

June 2017

According to the Banque de France's macroeconomic projections for France – constructed as part of the Eurosystem projection exercise on the basis of assumptions with a cut-off date of mid-May 2017 – the economic recovery should be confirmed over the projection horizon, with growth accelerating gradually from 1.1% in 2016 (annual average, working-day adjusted) to at least 1.4% in 2017, then to 1.6% in 2018 and 2019.

From 2017 onwards, the factors supporting French growth should become more balanced. The gains in purchasing power linked to cheaper oil are now behind us, resulting in a smaller contribution from domestic demand, and especially private consumption, than in 2015 and 2016. Conversely, growth should be supported by the upturn in global economic activity, and by the projected improvement in France's export market shares after the disappointing performance of 2016. Foreign trade is therefore expected to make a slightly less negative net contribution in 2017, after weighing by 0.7 percentage point in 2016, and should subsequently have a positive impact in 2018 and 2019.

After remaining weak in 2016 at an annual average of 0.3%, HICP inflation is projected to strengthen progressively to 1.2% in 2017 and 2018, and to 1.4% in 2019. Inflation excluding energy and food is projected to remain subdued at 0.6% in 2017, before rising again to 1.2% in 2018 and then 1.4% in 2019.

KEY PROJECTIONS FOR FRANCE

	2016 (30/05) wda	2016 (28/04) wda	2017	2018	2019
HICP	0.3	0.3	1.2	1.2	1.4
HICP excluding energy and food	0.6	0.6	0.6	1.2	1.4
GDP deflator	0.4	0.8	0.9	1.1	1.3
Real GDP	1.1	1.1	1.4	1.6	1.6
Contributions to GDP growth (in percentage points): ^{a)}					
<i>Domestic demand (excluding changes in inventories)</i>	2.0	1.9	1.6	1.5	1.5
<i>Net exports</i>	-0.8	-0.7	-0.5	0.1	0.1
<i>Changes in inventories</i>	-0.1	-0.1	0.3	-0.1	0.0
Private consumption	2.1	1.8	1.3	1.5	1.5
Government consumption	1.2	1.4	1.1	1.0	1.1
Total investment	2.7	2.7	2.6	2.1	2.0
<i>Government investment</i>	-0.2	-0.7	1.4	1.9	2.1
<i>Household investment</i>	2.4	2.1	3.2	1.2	0.4
<i>Business investment (NFCs- FCs-IEs)</i>	3.6	3.8	2.6	2.5	2.6
Exports	1.9	1.2	3.3	5.1	4.2
Imports	4.2	3.5	4.8	4.3	3.8
Real household disposable income (RHDI)	1.8	1.9	1.1	1.6	1.7
ILO unemployment rate (France and overseas territories, % of labour force)	10.1	10.1	9.7	9.6	9.3

Sources: Insee data for 2016 and the first quarter of 2017, published 28 April and 30 May 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.

Growth was lower than expected in 2016 but should gradually pick up pace

French GDP growth eased slightly to 1.1% in 2016 as the factors buoying domestic demand were partially offset by a strong negative foreign trade contribution. In annual average terms, GDP growth is now expected to increase gradually to at least 1.4% in 2017, then to 1.6% in 2018 and 2019, outstripping potential growth and leading to a narrowing of the output gap. The pace of expansion is nonetheless expected to remain below the average for the broader euro area. This projection is based on technical and international assumptions with a cut-off date of 16 May 2017.¹

The projection does not take into account any shifts in the economic policy stance or reforms introduced following the elections, or changes to economic agents' expectations, all of which could affect both the composition and level of activity and inflation. It should therefore be seen as reflecting the current underlying trend, as based on past economic policy choices and international environment forecasts, and before the impact of future economic policy decisions or the usual risks of external shocks.

As the benefits of cheaper oil prices unwind, domestic demand is expected to be more subdued

The strong 2016 gains in household purchasing power stemming from the drop in oil prices should dissipate over the projection horizon. The increase in energy price inflation should only gradually be offset by a recovery in wage income. Therefore, growth in private consumption is expected to ease slightly over the projection horizon, particularly in 2017.

¹ The revised quarterly national accounts published by Insee on 30 May have not been taken into account. The growth figure for the first quarter of 2017 was revised upwards, but without altering the overall economic outlook. Certain details and uncertainties could change, however.

Business investment should continue to be supported by the increase in economic activity and by low interest rates, despite continuing high debt ratios. However, investment growth is expected to soften relative to 2016, as the extra depreciation allowance, which provided a strong boost to investment last year, came to an end in April 2017. Despite this slowdown, the corporate investment rate should exceed 2008's peak in 2018, after already recovering markedly since 2013. The upward trend in the margin rate of non-financial corporations (NFCs) is expected to tail off temporarily in 2017, owing to higher oil prices and the stabilisation of the CICE-PRS measures. However, it should then pick up again over the remainder of the projection horizon, with margin rates rising slowly towards the average for 1996-2008.

Household investment should continue to benefit from temporary tailwinds in 2017, including zero-interest loans, the Pinel tax incentives for residential investment and low loan rates. In the medium term, however, demographic factors are expected to weigh on residential investment.

As of 2017, export growth should pick up again, driven by the global economic recovery

Exports grew by just 1.2% in 2016, resulting in a 1.1% decline in France's export market shares over the year. The weak performance was in part attributable to exceptional events (poor harvests, problems in Airbus's production chain, tourism), suggesting that market shares could rebound in 2017 and 2018 if these items revert to their more usual levels. France's trade performance is also expected to be lifted by a slightly more favourable international environment, with global demand now seen growing at a sharper pace than predicted in December. As a result, French exports could gather momentum over 2017, despite a disappointing start to the year. The contribution of foreign trade to growth should therefore be less negative in 2017 than over the last three years, and is expected to turn positive again in 2018 and 2019.

After remaining weak in recent years, annual average inflation should strengthen in 2017, driven primarily by the energy component, and then increase further in 2019, fuelled by the other index components

Inflation, as measured by the change in the harmonised index of consumer prices (HICP), should pick up over the projection horizon: after averaging 0.3% year-on-year in 2016, it is projected to rise to 1.2% in 2017, driven by growth in the energy component. The monthly pattern of inflation should prove more irregular, however, with marked fluctuations stemming essentially from energy and food prices. Inflation should then stabilise in 2018, but with the individual components making a more balanced contribution: inflation excluding energy and food is expected to hold steady at 0.6% in 2017 before rising as of 2018 on the back of falling unemployment and rising non-energy import prices. This trend should continue in 2019, supported in particular by a gradual acceleration in nominal wage growth. Both headline inflation and non-energy, non-food inflation should therefore converge in 2019, averaging 1.4% for the year.

The improvement in public finances needs to be kept up

On the basis of the information available at this stage, there is a risk the public deficit will remain just above the 3.0% ceiling in 2017, at 3.1% of GDP, after narrowing to 3.4% in 2016. The tax ratio (tax and social security receipts as a share of GDP) should inch up temporarily by 0.1 percentage point in 2017, owing to the postponement to 2018 of certain cuts to tax and social security charges, as well as the early collection of other taxes, notably corporate income tax. Meanwhile, the ratio of public spending (excluding tax credits) to GDP should fall by 0.3 percentage point over the year: growth in public spending was kept relatively contained in 2016, albeit to a lesser extent than in 2014 and 2015, and this moderation should continue in 2017 according to the initial Budget Law, helped principally by a decline in France's debt service cost. Nonetheless, the primary structural balance (i.e. excluding the cost of debt), calculated using European Commission methodology, is projected to remain unchanged. The gap between the Banque de France's 2017 deficit projection and the 2.8% figure in the Budget Law, as updated by the April Stability Programme, is attributable in more or less equal parts to the fact that our scenario factors in lower nominal GDP growth and stronger spending growth. On this basis, public debt should edge up again in 2017, reaching 96.8% of GDP (rise of 0.5 percentage point), and then continue to rise at a moderate pace over the remainder of the projection horizon. At this stage, the public deficit is expected to hover around 3% of GDP in 2018 and 2019, although with a slightly negative structural effort. These projections take into account the tax and social security measures already voted into law, but the impact of these measures is calculated on the basis of the Banque de France's own growth projections. They also factor in a similar pace of growth in public spending as in previous years, but one that differs significantly from the forecasts in the Stability Programme as there is insufficient detail on many of the measures for them to be incorporated into our scenario. It should be noted that the savings measures announced during the presidential campaign, which are essential to bring the deficit down to below 3.0%, have not yet been taken into account.

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I| Technical assumptions and the international environment: an improvement in foreign demand for French goods and services

The 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 mid-May 2017. Box 1 shows that the impact of the revisions to December's BMPE on growth and inflation forecasts is significant. That said, its intensity and diffusion lags vary, ranging, for example, from several months for the adjustment of energy inflation to oil price changes to over one year for the impact of exchange rate effects on economic activity and prices.

Since December 2016, exchange rate assumptions have remained almost unchanged. After falling sharply between 2014 and mid-2015, the nominal effective exchange rate started rising again up to the first quarter of 2016. Since then, it has been relatively stable.

After reaching a low of EUR 28 in January 2016, oil prices rebounded to close to EUR 50 in April 2017. While the recovery in Brent oil prices was faster than expected in December's BMPE, oil futures now suggest that prices will remain almost stable over the projection horizon. The price of a barrel of Brent should rise by an annual average of over EUR 7 in 2017, before stabilising in 2018 and 2019 at a lower level than expected in December when the slope of the futures curve was steeper.

Accommodative monetary policy should continue to keep nominal interest rates at low levels. Markets are pricing in a slight rise in the yield on 10-year government bonds.

The international environment is expected to be more favourable than predicted in December 2016. After slowing sharply in 2016 (to 2.1%), growth in demand for French exports should accelerate markedly in 2017, and then reach an annual average rate of close to 4.0% in 2018 and 2019. Demand from other euro area countries should be particularly strong. Meanwhile, demand from non-euro area countries, which was very weak in 2016, should pick up in 2017, but should continue to grow at a much slower pace than the average for 1995-2007 (7.4%).

Table 1: Technical assumptions and the international environment^{a)}

	2016	2017	2018	2019
Technical assumptions				
Brent oil price (USD/barrel)	44.0	51.6	51.4	51.5
Brent oil price (EUR/barrel)	39.8	47.6	47.0	47.1
Non-energy commodity prices in USD (annual percentage change)	-3.9	6.4	2.0	4.5
USD/EUR exchange rate	1.11	1.08	1.09	1.09
Euro nominal effective exchange rate (annual percentage change) ^{b)}	3.7	-0.4	0.3	0.0
3-month Euribor ^{c)}	-0.3	-0.3	-0.2	0.0
10-year French government bond yields ^{c)}	0.5	0.9	1.2	1.5
International environment, annual percentage change				
Extra-euro area competitors' prices on the export side (in EUR)	-4.9	5.4	2.4	2.6
World real GDP	3.0	3.3	3.6	3.5
World (excluding euro area) real GDP	3.2	3.5	3.8	3.8
Global (excluding euro area) trade	0.9	4.4	3.8	3.9
Foreign demand for French goods and services	2.1	4.5	3.9	3.8
<i>Intra-euro area</i>	3.9	5.4	4.5	4.2
<i>Extra-euro area</i>	0.6	3.7	3.3	3.5

Sources: Eurosystem. Blue-shaded columns show Banque de France projections.

a) These technical assumptions and international environment projections were constructed in by the ECB on 16 May in accordance with *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.

REVISIONS TO PROJECTIONS BETWEEN DECEMBER 2016 AND JUNE 2017

The Banque de France's GDP growth projection (wda) stands at 1.4% for 2017 and at 1.6% for 2018 and 2019. It has been revised upwards compared with the December 2016 publication¹ (by 0.1 percentage point or pp for 2017, 0.2 pp for 2018 and 0.1 pp for 2019).² This revision chiefly reflects more buoyant demand for French exports, even though this effect is partly mitigated when expressed as an annual average for 2017 by the carry-over from the disappointing export performances observed at the start of the year.

Compared with the December 2016 publication, the projection for HICP inflation remains unchanged at 1.2% for 2017, but has been reviewed downwards by 0.2 pp and 0.1 pp respectively for 2018 and 2019. The revisions to headline inflation notably reflect changes to our projections for oil prices, which have been revised upwards for 2017 then downwards for 2018 and 2019. Inflation excluding energy and food has been revised to a more limited extent: down by 0.1 pp for 2017, up by 0.1 pp for 2018 and only slightly for 2019.

* * *

For 2017, annual average growth in foreign demand for French exports has been revised upwards significantly (by 1.3 pp), with the changes mainly concentrated in Q4 2016 and Q1 2017. The usual multipliers suggest this will have a positive impact of 0.3 pp on economic growth for 2017. The actual revision to our projection is nevertheless smaller since the expected rebound in exports did not actually materialise in the period up to Q1 2017. Conversely, the carry-over for the contribution of net exports at the end of the first quarter was -0.7 pp, compared with an expected 0.0 pp in December's projection, and market shares were sharply down. Our projection assumes a strong rebound in market shares as of Q2 2017 but this is not expected to fully offset the negative surprise seen in the last two quarters. All in all, annual average growth in exports and the contribution of foreign trade to GDP have been revised sharply downwards (by 1.0 pp and 0.5 pp respectively). The ongoing negative contribution from foreign trade in 2017 will be offset to an extent by a better-than-expected contribution from inventories (revised up by 0.4 pp for 2017), in keeping with the strong variations observed in Q1 2017.

For 2017, the contribution of domestic demand to growth has been revised upwards by 0.2 pp since December. The projection for growth in private investment has been revised significantly upwards for both companies (by 0.8 pp) and households (by 1.3 pp). These revisions reflect a higher-than-expected rise up to Q1 2017, as well as stronger projections for growth in household investment in the coming quarters, based on recent developments in housing starts. Growth in private consumption has also been revised slightly upwards (by 0.1 pp) since the December projections. Since Q4 2016, the increase in energy inflation has indeed impacted household purchasing power, but households have smoothed their consumption by reducing their saving ratio. For the coming quarters, private consumption should gradually increase in line with real wages. The expectation for public demand, for its part, remains almost unchanged.

In 2018 and 2019, the increase in our GDP growth projection (0.2 pp for 2018 and 0.1 pp for 2019) can mainly be explained by the ongoing improvement in the international environment. Indeed, the upward revision to global demand for 2017 should continue to support economic activity in 2018. This effect should be amplified by the increase in export market shares after the low observed at the start of 2017. Export market shares should continue to increase slightly up to 2019 and the export growth projection has been raised by 1.2 pp for 2018 and by 0.3 pp for 2019. The improvement in the contribution of foreign trade for 2018 (by 0.2 pp) and 2019 (by 0.1 pp) is the main driver for more robust economic activity.

Growth in domestic demand for 2018 and 2019 has been revised upwards to a more moderate extent (by 0.1 pp for 2018 and by 0.0 pp for 2019), reflecting the upward revisions to household investment (0.8 pp for 2018 and 0.4 pp for 2019). Growth in private consumption, meanwhile, has been left unchanged for 2018 but has been revised downwards slightly for 2019 (by 0.1 pp), while the household saving ratio is now expected to return to a marginally higher level than in our December publication.

The unemployment rate as measured by the ILO has been revised downwards for the entire projection horizon: it should stand at 9.1% in Q4 2019, compared with a projected 9.4% in December. This revision to December's figure stems from the fact that Insee's downward revision to the labour force (140,000 fewer workers between 2017 and 2019) more than offsets the slightly less favourable outlook for employment.

For 2017, the projection for headline HICP inflation is unchanged versus December at 1.2%, although this masks two contrasting developments: on the one hand, the "energy" and "non-energy industrial goods" components have been revised upwards due to higher expectations for oil and non-energy import prices; on the other hand, the "services" component has been revised downwards owing to mixed trends in telecoms prices at the start of the year (see Box 2).

For 2018, HICP inflation has been revised down by 0.2 pp owing to the reduction in our oil price projection compared with December. However, HICP inflation excluding food and energy has been revised upwards by 0.1 pp, with non-energy industrial goods prices continuing to be underpinned by the pass-through of past import price rises throughout the production chain. HICP inflation for 2019 has been revised downwards very slightly compared with December, due in particular to the reduction in our 2019 projection for oil prices.

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 pp.

2| Economic outlook: the factors supporting growth should become more balanced

The current economic environment

In the manufacturing industry, all surveys indicate that the business climate was better than its long-term average at the start of the second quarter of 2017 (see Chart 1). Quantitative economic indicators also appear to be moving back in line with the business climate, after proving disappointing at the start of the year relative to the qualitative surveys.

In market services, surveys indicate that the business climate is also favourable. Meanwhile, in construction, indicators on housing starts as well as surveys on property development and public works, all seem to be holding up well, suggesting activity will continue to grow at a relatively sharp pace in the second quarter. Building permits have nonetheless stagnated since the end of 2016, signalling that the recovery in residential investment could run out of steam towards the end of this year or start of next year.

On this basis, GDP growth is expected to remain robust in the second quarter of 2017.

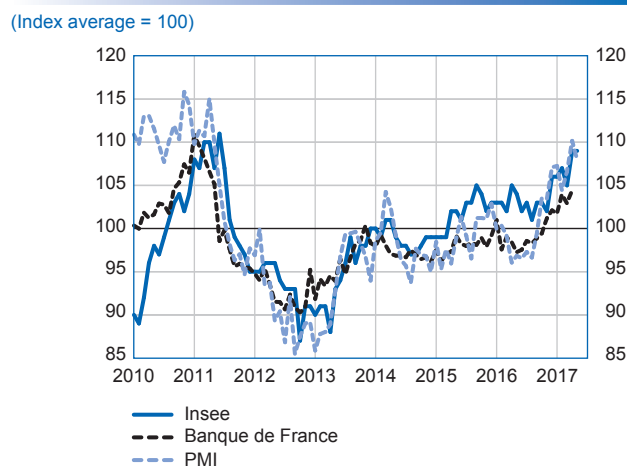
Due to the timing of the Eurosystem staff macroeconomic projection exercise, this projection is based on the quarterly national accounts published on 28 April 2017 (preliminary estimate for the first quarter of 2017) and not on those released on 30 May. In the second estimate, growth for the first quarter of 2017 was revised upwards from 0.3% to 0.4%, with inventory changes making a stronger positive contribution and business investment rising at a sharper pace. The growth carry-over for 2017 at the end of the first quarter was also revised upwards from 0.7 percentage point to 0.9 percentage point. This represents an upward risk to our growth projection for 2017.

Foreign trade should make up for weaker domestic demand

In 2015 and 2016, with the sharp drop in oil prices, French GDP growth was mainly driven by domestic demand (consumption and investment), while foreign trade, by contrast, made a strong negative contribution (see Chart 2). From 2017 onwards, domestic demand is now expected to slow slightly as the benefits of cheaper oil prices dissipate. Foreign trade, meanwhile, should gradually gain momentum, buoyed by accelerating foreign demand for French goods and services. **The net contribution of foreign trade to GDP is thus expected to be less negative in 2017 than in 2016, and should turn slightly positive in 2018 and 2019.**

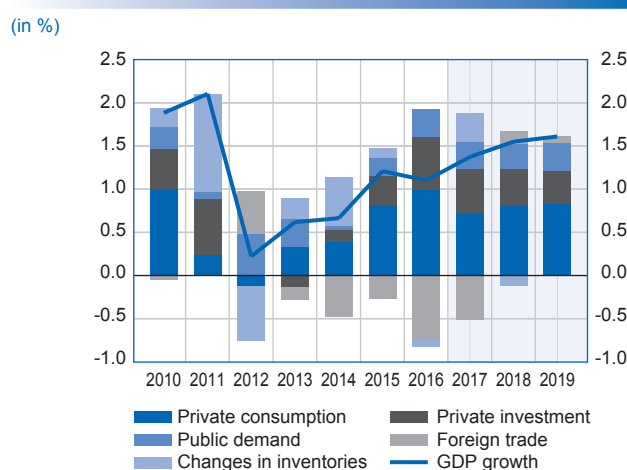
France's export performances proved mediocre in 2016 (annual average export growth of 1.2%), reflecting weak foreign demand for French goods and services, and a slump in export market shares. The drop in market shares was in part attributable to exceptional events such as poor harvests, problems in Airbus's production chain, and the negative impact of terrorist attacks on tourism. Consequently, once these factors return to more average levels following these temporary setbacks, **France should see a mechanical rebound in its export market shares**

Chart 1: Business climate in manufacturing (composite indicators)



Sources: Insee, Banque de France, Markit.

Chart 2: Contributions to GDP growth



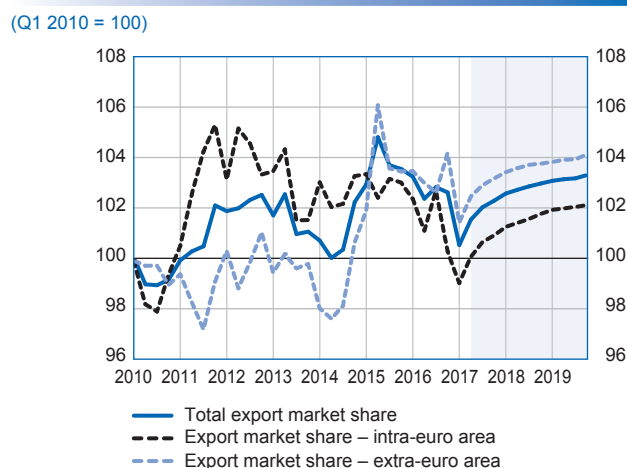
Sources: Insee, Banque de France calculations.

Note: Private investment groups together business and household investment. Public demand groups together government consumption and government investment.

in 2017 and 2018 (see Chart 3). Exports are thus projected to rise fairly sharply as of the second quarter of 2017, before slowing again gradually over the remainder of the projection horizon. They should also outpace foreign demand over the entire projection period, thanks to the competitiveness gains stemming from the CICE and PRS measures, and by the end of 2019, export market shares should have returned to near-average levels for the period 2015-2016.

Imports are set to remain robust between 2017 and 2019, despite more subdued growth in domestic demand. Indeed, the penetration rate (measured as the ratio of imports to an import intensity-adjusted measure of aggregate demand) should continue to rise over the projection horizon, moving back towards its historical trend.

Chart 3: Export market shares



Sources: Insee and Eurosystem data up to Q1 2017, Banque de France and Eurosystem projections.

After peaking between 2015 and 2016, growth in private consumption should be more moderate in 2017

Private consumption has been particularly strong over the past two years, supported by significant gains in purchasing power stemming from the oil counter-shock. As energy inflation moves upwards again, private consumption should slow significantly over 2017, although there should be some degree of consumption smoothing, as reflected in the projected fall in the 2017 saving ratio.

Despite slightly faster nominal income growth (annual average rise of 2.1%), household purchasing power is expected to be negatively affected by the pick-up in energy inflation in 2017, and should grow at a markedly slower rate of 1.1%, down from 1.9% in 2016.

In 2018 and 2019, private consumption is projected to gain momentum again, fuelled by stronger purchasing power gains stemming from faster nominal wage growth (due to the observed lag in the indexation of wages to prices) and the revaluation of certain welfare benefits. The saving ratio should nonetheless increase slightly.

The national accounts released on 30 May (and not included in our scenario) reveal a downside risk to our private consumption scenario (see section 5). The saving ratio has been revised downwards to 13.9% for the fourth quarter of 2016, which is much lower than the figure published at end-April and incorporated into this projection (14.5%), and well below historical levels. If the saving ratio were to rise more than anticipated in these projections, private consumption could potentially grow at a more moderate pace.

Table 2: Change in private consumption and in real household disposable income

(annual average percentage change)	2016	2017	2018	2019
Real household consumption	1.8	1.3	1.5	1.5
Real disposable income	1.9	1.1	1.6	1.7
Nominal disposable income	1.9	2.1	2.6	2.9
Contributions to growth in nominal disposable income				
Gross operating surplus	0.3	0.4	0.4	0.5
Gross wages	1.4	1.5	1.6	1.7
Net interest and property income	0.2	0.3	0.4	0.5
Current transfers	0.0	0.0	0.0	0.0
Social security benefits	0.6	0.5	0.8	1.0
Current taxes	-0.2	-0.3	-0.3	-0.5
Social contributions	-0.3	-0.2	-0.2	-0.3

Sources: Insee quarterly national accounts published on 28 April 2017. Blue-shaded columns show Banque de France projections. Figures do not take account of the national accounts published on 30 May.

Household investment should remain fairly dynamic up to the start of 2018

After plummeting by 20% between 2007 and 2015, household investment began to pick up again in 2016, rising by 2.1% over the year. The rebound was fuelled by improvements in the labour market and in household purchasing power, as well as by measures easing the terms on zero-interest rate loans and on the Pinel tax incentive for residential investment. These last two factors are expected to have a further marked impact in 2017, helping to drive household investment up by 3.2%. Beyond 2017, this temporary support should gradually disappear. Underlying demographic trends have become unfavourable, with a decline in the share of 30 to 59-year-olds in the general population; as a result growth in household investment is projected to slow markedly to 1.2% in 2018, then to 0.4% in 2019.

As a share of gross disposable income, household investment should remain relatively stable at around 8.1% or 8.2%. The household financial saving ratio, calculated as net lending as a percentage of gross disposable income, is projected to decline from 5.5% in 2016 to 5.0% in 2017, before rising again to 5.4% in 2019.

Despite the end of the extra depreciation measure, business investment should continue to benefit from the improved economic outlook and low interest rates

Growth in business investment accelerated sharply to 3.8% in 2016, helped by the extra depreciation measure which came to an end in April 2017. Although the impact of this tax incentive is expected to be weaker in 2017 than in 2016, it still appears to have been significant in the fourth quarter of 2016 and first quarter of 2017, and will probably be followed by strong counter-effect in the second quarter of 2017. **Following these sharp fluctuations, however, business investment should start to grow again at a pace that is more in line with its determinants (i.e. the recovery in activity and low cost of capital). It is thus predicted to grow by 2.6% in 2017, then by 2.5% in 2018 and 2.6% in 2019.**

Table 3: Ratios of non-financial corporations

(annual average, in %)	2016	2017	2018	2019
Margin rate	31.7	31.6	31.8	32.0
Investment ratio	23.4	23.6	23.8	23.9
Self-financing ratio	89.0	87.8	87.9	87.1
Profit ratio before dividends	27.3	27.3	27.5	27.4

Sources: Insee quarterly national accounts published on 28 April 2017. Blue-shaded columns show Banque de France projections. Figures do not take account of the national accounts published on 30 May.

Despite this slowdown relative to 2016, the investment rate for non-financial corporations (NFCs), which measures investment as a share of value added, is expected to remain high: it has already returned to just below the previous high seen in 2008 and should continue to improve over the projection horizon, reaching 24.0% by end-2019. Indeed, some forecasters predict it will rise even higher. One factor holding back investment, however, will be the continuing high level of corporate debt, which is expected to remain stable at around 130% of value added.

The improvement in the NFC margin rate is expected to tail off in 2017, before picking up again in 2018 and 2019, albeit at a very modest pace. After reaching an historical low in 2013 at 29.9%, the margin rate quickly rose again by 2 percentage points in 2014 and 2015, helped by the CICE and PRS competitiveness measures and a moderation of wage growth due to low inflation. However, this upward trend is expected to come to an end in 2017 as a result of higher oil prices, a slight acceleration in wage growth and a near-stabilisation of the CICE. The increase in the CICE tax incentive (from 6% to 7% of total payroll for 2017) should subsequently have a slightly positive impact in 2018 and 2019, pushing the margin rate to 32% at the end of 2019. However, this is still below pre-crisis levels, i.e. the 32-33% range observed between 1996 and 2008.

The unemployment rate should continue to fall

The unemployment rate has fallen by 0.9 percentage point over the past two years, from 10.5% of the labour force in the second quarter of 2015 to 9.6% in the first quarter of 2017. The improvement has been fuelled by stronger growth in market sector salaried employment – offset to an extent by weaker growth in non-market sector employment and a decline in non-salaried employment. In 2016, the French economy thus created 195,000 salaried jobs in the market sector as a trade-off for zero growth in apparent labour productivity (see Table 4). The acceleration in job creations began in 2015, driven by the economic recovery and measures to reduce labour costs (i.e. the CICE and PRS, recruitment incentives for SMEs). However, despite the rise in the CICE rate, these positive factors are expected to dissipate over the projection horizon, especially with the expiry of the SME recruitment incentives on 30 June 2017.

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

(annual average percentage change)	2016	2017	2018	2019
Value added deflator	0.8	0.7	1.0	1.2
Unit labour costs	1.2	1.2	1.0	1.1
Productivity per capita	0.0	0.5	1.0	1.1
Per capita nominal wage	1.4	1.6	2.0	2.2

Sources: Insee quarterly national accounts published on 28 April 2017. Blue-shaded columns show Banque de France projections. Figures do not take account of the national accounts published on 30 May.

Productivity gains are set to accelerate as of 2017, as can generally be expected during a period of economic recovery. Private sector salaried employment is projected to rise by 1.0% in 2017, after 1.2% growth in 2016. It should then continue to expand by 0.8% in 2018 and 2019, while labour productivity should grow at a trend rate of just over 1.0%.

At the same time, non-salaried employment is expected to grow at a slightly slower pace than predicted in December. The sharp upswing in non-salaried job creations since 2009, following the introduction of the “auto-entrepreneur” status, appears to have been losing momentum since the start of 2015. After falling by 6,000 in 2016, non-salaried jobs should start to rise again over the projection horizon, but at a pace that is more in line with market-sector salaried employment.

In the non-market sector, employment growth has slowed sharply in recent years, and the number of jobs is projected to inch down by 0.1% in 2017, before remaining stable in 2018 and 2019. Subsidised job growth in particular is expected to slow in 2017, given the size of the budget currently allocated to these contracts.

Overall, total employment is expected to rise over the projection horizon, but at a slower pace than the 0.7% growth seen in 2016: the projection for 2017 is for an increase of 0.6%, followed by 0.5% in 2018 and 0.6% in 2019. This slowdown in job creations should in part be offset by more moderate growth in the labour force, in line with the new forecasts published by Insee. Over the three years from 2017 to 2019, 140,000 fewer individuals are now expected to join the French labour force than in our December projections. As a result, the labour force is now seen expanding by 0.3% in 2017 and 2018 then by 0.2% in 2019, compared with a growth projection of 0.4% per year in our previous publication. **The unemployment rate should thus continue to decline steadily over the projection horizon, falling to 9.1% in the fourth quarter of 2019.**

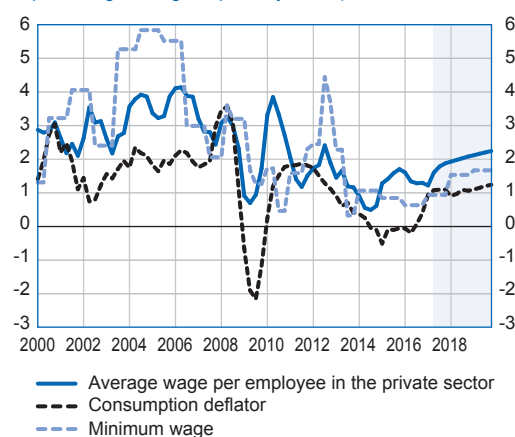
Real wage growth should tend towards 1% per year

Private sector nominal wage growth remained modest in 2016, at 1.4%. But in terms of purchasing power, this was mitigated to an extent by the low level of the consumption deflator (0.0%), resulting in fairly marked growth of 1.3% in real wages.

Nominal wage growth is expected to accelerate gradually as of 2017 reflecting the improvement in the labour market and the strengthening of headline inflation. In the private sector, the average wage per employee is seen rising by an annual average of 1.6% in 2017 then by 2.0% in 2018 and 2.2% in 2019. The minimum wage is also expected to grow, albeit at a more moderate pace, in line with the annual revaluation rules. **Due to the lag observed in the indexation of wages to inflation, however, growth in real wages (adjusted for the consumption deflator) is expected to be limited to 0.7% in 2017, then to 1.0% in 2018 and 2019.**

Chart 4: Private sector wages and consumption deflator

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



Sources: Insee data up to Q1 2017. Banque de France projections.

Annual productivity growth is seen edging up to 1.1% by the end of the projection horizon, while growth in private sector unit labour costs should remain moderate at around 1% in 2019.

3| Inflation should increase fairly sharply, although with some fluctuations, reaching 1.4% in 2019

In 2017, annual HICP inflation is expected to average 1.2%, up considerably compared with 0.3% in 2016. Its intra-annual profile should nevertheless be uneven up to the start of 2018, due mainly to its energy and food components (see Chart 4). After reaching a high of 1.5% in early 2017, HICP inflation should hover around 1.1% over the coming quarters. It should then gradually rise as of Q2 2018, to reach 1.4% in Q4 2019.

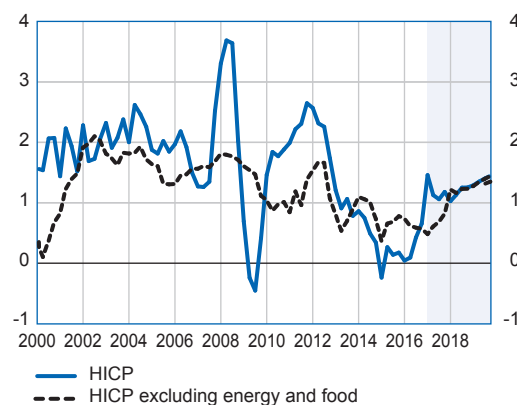
As an annual average, headline inflation should still be 1.2% in 2018, as in 2017, and then increase to 1.4% in 2019. Several factors are expected to contribute to this rise: oil prices should remain at higher levels than those observed in 2016 (as implied by futures prices at mid-May 2017), non-energy import prices should pick up (due to stronger global trade and economic activity) and domestic activity should recover. Inflation excluding energy and food remained weak in 2017 (annual average rate of 0.6%, unchanged on 2016), but should strengthen considerably as of 2018, rising to 1.2% in 2018 and 1.4% in 2019.

In 2017, headline inflation should therefore be driven by energy inflation, with an uneven intra-annual growth profile, whereas inflation excluding energy and food should remain stable.

After reaching a low of EUR 31 per barrel in Q1 2016, oil prices rebounded to EUR 51 in early April 2017. This recovery had a direct impact on the energy component of the HICP (which accounts for around 9% of the total index), via the price of oil products consumed by households (petrol, heating oil, etc.), which had already risen throughout 2016. Assuming crude oil prices remain stable at around EUR 47 per barrel as of Q2 2017, the energy component of the HICP should grow at an annual average rate of 6.3% in 2017 and contribute 0.5 pp to headline inflation, after making a negative contribution between 2014 and 2016. Energy inflation is nevertheless expected to display mixed trends in 2017: after peaking at 10.1% in Q1 2017, it should drop sharply as of Q2 2017 to stand at 4.0% in Q4 2017. Food inflation (around 20% of the total index) is also expected to strengthen slightly in 2017 (to 1.0%, after 0.5% in 2016) in the wake of the increase in agricultural production costs since mid-2016.

Chart 5: HICP and HICP excluding energy and food

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



Sources: Insee data up to Q1 2017, Banque de France projections.

Inflation excluding energy and food should remain low in 2017 at an annual average rate of 0.6% – unchanged on 2016. Meanwhile, service price inflation (which accounts for around 44% of the index) is also expected to remain stable versus 2016, at a rate of 1.0%, which is well below the long-term average (see Box 2). The economic recovery along with nominal wage growth should lead to a rise in inflation in labour-intensive sectors. It should nevertheless be partially offset in 2017 by the sharp decline in communications prices observed at the start of the year. Furthermore, growth in rent prices, linked to past inflation, is expected to remain moderate in 2017. Industrial goods inflation (around 27% of the total index) should remain at 0.0% as an annual average in 2017, in line with the level seen in 2016. The recovery in import prices observed at the start of 2017 should nevertheless gradually feed into industrial goods prices in 2017. Consequently, year-on-year growth in industrial goods prices excluding pharmaceutical products should rise from -0.4% in Q1 2017 to 0.5% in Q4 2017. However, due to the restrictions to public healthcare expenditure set out under the *Objectif national des dépenses d'assurance maladie* (ONDAM – National Objective for Health Insurance Spending) a further fall in the price of medicines is expected in 2017.

In 2018 and 2019, inflation excluding energy and food should pick up fairly significantly, and the composition of headline inflation should become more balanced.

Assuming that communications prices remain stable, service price inflation should improve considerably as of Q1 2018, then carry on increasing gradually in 2019, underpinned by continued growth in nominal wages and the steady fall in unemployment. Rent prices should also pick up with a lag on the back of the sharp rise in inflation in 2017. Industrial goods inflation is also expected to be stronger, propped up by the acceleration in non-energy import prices and strong wage dynamics.

Food inflation for 2018 and 2019 should remain close to the level seen in 2017. However, energy inflation is expected to decline in 2018 and 2019, in the wake of the expected stabilisation of oil prices, which would explain why the recovery of headline inflation should be fairly limited but with a more balanced composition.

Box 2

A SLOWDOWN IN FRENCH SERVICE PRICE INFLATION, DUE IN PART TO THE LAGGED, TEMPORARY PASS-THROUGH OF THE MID-2014 DROP IN OIL PRICES

The services component accounts for 44% of the overall Harmonised Index of Consumer Prices (HICP). It comprises all services to households, ranging from transport and communications, to rent, healthcare and restaurants. In 2016, annual service price inflation averaged 1.0%, down slightly from 1.2% in 2015. In April 2017 it barely reached 1.0% year-on-year, which is well below the average rate of 1.9% seen between 1999 and 2015.

Two periods of extremely subdued service price inflation have already been observed over the past 20 years:

(i) In 2000, service prices rose by just 0.6% (after 1.2% growth in 1999).

(ii) In 2013, service price inflation fell to 1.0%, primarily as a result of a drop in the price of communications following the entry of new operators into the mobile phone market in 2012.

The current situation differs from that in 2013 as the slowdown in inflation is more broad-based, affecting several sub-components of services HICP and not just communications. The chart opposite shows the contributions to services HICP of the six sub-components of the index.

If we compare 2016 with 2012, to avoid using 2014 or 2013 as a basis for comparison due to the sharp rise in VAT in the former and the drop in communications prices in the latter, we can see a marked slowdown in price growth in three out of the six components: housing; transport; and other services which comprises repairs, cleaning, hairdressing, etc.

The decline in the price of a barrel of oil between mid-2014 and the start of 2016 has played a role in bringing service price inflation down to its current low level. What are the channels through which oil shocks are transmitted to service prices?

- A direct impact on transport prices: this direct impact is clearly visible in the chart, which shows the transport sub-component making a negative contribution to service price inflation as of the end of 2015. The transport sub-component notably includes the air transport sector (40% of this item and 2% of overall services), where fares are closely linked to oil prices, although with a lag of a little over a year.

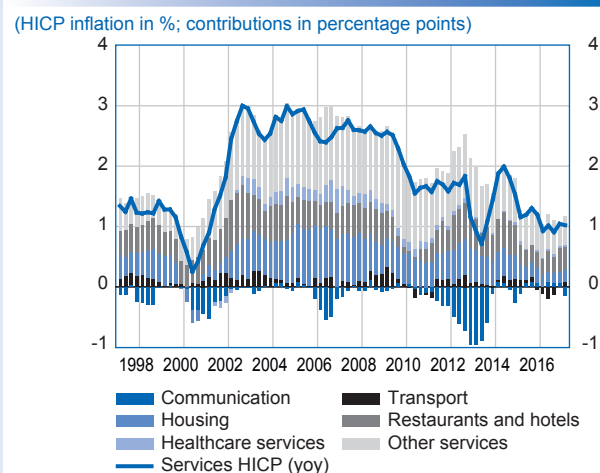
- An indirect impact via the fall in headline inflation: slower growth followed by a decline in oil prices helped to drive down headline inflation (see Box 3, Macroeconomic projections, June 2016). Moreover, the slowdown and subsequent fall in non-energy import prices also contributed to disinflation by lowering the price of manufactured goods. Headline inflation fell to 0.1% in 2015, from 0.3% in 2016. Lower headline inflation feeds through to services via two channels:

- First, disinflation affects rents via the *indice de référence des loyers* (IRL – Rent Reference Index), which is used to set the upper limit for annual rent price increases. Given that the IRL is indexed to headline inflation (excluding tobacco and rents) in the previous year, the decline in inflation in recent years has led to a reduction in rent price inflation.
- Second, in a context of high unemployment, lower headline inflation has contributed to a slowdown in nominal wages. Inflation and wage costs are closely correlated, and the relation between the two is known as the “price-wage spiral”. A decline in wage inflation will primarily affect those sector components that are most labour-intensive, that is restaurants and hotels, and other services.

In addition to the fall in headline inflation, two other measures have most likely helped to curb growth in labour costs since 2014. The *crédit d'impôt pour la compétitivité et l'emploi* (CICE – Tax Credit for Competitiveness and Employment), paid as of the start of 2014, probably led to a fall in labour costs. In addition, the cut to employers' social charges under the *Pacte de responsabilité et de solidarité* (PRS – Responsibility and Solidarity Pact) as of the start of 2015, has also had a direct impact. The decline in labour costs has led in turn to a moderation of service price inflation.

According to the Banque de France's projections (see main text), service price inflation should progressively rise again between 2017 and 2019, moving back towards its historical average.

Chart: Breakdown of service price inflation



Sources: Insee, authors' calculations.

Note: Contributions to the year-on-year trend in the quarterly average of the “services” component of the the Harmonised Index of Consumer Prices.

4| The improvement in public finances needs to be continued in 2017 for France to meet its EU commitments, and efforts should be kept up over the rest of the projection horizon to reduce the level of public debt

The gradual improvement in France's public finances continued in 2016, with the nominal public deficit shrinking to 3.4% of GDP from 3.6% in 2015.² The tax ratio (total tax and social security receipts as a share of GDP) remained stable over the year. Meanwhile, growth in public spending (excluding tax credits) was kept less contained than in 2015, resulting in a fall of just 0.2 percentage point in the ratio of spending to GDP. The government did implement savings measures over the year, notably relating to the ONDAM, and spending growth was curbed by the low inflation environment and by a fall in the debt service cost stemming from low interest rates. However, despite these factors, real primary public spending (i.e. adjusted for HICP excluding tobacco) increased by 1.3% in 2016, which is higher than the 1.1% and 0.8% growth seen respectively in 2015 and 2014.

According to the information currently available, the public deficit should narrow to 3.1% of GDP in 2017.

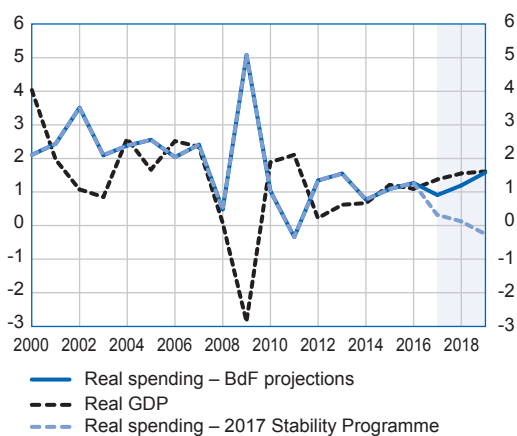
Tax and social security receipts are expected to improve in 2017, buoyed by a gradually improving macroeconomic environment, a rise in ecological taxation, continued efforts to clamp down on tax evasion, and the early collection of certain taxes (notably the increase in the fifth corporate tax instalment). Some of the cuts to taxes and social security contributions originally planned for 2017 under the PRS have also been postponed until 2018 (the final stage in the elimination of the corporate social solidarity contribution has been cancelled and replaced with a rise in the CICE rate in 2018, while income tax cuts for large corporations have also been postponed). As a result, the tax ratio is expected to rise temporarily in 2017 to 44.5% of GDP from 44.4% in 2016.

Public spending excluding tax credits is projected to grow by 1.7% in 2017. The rise should stem from an increase in the public sector wage bill following the two upward revisions to the index points in the pay grid (in July 2016 and February 2017, after a six-year freeze), and from additional expenditure on the government's focus areas, notably education, security and defence. It should also be fuelled by a gradual recovery in public investment, notably at the local level, after several years of cuts. The fall in the debt service cost from 1.9% to 1.8% of GDP should nonetheless offset some of this rise, helping to keep overall spending growth in check. In real terms and excluding interest payments, public spending is projected to grow by 0.9%.³

The gap between the Banque de France's 2017 deficit projection and the 2.8% figure in the Budget Law, as updated by the April Stability Programme, is attributable in more or less equal parts to the fact that our scenario factors in lower nominal GDP growth and higher spending growth.

Chart 6: Real primary public spending (excluding tax credits) and real GDP

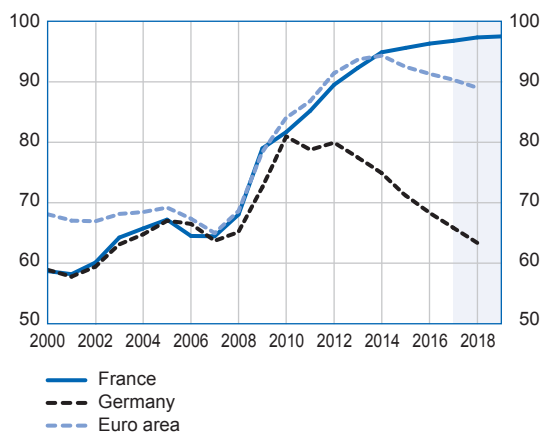
(annual average percentage change)



Sources: Insee, 2017-2020 Stability Programme, Banque de France.
Note: Spending is adjusted for HICP excluding tobacco.

Chart 7: Change in ratio of public debt to GDP

(in %)



Sources: Banque de France for France; European Commission for Germany and the euro area.

² Unlike the rest of this publication, which is based on the quarterly national accounts, the projections for public finances are based on the annual accounts, and have been updated according to the Insee publication of 24 March 2017 and the 2016 GDP figures released on 30 May 2017.

³ Inflation excluding tobacco should exceed the GDP deflator, helping to dampen real spending growth.

Overall, while spending growth is expected to remain subdued, most of the improvement in the public balance in 2017 should stem from the cyclical component, reflecting the economic recovery; meanwhile, the structural deficit (calculated according to EC methodology) should only be cut by 0.1 percentage point, as in 2016, and, excluding interest payments, the primary structural deficit should remain unchanged.

The Banque de France scenario does not take into account any measures not yet voted into law, or not set out in sufficient detail in the April Stability Programme, notably those related to savings. It should be noted that the savings measures announced during the presidential campaign, which are essential to bring the deficit down to below 3.0%, have not yet been taken into account. As a result, the trajectory for public spending after 2017 is largely based on the assumption that economic policy will remain unchanged. The deficit is therefore still projected to hover around 3% in 2018 and 2019, reflecting accelerating growth and continued falls in interest payments (although market rates are set to rise, older debt issues paying above current rates will reach maturity). The primary structural effort, however, is expected to be negative.⁴

Lastly, against this backdrop, France’s public debt is expected to continue inching upwards over the projection horizon, reaching 97.5% of GDP in 2019, up from 96.3% in 2016.

5| The outlook for economic activity and inflation remains subject to risks and will be affected by the direction of economic policy over coming years

These projections are subject to a number of uncertainties. Firstly, the direction of economic policy and any reforms following the elections, together with changes in economic agents’ expectations, will all affect the composition and level of activity and inflation over the three-year projection horizon. These projections should therefore be seen as reflecting the current underlying trend, as based on past economic policy choices and international environment forecasts, and before the impact of future economic policy decisions or the usual risks of external shocks.

Secondly, the improvement in export market shares factored into our projections could turn out to be smaller than expected. The saving ratio could also rise more sharply than predicted (particularly given that it was well below its historical average in the 30 May revised national accounts), which would in turn weigh on private consumption. On the upside, annual average growth in 2017 should be mechanically lifted by the upward revision to first quarter growth in the 30 May annual accounts. In addition, short-term business surveys appear generally positive, while household and business investment could both prove more dynamic than predicted.

Chart 8: Projection range for GDP growth

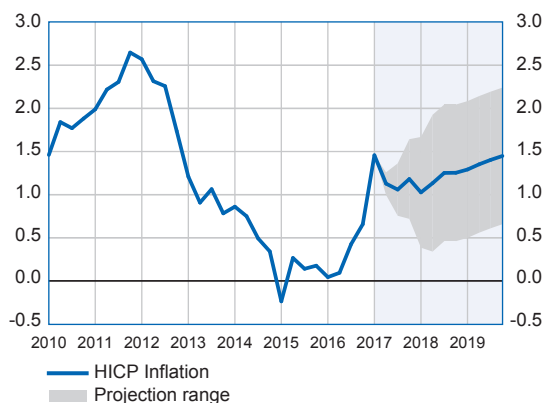
(year-on-year percentage change)



Sources: Insee for the period 2000-Q1 2017, Banque de France projections.

Chart 9: Projection range for annual HICP inflation

(year-on-year percentage change)



Sources: Insee for the period 2000-Q1 2017, Banque de France projections.

⁴ The public accounts could also be negatively affected by the government’s participation in the Areva recapitalisation, which poses a 0.1 percentage point downside risk to the deficit (not included in these projections). The French government is to provide EUR 4.5 billion out of a total planned cash injection of EUR 5 billion (EUR 2 billion for Areva SA and EUR 2.5 billion for Areva NewCo, which will also both receive capital from private investors). It is still unclear how Eurostat will choose to classify this operation – either as a financial transaction, in which case it will have no impact on the deficit, or as a capital transfer, particularly given that there is no prospect of a return on the investment, in which case it will weigh on the deficit. According to our analysis, the latter option appears more likely for the EUR 2 billion investment in Areva SA. Similarly, the transformation of the CICE into a permanent cut in employers’ charges in 2018, which is a welcome measure, should also have a one-off negative impact on the public accounts.

Appendix: Revisions to projections and technical assumptions since December 2016

Table A1: Revisions to projections since the December 2016 BMPE

	June 2017 BMPE					Revisions since December 2016 BMPE		
	2016 30 May wda	2016 28 April wda	2017	2018	2019	2017	2018	2019
HICP	0.3	0.3	1.2	1.2	1.4	0.0	-0.2	-0.1
HICP excluding energy and food	0.6	0.6	0.6	1.2	1.4	-0.2	0.1	0.0
GDP deflator	0.4	0.8	0.9	1.1	1.3	-0.1	-0.1	0.0
Real GDP	1.1	1.1	1.4	1.6	1.6	0.1	0.2	0.1
Contributions to GDP growth (in percentage points): ^{a)}								
<i>Domestic demand (excluding changes in inventories)</i>	2.0	1.9	1.6	1.5	1.5	0.2	0.1	0.0
<i>Net exports</i>	-0.8	-0.7	-0.5	0.1	0.1	-0.5	0.2	0.1
<i>Changes in inventories</i>	-0.1	-0.1	0.3	-0.1	0.0	0.4	-0.1	0.0
Private consumption	2.1	1.8	1.3	1.5	1.5	0.1	0.0	-0.1
Government consumption	1.2	1.4	1.1	1.0	1.1	0.1	0.0	0.0
Total investment	2.7	2.7	2.6	2.1	2.0	0.8	0.2	0.1
<i>Government investment</i>	-0.2	-0.7	1.4	1.9	2.1	0.0	0.0	0.3
<i>Household investment</i>	2.4	2.1	3.2	1.2	0.4	1.3	0.8	0.4
<i>Business investment (NFCs-FCs-IEs)</i>	3.6	3.8	2.6	2.5	2.6	0.8	0.1	-0.1
Exports	1.9	1.2	3.3	5.1	4.2	-1.0	1.2	0.3
Imports	4.2	3.5	4.8	4.3	3.8	0.7	0.4	-0.1
Real household disposable income (RHDI)	1.8	1.9	1.1	1.6	1.7	-0.1	0.3	0.2
Household saving ratio (% of gross disposable income)	14.0	14.5	14.3	14.4	14.6	-0.4	-0.1	0.1
ILO unemployment rate (France and overseas territories, % of labour force)	10.1	10.1	9.7	9.6	9.3	-0.2	-0.1	-0.2

Sources: Insee data for 2016, published on 28 April and 30 May 2017. Blue-shaded columns show Banque de France projections.

Annual percentage change except where otherwise indicated. Revisions to the December BMPE 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.

Table A2: Revisions to technical assumptions and the international environment^{a)}

	June 2017 BMPE				Revisions since December 2016 BMPE			
	2016	2017	2018	2019	2016	2017	2018	2019
Technical assumptions								
Brent oil price (USD/barrel)	44.0	51.6	51.4	51.5	0.9	2.2	-1.3	-3.1
Brent oil price (EUR/barrel)	39.8	47.6	47.0	47.1	1.0	2.3	-1.3	-2.9
Non-energy commodity prices in USD (annual percentage change)	-3.9	6.4	2.0	4.5	0.1	-0.2	-1.8	0.0
USD/EUR	1.11	1.08	1.09	1.09	-0.3%	-0.5%	0.3%	0.3%
Euro nominal effective exchange rate (annual percentage change) ^{b)}	3.7	-0.4	0.3	0.0	-0.1	-0.5	0.3	0.0
3-month Euribor ^{c)}	-0.3	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0
10-year French government bond yields ^{c)}	0.5	0.9	1.2	1.5	0.0	0.1	0.1	0.1
International environment, annual percentage change								
Extra euro-area competitors' prices on the export side (in EUR)	-4.9	5.4	2.4	2.6	0.4	2.7	0.0	0.2
World real GDP	3.0	3.3	3.6	3.5	0.1	0.1	0.2	0.0
World (excluding euro area) real GDP	3.2	3.5	3.8	3.8	0.1	0.1	0.2	0.0
Global (excluding euro area) trade	0.9	4.4	3.8	3.9	0.0	1.6	0.1	0.1
Foreign demand for French goods and services	2.1	4.5	3.9	3.8	0.1	1.3	0.1	0.0
<i>Intra-euro area</i>	3.9	5.4	4.5	4.2	0.7	1.4	0.2	0.1
<i>Extra-euro area</i>	0.6	3.7	3.3	3.5	-0.4	1.3	0.0	0.0

Sources: Eurosystem. Blue-shaded columns show Banque de France projections.

Revisions to December 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 by the ECB on 16 May 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.