	**1.0**	**1.5**
HICP excluding energy and food	**1.0**	**0.6**	**1.1**	**1.3**
GDP deflator	0.6	1.3	1.1	1.2
Real GDP	**0.2**	**1.2**	**1.4**	**1.6**
Contributions to GDP growth (in percentage points):				
Domestic demand (excluding changes in inventories)	*0.5*	*1.3*	*1.4*	*1.5*
Net exports	*-0.5*	*-0.1*	*0.1*	*0.0*
Changes in inventories	*0.2*	*0.0*	*-0.1*	*0.0*
Private consumption	0.6	1.6	1.5	1.5
Government consumption	1.5	1.7	1.1	1.0
Total investment	-1.2	-0.1	1.5	2.3
Government investment	*-6.9*	*-2.8*	*-1.3*	*1.4*
Household investment	*-5.3*	*-3.1*	*-1.7*	*-0.1*
Business investment (NFCs-FCs-IEs)	*2.2*	*1.9*	*3.4*	*3.3*
Exports	2.4	5.8	4.8	5.0
Imports	3.9	5.7	4.4	4.8
Real household disposable income (RHDI)	1.1	1.7	1.2	1.4
Household saving ratio (% of gross disposable income)	15.1	15.2	15.0	14.9
ILO unemployment rate (France and overseas territories, % of labour force)	10.3	10.2	10.0	9.7

Sources: INSEE data for 2014; the blue-shaded columns show Banque de France projections. Annual percentage changes except where otherwise indicated.

After three years of subdued growth, activity accelerated in 2015, driven by cheaper oil and the depreciation of the euro.

After three years of tepid growth (average of 0.4% per year), the French economy picked up pace in 2015, expanding at annual average rate of 1.5% in the first three quarters. Based on the latest economic indicators available in mid-November, French GDP should rise by 0.4% quarter-on-quarter in the fourth quarter of 2015.

For the full year 2015, the forecast is still for 1.2% growth in French GDP, which is unchanged versus the June projection. The economy is being sustained by stronger private consumption, reflecting the boost to household purchasing power from cheaper oil. Growth has also been fuelled by dynamic exports, despite the slowdown in global trade at the start of 2015: the depreciation of the euro's nominal effective exchange rate at the end of 2014 and, above all, at the start of 2015 prompted a rebound in France's export market shares over the first half of 2015. However, foreign trade is still making a negative contribution to growth in 2015 as strong exports are being offset by an increase in imports. Lastly, investment levels are continuing to weigh on the recovery, with household investment declining sharply and growth in business investment slowing.

The recovery should be confirmed in 2016 and 2017, but only very gradually as the international environment proves slightly less favourable than in 2015.

2016 and 2017 should see a confirmation of the recovery, although the pick-up in growth relative to 2015 should be more modest than predicted in June. GDP is expected to expand by 1.4% in 2016 then by 1.6% in 2017 (compared with June's projections for 1.8% and 1.9% growth respectively, before the fiscal consolidation measures in the 2016 budget law). External factors should be less favourable than in 2015, and than previously expected: the boost to household purchasing power from lower oil prices is expected to fade gradually; meanwhile, export growth should slow slightly in 2016 and 2017 due to the weakening of the outlook in emerging markets. France's foreign trade should nonetheless be sustained by the euro area recovery, and is expected to make a modest positive contribution to GDP growth in 2016.

The growth recovery will largely be sustained by domestic factors.

The growth acceleration in 2016 will notably be driven by stronger business investment. Various factors are expected to contribute to this trend: financing costs are likely to remain persistently low, even taking into account the low level of inflation, which is moreover expected to rise slightly; corporate profit margins should improve, helped by the Tax Credit for Competitiveness and Employment (CICE) and the reduction in employer social security contributions under the Responsibility and Solidarity Pact (PRS); firms should also benefit from the temporary measure allowing them to increase the amount they write down for certain capital goods; lastly, the recovery in demand should help stimulate investment spending. Business investment is projected to rise by 3.4% in 2016 then by 3.3% in 2017, although this is still well below the peaks of around 8% seen during previous recoveries. Uncertainties over the outlook coupled with higher debt levels should hinder the recovery to an extent, resulting in slightly lower rates of investment growth than predicted in June.

Household investment is set to remain persistently weak, notably as a result of demographic factors. Lower oil prices will no longer provide as much of a lift to household purchasing power, and private consumption will continue to grow, but only as a result of a slight decline in the saving ratio.

Inflation will be subdued by lower oil and other imported goods prices in 2015, but should recover progressively in 2016 and 2017.

Headline 12-month inflation, as measured by the change in the Harmonised Index of Consumer Prices (HICP), should average a modest 0.1% in 2015, before rising to 1.0% in 2016 followed by 1.5% in 2017 (1.6% year-on-year in the fourth quarter of 2017). Core inflation (HICP excluding energy and food), which is a less volatile indicator, is expected to fall to a lesser extent, averaging 0.6% in 2015 before recovering gradually to 1.3% in 2017. The GDP deflator should increase by around 1.2% per year over the period 2015-2017, after averaging growth of 0.8% between 2012 and 2014. Inflation projections are much lower than in June, owing to a sharper-than-expected fall in oil prices and downward revisions to imported goods prices.

There remain downside risks to this growth recovery and inflation scenario.

There are number of downside risks to the baseline growth scenario. On an external level, any slowdown in global growth would place a brake on French economic activity. On a domestic level, meanwhile, the expected recovery in business investment would be undermined if companies chose to use the gains from cuts to labour costs to raise wages or deleverage. Consumption would also be lower than predicted if the forecast decline in the household saving ratio failed to materialise in 2016 and 2017. In addition, the 2017 projections do not take account of the impact of the announced fiscal consolidation measures which still need to be set out in detail in the next government budget at the end of 2016. Moreover, while the impact of the November 2015 terrorist attacks is likely to be transitory and limited, there is a risk of a temporary fall in confidence among economic agents, which could affect their investment and consumption decisions. However, these threats are countered to an extent by a number of upside risks. On a domestic level, household investment could prove more robust than predicted, while stronger wage growth could help to buoy private consumption. Foreign trade would also make a stronger positive contribution to growth if the import penetration rate were to stabilise.

With regard to inflation, the risks appear skewed to the downside. The rebuilding of French corporate profit margins and firming of the euro area recovery could lead to higher-than-expected inflation. However, this is outweighed by the downward factors, namely persistently high unemployment and the downward revision to global growth, with potential further falls in oil and commodity prices.

1 | Technical assumptions and the international environment: weaker demand from emerging markets should slow the recovery in activity and inflation (see tables in the annex)

The baseline economic scenario incorporates the technical assumptions (exchange rates, interest rates, commodity prices) and international environment projections prepared by the Eurosystem (see notes to Table 1).

The euro effective exchange rate has appreciated slightly since the June projection, but remains markedly lower than its 2014 level. The euro has fallen sharply against the dollar since the summer of 2014, and the projection assumes it will hold steady at USD 1.09 up until 2017 (compared with an average of USD 1.33 in 2014). The nominal effective exchange rate of the euro also fell at the end of 2014 and in the first half of 2015, before appreciating slightly in the second half of 2015. Assuming it remains stable over the end of 2015 and thereafter, this should translate into annual average depreciation of 7.1% for 2015.[1] This is slightly lower than the June projection, which was for annual average depreciation of 8.1% in 2015.

Oil prices are currently at their lowest level since 2009. Brent crude has fallen sharply since the summer of 2014 and should average EUR 48 per barrel in 2015, which is EUR 26 below the average for 2014 (compared with the fall of EUR 17 integrated into the June projections). By convention, our assumption for oil prices is based on the path implied by futures prices. These point to a very gradual rise, with Brent crude continuing to average USD 48 per barrel in 2016, then edging up to USD 53 in 2017.

With the ECB maintaining an extremely accommodative monetary policy – particularly since the implementation of the Eurosystem's extended asset purchase programme (EAPP) – interest rates remain at record lows.

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

	2014	2015	2016	2017
Technical assumptions				
Brent oil price (USD/barrel)	98.9	53.8	52.2	57.5
Brent oil price (EUR/barrel)	74.4	48.4	48.1	52.9
Non-energy commodity prices in USD (annual percentage change)	-8.6	-18.7	-5.2	4.1
USD/EUR exchange rate	1.33	1.11	1.09	1.09
Euro nominal effective change rate (annual percentage change)[b)]	2.4	-7.1	0.1	0.0
3-month EURIBOR[c)]	0.21	-0.02	-0.19	-0.12
10-year French government bond yields[c)]	1.7	0.9	1.1	1.4
The international environment, annual percentage change				
Global CPI	2.5	2.0	2.5	2.7
Extra-euro area competitors' prices on the export side (in EUR)	-1.5	6.5	1.3	2.7
World real GDP	3.4	2.9	3.4	3.7
World (excluding euro area) real GDP	3.7	3.1	3.6	3.9
Global (excluding euro area) trade	3.2	0.5	2.9	3.8
Foreign demand for French goods and services[d)]	3.9	2.7	3.7	4.5
Intra-euro area	*4.5*	*5.3*	*4.9*	*5.5*
Extra-euro area	*3.4*	*0.3*	*2.7*	*3.7*

a) These technical assumptions and international environment projections were constructed by the ECB on 12 November for market data, and on 18 November for foreign demand for French goods and services, in accordance with the principles set out in *A guide to Eurosystem staff macroeconomic projection exercises*, ECB, June 2001, available at: *https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguideen.pdf*

b) Calculated against 38 trading partners of the euro area.

c) The forecasts for French 10-year government bond yields and Euribor were calculated using the yield curve.

d) Foreign demand corresponds to the weighted average imports of France's trading partners. The method of calculation is described in "Trade consistency exercise in the context of the Eurosystem projection exercises: An overview", *Occasional Paper Series* No 108, ECB, March 2010, available at: *https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp108.pdf*

Source: Eurosystem.

The international environment is less favourable than anticipated in the first half of the year. Global trade slowed sharply at the start of 2015, leading to a smaller-than-expected rebound in foreign demand for French goods and services (2.7% growth compared with the June projection of 3.5%). Demand from France's main trading partners should accelerate in 2016 and 2017, reaching an average annual rate of growth of 4.5% in 2017. This is nonetheless lower than the rate predicted in June (5.5% for 2017).

The decomposition of demand for French exports is expected to shift slightly relative to previous years. Demand from euro area countries should be more robust than that from non-euro area trading partners. Growth in intra-euro area demand should average 5.3% in 2015 – the fastest pace seen since 2005, with the exception of the temporary rebound in 2010. It should then remain dynamic over the projection horizon, accelerating to 5.5% in 2017. In contrast, despite recovering in 2016 and 2017, growth in extra-euro area demand should remain stuck below pre-crisis levels due to a weakening of the outlook in emerging markets and other commodity exporters.

1 As around half of France's foreign trade is with euro area countries, the change in France's nominal effective exchange rate against non-euro area countries is expected to be half the figure shown here.

Box 1

HOW WILL THE SLOWDOWN IN GLOBAL TRADE AFFECT THE FRENCH ECONOMY?

After a tentative recovery in 2014, global trade slowed abruptly and unexpectedly in the first half of 2015. Demand for French goods and services is now expected to increase by just 2.7% in 2015, compared with June's projection for 3.5% growth. This downward revision nonetheless masks diverging trends in the global economy, with the deterioration in demand from non-euro area countries more than offsetting the pick-up in demand within the single currency bloc.

This decline in extra-euro area imports stems from the ongoing slowdown in emerging Asian and Latin American countries, weakness in demand from commodity producing countries, and more temporary factors such as the sharp drop in UK imports in the first half of 2015.

Table 2: Assumptions regarding world demand for French goods and services

(annual percentage change; revision in percentage points)		2015	2016	2017
Total demand		2.7	3.7	4.5
	Revision	*-0.9*	*-1.5*	*-1.0*
Intra-euro area		5.3	4.9	5.5
	Revision	*0.6*	*-1.0*	*-0.6*
Extra-euro area		0.3	2.7	3.7
	Revision	*-2.1*	*-1.9*	*-1.3*

The contrasting trends in global growth are likely to persist into 2016 and 2017. The slowdown in China should be confirmed and will continue to weigh on commodity exporters and Asian economies. After bottoming out in 2015, growth in extra-euro area demand should accelerate slightly but will be noticeably weaker than expected in the June baseline scenario. By contrast, intra-euro area trade will remain dynamic. Overall, world demand for French exports will still recover, but at a slower pace than predicted in June (see Table 2).

The downward revision to world demand for French goods and services is one of the main factors behind the change to our growth forecasts versus June, as it will have a negative impact on exports over the projection horizon: according to the Mascotte projection model, GDP growth will be 0.2 percentage point (pp) lower in 2015, 0.4 pp lower in 2016, and 0.3 pp lower in 2017.

Over the three-year projection horizon, the fall in global demand is expected to rapidly cut French exports by 3.3%. This should be partially mitigated by a decline in imports (-3.1% over three years), resulting in a 0.3 pp drop in the contribution of foreign trade to growth over three years. However, the impact on output will be amplified by the reaction of business investment (-2.1%). Moreover, the decline in private sector employment should translate into a 0.1 pp rise in the rate of unemployment which will in turn weigh on private consumption (-0.5%). Over the projection horizon, GDP is expected to be 0.9% lower than predicted in June, while the impact on prices should be more modest (-0.1% over three years).

Nonetheless, this assessment is at the upper end of the projection range for the impact on French GDP of recent downward revisions to global demand. In fact, French (and European) exports proved robust in the first half of 2015, despite the levelling off of demand. With the exception of the correction seen in the third quarter of 2015, France's export market shares have been expanding since the third quarter of 2014, indicating that – so far – the impact on French exports from slowing world demand has been weaker than in the above simulation.

In addition, the assessment only looks at the impact of the decline in world demand for French goods and services, while leaving all other technical assumptions unchanged. As a result it does not take account of the indirect impact of the emerging market slowdown on commodity prices, which will soften the negative effect of lower global demand (for example, the decline of more than EUR 10 in the price of a barrel of Brent crude oil would add 0.2 pp to GDP growth over three years; see Table 2 in the annex).

2 | Economic outlook: the recovery in activity should be slower than predicted in June

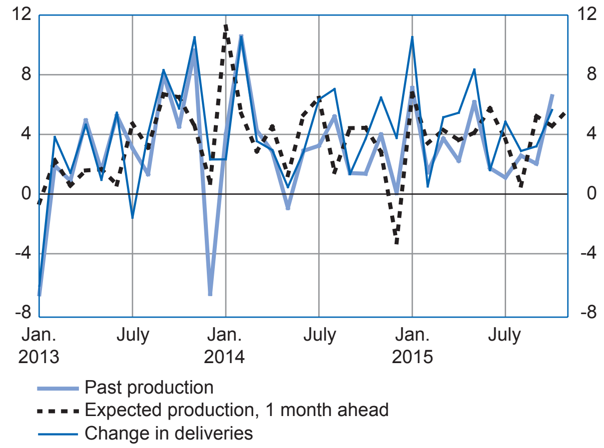
The current economic environment

According to the Banque de France's October Monthly Business Survey for industry, services and construction (published on 9 November), the monthly index of business activity (MIBA) points to a rise of 0.4% in GDP in the fourth quarter of 2015.

Activity accelerated in the third quarter of 2015, with GDP expanding by 0.3% relative to the previous three month period. Private consumption picked up (growth of 0.3%) after levelling off in the second quarter due to a slight decline in purchasing power. Business investment also improved slightly, while household investment posted a more modest fall. Domestic demand (excluding changes in inventories) contributed 0.3 percentage point (pp) to GDP growth, while the significant positive impact of changes in inventories was offset by the negative contribution from foreign trade.

Chart 1: Banque de France manufacturing survey

(balance of opinions)



The Banque de France's manufacturing industry survey points to a slight improvement in economic conditions in October. The indicators for deliveries and for past production both increased, while the indicator for forecast production rose above its long-term average (Chart 1). These first signals for the fourth quarter are consistent with quarter-on-quarter growth of 0.4% in GDP. Exports are expected to rebound, while inventories should make a negative contribution.

With regard to prices, headline HICP inflation stood at 0.2% year-on-year in October, while super core inflation (excluding food and energy) was 0.8%.

Inflation is still being subdued by falling oil prices, which drove the energy component of the HICP index down by 5.9% year-on-year in October. Inflation should nonetheless increase at the end of 2015, reflecting higher prices for imported goods. Prices of imported consumer goods, which have a delayed impact on retail prices, have already begun to rise, climbing 0.8% year-on-year in the third quarter of 2015 after a contraction of 1.9% a year earlier.

France's foreign trade should be buoyed by the euro area recovery

After weighing heavily on growth in 2014, foreign trade should make only a slightly negative contribution to economic activity in 2015.

After stabilising between 2008 and 2014, France's export market shares (measured as the ratio of exports to foreign demand for French goods and services) expanded sharply in the second half of 2014 and first half of 2015.

France's export performance has been boosted by government measures to enhance competitiveness (CICE and PRS) and, in the case of exports to non-euro area countries, by the depreciation of the euro. Despite the slowdown in growth in non-euro area countries in the first half of 2015, exports are expected to rise by 5.8% over the full year 2015.

The positive effects of the euro's past depreciation are expected to dissipate in 2016 and 2017, leading to slower growth in France's export market shares. Although remaining dynamic, exports should grow at a slower pace than in 2015, rising by 4.8% in 2016 and 5.0% in 2017.

In parallel, French import growth is projected to accelerate markedly in 2015, reaching 5.7%. Imports proved dynamic in the second half of 2014 and first and third quarters of 2015. France's import penetration rate (measured as the weighted average percentage of demand met by imports) has been rising since the second half of 2014, and the projection for imports in 2016 and 2017 assumes that this trend will continue. Imports are therefore projected to remain strong, rising by 4.4% in 2016 and 4.8% in 2017.

Overall, the contribution of foreign trade to GDP growth will be slightly negative in 2015, slightly positive in 2016, then negligible in 2017.

France's trade deficit (as measured under the national accounting system) is expected to narrow to 1.0% of GDP in 2015 and 2016, from 1.9% in 2014, reflecting a lower energy bill and robust exports.

Supported by a modest fall in the saving ratio, private consumption should continue to support economic growth

After rising by 0.6% in 2014, private consumption rose sharply at the start of 2015 (growth carry-over of 1.4% at the end of the third quarter), helped by gains in purchasing power. For the full year 2015, private consumption is expected to increase by 1.6%, which is in line with the pace of growth in purchasing power.

Nominal disposable income is expected to grow at a slightly faster pace in 2016 and 2017, reflecting the increase in economic activity. In real terms, however, this will be offset by stronger inflation. Growth in household purchasing power should therefore slow to 1.2% in 2016, before picking up slightly in 2017 to 1.4%.

Private consumption should grow at a similar pace to 2015 thanks to a slight decline in the saving ratio. Households are expected to smooth the recent positive impact of lower oil prices, setting aside some of the income windfall in 2015, then drawing down these savings in 2016 and 2017 to maintain the pace of growth in consumption. As a result the saving ratio should fall from 15.2% in 2015 to 14.9% in 2017.

Table 3: Change in private consumption and real household disposable income

(average annual percentage change)	2014	2015	2016	2017
Real household consumption	0.6	1.6	1.5	1.5
Household saving ratio	15.1	15.2	15.0	14.9
Real disposable income	1.1	1.7	1.2	1.4
Nominal disposable income	1.1	1.7	2.1	2.6
Contributions to growth in nominal disposable income				
Gross operating surplus	*0.1*	*0.3*	*0.4*	*0.5*
Gross wages	*1.0*	*1.1*	*1.2*	*1.6*
Net property income	*-0.2*	*0.1*	*0.5*	*0.4*
Current transfers	*0.0*	*0.1*	*0.0*	*0.0*
Social security benefits	*0.8*	*0.6*	*0.5*	*0.8*
Current taxes	*-0.2*	*-0.3*	*-0.2*	*-0.4*
Social contributions	*-0.3*	*-0.2*	*-0.3*	*-0.3*

Household investment should remain persistently low due to demographic factors

Household investment fell for the third consecutive year in 2014 (-5.3% after -1.5% in 2013 and -2.1% in 2012). It continued to decline in the first three quarters of 2015, and is projected to fall by 3.1% over the full year. Between the third quarter of 2013 and the third quarter of 2015, weaker investment in residential construction – both by households and public authorities – shaved 0.4 pp off average annual GDP growth.

In the short term, economic indicators show no sign of an improvement in residential construction investment. Although building authorisations have stabilised in recent months (growth of 0.5% in the third quarter of 2015, after a fall of 0.4% in the second quarter), the ratio of available housing stock (which reflects supply from developers) to new home sales (which reflects household demand) remains well above its long-term average.

Household investment expenditure is expected to continue declining in 2016 and should then stabilise in 2017. Various structural factors appear to be preventing a rebound in residential construction investment. In particular, demographic factors are weighing on potential demand for housing, as the 30-59 age bracket – traditionally the biggest category of home purchasers – is currently shrinking.

Business investment will be stimulated by the recovery in activity and improvement in corporate margins, and should thus make a significant contribution to the pick-up in growth in 2016 and 2017

Business investment has been fairly resilient since 2008. In particular, the investment rate for non-financial corporations (NFCs) – measured as the ratio of gross fixed capital formation (GFCF) to value added (VA) – has remained above its pre-crisis average (23% in 2014, compared with an average of 21% between 1995 and 2007).

After slowing in 2015 (1.9% growth), business investment is expected to accelerate over the remainder of the projection horizon, rising by 3.4% in 2016 and 3.3% in 2017.

Business investment will also be stimulated by the recovery in activity and, temporarily, by the "extra depreciation" measure (EUR 2.5 billion) introduced in April 2015. According to economic surveys, the effects of this mechanism will mainly be felt at the end of 2015 and start of 2016.

French companies are also expected to benefit from continuing favourable financing conditions, with real rates both on bank lending and market financing remaining at historical lows.

Lastly, the profit share of NFCs (defined as gross operating profit divided by gross value added) is expected to improve markedly over the projection horizon, reaching an average of 32.3% in 2017. NFC finances deteriorated sharply between 2008 and 2014, resulting in a 4 pp drop in the average profit share to 29.5% (compared with 32%-33% between 1996 and 2008). Since the third quarter of 2014, however, corporate profitability has been improving thanks to government measures to reduce labour costs (the CICE and PRS). This trend should continue up to 2017, helped by the last phase of the PRS and a moderation in wage growth. The average net profit share (the ratio of net profit before dividend payments to gross value added) is forecast to rise from 24.0% in 2014 (which is close to the average for the period 2000-2014 due to the favourable impact of lower interest rates on corporate profits) to 26.8% in 2017.

Chart 2: Corporate self-financing ratio

(quarter-on-quarter percentage change)

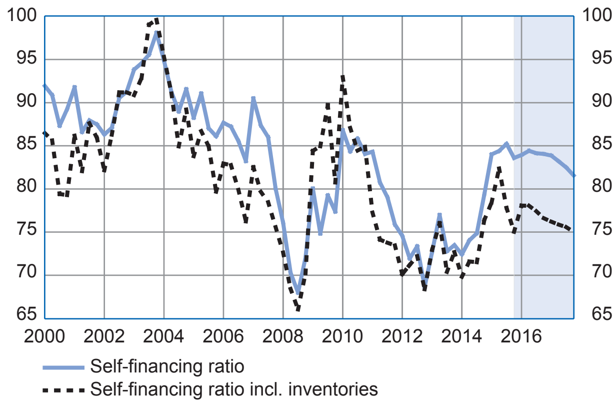


Table 4: NFC corporate ratios

(in %)	2014	2015	2016	2017
Profit share	29.5	31.1	31.8	32.3
Investment ratio	23.1	23.0	23.3	23.7
Self-financing ratio	75.2	84.3	84.1	82.8
Net profit share (before dividends)	24.0	26.0	26.6	26.8

Against this backdrop – and despite the increase in investment expenditure – the NFC self-financing ratio is expected to move back up towards its 2010 level. This is well above the trough seen between 2012 and 2014, but still fairly low relative to long-term trends.

The unemployment rate should fall slightly

As in 2014, private sector employment should see only modest growth in 2015 (average annual rise of 0.2%). The situation should improve in subsequent years, with employment rising by a more noticeable 1.0% in 2016 and 0.9% in 2017. The gains in labour productivity associated with the closing of the productivity cycle, and which usually accompany an economic recovery, will reduce the pass-through of rising activity to private sector employment. This should be offset to an extent by the CICE and PRS, which are expected to continue supporting job creations over the projection horizon.

In the non-market sector, annual jobs growth will be strongly linked to the government's subsidised jobs programme. In 2014, 340,000 subsidised positions were created in the non-market sector, while in 2015 a further 65,000 posts should be opened up, along with 270,000 insertion contracts (CUI-CAE). This should lead to a slight increase in the stock of subsidised job vacancies over 2015. However, from 2016 onwards, the figure should stabilise.

Excluding the effect of the subsidised jobs programme, non-market sector employment will be impacted by ongoing public sector job cuts. After rising by 1.4% in 2014, public sector employment is expected to grow by a weaker 1.1% 2015, before stabilising in 2016 (0.1%) and then contracting marginally in 2017 (-0.1%).

Overall employment should therefore be fairly dynamic: after rising by 0.4% in 2014 and 2015, it should grow by 0.8% in 2016, helped by private sector job creations, before slowing slightly to 0.7% in 2017 as productivity increases. Assuming growth of 0.3% in the labour force in 2015 and 0.4% in 2016 and 2017, the unemployment rate should thus fall slightly over the projection horizon. **The average ILO unemployment rate should remain broadly stable at 10.2% in 2015 (after 10.3% in 2014), before inching down to 9.7% in 2017.**

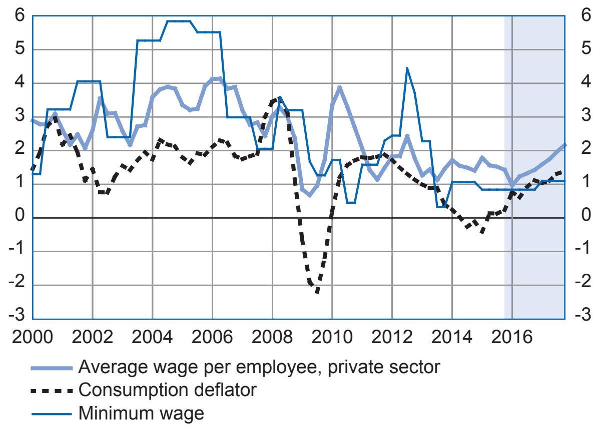
Nominal wage growth has been slowing in France since 2011 under the combined impact of high unemployment and low inflation. The average wage per employee (gross wages including bonuses and overtime pay) and the basic monthly wage (excluding bonuses and overtime pay) have both followed similar trends: growth in the basic monthly wage slowed from 2.0% year-on-year at the start of 2011 to 1.2% in the third quarter of 2015, while growth in the average wage per employee fell from 2.0% to 1.3% over the same period (Chart 3). The first quarter of 2015 saw robust growth in per capita wages, driven by sectors such as legal services, engineering and transport equipment. However, there was no confirmation of the trend in the second quarter, indicating that wage growth is likely to remain subdued up to the first quarter of 2016. Thereafter, the baseline scenario assumes a gradual rise in nominal per capita wages.

In the market sector, the average wage per employee is expected to increase by 1.5% in 2015. As a result, real wage growth will accelerate markedly over the year, but this will be offset by higher inflation in 2016 and the fact that the minimum wage is indexed to past price rises. Nominal wages will rise by just 1.2% in 2016, accelerating slightly to 1.8% in 2017 as inflation increases.

Labour costs are expected to increase at a slower pace than wages, as the EUR 10 billion of cuts to employers' social contributions under the PRS help to contain growth in total compensation (i.e. including employer payroll charges) in 2015, 2016 and to a certain extent 2017. Compensation per employee (gross wages and salaries and employers' social contributions, divided by total employment) is thus projected to rise by 1.1% in 2015, 0.8% in 2016, and 1.8% in 2017.

Chart 3: Private sector wages and consumption deflator

(year-on-year percentage change)



Box 2

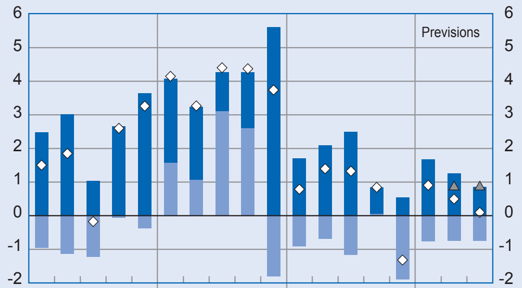
EVOLUTION OF UNIT LABOUR COSTS IN FRANCE AND THE EURO AREA SINCE THE LAUNCH OF MONETARY UNION

Between 1999 and 2007, unit labour costs (measured as the ratio of total compensation, including employers' social contributions, to GDP) increased at a slightly faster pace in France than in the broader euro area (average annual growth of 1.8% compared with 1.5% for the single currency bloc). Compensation per employee grew at a robust pace in France (3.0% compared with 2.5% for the euro area), while gains in labour productivity were in line with the average for the region (1.1% compared with 1.0%). With regard to the other major euro area countries, both Spain and Italy saw sharp increases in unit labour costs (3.3% and 2.6% respectively), as growth in compensation per employee outstripped gains in productivity. Germany, meanwhile, was the only one of the four major countries to see negative average annual growth in unit labour costs (-0.2%), reflecting moderate wage growth and productivity gains that were close to the euro area average.

In the first phase of the crisis, from 2007 to 2009, the divergences in unit labour costs between countries narrowed considerably. The drop in economic activity prompted sharp declines in apparent labour productivity (i.e. GDP divided by the total number of employees) and, to a lesser extent, in productivity per hour, especially in countries which took steps to safeguard employment. Only Spain saw a rise in labour productivity over the two-year period, due to the sharp drop in employment. In France, unit labour costs grew at a slower pace than in the rest of the euro area as wage growth was weaker over the period, while output proved more resilient, leading to smaller falls in productivity.

Chart 4: Unit labour costs
(national accounts data)

(average annual percentage change)



	EA	FR	DE	IT	ES	EA	FR	DE	IT	ES	EA	FR	DE	IT	ES	EA	FR	FR
	1999-2007					2007-2009					2009-2014					2014-2017		
Compensation	2.5	3.0	1.0	2.7	3.7	2.5	2.2	1.2	1.7	5.6	1.7	2.1	2.5	0.8	0.6	1.7	1.3	0.9*
Productivity	-1.0	-1.1	-1.2	-0.1	-0.4	1.6	1.1	3.1	2.6	-1.8	-0.9	-0.7	-1.2	0.1	-1.9	-0.8	-0.8	-0.8
Unit labour costs	1.5	1.8	-0.2	2.6	3.3	4.1	3.3	4.4	4.4	3.7	0.8	1.4	1.3	0.8	-1.3	0.9	0.5	0.1*
Excl. government measures a)																	0.9	0.9

* Unit labour costs and compensation are corrected for the impact of the CICE. In the national accounts, the CICE corresponds to a subsidy paid to the employer which increases the firm's gross operating surplus but does not affect employee compensation. Unit labour costs are corrected for the impact of the CICE using an accounting approach.

(a) excluding the PRS (reduction in employers' social contributions) and the CICE.

Sources: Eurosystem, Banque de France projections.

The second phase of the crisis, from 2009 to 2014, saw something of a rebalancing in labour costs, notably between Spain and Germany. In Spain, they fell by an annual average of 1.3% as a result of strong productivity gains and wage moderation. In Germany, meanwhile, growth in labour costs outstripped the euro area average (1.3%), driven by a sharper increase in wages. The adjustment was less marked in Italy, where unit labour costs rose by 0.8%, in line with the euro area average, due to stagnating productivity, and despite weak growth in wages. France, however, managed to avoid the rebalancing trend entirely. Growth in compensation per employee exceeded the euro area average (2.1% compared with 1.7%), continuing the trend seen before the crisis, while productivity gains were smaller (0.7% compared with 0.9%). As a result, unit labour costs grew faster than the average for the euro area, and at an almost identical pace to that seen in Germany.

This readjustment in relative unit labour costs in the euro area should continue over the projection horizon, and this time is expected to extend to France. French unit labour costs should increase at an annual average rate of 0.5%, which is slightly lower than previously and below the euro area average (1.0%). Per capita wages should rise at a below-average rate for the euro area (1.3% compared with 1.7%), while gains in productivity should be comparable (0.8%). This trend will be helped by the PRS (Responsibility and Solidarity Pact), which should shave around 0.4 percentage point per year off unit labour cost growth. Corrected for the impact of the CICE (Tax Credit for Competitiveness and Employment), growth in unit labour costs should be even lower (annual average of 0.1%) over the projection horizon.

3| After averaging just 0.1% in 2015, inflation should increase to 1.0% in 2016 then to 1.5% in 2017

Headline HICP inflation remained very weak in the third quarter of 2015 (0.1% year-on-year), but is expected to rise gradually to 1.6% at the end of 2017, driven by higher oil and imported goods prices and by the recovery in economic growth.

Headline 12-month HICP inflation is projected to average 0.1% in 2015, 1.0% in 2016 and 1.5% in 2017, after 0.6% in 2014 (see Key Projections table). Core inflation (excluding food and energy) should be 0.6% in 2015, 1.1% in 2016 and 1.3% in 2017, after 1.0% in 2014. French HICP inflation should be in line with the figures for the euro area (0.1% in 2015, 1.0% in 2016 and 1.6% in 2017).

Trends in energy and manufactured goods prices should continue to weigh on inflation in 2015.

The steep falls in oil prices since mid-2014 should result in an annual average contraction of 4.4% in the energy component of the HICP index in 2015, after a decline of 0.8% in 2014. Energy accounts for close to 10% of the overall index. In addition, the weak growth in non-energy imported goods prices since 2014 has continued to drag on manufactured goods prices in 2015 (-0.4% year-on-year in the third quarter of 2015, after -0.3% the previous year). However, this effect should fade gradually as imported goods prices rise. Consumer goods prices are projected to climb 0.7% year-on-year in the third quarter of 2016.

In 2016, the HICP energy component is expected to fall at a more modest rate (-0.3% year-on-year) as the impact of past oil price falls begins to drop out of the annual comparison. In 2017, it should increase by 3.3%.

In the medium term, the rebound in non-energy import prices, coupled with the rise in the value added deflator as a result of the recovery, should bring manufactured goods inflation back into positive territory. In services, price inflation will remain historically moderate due to subdued growth in unit labour costs.

With growth in unit labour costs remaining modest, the 1.2% annual rise in the value added deflator (above the average of 0.4% for the period 2009-2014) should help to drive the increase in profit margins described previously. Margin growth should level off towards the end of the projection horizon as wages begin to move upwards again.

Chart 5: HICP and HICP excluding energy and food

(quarterly averages, year-on-year percentage change)

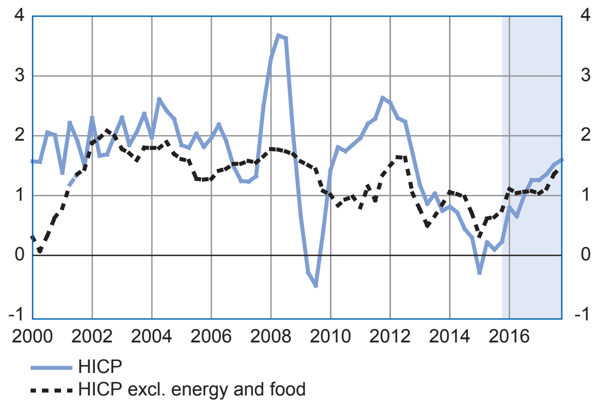
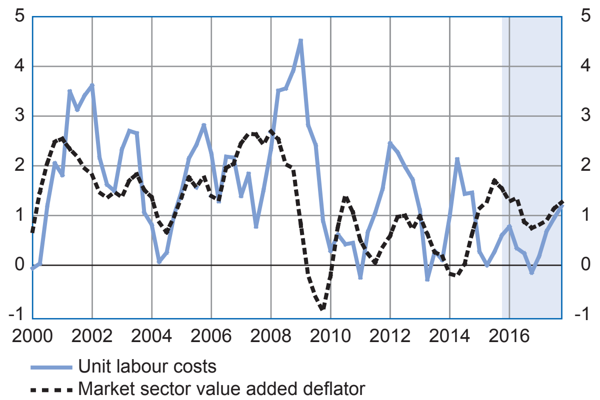


Chart 6: Unit labour costs and value added deflator

(year-on-year percentage change)



4| Public finances: fiscal consolidation needs to be maintained in order to meet the 3% public deficit target in 2017

The gradual improvement in public finances should continue in 2015, bringing the nominal deficit down to a projected 3.8% of GDP from 3.9% in 2014.

The year 2015 was marked by a number of cuts to taxation, notably the escalating impact of the CICE and the start of the measures introduced under the PRS (cuts to employers' social contributions). The ratio of receipts from taxes and social contributions to GDP has fallen for the first time since the onset of the 2008 crisis (-0.6 pp). At the same time, public spending should also fall as a share of GDP (-0.9 pp) and growth in public spending should remain modest: excluding tax credits, nominal outlays are projected to rise by 0.9% in 2015, in line with 2014, compared with average annual growth of 2.4% from 2011 to 2013. Limiting nominal spending growth has been made easier by near-zero inflation (annual average CPI inflation excluding tobacco has been negligible in 2015) and by the decline in France's debt service costs. However, in real terms (i.e. adjusted for CPI inflation excluding tobacco), primary spending (excluding tax credits) is expected to rise by 1.1% in 2015 after growth of 0.7% in 2014 and average growth of 0.9% between 2011 and 2013.

2016 should see a more sizeable reduction in the public deficit, to 3.4% of GDP. As a share of GDP, tax and social security receipts are expected to fall by 0.1 pp versus 2015, while public spending should fall by 0.5 pp (excluding tax credits).

The projection for the public deficit is close to the government's forecast for 3.3% of GDP in 2016, although based on slightly different assumptions. In particular, primary spending is projected to be slightly higher than in the government's forecast, as the impact of the savings measures announced in the draft budget remains unclear and has not yet been taken into account (notably the measures that still need to be negotiated with UNEDIC).[2] This is in part offset by lower debt service costs in the Banque de France projection.

Provided it continues its efforts to rein in public spending, France should be able to meet its European nominal deficit target of 3.0% in 2017, enabling it to exit the excessive deficit procedure.

5 Uncertainties: there remain downside risks to the baseline growth and inflation scenario

The baseline scenario of a confirmation of the recovery in 2016 and an acceleration of growth in 2017 is subject to a high degree of uncertainty. Charts 7 and 8 show the potential ranges around the central projections, based on an analysis of historical projection errors.

There are various specific downside risks to growth. On an international level, less dynamic global trade, in particular weaker demand from emerging economies, would hamper economic activity in France. On a domestic level, the forecast revival of business investment could be dampened if businesses chose to use the gains from cuts to labour costs to raise wages or deleverage. Private consumption would also be weaker than expected if the forecast decline in the saving ratio failed to materialise in 2016 and 2017 (previous projections tended to overestimate the fall in the saving ratio). With regard to the November 2015 terrorist attacks, while the impact is likely to be transitory and therefore limited, there is a risk of a temporary decline in confidence among economic agents which could affect investment and consumption decisions.

Finally, the forecasts presented here for 2017 do not include the impact of additional fiscal consolidation measures, which will need to be set out in detail and voted into law in subsequent budgets for France to meet its 3.0% European deficit target.

These threats are nonetheless partly mitigated by upside risks. The Eurosystem's extended asset purchase programme could provide a larger-than-anticipated boost to GDP growth and inflation between now and 2016, as our models are calibrated using historical data and could therefore understate the favourable effects of the new measures. On a domestic level, household investment might be less sluggish than expected, while stronger wage growth would support private consumption (albeit at the expense of competitiveness). Foreign trade would also make a stronger positive contribution to growth if the import penetration rate were to stabilise. The baseline scenario assumes a rise in the penetration rate, in line with previous trends. However, if it were to stabilise in 2016 and 2017 due to the advanced stage in the current process of globalisation of production, imports would be less dynamic than projected.

2 The creation of 8,500 additional jobs in the police force, legal services and customs, and the halt to job cuts in the armed forces announced by the President of the Republic on 16 November 2015, should, at this stage, add less than 0.1 pp to the deficit. The additional public sector job creations already announced are included in our projections.

In the case of inflation, the risks also appear skewed to the downside at this stage. The rebuilding of French corporate profit margins and firming of the recovery in the broader euro area could spur higher inflation. However, this appears to be outweighed by the downward factors, namely persistently high unemployment and the downward revision to global growth, with the further falls in oil and commodity prices that this could imply.

Chart 7: Projection range for GDP growth

(year-on-year percentage change)

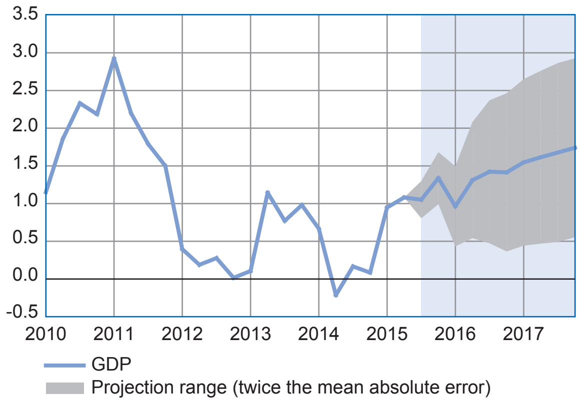
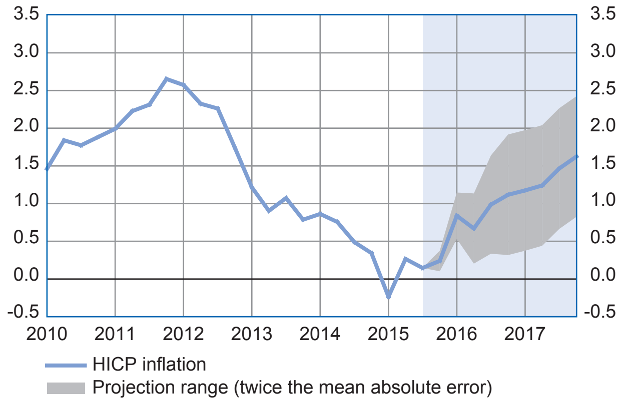


Chart 8: Projection range for annual HICP inflation

(year-on-year percentage change)



Annex: Revisions to projections since June 2015

Table A1: Revisions to projections since the June BMPE

	2012	2013	2014	December 2015 BMPE 2015	December 2015 BMPE 2016	December 2015 BMPE 2017	Revisions since June 2015 BMPE 2015	Revisions since June 2015 BMPE 2016	Revisions since June 2015 BMPE 2017
HICP	**2.2**	**1.0**	**0.6**	**0.1**	**1.0**	**1.5**	**-0.2**	**-0.5**	**-0.2**
HICP excluding energy and food	**1.5**	**0.7**	**1.0**	**0.6**	**1.1**	**1.3**	**0.1**	**-0.1**	**-0.3**
GDP deflator	1.2	0.8	0.6	1.3	1.1	1.2	0.2	0.1	-0.1
Real GDP	**0.2**	**0.7**	**0.2**	**1.2**	**1.4**	**1.6**	**0.0**	**-0.4**	**-0.3**
Contributions to GDP growth (in percentage points):*									
Domestic demand (excluding changes in inventories)	*0.3*	*0.6*	*0.5*	*1.3*	*1.4*	*1.5*	*0.1*	*-0.2*	*-0.3*
Net exports	*0.5*	*0.0*	*-0.5*	*-0.1*	*0.1*	*0.0*	*0.3*	*-0.1*	*0.0*
Changes in inventories	*-0.6*	*0.2*	*0.2*	*0.0*	*-0.1*	*0.0*	*-0.4*	*-0.2*	*0.0*
Private consumption	-0.2	0.5	0.6	1.6	1.5	1.5	-0.1	0.0	-0.1
Government consumption	1.6	1.7	1.5	1.7	1.1	1.0	0.3	0.2	0.1
Total investment	0.3	-0.4	-1.2	-0.1	1.5	2.3	0.6	-1.0	-1.2
Government investment	*1.8*	*0.2*	*-6.9*	*-2.8*	*-1.3*	*1.4*	*-0.8*	*-0.9*	*1.4*
Household investment	*-2.1*	*-1.5*	*-5.3*	*-3.1*	*-1.7*	*-0.1*	*1.1*	*-1.3*	*-4.3*
Business investment (NFCs-FCs-IEs)	*0.8*	*-0.2*	*2.2*	*1.9*	*3.4*	*3.3*	*0.8*	*-0.9*	*-0.9*
Exports	2.6	1.8	2.4	5.8	4.8	5.0	0.4	-1.0	-0.7
Imports	0.8	1.8	3.9	5.7	4.4	4.8	-0.6	-0.6	-0.6
Real household disposable income (RHDI)	-0.9	-0.1	1.1	1.7	1.2	1.4	0.1	-0.1	-0.2
Household saving ratio (% of GDI)	15.1	14.7	15.1	15.2	15.0	14.9	0.1	0.1	0.0
Unemployment rate (ILO, France and overseas territories, % of labour force)	9.8	10.3	10.3	10.2	10.0	9.7	-0.1	-0.1	0.1

Notes: Annual percentage change except where otherwise indicated.

Revisions to June 2015 BMPE data are in percentage points.

*The sum of the contributions does not necessarily correspond to GDP growth as figures have been rounded.

Sources: Insee data for 2013 and 2014; the blue-shaded columns show Banque de France projections.

Table A2: Technical assumptions and the international environment [a)]

	2012	2013	2014	December 2015 BMPE 2015	2016	2017	Revisions since June 2015 BMPE 2015	2016	2017
Technical assumptions									
Brent oil in USD	112.0	108.8	98.9	53.8	52.2	57.5	-10.0	-18.8	-15.6
Brent oil in EUR	87.1	82.0	74.4	48.4	48.1	52.9	-8.7	-15.5	-12.5
Non-energy commodity prices in USD (annual percentage change)	-14.3	-6.1	-8.6	-18.7	-5.2	4.1	-5.1	-8.2	-0.8
USD/EUR exchange rate	1.28	1.33	1.33	1.11	1.09	1.09	-0.01	-0.03	-0.03
Euro nominal effective exchange rate (annual percentage change) [b)]	-4.6	4.6	2.4	-7.1	0.1	0.0	1.0	0.4	0.0
Three-month Euribor	0.57	0.22	0.21	-0.02	-0.19	-0.12	0.0	-0.2	-0.3
Ten-year government bond yields [c)]	2.5	2.2	1.7	0.9	1.1	1.4	0.0	-0.1	-0.1
International environment, annual percentage change									
Global CPI	2.8	2.9	2.5	2.0	2.5	2.7	0.5	-0.2	-0.3
Extra-euro area competitors' prices on the export side (in EUR)	7.1	-3.7	-1.5	6.5	1.3	2.7	-1.7	-0.8	0.3
World real GDP	3.3	3.2	3.4	2.9	3.4	3.7	-0.3	-0.5	-0.2
World (excluding euro area) GDP	4.0	3.7	3.7	3.1	3.6	3.9	-0.3	-0.5	-0.2
Global (excluding euro area) trade	4.4	2.9	3.2	0.5	2.9	3.8	-1.5	-1.9	-1.4
Foreign demand for French goods and services [d)]	1.2	2.2	3.9	2.7	3.7	4.5	-0.9	-1.5	-1.0
Intra-euro area	*-2.1*	*1.1*	*4.5*	*5.3*	*4.9*	*5.5*	*0.6*	*-1.0*	*-0.6*
Extra-euro area	*4.3*	*3.2*	*3.4*	*0.3*	*2.7*	*3.7*	*-2.1*	*-1.9*	*-1.3*

Notes: Revisions to June BMPE data are expressed as percentages for levels, and as percentage points for rates of growth.

a) These technical assumptions and international environment projections were constructed by the ECB on 12 November for market data, and on 18 November for foreign demand for French goods and services in accordance with the principles set out in *A guide to Eurosystem staff macroeconomic projection exercises*, ECB, June 2001, available at: *https://www.ecb.europa.eu/pub/pdf/other/staffprojectionsguideen.pdf*

b) Calculated against 38 trading partners of the euro area.

c) The forecasts for French 10-year government bond yields and Euribor were calculated using the yield curve.

d) Foreign demand corresponds to the weighted average imports of France's trading partners. The method of calculation is described in "Trade consistency exercise in the context of the Eurosystem projection exercises - An overview", *Occasional Paper Series* No 108, ECB, March 2010, available at: *https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp108.pdf*

Sources: Eurosystem, Banque de France macroeconomic projections.