



## EcoFlash

### French public finances: a positive outcome for 2025 to be confirmed in 2026

According to INSEE, the French public deficit in 2025 improved by 0.7pp at 5.1% of GDP (the government targeted 5.4%). This improvement is due to the rebound in the rate of compulsory levies (CL). The public debt ratio is also below projections (115.6% versus 116.2%), although its increase in 2025 was as expected (+3pp). This evolution, along with the repercussions of the shock in Iran, particularly regarding interest rates, suggest to stick with fiscal consolidation efforts in 2026. The deficit is expected to benefit from a better starting point, the anticipated increase in the CL included in the 2026 budget, and the likely favourable impact on revenue from higher nominal growth in 2026. However, the government's leeway to support households and businesses in front of the inflationary shock is more constrained than in 2021–23. This support is therefore likely to be more limited this time around.

**A relatively positive surprise in 2025.** The public deficit was lower than expected in 2025, standing at 5.1% of GDP (compared with 5.4% according to the government's projections for 2025 and following 5.8% of GDP in 2024). The reduction in the deficit is due to the **rise in the CL – reaching 43.6% in 2025 compared with 42.8% in 2024** – linked to the tax increases included in the 2025 Finance Law. At the same time, public expenditure has risen to 57.2% of GDP, compared with 57% in 2024. The rise in some expenditure (interest payments, defence, policing, justice) has, in fact, offset the reductions, particularly in central government expenditure. **As for public debt, the surprise is also positive, with the figure standing at 115.6% of GDP in 2025** (compared with 115.9% according to the government's forecasts; 116.2% according to ours). However, this improvement stems mainly from an upward revision of nominal GDP in 2024 and 2025, resulting in a decrease in the debt ratio for 2024 to 112.6%, compared with the 113.2% previously estimated. However, the increase in the public debt ratio between 2024 and 2025 is +3pp (as we had anticipated; +2.7pp in the government's forecast).

**Before the war in Iran, 2026 had got off to a promising start. The draft budget, which was approved in February, once again prioritize the increase of the CL to reduce the public deficit.** We anticipate a further rise in the CL-to-GDP ratio, which is expected to converge towards its pre-Covid average (44.4%). Expenditure is also expected to rise due to the increases in defence spending, higher interest charges and contributions to the EU budget. **The war in the Middle East is expected to have an impact on public finance.** Based on the assumption that oil prices stabilise around \$100 per barrel during the 2<sup>nd</sup> quarter, followed by a relative decrease thereafter (with prices remaining approximately \$10 above pre-conflict levels by year-end), inflation is projected to increase by 1 pp in 2026, while real GDP growth is expected to fall by 0.3 pp. However, according to our calculations, public finances are more sensitive to changes in nominal growth, which is expected to be higher, than to real growth. Over the past fifteen years, an additional 1 pp of nominal growth has led to a nearly EUR 10 billion improvement in the deficit (0.3% of GDP). **Excluding support measures, the public deficit could therefore be reduced by nearly 0.2 percentage points of GDP. This would make it easier to meet the target of 5% of GDP, although this assessment is subject to significant uncertainties.**

**Beware of complacency.** A notable rise in inflation is expected. We estimate that fuel prices rose by nearly 17% in March, contributing an additional 0.6 percentage points to headline inflation. **The government has therefore announced its intention to implement support measures in response to the energy shock, which are expected to be more modest in scale than in 2022**, primarily due to limited flexibility in achieving the 5% public deficit target. For the time being, the energy shock is less widespread than it was from 2021 to 2023. Electricity prices are expected to remain stable, as gas is not required for its generation, unlike in 2022. The rise in gas prices is occurring at the end of winter, contrasting with the rise that took place just before winter in 2021. Furthermore, before the outbreak of the war in Iran, the French economy was not experiencing any inflationary pressures, with harmonised inflation recorded at 1.1% y/y in February, roughly its pre-Covid level. **The conflict in Iran has also resulted in a rise in interest rates to a level slightly higher than we had anticipated:** 3.87% for the 10-year OAT on 27 March, compared with 3.65% at the end of March according to our pre-conflict forecasts (so, about 20 basis points higher). Although a rise in interest rates has little immediate impact on the deficit and debt-to-GDP ratios due to the debt's long average maturity (8½ years), a sustained rise could require additional fiscal measures to bring the public deficit back down to 3% of GDP by the end of the decade. While the interest burden is projected to reach 2.5% of GDP in 2026 and 3.7% in 2030, according to our forecasts, a sustained increase of 100 basis points in all interest rates (significantly above current levels) would result in an additional 0.1pp of GDP in interest payments after one year (and 0.5pp after five years). It is therefore crucial for France to meet its budget deficit target and, as far as possible, refrain from using its potential leeway (lower public deficit in 2025, additional revenue in the event of a rebound in nominal growth in 2026). Demonstrating that the consolidation effort is continuing year after year would help to limit the widening of the *spread* with Germany.

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