FRANCE: WILL THIS FISCAL CONSOLIDATION BE DIFFERENT?

Discussions on the 2025 draft finance law (PLF) have just begun in the French National Assembly. The backdrop for this PLF must be outlined. France is setting out to consolidate its budget, which is a major yet necessary task. However, things are hanging in the balance due to power struggles in the National Assembly. Over the past few years, a high fiscal deficit has been run up, with the 2024 fiscal deficit and interest burden (which is expected to increase by nearly 1 point of GDP by 2027) leaving the French government with no choice but to take action. In order to stabilise its public debt ratio, France will have to bring its fiscal deficit below 3% of GDP and therefore reduce it each year for at least five years. Regardless of the approach (significant tax hikes) or the timing (concomitant with the first signs of deterioration in the financial situation of businesses), this fiscal consolidation is expected to be no different from previous ones, as it will negatively affect French growth, despite this adverse impact being offset by monetary easing.

The 2025 budget is likely to involve a relatively major fiscal consolidation effort, which was already featured in the most recent version of the stability programme sent by France to the European Commission last April, in order to return to a fiscal deficit of less than 3% in the long term. However, in France, periods of fiscal consolidation are the exception rather than the rule, as it has been almost 10 years since the country went ahead with fiscal consolidation (the withdrawal in 2022-23 of the temporary measures introduced during the COVID period cannot be considered as a fiscal consolidation). The lack of a majority in the National Assembly could make things even more complicated. However, this consolidation is particularly necessary, as the fiscal trajectory is very far off its target level (according to the government, there is a deficit of 6.1% in 2024, compared to a deficit of 4.4% in the initial draft budget bill and a deficit of 5.1% in April's stability programme). Therefore, the task ahead is even bigger, with the government bill including 1.4 GDP points of structural adjustment, excluding the interest burden, in 2025.

Why is the country embarking on such a major endeavour? Because France, through its budget, was one of the countries that took the greatest measures to limit inflation, thereby supporting household purchasing power. It did this through measures which cannot all be withdrawn today (particularly measures which have benefitted from inflation indexation, including pensions and income tax brackets), and which were to be financed by a recovery in consumption which has yet to materialise. The public-expenditure-to-GDP ratio has increased slightly (54.6%, excluding tax credits and excluding the interest burden, in 2023, and 54.9% in 2024, according to the government), but the public-revenue-to-GDP-ratio (51.6% in 2023, with no improvement likely in 2024) fell significantly and is even nearly 1.5 points lower than it was prior to COVID in 2019. For example, as household consumption figures have not lived up to expectations, VAT revenues have logically been equally disappointing. In 2024, social welfare benefits of all kinds are expected to have contributed to an increase of 1.8 points (equal to the contribution of wages and salaries) in household gross disposable income (GDI), while compulsory levies only took off 0.9 points. Therefore, there is a major net gain, following on from the major net gain in 2023 (+1.6 points, compared to -0.9 points). Therefore, consumption could have recovered.

The fiscal support provided to the French economy in recent years was to be financed, at least in part, by growth. However, in our opinion, growth should be slightly higher than the target revised to 1% last spring by the government (we are forecasting 1.2%).

Nevertheless, this is pretty much the only good news, as the growth drivers, which differ significantly from expectations, has ultimately not delivered the expected fiscal revenues. On the demand side, exports are the only component that have performed in line with expectations, unlike all of the others, including household consumption and private investment. While France's growth is ultimately not particularly far from expectations, it is because it has imported less, with declining imports the positive consequence of falling domestic demand for goods, as well as of destocking by companies (which have bought fewer industrial inputs). However, while a decrease in imports does not contribute anything to the government's tax receipts, the decrease in consumption is detrimental to them, through the aforementioned lower VAT revenues. The other driver has been public consumption, ultimately accounting for nearly a third of the growth in 2024, according to our estimates. This contribution is not unprecedented, but it is rather high.

So, what's next? Don't put off until tomorrow what you can do today. Therefore, fiscal consolidation should begin as early as next year. Why? In order to return, in the long run, to this much-touted 3% public deficit that will help stabilise the public debt-to-GDP ratio, given that nominal GDP growth is expected to hover at between 2.5 and 3% over the coming years, i.e. little or no more than the current 10-year interest rate level (which in itself is even somewhat at the top of the range).

However, this task should be undertaken at an even pace so that growth is not overly adversely affected. Nobody is currently demanding for the deficit to return below 3% in 2027, and the government is targeting 2029. It sounds far away, but it is actually really soon. What's more, as the interest burden is expected to increase by 0.3% of GDP per year by 2027, the effort required to reduce the deficit will only increase. Therefore, starting in 2025 is seemingly a must. However, the remedy may taste bitter. The economic, social and financial report attached by the government to its draft budget includes EUR 29.5 billion of tax hikes in 2025, i.e. nearly 1 point of GDP, with EUR 22 billion of them targeted at businesses. While things may change during the parliamentary debate, at a time when businesses are already seeing their margins decrease (to 30.8% during Q2 2024, compared to 33.3% a year earlier) and their savings fall (79.4% of their investment, their lowest point since Q3 2008, excluding the pandemic), this kind of tax hike will adversely affect French growth.

Stéphane Colliac