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FRANCE

France's very low inflation rate is a major challenge for public finances

Inflation fell to 0.3% in France in January, reigniting the debate over the orientation of the ECB's monetary policy. However, I believe the implications for French public finances are even more concerning



With inflation regarded as being too low by the Banque de France, this could have an impact on the continued public finances strain

French inflation persistently undershooting the eurozone's average

In France, inflation stood at 0.3% year-on-year in January, down from 0.8% in December. According to the harmonised index, it reached 0.4%, compared with 0.7% the previous month. Such a low level had not been observed since the Covid-19 pandemic, a period marked by the collapse in demand linked to lockdowns. Before that, one would have to go back to 2016.

This weakness is primarily explained by the sharp fall in prices of manufactured goods ($\downarrow 1.2\%$ year-on-year), linked to a change in the seasonal sales timing. Energy prices are also weighing heavily on inflation, with a year-on-year decline of 7.6%, reflecting both developments in global markets and the 15% cut in regulated gas tariffs decided in February 2025. By contrast,

food inflation accelerated in January to 1.9% year-on-year, while services inflation slowed to 1.7%. Core inflation stands at just 0.7%.

The French situation contrasts sharply with that of the rest of the euro area, where inflation reached an average of 1.7% in January according to the flash estimate, and where core inflation remains much higher, at 2.3%. In this context, criticism is growing in France of an ECB monetary policy deemed ill-suited to the national situation. [With the key interest rate held at 2% for several months](#), some argue that the French economy is being subjected to an excessively restrictive policy. This issue was once again raised by the Governor of the Banque de France, [François Villeroy de Galhau, this Wednesday before the National Assembly](#).

Is monetary policy too restrictive for France?

It is true that with very low inflation and policy rates at 2%, the real interest rate faced by the French economy is positive and higher than in neighbouring countries where inflation is more dynamic. Some people argue that this weighs on investment and, more broadly, on economic activity. However, in assessing how restrictive monetary policy is, it is not inflation in a single month that matters, but rather expected inflation and its trajectory over the coming years.

Inflation is expected to rise in France in the months ahead. The timing of seasonal sales differs in 2026 compared with 2025, which will lead to a more pronounced increase in prices in February. In addition, the 15% cut in electricity prices implemented on 1 February 2025 will drop out of the base effect this month, mechanically pushing energy inflation higher. This rebound will nevertheless remain limited, and my forecast of average inflation of 1.3% in 2026 already appears optimistic. With inflation close to 1% in France, it will continue to be well below that of the euro area, where we expect inflation to average 1.9%. However, investment decisions probably consider longer-term inflation expectations. In that regard, the priced in inflation by the market for France over the next 10 years is only marginally below the eurozone's average market pricing of inflation.

Anyway, inflation differences between member states are normal within a monetary union and will not lead the ECB to change its stance, as long as there is no risk of an inflation undershoot for the whole of the eurozone. Monetary policy must be set for the euro area, not tailored to a single country. Nevertheless, it is likely that the Governor of the Banque de France will continue to warn his counterparts about the risks of too low inflation. In particular, the issue of the euro's appreciation and its impact on imported inflation will remain under scrutiny. [We indeed believe that a further strong appreciation of the euro could reopen the door to interest rate cuts](#).

Low inflation not necessarily harmful to the economy...

It should also be recalled that low inflation in France is not intrinsically negative for the economy. François Villeroy de Galhau regularly stresses that more subdued inflation has

allowed wage growth in France to remain more moderate than in partner countries, thereby supporting competitiveness. Since the end of 2019, the increase in unit labour costs in market sectors has been 10 percentage points lower than in Germany, and 6 percentage points lower than in the euro area.

In theory, this competitiveness gain is an asset. However, it still needs to translate into faster growth. So far, political and fiscal uncertainty in recent months has prevented any significant rebound in activity. One can only hope that these competitive advantages will eventually feed through to growth in the months ahead.

A serious threat to public finances sustainability

I believe that where low inflation could become truly problematic is in the dynamics of public debt. Low inflation implies weak nominal growth. If, as we expect, real GDP growth stands at around 1% in 2026, with inflation also close to 1%, nominal growth would barely reach 2% (the GDP-deflator is pretty close to consumer price inflation). At the same time, according to the latest European Commission forecasts, the implicit interest rate on French public debt would rise to 2.2% in 2026 and 2.4% in 2027. In this context, nominal growth is no longer sufficient to offset the interest burden, and even in the absence of a deficit, the public debt-to-GDP ratio would mechanically increase (because debt to GDP is above 100%).

For France, the problem is even more acute as public finances are already in very poor shape. The 2026 budget plans for a public deficit of 5% of GDP, after 5.4% in 2025, which would push public debt to 118.2% of GDP, compared with 115.9% in 2025. This compromise budget has resolved none of the structural imbalances. With the presidential election scheduled for April 2027 approaching, budget discussions for 2027 are expected to be even more delicate, making a lasting reduction in the deficit unlikely in the coming years.

Under these conditions, France risks remaining durably trapped in a high-deficit regime, while low inflation keeps nominal growth at an insufficient level. In the absence of a major positive productivity shock capable of sustainably lifting real growth, the public debt ratio will continue to deteriorate rapidly. This deterioration will be more pronounced than in other European countries, such as Belgium, where the deficit is also high, but more dynamic inflation provides stronger support to nominal growth.

It is often said that inflation is the debtor's friend. In the French case, its weakness acts as an accelerator of existing vulnerabilities. The sustainability of public finances, therefore, continues to stand out as one of France's main macroeconomic challenges for the years ahead.

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