MACROECONOMIC PROJECTIONS
FRANCE

BANQUE DE FRANCE
EUROSYSTÈME

June 2015

According to the Banque de France's macroeconomic projections – constructed as part of the Eurosystem projection exercise – after three years of virtually flat growth, French GDP will expand by an annual average of 1.2% in 2015, 1.8% in 2016 and 1.9% in 2017 (before the impact of the fiscal consolidation measures announced in the stability programme, but which still need to be set out in detail in subsequent government budgets). French growth is expected to be underpinned by a combination of external factors (cheaper oil and a weaker euro nominal effective exchange rate), factors specific to the euro area (expansionary monetary policy), and domestic factors (improvement in corporate profit margins). In parallel, euro area GDP is expected to expand by 1.5% in 2015, 1.9% in 2016 and 2.0% in 2017.

French HICP inflation should remain very low in 2015, at an annual average of 0.3%, before rising again to 1.7% by 2017. For the euro area as a whole, headline inflation is projected to be 0.3% in 2015, rising to 1.8% by 2017.

KEY PROJECTIONS FOR FRANCE

	2013	2014	2015	2016	2017
HICP	**1.0**	**0.6**	**0.3**	**1.4**	**1.7**
HICP excluding energy and food	**0.7**	**1.0**	**0.6**	**1.2**	**1.6**
GDP deflator	0.8	0.6	1.0	1.0	1.2
Real GDP	**0.7**	**0.2**	**1.2**	**1.8**	**1.9**
Contributions to GDP growth (in percentage points):					
Domestic demand (excluding changes in inventories)	*0.6*	*0.5*	*1.1*	*1.6*	*1.9*
Net exports	*0.0*	*-0.5*	*-0.4*	*0.2*	*0.0*
Changes in inventories	*0.2*	*0.2*	*0.5*	*0.0*	*0.0*
Private consumption	0.5	0.6	1.7	1.5	1.6
Government consumption	1.7	1.5	1.4	0.9	0.9
Total investment	-0.4	-1.2	-0.7	2.5	3.5
Public investment	0.2	-6.9	-2.0	-0.4	0.0
Household investment	-1.5	-5.3	-4.2	-0.3	4.2
Business investment (NFCs-FCs-IEs)	-0.2	2.2	1.1	4.4	4.2
Exports	1.8	2.4	5.4	5.8	5.7
Imports	1.8	3.9	6.3	5.0	5.4
Real household gross disposable income (GDI)	-0.1	1.1	1.6	1.3	1.6
Household saving ratio (% of GDI)	14.7	15.1	15.1	14.9	14.9
Unemployment rate (ILO, France and overseas territories, % of labour force)	10.3	10.2	10.3	10.1	9.6

Annual rate of growth except where indicated otherwise.

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

The French economy should benefit from a more favourable international environment and from gains in competitiveness stemming from the weaker euro.

Euro area growth has picked up slightly in recent quarters and is expected to gain further momentum in the period ahead. In France, after rising by 0.2% in the third quarter of 2014 then stagnating in the fourth quarter of 2014 (0.0%), GDP grew by a sharper 0.6% in the first quarter of 2015. Based on the latest economic indicators available in mid-May, the French economy should expand by around 0.3% in the second quarter of 2015 (the cut-off date for the assumptions used in these projections is 12 May 2015).

Global trade began to accelerate at the end of 2014, and world demand for French goods and services is expected to increase at a more sustained pace: 3.5% in 2015, 5.3% in 2016 and 5.5% in 2017, after average annual growth of 2% between 2008 and 2014. The decline in the euro nominal effective exchange rate at the start of 2015, coupled with measures to cut labour costs (the CICE or Tax Credit for Competitiveness and Employment, and the PRS or Responsibility and Solidarity Pact), should enable France to increase its export market shares slightly in 2015, and then keep them stable in 2016 and 2017. Recent developments in the international environment should thus help to bolster the outlook for exports (growth of 5.4% in 2015, 5.8% in 2016 and 5.7% in 2017, after 2.4% in 2014). However, the positive impact of this export rebound on growth should largely be offset by stronger imports (rise of 6.3% in 2015, 5.0% in 2016 and 5.4% and 2017, after 3.9% in 2014), due notably to the revival of business investment which has a high import content. The trade deficit (as measured in the national accounts) is expected to shrink from 1.9% of GDP in 2014 to 1.6% in 2015 and 2016 as a result of France's declining energy bill. Assuming a gradual recovery in oil prices, however, the deficit should subsequently widen again in 2017.

Another major change in the global environment, the fall in oil prices at the end of 2014, should have a marked impact in 2015.

The drop in oil prices at the end of 2014 should translate into savings of 0.8% of GDP on France's 2015 energy bill. Cheaper oil dragged annual inflation into negative territory in the first quarter of 2015, helping to boost household purchasing power. As a result, private consumption is expected to accelerate in 2015, although the trend will be dampened to an extent by persistent weakness in the labour market. As of 2016, the saving ratio is expected to fall back slightly towards its long-term average, which should provide further support for consumption. Coupled with favourable credit conditions, the gains in purchasing power should help stem the sharp decline in housing investment which has been dragging on French growth since 2008. Housing investment has contributed an annual average of -0.2 pp to French GDP growth since 2008. Household investment fell for the third consecutive year in 2014: -5.3%, after -1.5% in 2013 and -2.1% in 2012. Although economic indicators do not suggest a rapid turnaround in these trends, household investment is nonetheless expected to decline at a slower pace in 2015 and 2016, before turning upwards again as of 2017.

On a domestic level, the measures introduced to cut labour costs should also start to support activity via gains in cost competitiveness which will in turn boost exports, job creations and business investment.

The CICE and the cuts to employers' social contributions introduced under the PRS should help to stem the decline in French corporate earnings. Profit margins have already begun to recover, and this, combined with a persistently low cost of debt and projected increases in the capacity utilisation rate, should help to stimulate business investment. After the stagnation seen at the end of 2014, which is expected to continue in the first half of 2015, business investment should start to recover in the second half of the year. For the full year 2015, investment is forecast to rise by 1.1%, then by 4.4% in 2016 and 4.2% in 2017. The self-financing rate is also expected to improve, returning to its 2010 level. In parallel, unemployment should stabilise in 2015 and gradually decline as of 2016.

HICP inflation should be kept low by cheaper oil in the near term, before recovering in 2016 and 2017.

Inflation, as measured by the change in the Harmonised Index of Consumer Prices (HICP), is expected to average 0.3% in 2015 (after 0.6% in 2014), before rising to 1.4% in 2016 and 1.7% in 2017. HICP inflation excluding food and energy, which is a less volatile indicator, is expected to slow to 0.6% in 2015 (after 1.0% in 2014) before rising again gradually to 1.2% in 2016 then to 1.6% in 2017. The GDP deflator should rise to 1.0% in 2015 (after 0.6% in 2014) then remain steady at 1.0% in 2016, before rising again to 1.2% in 2017.

The outlook for the French economy is brightening, but uncertainties remain.

The risks to our inflation projections are on the whole balanced. In the case of GDP, however, our projections are subject to a number of downside risks. GDP growth would be weaker than expected in the event of a slowdown in global growth, sharp rises in oil prices or in the euro exchange rate, or the onset of geopolitical crises. On a domestic level, 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 expected if the household saving ratio failed to fall back towards its long-term average in 2016. Lastly, the projections presented here for 2016 and 2017 do not take into account the impact of the announced fiscal consolidation measures which still need to be set out in detail and voted into law in forthcoming government budgets.

1 | Technical assumptions and the international environment: French growth should be supported by external factors

The economic scenario is based on the technical assumptions (exchange rates, interest rates, commodity prices) and international environment projections prepared by the Eurosystem.

Since the summer of 2014, the euro has depreciated both against the dollar and, to a lesser extent, in nominal effective terms. Our projection assumes that, after falling sharply recently and then recouping some of its losses, the euro will hold steady against the dollar at USD 1.12 up until 2017 (down from an average of USD 1.33 in 2014). The euro's nominal effective exchange rate also fell at the end of 2014 and start of 2015. Assuming it remains stable for the rest of the year, this is expected to translate into annual average depreciation of 8.1% for 2015, which will be followed by a stabilisation in 2016 and 2017.[1]

Crude oil prices have also dropped sharply since the summer of 2014. By convention, our assumption for oil prices is based on futures prices over the projection horizon, and these point to a gradual rise in the price of a barrel of Brent oil to USD 74 by the fourth quarter of 2017. In 2016, however, the price per barrel will remain EUR 18.5 below its 2013 average.

Against a backdrop of stable financial markets and exceptionally accommodative monetary policy – notably since the implementation of the Eurosystem's extended asset purchase programme (EAPP) – interest rates remain at record lows.

At the end of 2014, France's main trading partners posted a slight pick-up in GDP growth, helping to spur global trade and world demand for French goods and services. This acceleration is expected to be confirmed over the projection horizon, with growth in foreign demand for French goods and services accelerating to 5.5% in 2017.

Intra-euro area demand is expected to be more dynamic than extra-euro area demand and should rise by 4.7% in 2015, its fastest pace since before the crisis (excluding the rebound in 2010). The improvement will mainly stem from stronger economic growth in France's main trading partner countries.

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

	2013	2014	2015	2016	2017
Technical assumptions					
Brent oil price (USD/barrel)	108.8	98.9	63.8	71.0	73.1
Brent oil price (EUR/barrel)	82.0	74.4	57.1	63.5	65.4
Non-energy commodity prices in USD (annual percentage change)	-4.6	-6.2	-13.6	2.9	4.9
USD/EUR exchange rate	1.33	1.33	1.12	1.12	1.12
Euro nominal effective exchange rate (annual percentage change)[b)]	4.7	2.3	-8.1	-0.2	0.0
3-month EURIBOR	0.2	0.2	0.0	0.0	0.2
Ten-year French government bond yields[c)]	2.2	1.7	0.9	1.2	1.5
The international environment, percentage annual change					
Global CPI	2.9	2.2	1.5	2.7	3.0
Extra-euro area competitor's prices on the export side	-3.8	-1.2	8.2	2.1	2.3
World real GDP	3.3	3.4	3.2	3.8	3.8
World (excluding euro area) real GDP	3.9	3.7	3.4	4.1	4.1
Global (excluding euro area) trade	3.2	2.7	2.0	4.8	5.2
World demand for French goods and services	2.2	3.5	3.5	5.3	5.5
Intra-euro area	*1.1*	*4.0*	*4.7*	*5.9*	*6.1*
Extra-euro area	*3.3*	*3.0*	*2.4*	*4.6*	*5.0*

Sources: Eurosystem; Banque de France macroeconomic projections

Notes:

a) These technical assumptions and international environment projections were constructed by the ECB on 12 May in accordance with the principles set out in the article *A guide to Eurosystem staff macroeconomic projection exercises*, 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 forecast for French 10-year government bond yields was calculated using the yield curve.

1 *As a large share (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 currencies is expected to be half the figure shown here.*

BOX 1

HOW WILL OIL PRICES AND THE EXCHANGE RATE AFFECT THE FRENCH ECONOMY?

Brent oil prices and the euro exchange rate have fluctuated markedly since the middle of 2014. The price of a barrel of Brent oil has fallen from its peak of EUR 83 in June last year, and at mid-May 2015 stood at EUR 58. The euro nominal effective exchange rate (NEER) depreciated by around 9% over the same period, which is roughly equivalent to the annual average variation from 2014 to 2015.

The recent oil countershock is similar in scale to those witnessed in 1986 and in 1996-1998. However, although the price of Brent fell by roughly the same amount in 2014 as in 1986 (around EUR 30 in national currency and at constant prices), energy imports accounted for a smaller share of national output in 2014 than in 1986, substantially lowering the impact of the price fall on French GDP.

Between Q2 2014 and Q1 2015, the change in France's energy bill is estimated at -0.8% of GDP, which is greater than the variation observed during the 1996 countershock (-0.6%) but less than in 1986 (-2.1%).

Table A: Change in the components of France's energy bill during the past three downwards oil shocks

In %

Peak Trough	1985Q4 1986Q3	1996Q4 1998Q4	2014Q2 2015Q1
Percentage change			
Euro NEER	–	6.8	-7.9
Euro exchange rate against the USD	16.4	-6.7	-17.9
Brent oil in USD	-56.3	-51.7	-50.4
Brent oil in EUR	-62.5	-48.2	-39.6
Brent oil in 2014 EUR	-63.9	-49.1	-40.2
Absolute change in price per barrel			
Brent oil in USD	-15.9	-12.3	-55.5
Brent oil in EUR	-21.2	-9.1	-31.8
Brent oil in 2014 EUR	-35.4	-11.8	-32.3
Change in percentage points of GDP			
Energy bill	-2.1	-0.6	-0.8

This box describes the impact of the oil and NEER shocks as the difference between our assumptions and a benchmark scenario where Brent oil prices and the euro NEER remain stable at their average Q2 2014 levels. The impact is estimated using the Mascotte forecasting model.[1] The impact of the euro's depreciation is estimated excluding its effect on oil prices, i.e. at constant euro Brent prices. The simulations also take into account the positive effects of the shocks on France's Eurosystem trading partners, and hence on world demand for French goods and services and on the prices of France's competitors. Table B summarises the findings of these simulations.

At constant exchange rates, the decline in the dollar-denominated price of Brent oil leads to a decline in the euro Brent price. This translates into a fall in import prices which is passed through to consumer prices. Over 2 years, the result is an impact of -0.7% on the average level of the HICP, which boosts household real disposable income. Assuming households will try to smooth their consumption, however, this results in a temporary 0.2% rise in savings in the first year. The increase in household spending is thus spread over two years (annual average growth of 0.3% in the first year followed by 0.2% in the second). Stronger foreign demand boosts French exports in the first year, helping to offset the increase in imports linked to robust domestic demand. Overall, the fall in the Brent oil price adds 0.3% to GDP over two years, with a slightly stronger impact in the first year than in the second.

The change in the euro effective exchange rate affects French growth via its impact on non-euro area competitors' export and import prices. A weaker euro makes France more price competitive, thereby increasing its exports, but it also raises the price of its imports. Over two years, the effect of the fall in the nominal effective exchange rate (excluding the impact on euro oil prices) is a 0.8% rise in GDP and a 0.4% rise in the HICP.

Taken together, the downward trends in oil prices and in the NEER have a positive net impact on French growth (1.1 pp over 2 years) due to the increase in household spending and the improvement in France's export market shares. The disinflationary effect of cheaper oil (impact of -0.3 pp on inflation over 2 years, with all of the decline occurring in the first year and a slight rebound in the second year) is partially offset by the depreciation of the euro which raises the cost of goods and service imports.

These forecasts could prove slightly optimistic in that they do not take into account possible shortages in production capacity.

Table B: Impact of oil price and exchange rate (NEER) variations on the French economy since Q2 2014

Shock	Size of the shock (in %) 2015	Size of the shock (in %) 2016	Macroeconomic effects (in pp) GDP growth 2015	GDP growth 2016	HICP inflation 2015	HICP inflation 2016
Brent oil in EUR	-28.8	-20.9	0.2	0.1	-0.7	0.0
NEER	-9.2	-9.4	0.4	0.4	0.2	0.2
Total			0.6	0.6	-0.5	0.2

1 Mascotte or *Modèle d'Analyse, de prévision et de Simulation de la COnjoncture TrimesTriElle* (Quarterly economic analysis, forecasting and simulation model) is the Banque de France's forecasting model for the French economy and is used to construct macroeconomic projections over a two to three year horizon.

2 | Economic outlook: the recovery is expected to accelerate gradually

The current economic environment

According to the Banque de France's April *Monthly Business Survey* for industry, services and construction (published on 12 May), the monthly index of business activity (MIBA) points to a rise of about 0.3% in GDP in the second quarter of 2015.

The first quarter of 2015 saw a marked acceleration in activity, with GDP expanding by 0.6% after 0.0% growth in the final quarter of 2014. Private consumption was particularly dynamic (increase of 0.8%) owing to gains in purchasing power at the end of 2014, and to a temporary surge in energy consumption after the mild weather of the previous quarter. Domestic demand contributed 0.5 percentage points to GDP growth, as did inventory changes, while external trade made a negative contribution of -0.5 percentage points.

Both the Insee and Banque de France manufacturing industry surveys point to a slight improvement in economic conditions in April. Business climate indicators were close to their long-term average, while the indicator for expected production has remained stable since the start of the year (see Chart 1). Insee's May survey confirmed the improvement, with a sharp jump in the balance of opinions for past production. Nonetheless, the balance of opinions for personal production expectations remained unchanged on the previous month.

In the construction industry, the Banque de France's April survey indicated that activity was stable over the month, while Insee's May survey showed that confidence indicators remain well below their long-term average. Surveys on civil engineering and building (see Chart 2) suggest that the construction sector will continue to drag on growth in the second quarter.

Chart 1: BdF manufacturing industry survey

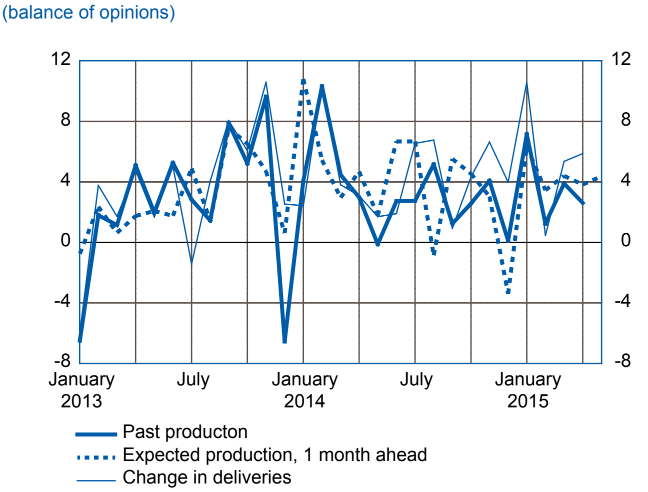
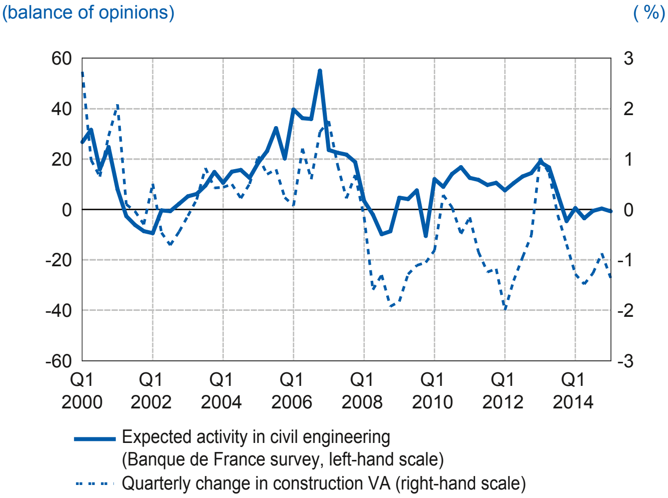


Chart 2: Expected activity in civil engineering and value added in the construction sector



With regard to prices, annual HICP inflation stood at 0.1% in April 2015 while underlying HICP inflation (excluding food and energy) recovered slightly, rising to 0.5%.

Inflation is still being dragged down by falling oil prices, which led to a year-on-year contraction of 3.5% in the energy component of the HICP. Inflation is expected to continue moving upwards in 2015 as the prices of energy and other imports recover.

France's foreign trade should benefit from a more favourable international environment

Foreign trade is expected to make a rising contribution to French growth over the projection horizon, helped by stronger global demand and gains in price competitiveness.

After a prolonged period of stabilisation since 2008, France should see a slight expansion in its export market shares (calculated as the ratio of French exports to world demand for French goods and services) over the projection horizon. Export growth is expected to increase to 5.4% in 2015, then to 5.8% in 2016 and 5.7% in 2017.

Outside the euro area, France's market shares are expected to be boosted by gains in competitiveness stemming from the fall in the euro in early 2015 and, to a lesser extent, measures to cut labour costs (the CICE and PRS).

At the same time, French import growth is projected to accelerate markedly to 6.3% in 2015, falling back slightly to 5.0% in 2016 and 5.4% in 2017. French imports have proved buoyant over the past three quarters, fuelled by strong demand for manufactured goods. Indeed, in the second half of 2014, the GDP elasticity of imports was well above the average for the period 2000-2007. The projection for imports up to end-2016 is based on the assumption that this elasticity will remain slightly above its long-term average, supported by a robust pace of investment which has a high import content.

The strength in imports is expected to offset the rise in exports, resulting in a contribution of -0.4 pp from foreign trade to French GDP growth in 2015, followed by a positive contribution of 0.2 pp in 2016, and 0.0 pp in 2017.

The trade deficit (measured according to national accounting methodology) is projected to narrow to 1.6% of GDP in 2015 and 2016, from 1.9% in 2014, owing to the fall in France's energy bill.

With futures contracts pointing to a rise in oil prices, the trade deficit is expected to widen again slightly in 2017. The majority of these changes will stem from net energy imports, which are forecast to decline as a share of nominal GDP in 2014 and 2015 as oil prices fall, dropping from 2.9% of GDP in 2013 to 1.9% in 2015, before rebounding again in 2016 and 2017. Assuming an upturn in energy prices and a recovery in activity, net energy imports as a share of GDP should rise to 2.2% in 2016, and 2.3% in 2017

Private consumption is expected to be boosted by gains in purchasing power in a context of very low inflation

In 2014, private consumption rose by 0.6% after growth of 0.5% in 2013, supported by a 1.1% increase in household disposable income in 2014 (after -0.1% in 2013).

The rebound in disposable income can be attributed to the stabilisation in taxes and social security contributions in 2014 after the sharp rises seen in 2013, and to the absence of job destructions in 2014. Gross wages should remain the main driver of household income growth as employment rises, and despite continuing moderation in wages (see "Labour market and wages" below).

Chart 3: Market shares (French exports/world demand for French goods and services)

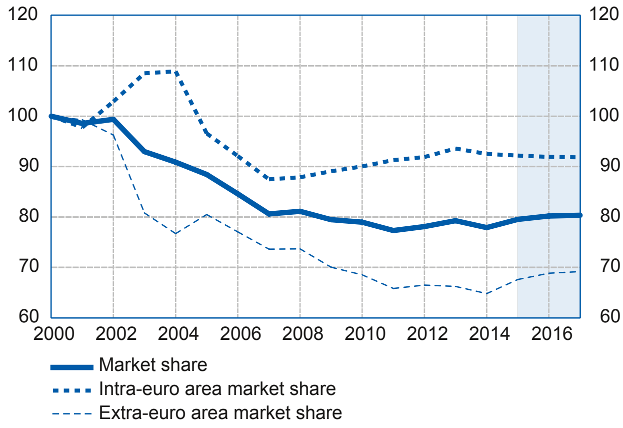


Chart 4: Trade balance
(national accounts data)

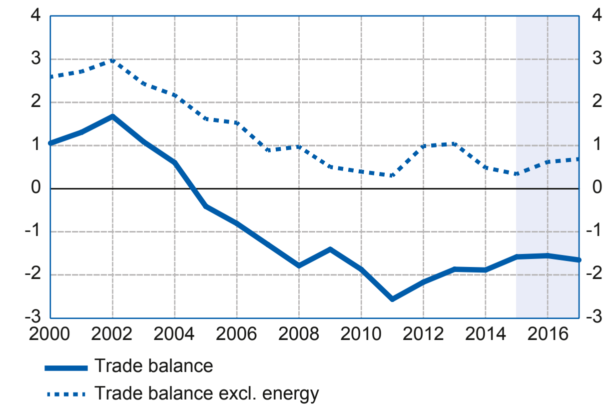


Table 2: Change in private consumption and household real disposable income

(annual percentage change)	2013	2014	2015	2016	2017
Real private consumption	0.5	0.6	1.7	1.5	1.6
Household saving ratio (% of disposable income)	14.7	15.1	15.1	14.9	14.9
Household real disposable income	-0.1	1.1	1.6	1.3	1.6
Nominal disposable income	0.6	1.1	1.7	2.6	3.1
Contributions to growth in nominal disposable income:					
Gross operating surplus	*0.1*	*0.1*	*0.3*	*0.6*	*0.6*
Gross wages	*0.6*	*1.0*	*0.9*	*1.4*	*1.8*
Net property income	*0.1*	*-0.2*	*0.3*	*0.6*	*0.6*
Government net transfers to households	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Social transfers	*1.0*	*0.8*	*0.5*	*0.7*	*1.0*
Direct taxes	*-0.6*	*-0.2*	*-0.3*	*-0.4*	*-0.5*
Social security contributions	*-0.5*	*-0.3*	*-0.1*	*-0.2*	*-0.3*

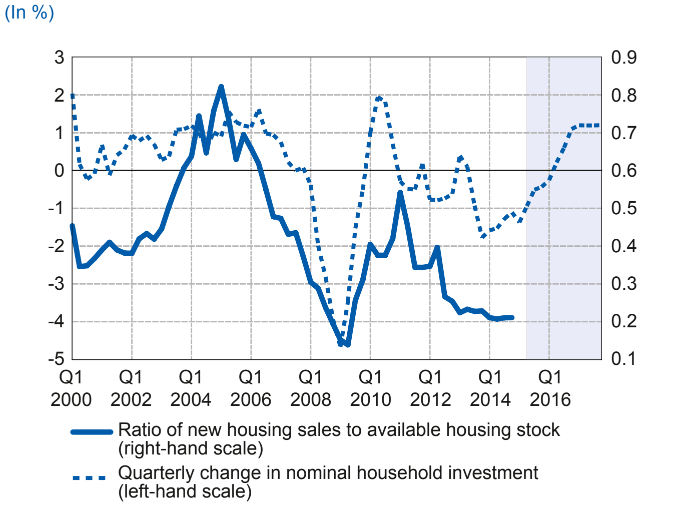
The impact of lower oil prices on inflation should lift household purchasing power. With the saving ratio expected to remain stable, private consumption is forecast to rise at the same pace as purchasing power in 2015. In 2016, however, inflation is expected to return to more usual levels (1.4% after 0.3% in 2015) while the saving ratio should fall back slightly towards its long-term average (14.9%). As a result, private consumption is seen rising by 1.7% in 2015, followed by 1.5% in 2016, and 1.6% in 2017.

Household investment is not expected to rebound before 2016

In 2014, household investment declined for the third consecutive year (-5.3% after -1.5% in 2013 and -2.1% in 2012). Economic indicators hold out little prospect of an improvement in the short term. The ratio of new home sales to available housing stock, which is strongly correlated with quarterly changes in household investment, remains close to its 2009 level (see Chart 5). Despite favourable credit conditions, household investment is expected to continue declining in 2015.

Household investment should nonetheless start to rise again in 2016, helped by the recovery in activity, lower unemployment and higher household disposable income. The slight rise in bank lending rates forecast for 2016 is not expected to affect this recovery.

Chart 5: Household investment



Business investment should be stimulated by the recovery in activity and by the investment incentives and cuts to labour costs introduced by the government.

Business investment was relatively dynamic in 2014, rising 2.2% after a decline of 0.2% in 2013. In particular, the investment rate for non-financial corporations (NFCs) – measured as the ratio of gross fixed capital formation (GFCF) to value added – stayed above its pre-crisis level (23% in 2014, compared with an average of 21% for the period 1995-2007).

NFC finances nonetheless remain relatively fragile. The average gross margin rate (measured as the ratio of gross operating surplus to value added) has contracted by over 4 pp since 2008 (after remaining stable from 1986 to 2008 at between 31% and 34%) and hit a low of 29% in 2014. The capacity utilisation rate in the manufacturing industry (81% in 2014 according to Insee surveys) is still below its long-term average (85%, although the downward trend in this rate over the very long term makes this difficult to interpret). As a result, investment is expected to continue growing at a very moderate pace in the first half of 2015, despite the rebound in growth.

Over the projection horizon, investment levels should be boosted by the recovery in activity which is expected to push the capacity utilisation rate up by 0.3 pp between the fourth quarters of 2014 and 2017. Improving corporate finances should also provide a lift, as will the recent 5-year, EUR 2.5 billion plan introduced by the government to stimulate investment in equipment goods (tax deductions for companies that invest).

Government measures to reduce labour costs (the CICE and PRS) and the lower euro exchange rate have been helping companies to rebuild their profit margins since 2014, and this trend is expected to continue in the period ahead. French companies are also expected to benefit from continuing favourable financing conditions, with historically low real rates both on bank lending and market financing.

Business investment should therefore rise by 1.1% in 2015, accelerating to 4.4% in 2016 and 4.2% in 2017. In parallel, the self-financing rate should also see an improvement, moving back towards – but remaining slightly below – its 2010 level.

Table 3: NFC corporate ratios

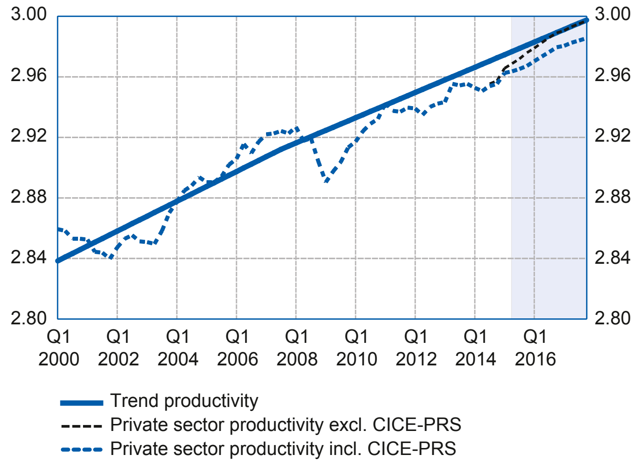
(in %, annual average)	2013	2014	2015	2016	2017
Gross margin rate	29.8	29.5	31.1	32.1	32.7
Investment rate	22.8	23.1	22.8	23.4	24.0
Self-financing rate	74.0	75.2	84.5	83.4	81.3

The labour market is expected to improve gradually

The year 2014 was marked by a stabilisation in private sector employment (average variation of 0.0% over the year, after -0.2% in 2013). The improvement should continue in 2015, as the recovery in activity and first effects of the CICE-PRS measures drive private sector employment gradually upwards. Over the projection horizon, jobs growth in the private market sector is expected to be dampened by gains in labour productivity stemming from the economic recovery: as Chart 6 shows, the scenario is based on the assumption that the productivity cycle will complete its course over the projection horizon, excluding the impact of the CICE and PRS. Overall, private sector employment is projected to grow by an average of 0.2% in 2015, then by 1.0% in 2016 and 1.3% in 2017.

Chart 6: Private sector labour productivity

(in logarithm)



In the non-market sector, employment should be supported by the ongoing subsidised jobs programme. The government has announced the creation of an additional 65,000 subsidised positions in 2015. It has also raised the number of job insertion contracts (CUI-CUA) to be created for the non-market sector in 2015 to 300,000, and extended the duration of these contracts from 9 to 12 months. This will lead to a slight rise in the stock of subsidised job vacancies over 2015, but the figure should then stabilise from 2016 onwards as unemployment remains persistently high.

In the public sector, the ongoing job cuts should start to affect employment levels from 2015 onwards. After rising by 1.4% in 2014, public sector employment is expected to increase by just 0.6% in 2015, and then decline by 0.1% in 2016 and by a further 0.4% in 2017.

Taken together, these factors should lead to a modest recovery in overall employment, with growth of 0.3% in 2015 followed by 0.7% in 2016 and 0.9% in 2017, after a rise of just 0.3% in 2014. Assuming average growth in the labour force of 0.5% in 2015 and 0.4% in 2016 and 2017, the upwards trend in unemployment should begin to reverse as of 2015.

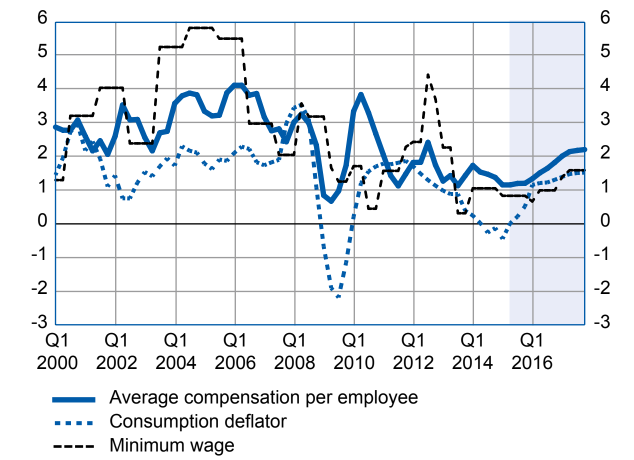
The annual average unemployment rate is expected to remain almost stable in 2015 at 10.3%, before falling to 10.1% in 2016 and to 9.6% in 2017.

High unemployment and low inflation have led to a slowdown in nominal per capita wages in France since 2011. Average compensation per employee and the basic monthly wage have both followed the same basic trend: the pace of growth in the basic monthly wage (gross wages excluding bonuses and overtime pay) has been slowing since 2011, from 2.0% year-on-year at end-2011 to 1.5% at the end of 2014; growth in average compensation per employee has also slowed from 2.1% to 1.4% over the same period (Chart 7).

Growth in compensation per employee is projected to remain below the annual average of 2.5% recorded since 1995. In the private sector, gross per capita wages should rise by just 1.2% in 2015 as high unemployment and low inflation curb employee bargaining power. In 2016, wages are projected to rise by 1.6%, then by 2.1% in 2017. Unit labour costs should rise more moderately as the EUR 10 billion of cuts to employer social security contributions under the CICE-PRS help to contain growth in super-gross wages (i.e. wages including employer social security contributions) in 2015 and 2016. Super-gross wages are expected to rise by 0.7% in 2015 and by 1.0% in 2016, before rebounding by 2.2% in 2017.

Chart 7: Private sector wages and consumption deflator

(% change, year-on-year)



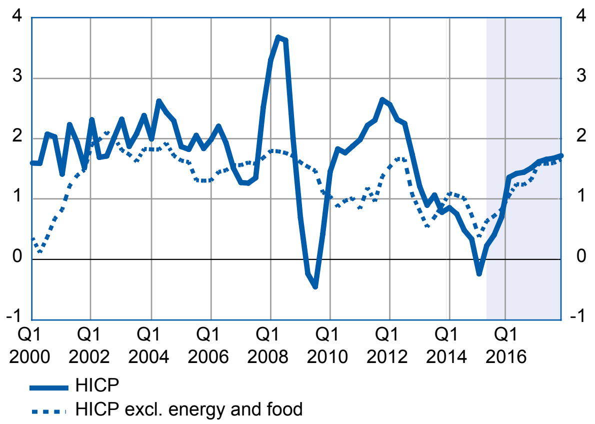
3 | Inflation: return to a rate of between 1% and 2% as of 2016

Inflation should gradually turn upwards again due to the forecast rebounds in oil prices, in imported inflation and in activity.

Annual HICP inflation was negative in the first quarter of 2015 (-0.2% year-on-year) but should quickly turn positive again and then accelerate gradually under the impact of rising oil and import prices and the recovery in domestic growth. Our forecast is for average annual HICP inflation of 0.3% in 2015, 1.4% in 2016 and 1.7% in 2017, after 0.6% in 2014. Excluding energy and food, inflation is expected to average 1.2% in 2016 and 1.6% in 2017, after 1% in 2014 and 0.6% in 2015. French HICP inflation should be in line with the euro area average (0.3% in 2015, 1.5% in 2016 and 1.8% in 2017).

Chart 8: HICP and HICP excluding energy and food

(% change, year-on-year)

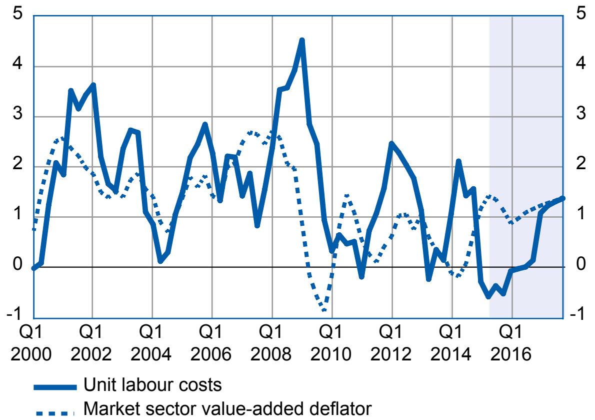


Energy and manufactured goods are expected to place a drag on inflation in 2015.

The sharp drop in oil prices in 2014 should continue to have a significant impact on the energy component of the HICP, pushing it down by 2.3% in 2015, in spite of the rise in the cost of electricity and in indirect taxation.

Chart 9: Unit labour costs and value-added deflators

(% change, year-on-year)



In 2016, as the impact of past declines in oil prices drops out of the annual comparison, HICP energy inflation is forecast to turn positive again.

The decline in the price of non-energy imports in 2014 should continue to weigh on manufactured goods prices in 2015 (-0.2%).

In the medium-term, the upturn in non-energy import prices, caused notably by the weaker euro, coupled with higher value-added deflators stemming from the growth recovery, should gradually lead to increases in the price index for manufactured goods. The rise in value-added deflators coupled with subdued growth in unit labour costs, should help to drive the improvement in profit margins described previously (Chart 9).

4 | Public finances: ongoing fiscal consolidation

The public deficit should shrink to 3.8% of GDP in 2015, but further significant efforts will be needed to meet the target of 3% in 2017.

Despite the weak economic context, France's nominal public deficit contracted slightly to 4.0% of GDP in 2014, largely as a result of a sharp slowdown in public spending, and notably cuts to local authority investment. Gross public debt amounted to 95.6% of GDP in 2014.

In 2015, the public deficit should narrow further to 3.8% of GDP. Excluding tax credits and interest payments, real public spending (adjusted for consumer price inflation) is expected to rise by 1.0%, taking into account the savings included in the 2015 budget. Moreover, based on our assumptions for interest rates (see Table 1), France's debt service payments are expected to fall slightly over the year. On the revenue side, overall tax receipts should fall to 44.5% of GDP in 2015 from 44.9% in 2014, as cuts to employer payroll charges under the CICE and PRS outweigh the rise in revenues stemming from the recovery in growth.

For 2016-2017, the projections are based on conventional assumptions, that is excluding the impact of the fiscal tightening measures announced in the stability programme but still to be fleshed out in forthcoming budgets. Public finances should continue to improve due to the favourable economic conditions and the fiscal consolidation measures already set out in April 2015's stability programme. Tax receipts are expected to be boosted by renewed economic growth, despite the cuts to payroll charges under the CICE-PRS. Meanwhile, public spending will grow at a moderate pace. The ratio of public debt to GDP should stabilise towards the end of the projection horizon.

France should thus be able to meet its European nominal deficit target in 2017, helped by a favourable economic environment, and provided the measures to be adopted in subsequent budgets can keep growth in real public spending, excluding tax credits and interest payments, below recent trends.

5 | Uncertainties: the baseline scenario of a strengthening recovery faces downwards risks to growth

The central forecast of a gradual acceleration in the recovery remains vulnerable to the usual uncertainties (Charts 10 and 11, estimated on the basis of historical forecast errors).

There are also a number of specific downside risks to growth. These could materialise in the event of a slowdown in global growth, sharp rises in oil prices or in the euro exchange rate, or the onset of geopolitical crises. In particular, a faster-than-expected recovery in the Brent oil price would have a significant impact on our scenario, weighing on household purchasing power and thereby dampening domestic demand both in France and in our main trading partner countries. If this scenario were to occur, global growth forecasts would be revised downwards and inflation forecasts upwards.

On a domestic level, the forecast revival of business investment could be tempered if businesses chose to use the gains from cuts to labour costs to raise wages or deleverage, or if the saving rate failed to return towards is long-term average in 2016, dampening consumption. Moreover, in the event of supply constraints, import growth would be stronger than expected, which would lower the net contribution of exports to growth in our projections.

Lastly, the projections presented here for 2016 and 2017 do not include the impact of the additional fiscal consolidation measures still to be set out in detail and voted into law in subsequent budgets.

Conversely, the Eurosysem's extended asset purchase programme could have a stronger-than-expected positive impact on GDP growth between now and 2016, as our models are calibrated using historical data and could therefore underestimate the favourable effects of the new measures.

Risks to inflation appear on the whole balanced. On the one hand, a steeper upward trend in oil prices, coupled with stronger efforts by businesses to rebuild profit margins, could lead to more marked acceleration in inflation. On the other hand, persistently high unemployment or the fall in wage costs linked to the CICE and PRS measures could lower inflation.

Chart 10: Range of forecasts for annual GDP growth

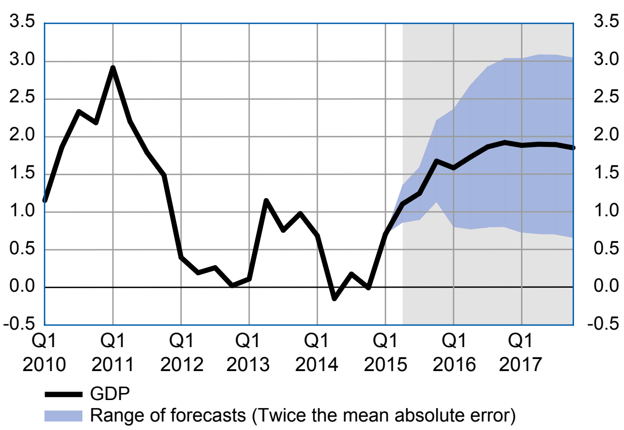


Chart 11: Range of forecasts for annual HICP inflation