

## France's public deficit widens sharply

France's public finances deteriorated in 2023, with the deficit reaching 5.5% compared with 4.8% in 2022. This is much worse than the government had forecast, and fiscal policy is likely to become more restrictive



### Renewed attention to public finances, which are deteriorating sharply

In a spectacular turn of events after years without the French budget situation arousing any interest, the question of the sustainability of public finances has returned to the centre of the news. The publication of the deficit and debt figures for 2023 has been much-anticipated, and the figure is finally official. The French statistics institute, INSEE, announced this morning that the public deficit in France amounted 5.5% of GDP in 2023 compared with 4.8% in 2022.

This deterioration is attributable to slowing revenues rising by just 2% year-on-year, while expenditure is increasing by 4.3% over the same period. In 2023, public spending represented 57.3% of GDP, down from 58.8% in 2022, while revenues were equivalent to 51.9% of GDP compared with 54% in 2022. Against this backdrop, French public debt reached 110.6% of GDP, compared with 111.9% in 2022. Before the pandemic, French debt was equivalent to 97.9% of GDP.

## Worse than forecast by the government

This figure is significantly higher than the government's target of a deficit of 4.9% of GDP by 2023. The slippage is not attributable to public spending – which has broadly behaved as expected – but rather to revenue, which has been much weaker than forecast. This is particularly the case with revenue from corporation tax, while VAT, social security contributions and income tax have also been disappointing. Weak GDP growth in the second half of 2023 and sluggish job creation account for some of this disappointment, while overly optimistic forecasts account for the rest. Ultimately, 2023 was synonymous with a marked deterioration in public finances. The official figures have not all been published yet, but France will find itself among the countries with the worst budget situation in the EU.

## The budget situation will also deteriorate significantly in 2024

This setback has largely jeopardised the government's targets for 2024 and, more generally, the entire budget trajectory envisaged until the end of Emmanuel Macron's second five-year term in 2027. While the government has widely reiterated that the target of a 3% deficit in 2027 is as relevant as ever, how this will be achieved remains highly uncertain.

For 2024, the government had targeted a deficit of 4.4% of GDP. Given the revised figures for 2023, this target is now completely unattainable, with the starting point being much worse than expected. At the end of 2023, the government was also counting on GDP growth of 1.4% in 2024. This growth forecast was revised down to 1% in February but remains rather optimistic. INSEE estimates that GDP growth should be 0% in the first quarter and 0.3% in the second, which would take the carry-over effect at 0.5% by mid-year. Reaching 1% for the year as a whole would require quarterly growth to average 0.8% in the third and fourth quarters, which seems highly unlikely at this stage. We are slightly less optimistic than INSEE for the first part of the year and are expecting GDP growth of 0.5% for 2024 as a whole. In short, with a worse-than-expected starting point and weaker-than-expected growth, the deficit could well exceed 5% again in 2024.

## Fiscal policy is likely to become much more restrictive

Faced with such a situation, the government will have to act. But how is it going to rectify the situation? The situation is extremely complex. On the one hand, the government does not have a majority in parliament, which makes any vote on a public finance bill very complicated. In addition, June will be tied to the European elections, and it is difficult for the parties in power to pass unpopular reforms before these take place. Between now and the end of June, there will be new assessments of France's budgetary situation by the rating agencies. The government will have to announce measures in order to avoid a downgrading.

It is likely that new savings measures will be proposed by the government, above the 10 billion already announced. Over the last few days, a number of ideas have been floated, including savings to be made by local authorities, questions about unemployment insurance, and a whole series of spending measures (the effectiveness of which needs to be analysed), but no concrete decision appears to be underway yet. Since the beginning of Macron's presidency, the idea has been not to raise taxes, but only to modulate spending. In recent days, the government's supporters seem to be going back on this idea, with some mentioning targeted tax rises. Tax rises can therefore no longer be ruled out.

Beyond the issue of 2024, the real test is going to be in September with the 2025 budget. Given the

new Stability and Growth Pact, the French government will be forced to take more significant measures. Ultimately, even if uncertainty reigns over the measures that will be taken, fiscal policy will become markedly more restrictive over the coming quarters and years, which will weigh on economic growth after years of very expansionary fiscal policy.

## Market reaction contained and bonds to benefit from monetary policy easing

Markets have absorbed the rumours of a higher deficit, with the 10Y French sovereign bonds spread widening around 2-3bp more versus Bunds than the wider trends would have suggested last week. This leaves the 10Y spread at around 47bp currently. The direct impact has therefore been relatively muted, suggesting worries about the government's ability to steer the budget to a sustainable path are contained.

For now, risk sentiment towards sovereign spreads in general looks very robust with the prospect of the European Central Bank soon turning towards easing monetary policy on the cards. But there is a risk that the very tight levels in spreads overall get challenged as the EU parliamentary elections and a potential shift to the right move into focus. In terms of yield levels, we foresee long-term yields having some scope to go lower as the first ECB rate cuts materialise, which we're currently pencilling in for June.

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