FRENCH BUDGET: THE HARDEST PART IS YET TO COME

France's fiscal deficit worsened in 2023 and 2024. Spending growth was maintained, despite the slowdown in public revenues growth. The 2025 budget should enable consolidation to begin thanks to a rebound in revenues. However, spending as a share of GDP is expected to remain relatively stable. The challenge of continuing fiscal consolidation in 2026 therefore remains intact. This exercise will be constrained by the expected increase in interest payments and military spending.

The next budget is already a hot topic in France. The late adoption of the 2025 budget and the difficult political context justify the early emergence of this topic. The government is once again planning to reduce the fiscal deficit in 2026, while the slowdown in growth in 2025 is already undermining this year's deficit target (5.4% of GDP).

LOOKING BACK

It is important that the initial budget target and final execution align in 2025, after two years of significant slippage (fiscal deficit exceeding initial targets by 0.4 percentage points of GDP in 2023 and 1.4 percentage points in 2024). The increase in the deficit as a percentage of GDP was therefore steady between 2022 (-4.7%, then -5.4% in 2023) and 2024 (-5.8%). However, most other Eurozone countries continued to consolidate their public finances. The interest burden increased only moderately over the period (2.1% of GDP in 2024, compared with 2% in 2022) and is therefore not a driver. The explanation lies in a significant gap between public revenue and expenditure.

Public spending evolved broadly in line with nominal GDP growth during the inflationary period. The spending-to-GDP ratio remained high, exceeding pre-COVID levels. As a result, the budget fully offset inflation, whereas partial compensation would have brought the public spending ratio back to its pre-pandemic level. Social benefits rose sharply, outpacing inflation in 2024, while pensions offset the (higher) inflation observed in 2023[1].

Thus, France also maintained its higher level of public spending compared to other European countries, mainly due to the weight of its social security system, which exceeds that of other European countries. In addition, the weight of social spending in GDP increased in 2024. It thus returned to the highest level (excluding the COVID period) reached in 2014, before fiscal consolidation between 2014 and 2019 made it possible to reduce its weight slightly (*Chart 1*)[2].

However, the tax base capable of financing these expenditures did not experience the same momentum. Wages grew more slowly than inflation, as did social security contributions based on wages. The decline in compulsory levies (CL) as a percentage of GDP also affected other items, but for different reasons (*Chart 2*). VAT revenues suffered from sluggish consumption, and registration fees from the decline in real estate transactions. Income tax revenues were penalised by the indexation of tax brackets to inflation. The strength of corporate margins in 2023-24 allowed stabilising of the corporate taxes in 2024 (after the 2023 normalisation of corporate income tax revenues, which had been exceptionally high in 2022 due to the impact of COVID aid on taxable income).

PUBLIC SPENDING BY ADMINISTRATION IN % OF GDP IN 2014, 2019 AND 2024 (NON CONSOLIDATED DATA)

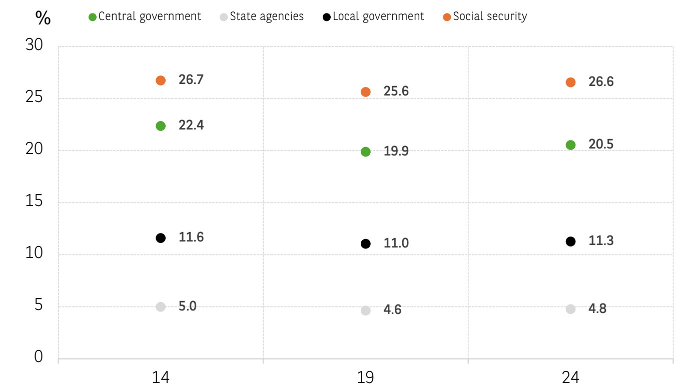

CHART 1 SOURCE: INSEE, BNP PARIBAS

COMPULSORY LEVIES (CL) AND OTHER REVENUES IN % OF GDP (CL UNADJUSTED WITH TAX CREDITS)

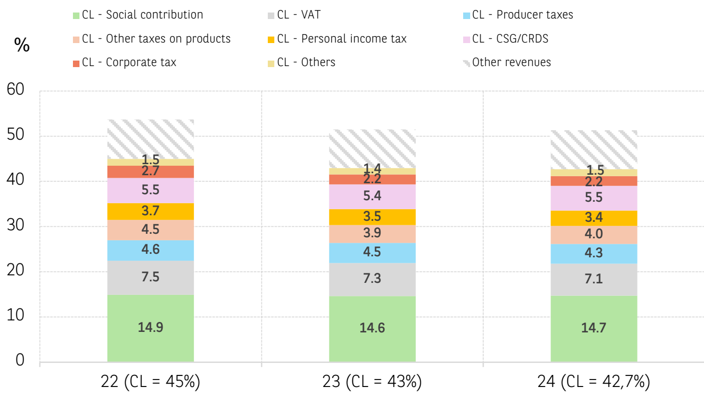

CHART 2 SOURCE: INSEE, BNP PARIBAS

2025: FISCAL CONSOLIDATION BEGINS

2025 should mark a turning point. Except for the VAT, as the government's assumption regarding household consumption growth remain higher than ours (1.2% vs. 0.7%). This will be difficult to achieve given the stagnation in consumption observed in the first quarter. For the rest, the revenue momentum should lead to a slight rebound in the CL-to-GDP ratio:

1 Social spending increased by 5.5% compared with nominal GDP growth of 3.5% and inflation of 2% in 2024, following an annual average of 4.9% in 2023.
2 In the chart, fiscal spending is unconsolidated. It therefore includes transfers between levels of government, mainly from the central government to social security and local governments. The gap between consolidated and unconsolidated public spending is stable between 2019 and 2024, at around 6 points of GDP (7 points of GDP in 2014).

- Wages are now rising faster than inflation: social security contributions, the CSG and CRDS should therefore follow suit.
- The resilience of the business environment in 2024 should help sustain corporate tax revenues.
- In the absence of further measures to support households (such as indexing income tax brackets to inflation as in 2023-24), income tax revenue should grow at a rate closer to GDP growth.
- The two measures announced as exceptional, the corporate tax surcharge and the exceptional contribution on high incomes, should ensure a rebound in the share of public revenue in GDP.

In the medium term, successful fiscal consolidation—a consolidation that ultimately stabilises public debt without overly penalising growth—cannot rely too heavily on revenues. Taxation is higher than the European average. This is true for businesses, mainly through production taxes. Despite a decline, they remain higher than in most other European countries (apart from Sweden). An increase in taxes would widen the gap between France's tax level and that of its main neighbors and undermine France's competitiveness.

More room for maneuver should be found on the public spending side, primarily because its share of GDP is higher than before COVID-19. With social benefits fully indexed to inflation in 2023-24, they have become a major driver to household disposable income dynamics. This support could now decline more easily, as wages have been rising faster than inflation for nearly a year and are expected to continue doing so. However, our forecasts point to relative stability in the public spending-to-GDP ratio in 2025. It is mainly the rebound in revenues that would allow the deficit to decline.

2026: THE IMPOSSIBLE TRINITY OF CONSOLIDATION (WHICH MUST NEVERTHELESS BE PURSUED)

In 2026, fiscal room for manoeuvre will be (even more) limited due to higher interest payments and military spending.

In 2026, the interest expenditure is expected to increase more significantly, whereas it was more contained in 2025. This is because the impact of falling inflation on inflation-linked bonds should partly offset that of higher interest rates. However, the full effect of the latter on the interest burden will be felt increasingly, given the average maturity of public debt (8½ years). The situation is expected to deteriorate from 2026 onwards. According to our estimates, the interest expenditure-to-GDP ratio is expected to increase by nearly 0.4 percentage points of GDP in 2026 and by more than 0.3 percentage points of GDP per year on average between 2025 and 2029, weighing by the same amount on the fiscal deficit. Its contribution to the fiscal deficit would thus rise from 2.2 percentage points of GDP in 2025 to 3.6 percentage points in 2029 (*Chart 3*), exceeding its previous record (3.1% of GDP in 1996). In addition, a further 50 basis points increase in interest rates would further increase the interest burden, with a cumulative effect (an additional 0.1 percentage point of GDP after two years, 0.3 percentage point after five years).

INTEREST EXPENDITURE, IN % OF GDP

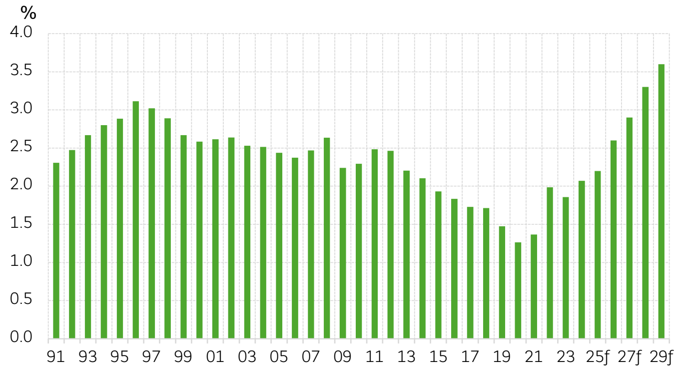

CHART 3 SOURCE: INSEE, BNP PARIBAS

In terms of military spending, the 2025 budget provides for an increase of nearly EUR 4 billion compared to 2024 (just over 0.1 percentage point of GDP). From 2026 onwards, this effort is expected to accelerate further, with the budget increasing by nearly 0.2 percentage point of GDP per year. This would allow military spending to reach 3% of GDP in 2030 (0.5 percentage point of GDP more than provided for in the military programming law), an assumption we are considering given the desire to accelerate the rearmament effort. Nevertheless, this effort should be smoothed out over time, given the high level of the fiscal deficit. In 2026, there will therefore be 0.6 percentage points of additional spending with these two additional costs (debt servicing and rearmament).

In this context, bringing the fiscal deficit back to 5% (our assumption for 2026), so reducing it by 0.4 percentage points of GDP compared to 2025, would require an effort of 1 percentage point of GDP on the primary deficit (1.4 percentage points to bring it back to 4.6% of GDP, as currently projected by the government). Given weaker GDP growth in 2025 (0.6%) and a return to the 2023-24 pace in 2026 (1.1%), there should be little room for maneuver on the revenue side. The focus will therefore likely be on reducing the spending-to-GDP ratio (excluding the two items described above). In other words, public spending should increase, but at a slower pace than GDP. Wages have been rising faster than inflation since 2024. Public spending support is therefore less essential to protecting household purchasing power than in 2022-23.

Budgetary choices will certainly be difficult but postponing them would only complicate the equation further. Even with fiscal consolidation between now and 2029 (which, in our forecasts, would bring the fiscal deficit back to 3.5% of GDP by that date), public debt would rise again to nearly 120% of GDP (7 points above the 2024 level). Fiscal consolidation will then be more difficult: by the end of the decade, France will have to at least balance its primary budget (i.e., excluding interest payments), given the dynamics of interest rates and expected average nominal growth in the coming years (2.5%), if it wants to stabilise its debt[3].

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3 See our Chart of the Week, *Public debt stabilization: towards primary budget surpluses in a growing number of countries*, 24 april 2025