Prospects

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# FRENCH DEFICIT AND POLITICS: too late to get out of the woods?

- **Back in February, François Bayrou's government managed to pass a thorny but unconvincing budget for 2025. Since then, you have rightfully forgotten about this topic: speculation about a potential new snap election** (and tariffs, of course) **took centre stage recently.**
- **However, public finances remain the most critical and structural sticking point in French politics right now. Nothing has changed since last year's snap election. Over the medium term, France still has to deliver its largest fiscal adjustment of the past 70 years to stabilise its debt-to-GDP ratio, namely 3.0-4.0% of GDP.**
- **At the end of March, INSEE said that France's 2024 general government budget deficit was 5.8% of GDP (or c.EUR170bn). This figure is narrower than the government's (and our) latest forecast of 6.0%. We still expect that the government's target of 5.4% would be missed in 2025, but by a lesser extent than previously anticipated. Risks are now more tilted to the upside on this deficit figure but we consequently revised down our 2025 public deficit forecast to 5.6% of GDP (previously 6.0%).**
- **Finally, we look at the possible future lever to solve this issue. French public spending amounted to 57.0% of the GDP in 2023, 7.5ppt more than the Eurozone average. This gap mainly comes from pensions (2.2ppt more than the average) and healthcare (1.5ppt). Without tackling these issues, any substantial fiscal consolidation would remain remote and the debt-to-gdp ratio will continue on its upward path.**

## The 2024 deficit slippage was less acute than anticipated: why did this happen, and is it good news?

**At the end of March, INSEE said that France's 2024 general government budget deficit was 5.8% of GDP (or c.EUR170bn). This figure is narrower than the government's (and our) latest forecast of 6.0%.**

This beat is mainly explained by better-than-expected tax receipts at the end of 2024. The lower 2024 deficit ratio remains significantly larger than:

- ✓ The deficit in both 2023 (5.4%, 10bp better than under the previous estimate) and in 2022 (4.8%)
- ✓ The deficit expected by the Government when the initial finance law was voted at the end of 2023 (expected at 4.4% at the time, so 140bp lower) and even after a first round of upward revision in April 2024 (expected at 5.1% at the time, so 70bp lower), due to an upward surprise for the 2023 deficit rising to 5.5%.

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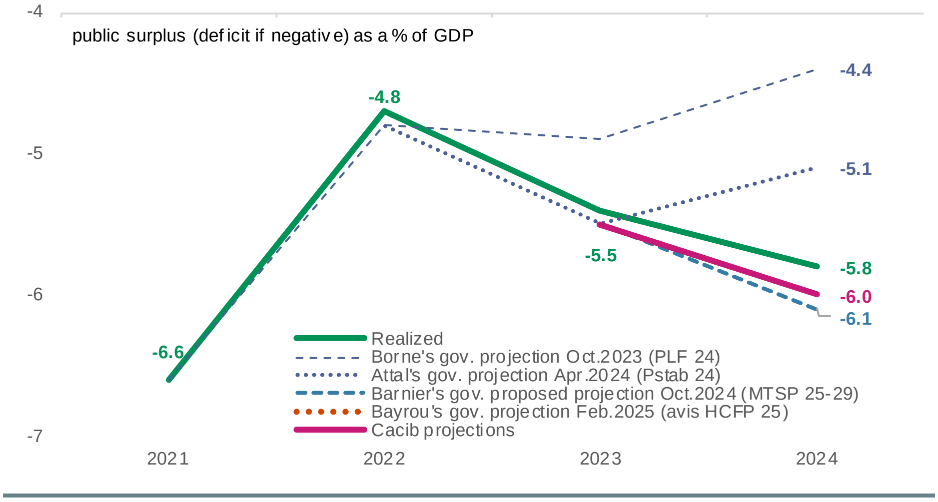
**Evolution of French General Government deficit vs forecasts since 2021**




*Source: INSEE, Crédit Agricole CIB*

**In any case, at first glance, the 5.4% target for 2025 voted for in February by François Bayrou's government should be thought of as closer than expected.**

## The debt-to-GDP bounce is even stronger than expected: why is that, and will it continue?

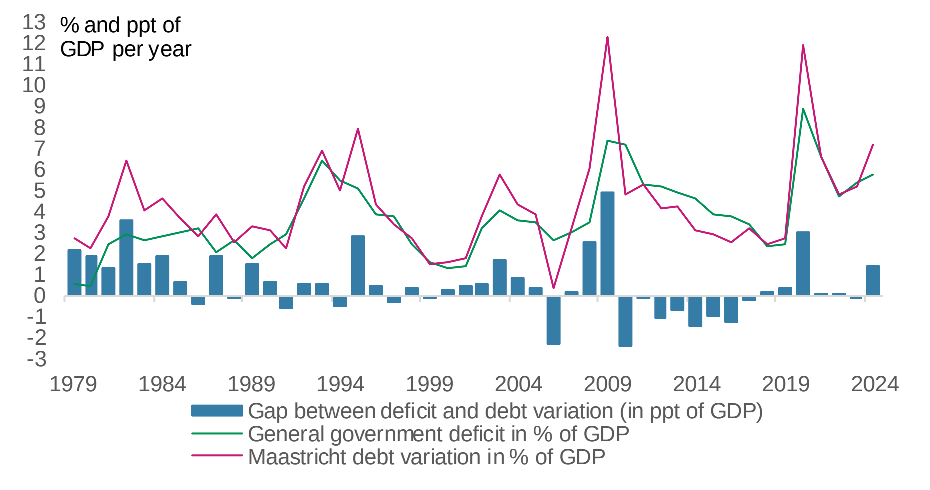
Maastricht debt is "gross" debt (no assets are deducted), "consolidated" (reciprocal claims and debts between public administrations are eliminated) and at "nominal value" (outstanding amounts are not revalued according to the prices of financial liabilities).

Maastricht general government debt amounted to EUR3,305bn at the end of 2024, up by EUR203bn over the year. Consequently, the Maastricht general government debt-to-GDP ratio rose by 3.2ppt, from 109.8% to 113.0%, 10bp above our estimates, despite the beat on the deficit.

The rise in general government debt-to-GDP ratio corresponds to an 'implicit deficit' of 6.9% of GDP, 110bp more than what is implied by the actual deficit figure, or EUR33bn.

**The EUR33bn gap between the rise in debt and deficit was one of the highest in years in 2024. Given the drift of the deficit and the even larger drift of debt, an examination of this gap is required to assess the causes, the nature and the possible further drift of this situation.**

**Deficit vs Maastricht debt variation of the French general government**




*Source: INSEE, Crédit Agricole CIB*

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A gap between the rise in debt and the deficit can stem from:

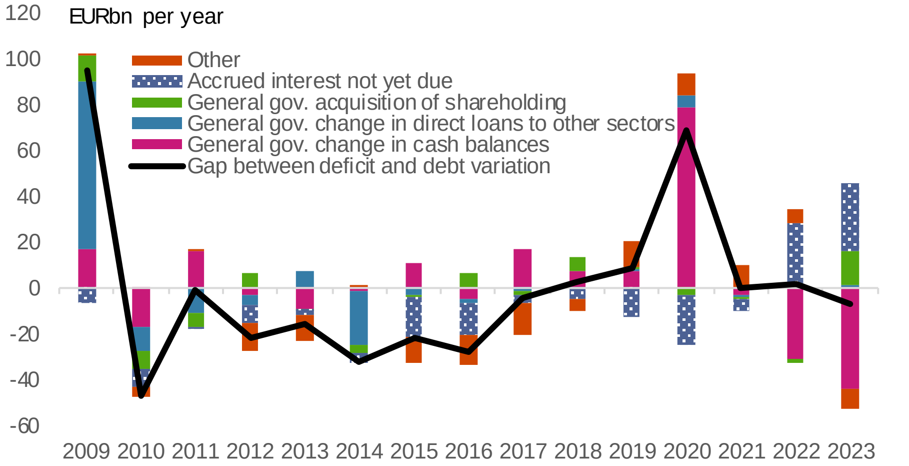
- ✓ **Variation of general government cash holdings that are excluded from the deficit.** Maastricht debt is not net of cash holdings; consequently, an increase as in 2009 or in 2020 results in higher debt variation than deficits, which is usually counterbalanced with a slower rise in debt in subsequent years.

- ✓ **General government loans to other sectors which are excluded from the deficit.** For instance, loans to the banking sector in 2009 were financed by additional public debt issuance but are not generating deficit. It is usually counterbalanced with repayment later on.

- ✓ **Financial operations such as acquisition or disposal of shareholdings that are also excluded from the deficit.** This was the case for bank nationalisations in the 1980s. Motorway privatisations in 2006 had the reverse impact.

- ✓ **Accrued interest not yet due on general government debt which are excluded from the deficit as well.** They correspond to interest generated during the year but not yet paid (because it is paid on the anniversary date, for example). It also includes the amortisation of issue premiums and discounts. When refinancing rates are higher than the apparent interest cost on outstanding debt, this tends to increase debt more than deficit, and conversely.

**Breakdown of the gap between deficit vs Maastricht debt variation of the French general government since 2009**




*Source: INSEE, Crédit Agricole CIB*

**For 2024, the previous breakdown is not yet available, but INSEE provides some details:**

**The EUR33bn of gap between general government deficit and debt variation is mainly central government and social security, not local entities.** When netted from changes in cash balances and short-term securities as well as loans to the private sector of each entity, a remaining EUR21bn appears. While **on the central government side, the EUR16.2bn** amount probably results from **accrued interest not yet due, INSEE specifies for social security:**

> *General government holdings of listed equities and equity securities in collective investment schemes increased by EUR11.8bn. This increase was mainly driven by the ASSOs, whose assets held, mainly in collective investment schemes, rose (+EUR10.7bn or +7.3%), with a revaluation effect, and an effect of asset purchases by units generating surpluses.*

**While the accrued interest factor will probably continue to contribute to a larger rise in public debt than the deficit, others such as the rise in cash balances will likely revert in the near future, suggesting a potential drag on the expected rise in debt-to-GDP ratio.**

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**Breakdown of the gap between deficit vs Maastricht debt variation of the French general government in 2024**

| | Deficit (1) | Debt increase (2) | Gap between deficit and debt variation (3)=(2)-(1) | Cash, short term assets and direct loans to private sector variation (4) | Gap between deficit and debt variation ex. cash (3)-(4) |
|---|---|---|---|---|---|
| Central Gov. | 152.3 | 170.5 | 18.2 | 2.0 | 16.2 |
| Local entities | 16.7 | 13.8 | -2.9 | 0.5 | -3.4 |
| Social security | -1.3 | 21.7 | 23.0 | 10.2 | 12.8 |
| Other | 1.8 | -3.2 | -5.0 | -0.4 | -4.6 |
| **General Gov. (total)** | **169.6** | **202.7** | **33.2** | **12.3** | **21.0** |

*Source: INSEE, Crédit Agricole CIB*

## Where do we stand for 2025 already? Will that gap persist or reverse?

**We recently updated our forecast to include the latest data published by INSEE.**

**We revised our 2025 public deficit forecast to 5.6% of GDP (previously 6.0%). This corresponds to a deficit of EUR167bn. This upward revision is due to the relatively good surprise on 2024 public deficit[1], not to an additional effort on fiscal policy. We still expect that the government's target of 5.4% would be missed, but by a lesser extent than previously anticipated.**

**We expect the gap observed in 2024 between the rise in public debt and the deficit to turn negative in 2025, albeit by a tiny amount corresponding approximately to the observed variation in cash balances and short-term securities as well as loans to the private sector in 2024. Consequently, we estimate that public debt would rise by 3.3ppt in 2025 to 116.3% of GDP.** This rise in public debt would amount to EUR156bn, corresponding to 5.2% of GDP, 40bp less than the deficit. We might, however, revise this point later, when we have more details on the factors driving the gap in 2024.

**However, it is important to keep in mind that risks are mainly tilted to the downside over the short term on our growth scenario:**

- ✓ Our current growth forecast for France in 2025 is 0.8%, which is still achievable but rather in the optimistic fringe of forecasters. The government recently updated its growth forecast to 0.7% (2025 annual progress report on the medium-term budgetary and structural plan for 2025-29), but its inflation forecast is still elevated at 1.4% for CPI (we are at 1.1%), while the mean of the Consensus Forecast for growth was at 0.6% in April (1.3% for CPI inflation). The government now expects public debt at 116.2% of GDP in 2025.

- ✓ We have only partially included tariffs in our scenario, since it was built before the "reciprocal tariffs" (in Donald Trump's sense of the term) were announced on 2 April. Although the negative potential for French growth remains limited (we are talking about 20-30bp of drag in 2025 and a cumulative 50-70bp of GDP drag by 2030 in a very severe scenario[2], ie, reciprocal tariffs as announced by the US administration plus reciprocal retaliation), this constitutes an upward risk to public deficit and debt ratios.

For 2026, we forecast a public deficit of 5.1% GDP, far from the current government target of 4.6%, but still corresponding to an adjustment of 50bp of GDP.

In that scenario, public debt would rise to 117.6% of GDP, in line with the more prudent government target.

[1] This mainly reflects the lower starting point, as the 2024 deficit amounted to 5.8% of GDP against 6.2% in our December 2024 forecasts – revised to 6.0% in January).

[2] We internally estimate that with an increase to 20% (which is paused with a floor increase to 10% for at least 90 days) without retaliation, for France, GDP growth is reduced by -0.1ppt in 2025, -0.2ppt in 2026, -0.1ppt in 2027. It does not have a lasting impact on growth afterwards (i.e. -0.4ppt on GDP cumulatively between now and 2027).

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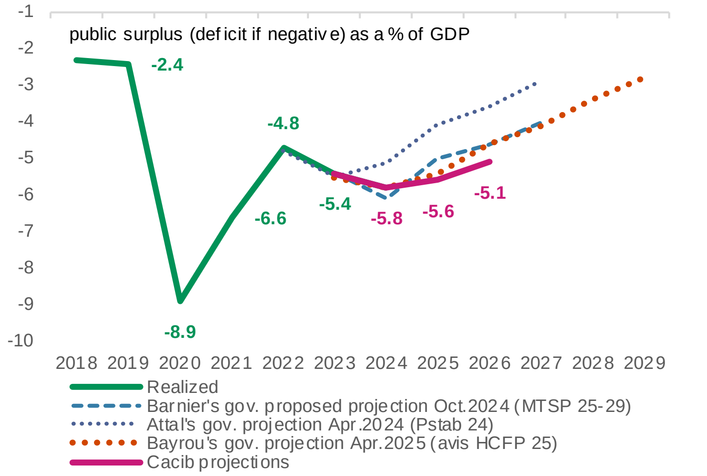
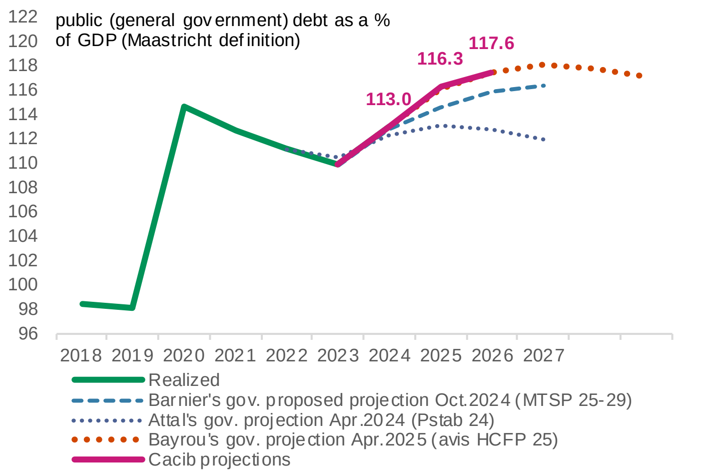
Again, risks are tilted to the downside on growth and upside on deficit and debt metrics.

**General government deficit trajectory**




*Source: INSEE, French Ministry of Finance, Crédit Agricole SA, Crédit Agricole CIB*

**General government Maastricht debt trajectory**




*Source: INSEE, French Ministry of Finance, Crédit Agricole SA, Crédit Agricole CIB*

## Where does France overspend relative to peers?

**Over the medium term, France still has to deliver its largest fiscal adjustment of the past 70 years to stabilise its debt-to-GDP ratio.** France should target a primary surplus of 0.0-1.0% of GDP each year, which means a public deficit of c.1.5-2.5% to completely stabilise its public finances. This represents around 3.0-4.0% of GDP of fiscal consolidation. In other words, the annual deficit must reduce by c.EUR100-120EURbn. The French public debt over GDP ratio is currently rising by c.1.5ppt per year with a deficit around 5.5% structurally.

The high level of public spending in France is partly linked to the social model (even if, of course, it remains necessary to be able to finance it). France also has higher revenues than other countries as a percentage of GDP, precisely in order to finance this social model (even if it is currently insufficient). Given the high level of revenue, France has limited scope to increase it further. **Logically, clients frequently ask us where France is overspending relative to peers and where it could cut spending then[3].**

Eurostat provides a breakdown of public spending by "function" in EU countries. Most of the "functions" in this nomenclature correspond to public policies. This data therefore makes it possible to compare the cost of public policies, as a share of GDP, in France and in other European countries[4].

Public spending in France represented 57.0% of GDP in 2023, 7.5ppt more than the Eurozone average, vs 53.7% in Italy, 48.4% in Germany, 45.4% in Spain and 43.2% in the Netherlands.

**Consequently, the largest contribution to that gap is social security[5], not central government administrative spending or education.** Public spending on social security represented 32.1% of GDP in 2023, 5.1ppt more than the Eurozone average, vs 27.5% in Italy, 27.1% in Germany, 24.8% in Spain and 22.8% in the Netherlands. This gap has tended to increase over the past 20 years.

**By function, the French government's 7.5ppt of GDP overspending vs the rest of the Eurozone mainly comes from pensions (2.2ppt more than the average) and healthcare (1.5ppt).** Almost all other functions display overspending as well but to a lesser extent, namely Family (0.5ppt), Defence (0.5ppt), Education (0.4ppt), Culture (0.4ppt) and Research (0.4ppt).

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[3] This is all the more important given the challenge posed by the likely increase in defence spending given the current context (some of which has already been provided for in the military programming law), and possibly also in the longer term by investment in the ecological transition and adaptation to climate change, which will thwart the objective of reducing spending

[4] Public spending can be compared to GDP to some extent as GDP is equal to the sum of incomes and is therefore an approximate measure of the base on which the taxes and social contributions that finance this spending are levied.

[5] We defined 'social security' as the sum of spending on pension (including survivor pensions), healthcare (hospitals, doctors and pharmacy benefits), family (maternity and family benefits), unemployment benefits, social exclusion and housing benefits.

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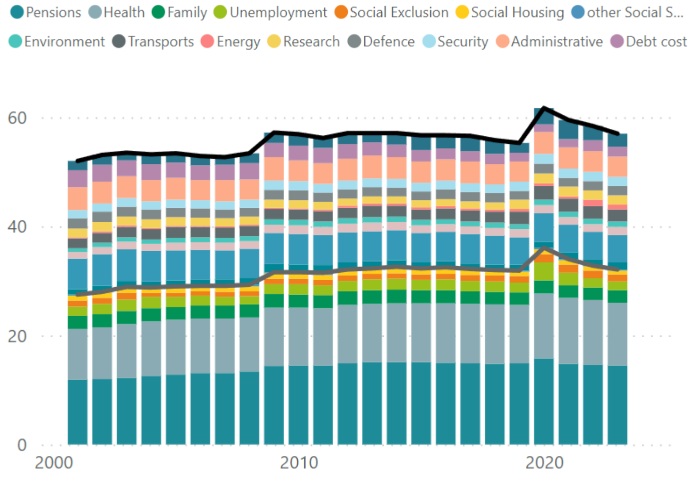
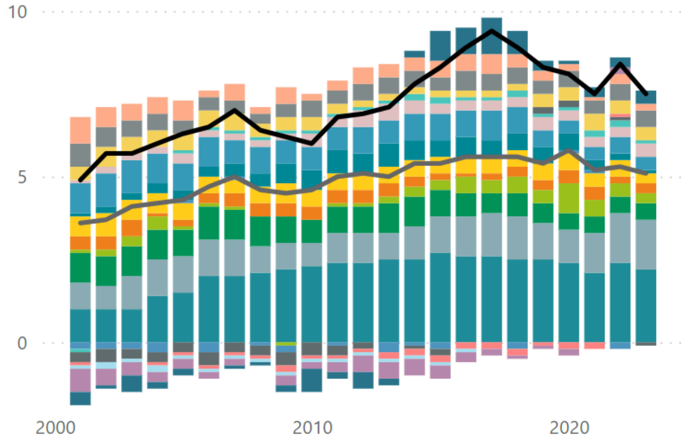
**French general government spending by function as a % of GDP**




*Source: Eurostat, CMIT by Crédit Agricole CIB*

**Difference between France and Eurozone general government spending in ppt of GDP with breakdown by function**




*Source: Eurostat, CMIT by Crédit Agricole CIB*

A 3.5ppt deficit reduction should therefore imply a cut by half of all that excess spending. It means that finding more than 1% of GDP (EUR30-35bn on a yearly basis) on pensions and at least 0.7% (c.EUR20bn) on healthcare. Without that, any substantial fiscal consolidation remains remote.

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# Appendix – local entities' deficit and debt

## Definition

Local public administration entities (ie, local entities) includes Regions, Departments, Cities as well as some local public establishments such as Île de France Mobilités and Société du Grand Paris. They are called "APUL" in French public accounting.

## Local entities' deficits

**Local entities are subject to a 'golden rule' of public finance** that requires that they balance their operating expenditure with their operating revenue (including some transfers from the central government) and **cover** the repayment of past borrowings with the operating surplus or investment grants.

The gap between operating revenues and spending (which cannot be negative because of the golden rule) is called the self-financing capacity ("CAF").

**Local entities are however free to finance their non-financial investments through new borrowings (eg, bank loans or bond issuance for the largest) if they exceed their CAF.**

The local entities' deficit corresponds to the difference between their total expenditures, including non-financial investment, and their revenue (their 'net lending' is the balance between revenue and expenditure). It is part of the total (general government) deficit.

To sum this up:

- ✓ Local entities operating revenue (1)
- ✓ Local entities operating spending (2)
    - Self-financing capacity (CAF) (3) = (1) - (2)
- ✓ Non-financial (net) investments (4)
    - Local entities deficit = (4) - (3)

In 2024, local entities had a deficit of EUR16.7bn (or 0.6% of GDP), up from EUR9.5bn in 2023.

## Local entities' debt

**Local entities' debt is their debt as defined by the Maastricht Treaty, as explained above.** At the end of 2024, it amounted to EUR262bn, or 9.0% of GDP, after EUR248bn and 8.8% of GDP at the end of 2023.

At the end of 2023, 58% of this debt was attributable to cities, 15% to *départements* (excluding Paris, as Paris is both a *département* and a city) and 17% to regions for 17%.

At the end of 2023, 75% of this debt consisted of long-term bank loans. Long-term debt securities (bonds) also account for 23% of this debt. This proportion has been rising steadily in recent years (it was just 3% in 2008). In 2023, the interest expense of local authorities was EUR5.1bn (including bank charges and commissions in national accounts).

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