

APPENDIX II. FRANCE: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of December 28, 2007)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication	Memo Items:	
						Data Quality—Methodological Soundness ⁶	Data Quality—Accuracy and Reliability ⁷
Exchange Rates	11/07	12/06/07	Monthly	Monthly	Monthly		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	10/07	11/30/07	Monthly	Monthly	Monthly		
Reserve/Base Money	06/06	08/06	Weekly	Weekly	Weekly	O, O, LO, LO	O, O, O, O, O
Broad Money	11/07	12/07	Monthly	Monthly	Monthly		
Central Bank Balance Sheet	10/07	11/28/07	Monthly	Monthly	Monthly		
Consolidated Balance Sheet of the Banking System	10/07	11/28/07	Monthly	Monthly	Monthly		
Interest Rates ²	10/07	12/17/07	Monthly	Monthly	Monthly		
Consumer Price Index	11/07	12/18/07	Monthly	Monthly	Monthly	O, O, O, O	O, O, O, O, NA
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	Q2:2007	10/07	Quarterly	Quarterly	Quarterly	O, O, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ —Central Government ⁵	07/05	09/06	Monthly	Monthly	Monthly		
Stock of Central Government Debt	07/06	09/06	Monthly	Monthly	Monthly		
Stock of Central Government-Guaranteed Debt	Q1:2006	08/06	Quarterly	Quarterly	Quarterly		
External Current Account Balance	Q2:2007	11/07	Quarterly	Quarterly	Quarterly	O, O, O, LO	O, O, O, O, O
Exports and Imports of Goods and Services	Q3:2007	12/07	Quarterly	Quarterly	Quarterly		
GDP/GNP	Q3:2007	12/07	Quarterly	Quarterly	Quarterly	O, O, O, O	O, LO, O, O, O
Gross External Debt	12/31/05	06/06	Monthly	Monthly	Monthly		

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³Foreign, domestic bank, and domestic nonbank financing.

⁴The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵This information is provided on a budget-accounting basis (not on a national accounts basis).

⁶Reflects the assessment provided in the data ROSC or the Substantive Update (published in October 2003, and based on the findings of the mission that took place in March 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁷Same as footnote 6, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

FRANCE

**Staff Report for the 2007 Article IV Consultation
Supplementary Information**

Prepared by the European Department

(In consultation with the Policy Development and Review Department)

Approved by Michael Depler and Matthew Fisher

February 12, 2008

This supplement to the staff report for the 2007 Article IV consultation with France provides an update on staff's revised economic outlook, recent developments in financial markets, and structural reform proposals. The information does not alter the thrust of the staff appraisal.

Summary

Growth is forecast to dip in 2008 to 1.5 percent, slightly lower than anticipated in the staff report due to a further weakening of the global environment, as set out in the recent interim WEO. Headline inflation has continued to rise, given higher oil and food prices, but core inflation remains below 2 percent. While the banking system so far appears to be only moderately affected by the ongoing financial turmoil, the full extent of necessary write-downs is still unknown, and a massive fraud case at Société Générale is troubling. The Commission for the Liberalization of Growth in France (Attali Commission) has presented its report and the government has undertaken to implement most of its (over 300) specific recommendations, though protests by taxi drivers seem to have led it to distance itself from the report's proposals in this area.

Output and inflation

1. **Staff projects a deceleration of GDP growth to 1½ percent in 2008** (Table 1). The revision is driven by slower growth in the U.S. and Europe and the effects of higher inflation on consumer spending. It is consistent with the mark-down of ½ percentage point in euro area growth in the interim WEO published on January 29, which reflects broadly evenhanded reductions across main euro area countries. While lending flows to the private sector have continued to be strong, the global financial market turmoil has led to appreciably tighter bank lending standards for firms. Recent developments have also weighed on consumer confidence, which dropped in January to its lowest level in 12 years. The tax cuts approved

in July 2007 and in the 2008 budget (½ percent of GDP) became fully effective in January and stand to mitigate somewhat the negative external effects on demand. With a fiscal deficit projected by staff to widen to 2.8 percent of GDP (versus 2.7 percent of GDP in the staff report) in 2008—near the Maastricht limit—and a relatively high debt/GDP ratio, there is no room for additional discretionary fiscal stimulus. In this respect, on February 12, 2008 the ECOFIN Council invited France to “strengthen the pace of budgetary consolidation and debt reduction.” The risks to the staff’s forecast are broadly balanced, with downside risks related to the international environment and, on the upside, a possibly stronger rebound in the aeronautics and automobile industries. A relatively strong showing of industrial production in December 2007 may provide some ground for the latter.

Financial sector

2. **On January 24, Société Générale (SG) communicated that a massive rogue dealing fraud has cost the bank €4.9 billion.** SG reported the fraud in addition to €2.1 billion in U.S. residential mortgage and monoline related write-downs; the latter were revised to €2.6 billion on February 11. SG has launched a rights issue to raise €5.5 billion in fresh capital in the market. In a report, issued on February 4, the authorities concluded that the fraud was an isolated event, but pointed to failures in the bank’s internal controls of derivatives trading, with questions already raised last year by the derivatives exchange, Eurex. The report finds that the subsequent unwinding of the trader’s position conformed to market practice, but was carried out under difficult market conditions. Minister Lagarde has asked for clarification of the communication requirements between regulatory agencies and the government in crisis management. Various other enquiries into the episode are underway. Separately, the authorities have indicated their aversion to possible hostile takeover bids of SG.

3. **Notwithstanding the SG episode, the French banking system appears to be only moderately affected by the ongoing financial turbulence.** So far, most of the large French banks have disclosed manageable exposure to the U.S. subprime market. Two of the large banks have revealed preliminary results for the entire year: BNP has reported an increase over last year’s net income, and—excluding the fraud-related write-downs—SG has reported stable results, despite losses related to the turbulence. However, banks’ exposure and risk may increase in case of a worsening situation of monoline bond insurers¹ and a persistence of the turmoil.

4. **The government has asked financial institutions and regulators to join in efforts at both the national and international level to strengthen internal control of market operations.** The government has asked firms and regulators to work together on improved

¹ BNP and SG are among the eight banks that have joined to aid Ambac Financial Group, a large bond insurer hit by the global turmoil.

internal control systems and better regulation of operational risk management, to reduce vulnerabilities in the French banking system. It noted that banks' management should be fully involved in risk control and fraud identification, and that supervisors may need to raise monetary sanctions against violations of regulations. France has called for setting homogeneous international standards on the management and transparency of operational and reputational risk, within the framework of Basel II.

5. **Credit standards have tightened appreciably in corporate lending, but not in household lending.** The *Banque de France*'s most recent lending survey reported a sharp tightening of banks' credit standards to firms in the fourth quarter and expectations of a further tightening in 2008. French firms have relatively strong balance sheet positions and are less reliant on bank lending than in some other euro area countries; nonetheless, tightening credit conditions, especially if confirmed going forward, would compound downside risks to growth.² In contrast to firms, lending standards to households have remained little changed. This difference suggests that, beyond the impact of the turmoil on bank leverage, the worsening economic outlook may have played a major role in the credit tightening.

Structural issues

6. **President Sarkozy has undertaken to implement most of the Attali Commission's proposals to generate growth in France.** In mid-January, the Commission presented 316 specific measures (*décisions*) covering education, future technologies, competitiveness of SMEs, labor markets, rents and privileges, taxation, and public spending. The objectives are to raise potential growth by 1 percentage point, reduce unemployment to 5 percent, cut poverty, and improve living conditions in problem neighborhoods by 2012. Prime Minister Fillon announced the presentation of a draft law on the "modernization of the economy" in spring 2008, which would also include proposals on the deregulation of retail trade, strengthened competition policies, and measures in support of SMEs. He also initiated consultations with social partners and economic agents to formulate reform plans in a number of other areas, including the regulated professions. Protests by taxi drivers seem, for their part, to have induced the government to distance itself from the specifics of the Attali report's recommendations. Other report proposals are to be covered by existing processes, such as the general expenditure review (RGPP) and negotiations on pension reform due later this year. Ahead of these talks, the government has announced a multi-year increase in the minimum pension (*minimum vieillesse*), with a first installment already in 2008.

² See Selected Issues II, Financing and Risks of French Firms (www.imf.org). The tightening of lending standards for credit to firms, which was more moderate in France until October 2007 (¶7 of the staff report), is now in line with the euro area average.

Staff assessment

7. **The events at Société Générale are troubling, and revealing of serious shortcomings in internal controls, but not such as to affect the overall stability of the French financial system.** If Société Générale successfully concludes its announced recapitalization of €5.5 billion or is merged with a stronger partner, there are unlikely to be systemic repercussions. Contestability, including by potentially interested foreign parties, should however be fully assured. Efforts to enhance operational risk management to avert similar frauds in the future are welcome, with effective enforcement of existing regulations being the priority, and incentives to undue risk-taking in proprietary trading re-examined; regulatory changes might also be needed, and weighed against their cost implications.

8. **Many measures proposed in the Attali report could help lift growth and raise consumer welfare.** The removal of barriers to doing business in the retail sector, including hotels and restaurants, and the strengthening of competition policies would raise supply, improve the efficiency of markets, and lower consumer prices—and are specifically endorsed in the staff report (¶36 and others). Their inclusion in a broader liberalizing draft law in the spring is welcome. With respect to other reforms, it will be important that consultations with social partners and professionals do not result in undue delays or weak agreements, maximizing long-term benefits to consumers. Given the state of public finances, it will be important to offset the budgetary costs of some of the proposals by a redeployment of resources.