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Statement by Mr. Palotai, Mr. Just, and Mr. Marek on France
(Preliminary)
Executive Board Meeting
January 13, 2021

We thank staff for the detailed set of reports and Mr. Buissé and Mr. Rozan for their helpful Buff statement. France has been severely hit by the fallout of the crisis, but the authorities' timely policy response has moderated the impact of the shock on the economy. The outlook for France is subject to uncertainty, depending on the duration of the restrictive measures as well as the deployment of the vaccine. The policy response should therefore continue to counter the pandemic, while strengthening fiscal sustainability in the medium term. Pursuing structural transformation focusing on digitalization and green economy will be critical to enhance competitiveness and sustainability. We associate ourselves with the statement by Mr. Pösö.

Targeted fiscal support should be combined with pursuing prudent medium-term fiscal positions through expenditure-based consolidation. The policy response has provided strong and timely support to both companies and households, alleviating the impacts of the crisis on the economy. We note positively that the authorities aim to strengthen corporate balance sheets through medium- to long-term financing provided to firms with viable business models in need of further expansion. However, we encourage them to closely monitor the scheme's effectiveness as the public portfolio guarantees represent a contingent liability for the government. In view of the already high primary fiscal deficits projected for the coming years and possibly over-optimistic medium-term growth assumptions, we encourage the authorities to implement a medium-term fiscal consolidation to bring public debt on a downward path. We are concerned by staff's projections of overall public debt as a share of GDP, suggesting it will be on an upward trend until the end of the projection horizon in 2025. Therefore, reforms bolstering fiscal sustainability should be the authorities' medium-term priority, in particular of the pension system and unemployment benefits reform.

Addressing insolvency risks and profitability challenges will be critical to the stability of the banking sector, while the insurance sector needs to be closely monitored. We take positive note of the banking sector's capital and liquidity position which helped contain the financial stability risks so far. While the NPL ratio was relatively low prior to the pandemic, we underscore that the supervisory authorities need to stay vigilant of the vulnerabilities arising from the withdrawal of the liquidity support and loan guarantees to corporates as well as the real estate market developments. Adequate loan provisioning is therefore critical. Banks' balance sheets could be further impacted by corporate bankruptcies, which are traditionally high in France and will be further amplified by the current crisis. We therefore encourage the authorities to swiftly implement the EU Directive on Preventive Restructuring Frameworks. The low-for-long environment also creates profitability challenges for both banks and insurance companies. While we acknowledge the insurers' strong solvency position, low interest rates may weigh on their ability to meet long-term liabilities. Supervisors should also monitor the bank insurance sectors exposures in view of the risks stemming from climate change-induced losses and pay close attention to cyber security.

The authorities should press ahead with structural reforms and increase productivity. We note that unemployment was substantially above the EU average already before the crisis. We are concerned that despite the large-scale support, the unemployment rate is projected to increase to about 10½ percent and decline only gradually. Therefore, policies should in particular focus on integrating disadvantaged groups into the labor market, including those with low education and migrants. This would also address inequality of opportunities. More progress is needed to reduce labor market segmentation, once the employment support schemes, including the short-time work scheme, have been scaled back. Greater diffusion of best practices and technology in the economy, as well as enhancing competitiveness in the services sector through reducing regulatory barriers to entry, will be critical to strengthen productivity. As the share of "zombie firms" was relatively high prior to the crisis, the current public support schemes should avoid extending lifelines to companies, which would otherwise no longer be productive. The Plan de Relance should be implemented in line with these objectives, in particular to stimulate the digital transition and eliminate distortive taxation.