ECO FLASH

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France: A slow but continuous reduction in the fiscal deficit since 2010

Hélène Baudchon

- **In 2018, according to preliminary INSEE estimates, France's fiscal deficit narrowed by 0.3 points compared to 2017, to 2.5% of GDP.**
- **This is a good surprise compared to the government's target of 2.7%.**
- **Mandatory levies and public spending both declined slightly as a share of GDP, by 0.2 and 0.4 points, respectively.**
- **The public debt ratio levelled off at 98.4% of GDP. Although the ratio has yet to decline, at least it did not increase either, for the first time since 2007.**
- **Thanks to the better-than-expected figure for 2018, the temporary slippage of the fiscal deficit above the 3% threshold in 2019 is likely to remain limited.**

France: Fiscal deficit and public debt

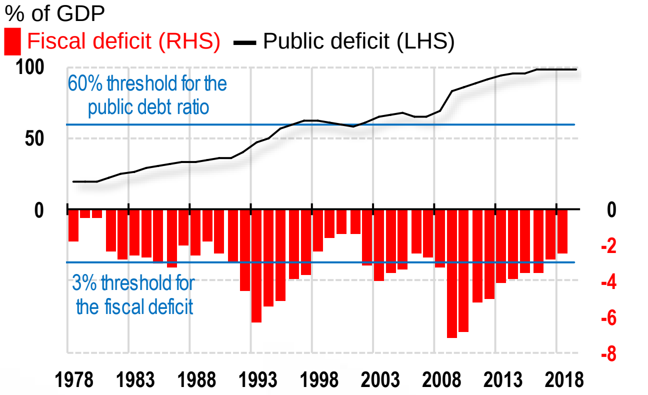

Chart 1 Source: INSEE

In 2018, according to preliminary INSEE estimates, France's fiscal deficit narrowed by 0.3 points compared to 2017, to 2.5% of GDP[1]. This is smaller than the -0.7 point improvement in 2017, but the deficit reduction goes on nonetheless. Moreover, this is a good surprise for the government whose 2018 deficit target was 2.7%.

Deficit reduction continues, but differs from one year to the next

In 2018, the fiscal deficit improved for the 9th consecutive year, which is unprecedented. From the record high of 7.2% of GDP in 2009, the deficit has narrowed to 2.5% in 2018, a reduction of nearly 5 points in nine years. The average reduction is 0.5 points a year, but this figure masks big differences depending on the year, in terms of both the size and nature of deficit reduction (see chart 2).

Most of the reduction occurred in the early years of the period under review here, even if the deficit significantly narrowed in 2017 too. A bit more than half of the improvement is structural, the biggest part of it having been achieved in the first years of the consolidation process, between 2011 and 2013 more precisely. Since 2014, there has not been any real additional efforts to reduce the primary structural deficit, except in 2017, meaning most of the deficit reduction has been cyclical since then. It is also worth mentioning that between 2012 and 2016, the reduction in debt service as a percentage of GDP significantly helped deficit reduction,

[1] The publication of the preliminary estimates of public administration accounts for 2018 was accompanied by an 0.1 point upward revision of the 2017 deficit to 2.8%.

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accounting for about half of the decline in the deficit over the period (0.8 points out of 1.7). Regarding 2018, the breakdown of the deficit is based on preliminary estimates, since some data is not available yet. The 0.3 point improvement seems to be primarily cyclical (to the tune of 0.2 points). To summarize, the whole picture is one of a definite but slow fiscal deficit reduction.

In 2018, deficit reduction is also characterised by a concomitant decline in the weight of mandatory levies and public spending as a share of GDP (by 0.2 and 0.4 points, respectively). With the benefits of insight, the period 2013-2014 appears as a turning point, marking the high point for public spending (57.2% of GDP in 2014[2]) and mandatory levies (44.9% of GDP in 2013). Since then, we are observing a stabilisation, even a decline that remains within the thickness of the line though (see chart 3). Yet the government intends to continue this downtrend: its target is to reduce the weight of public spending (excluding tax credits) and mandatory levies by 3 points and 1 point, respectively, over the course of its 5-year term.

The year 2018 might also be a turning point for the public debt ratio. According to preliminary INSEE estimates, the debt ratio levelled off at 98.4% of GDP. Although the ratio has not declined yet, at least it has not increased either, for the first time since 2007. Better yet, a decline is foreseeable in 2019 and 2020. Based on our forecasts for interest rates (about unchanged in both years), nominal growth (3% and 2.7%, respectively) and the primary deficit (-1.4% and -0.2% as a percentage of GDP, respectively), the public debt ratio would decline by about 1 point in 2019 and by nearly 2 points in 2020[3]. Of course, these are only estimates and cannot be taken for granted. Nonetheless, there is a high probability that the debt ratio will decline given the efforts already made to reduce the primary deficit, combined with the very low level of interest rates, which are much lower than the nominal growth rate[4].

The 2019 deficit will be above but close to 3%

The expected temporary slippage of the fiscal deficit above the 3% threshold in 2019 should remain contained thanks to the better-than-expected performance in 2018. This overrun can be attributed to two distinct factors:

1/ First, the fiscal cost of transforming the CICE tax credit into lower charges, which is estimated at about 1 point of GDP.

2/ Thereafter, the fiscal cost of the plan to boost the purchasing power of low-income households, which was announced on 10 December 2018 in response to the Yellow Vest movement. The cost of this package amounts to nearly EUR 11 bn, or 0.5 points of GDP, which drives the deficit above the 3% threshold in 2019.

France: Breakdown of the fiscal deficit

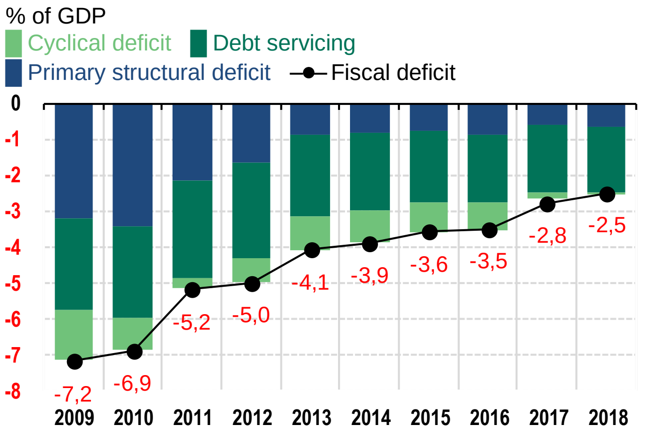

Chart 2 Source: INSEE, European Commission

France: Public spending and revenues

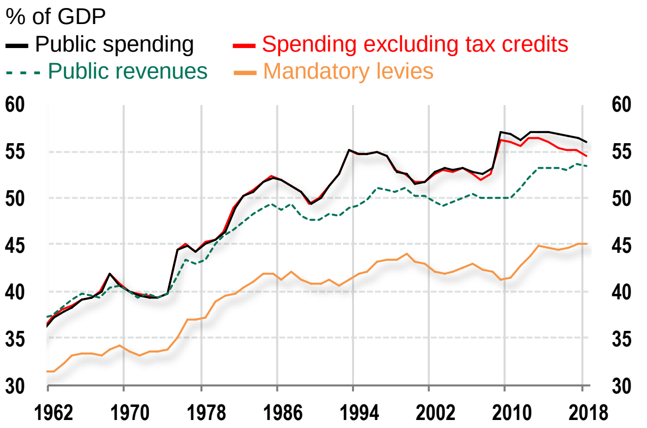

Chart 3 Source: INSEE

Determined to limit the slippage as much as possible, however, the government worked on finding and generating nearly EUR 4 bn in financing measures. According to the 2019 finance bill passed on 28 December 2018, the new government's deficit target for 2019 is 3.2% of GDP. At the same time, the 2018 deficit target was also revised upwards to 2.7%. These new deficit targets are based on the same growth assumptions as in the 2019 draft budget bill (1.7% in 2018 and 2019), but with the structural adjustment reduced to zero in both years, compared to 0.1 and 0.3 points previously.

These assumptions (2018 deficit of 2.7%, no structural adjustment in 2019), combined with our significantly lower growth forecast for 2019 (1.2%), brought our estimate of the 2019 deficit to 3.4%. The better-than-expected results for 2018 automatically lowers this deficit forecast to 3.2%[5].

The government is also exploring the idea of revising its deficit target for 2019. Any revision is bound to be limited, however, since the positive impact of the better 2018 figure will be

[2] The weight of total public spending only levelled off that year while spending excluding tax credits well started to decline, and their fall as a percentage of GDP reaches a cumulative 2 points in 2018.

[3] These results were obtained using a simple but rough calculation in which the change in the debt ratio is equal to: $((i_n - g_n)/(1+g_n)) * D_{n-1} - dp_n$, where i_n is the nominal 10-year interest rate for year *n*, g_n the nominal growth rate for year *n*, D_{n-1} the public debt ratio for the year *n-1* and dp_n the primary balance for the year *n*.

[4] A recession would compromise the expected downturn in the public debt ratio.

[5] Debt servicing is now expected to hold steady at 1.8% instead of increasing slightly to 1.9%, which also helps, but only marginally.

offset by the negative impact of the inevitable downward revision of the government's 2019 growth forecast. According to recent statements by Bruno Le Maire, Minister of the Economy and Finance, this new growth forecast should be around 1.4%. Based on this figure, and assuming the government maintains its scenario of no structural adjustments, we estimate the government's new 2019 deficit target at 3.1%.

Of course, this forecast is sensitive to its underlying assumptions. The table below illustrates this point by showing how much the deficit moves above or below the 3% threshold depending on the real growth rate and structural adjustment assumptions used. This exercise is limited, however, by the fact that it is based on an "unchanged debt servicing charge". Yet this variable is unlikely to change much this year and should have only a minor impact. To complete the picture, we have nonetheless included an additional line showing the variation in the deficit based on different debt servicing assumptions (centred on our central scenario of 1.82% of GDP, with intervals of 0.02, which is the (negative) variation observed between 2017 and 2018), using a scenario of 1.4% growth and no structural adjustment. From this table we can also gleam a rather positive message: although the scenario of a deficit holding at or slightly below 3% in 2019 is still not very likely, it nonetheless becomes again a real possibility.

The government might also decide to maintain its deficit target at 3.2%[6] in order to finance the new stimulus measures that are likely to arise in response to the Great National Debate. According to our calculations, based on the government's relatively optimistic growth forecast (1.4%), new stimulus measures could amount to a maximum of EUR 5 bn. This figure could be lifted, however, if new fiscal consolidation measures are also adopted, which seems likely. We should know the verdict, or at least a few key elements, within the next 10 days or so, when France submits its new Stability Programme to the European Commission, scheduled for 10 April, while the first conclusions of the Great Debate are expected in mid-April.

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■ France: deficit scenarios

Level of the 2019 fiscal deficit (% of GDP) based on different real growth rate and structural adjustment assumptions

		Real growth rate												
		0.5%	**0.6%**	**0.7%**	**0.8%**	**0.9%**	**1.0%**	**1.1%**	**1.2%**	**1.3%**	**1.4%**	**1.5%**	**1.6%**	**1.7%**
Structural adjustment: A negative (positive) figure indicates a deterioration (improvement) in the structural deficit	**-0.5**	-4.1	-4.0	-4.0	-3.9	-3.9	-3.8	-3.8	-3.7	-3.7	-3.6	-3.6	-3.5	-3.5
	-0.4	-4.0	-3.9	-3.9	-3.8	-3.8	-3.7	-3.7	-3.6	-3.6	-3.5	-3.5	-3.4	-3.4
	-0.3	-3.9	-3.8	-3.8	-3.7	-3.7	-3.6	-3.6	-3.5	-3.5	-3.4	-3.4	-3.3	-3.3
	-0.2	-3.8	-3.7	-3.7	-3.6	-3.6	-3.5	-3.5	-3.4	-3.4	-3.3	-3.3	-3.2	-3.2
	-0.1	-3.7	-3.6	-3.6	-3.5	-3.5	-3.4	-3.4	-3.3	-3.3	-3.2	-3.2	-3.1	-3.1
	0.0	-3.6	-3.5	-3.5	-3.4	-3.4	-3.3	-3.3	**-3.2***	-3.2	**-3.1****	-3.1	-3.0	-3.0
	0.1	-3.5	-3.4	-3.4	-3.3	-3.3	-3.2	-3.2	-3.1	-3.1	-3.0	-3.0	-2.9	-2.9
	0.2	-3.4	-3.3	-3.3	-3.2	-3.2	-3.1	-3.1	-3.0	-3.0	-2.9	-2.9	-2.8	-2.8
	0.3	-3.3	-3.2	-3.2	-3.1	-3.1	-3.0	-3.0	-2.9	-2.9	-2.8	-2.8	-2.7	-2.7
	0.4	-3.2	-3.1	-3.1	-3.0	-3.0	-2.9	-2.9	-2.8	-2.8	-2.7	-2.7	-2.6	-2.6
	0.5	-3.1	-3.0	-3.0	-2.9	-2.9	-2.8	-2.8	-2.7	-2.7	-2.6	-2.6	-2.5	-2.5

* BNP Paribas forecast ** BNP Paribas estimates of the government's forecast
Blue areas correspond to situations in which the deficit is equal to or lower than 3%.

Level of the 2019 fiscal deficit (% of GDP) based on different debt servicing assumptions using a scenario of 1.4% growth and no structural adjustment

Debt servicing (% of GDP)												
1.70	**1.72**	**1.74**	**1.76**	**1.78**	**1.80**	**1.82***	**1.84**	**1.86**	**1.88**	**1.90**	**1.92**	**1.94**
-3.0	-3.0	-3.1	-3.1	-3.1	-3.1	-3.1	-3.2	-3.2	-3.2	-3.2	-3.2	-3.3

* BNP Paribas forecast: 2018 level, unchanged in 2019

Table

Sources: INSEE, BNP Paribas

[6] We rule out the case of a fiscal deficit above 3.2%, which would call into question the government's fiscal credibility.

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