Haut Conseil des Finances Publiques

Opinion n° HCFP-2019-1

on the macroeconomic assumptions of the 2019-2022 Stability programme

9 April 2019

Summary

The Stability programme is submitted every year by mid-April in the context of the European semester. The High Council of Public Finance observes that this Stability programme has been designed independently of the future developments that might follow the "Great National Debate". Moreover, the way how Brexit will be implemented is a major risk upon growth prospects.

With these reservations, the High Council considers that the growth, employment and payroll forecasts for 2019, which have been revised downwards since the last budget bill, are realistic. The inflation forecasts are plausible.

The High Council deems the Government's estimates of potential growth and output gap for the years 2019 to 2022 reasonable, as they are within the available estimation range.

However, as in April 2018, it points out that the uncertainty surrounding the estimates of output gap is significant. Particularly, the tension and inflation indicators provide divergent messages. Indeed, although capacity utilization rates in manufacturing and recruitment difficulties are above their long-term average at the beginning of 2019, underlying inflation, which faintly fluctuates and stays at a low level, does not show any signs of tension.

The High Council stresses that the Government's growth forecasts for the years 2020 to 2022 have been revised downwards since the Stability programme of April 2018, which had been considered "optimistic" by the High Council. The adopted scenario, which states an actual growth being close, but slightly above the potential growth until 2022, corresponds to a stable output gap around zero. The High Council notes that this scenario is a more reasonable basis for multi-year public finance programming.

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The High Council of Public Finance notes that the Government chose to build a more credible medium term macroeconomic scenario.

However, it points out that, due to the revision of the macroeconomic scenario and to the more significant tax reduction in comparison with the previous Stability programme, the current one leads to a significantly lower reduction of actual and structural deficits in 2022 and, as a consequence, of public debt. Therefore, a rigorous respect of public expenditure objectives is even more required.

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Introductory remarks

Under article 17 of the constitutional bylaw n°2012-1403 of 17 December 2012 on public finance planning and governance, the High Council of public finance delivers an opinion on the macroeconomic assumptions associated with the Stability programme for the years 2019 to 2022. The Stability programme shall be submitted to the European institutions annually before 30 April (article 4 of the regulation (EC) n°1466/97), and delivered to the French Parliament two weeks before (article 14 of the public finance programming law for the years 2011 to 2014 n°2010-1645 of 28 December 2010). **Consequently, this Stability programme has been designed independently of the future developments that might follow the "Great National Debate". Moreover, the way how Brexit will be implemented is a major risk upon growth prospects.**

1- The opinion's scope

Under the article 17 of the constitutional bylaw of 17 December 2012, the High Council of public finance delivers an opinion on the macroeconomic assumptions of the Stability programme.

Thus, the following opinion is not about the scenario for public finance itself. However, given the effects of public finance on growth in the short and medium terms, the High Council took into account other issues related to public finance in order to assess the consistency of the macroeconomic assumptions submitted by the Government.

2- On the information submitted

The High Council of public finance received from the Government on 3 April 2019 the referral file on the macroeconomic assumptions of the 2019-2022 Stability programme. The file was supplemented with detailed answers to a questionnaire previously addressed to the relevant administrations. On 5 April 2019, the administrations answered an additional questionnaire as well.

3- On the methodology used by the High Council

To assess the realism of the macroeconomic forecasts submitted by the Government, the High Council considered all the information available at the day of its publication: last statistics and other information provided by the Government.

The High Council's opinion relies on the last economic forecasts produced by several institutions, including international organizations – the European Commission, the International Monetary Fund (IMF), the European Central Bank (ECB) and the Organization for Economic Cooperation and Development (OECD) – and national institutions : the French National Institute of Statistics and Economic Studies (Insee), the Banque de France and forecasting institutes such as COE-Rexecode or the French Economic Observatory (OFCE).

Moreover, the High Council organized hearings with representatives of the Treasury General Directorate, the Budget Directorate, INSEE and other institutions and experts from outside the French Ministry of finance (representatives of OFCE, OECD, COE-Rexecode and the Banque de France).

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After a general analysis of the economic context (I), the High Council delivers its opinion on the macroeconomic forecasts submitted by the Government in the Stability programme for 2019 (II) and for 2020-2022 (III).

I- A less supportive global and European economic environment in 2019

1- The growth of international trade slowed down sharply in 2019

The growth of international trade was fast in 2017 (+5.7%) and still sustained in 2018 (+4.8%), but tightened in the end of the year 2018. This downturn is due to many factors, especially the rise in the tariffs initiated by the United States, the slackening of emerging countries (China in particular) and the difficulties experienced by the car sector.

In the United States, economic activity was sustained in 2018, but it will likely slow down since the effects of the budgetary drive are fading.

The Chinese growth is running out of steam due to a slowdown of domestic and foreign demand at the same time. The evolutions of the other emerging countries are contrasted: fast growth in India, fragile recovery in Russia, recession in Turkey.

In 2019, the growth of international trade in annual average would slow down and be around 3% (3.3% according to the OECD in March, 2.6% for the WTO and 3.4% for the FMI in April) despite a rebound expected during the year.

2- In the Euro Area, the drop of growth is particularly marked

During the second semester of 2018, European growth has been weak (semester-on-semester rate of 0.4%), with a slight decrease in the German and Italian GDP (-0.2%). This slowdown, which reflects the slackening of international trade, was accentuated by the adaptation difficulties experienced by the car sector towards the implementation of the new norms of approval on 1 September 2018, especially in Germany.

For the first semester of 2019, the Euro Area could get back to a moderate growth thanks to consumption. The decrease in inflation and the adoption of policies that aim to support households' revenues in several countries (Germany, Italy, France and Spain) would trigger gains in purchasing power.

Growth forecasts for 2019 coming from the *Consensus Forecasts* and the international organizations have been noticeably revised downwards since spring 2018.

On the whole, the growth of the Euro Area would reach 1.3% according to the European Commission, the IMF and the French Government, 1.2% for the OECD or 1.1% for the ECB. In other words, the growth in 2019 would be markedly lower than in the last two years (2.5% in 2017 and 1.8% in 2018). This growth forecast is consistent with the deterioration of the business climate for a year.

3- The French growth is slightly above the average of the Euro Area since mid-2018

In a background of contrasted evolutions within the Euro Area, the French growth was slightly more sustained than the growth of its main neighbors during the second semester of 2018. Such a situation was expected, since the first semester was affected by the schedule of fiscal policies in particular. It reflects the lower sensibility of the French economy regarding external shocks as well.

France benefited from more sustained business investment and from a slightly more favorable contribution of foreign exchanges, in comparison with the Euro Area. However, households' investment has been less dynamic. Furthermore, consumption has been lifeless in the fourth quarter, especially due to the social movements that took place in the end of the year.

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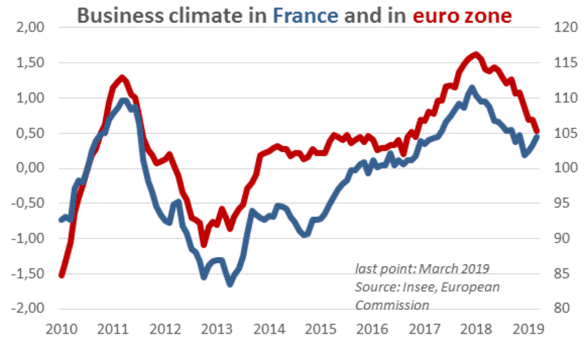
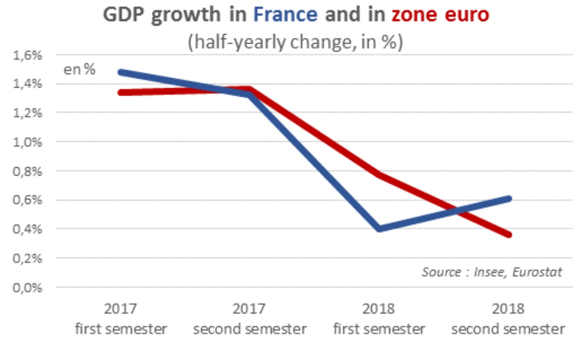




With respect to the Euro Area, French growth spread might remain stable during the first semester of 2019, according to Insee's forecasts and to the organizations heard by the High Council. After a continuous deterioration of French business climate during 2018, it slightly recovered in February and March, and its level is now slightly superior to its long run average. Domestic demand would be strengthened by a recovery of consumption, which would be brought by significant gains in purchasing power in the fourth quarter of 2018 and in the first quarter of 2019.

4- The international environment remains subject to significant uncertainties

The macroeconomic background presents several uncertainties that might affect global and European activity.

The way how Brexit will be implemented is a major risk that might be realized in the very short run. A no-deal Brexit would have a strong negative impact on the dynamics of French growth[1].

The stiffening of protectionist tensions and an increased slowdown of Chinese and American activity are still major risks. The recovery of international trade might be slower than predicted.

The path of French growth depends on the evolutions of its main neighbors in the Euro Area too. The pursuit of the slowdown observed in Italy and in Germany for the last quarters would affect French activity.

Conversely, some countries might use their budgetary leeway in order to support the economic activity more.

Furthermore, more expansive monetary policies, which are resulting from the decisions made by the Fed and the ECB during the last months, soften the risk of a fast increase in the interest rates.

[1] In its « Note de conjoncture » published in March 2019, the Insee estimated the impact on trade of an increase in tariffs between the United Kingdom and the European Union. Even if such an increase would be only a part of the Brexit impact, its cumulated effect on the French economy "would be around -0.3% of the GDP, spread on several quarters" in the case of a "soft Brexit", and "around -0.6%" in the case of a "hard Brexit".

II- Observations on the forecast for 2019

1- The Government's scenario

According to the Government, *"After +1.6% in 2018, the growth would reach +1.4% in 2019. […]*

Growth would stabilize in 2019 and 2020 to a sustained pace, but it would be slightly under the pace of 2018. Households' consumption would be strongly supported by the policies aiming to support purchasing power, particularly those taken in December. […] However, French exports would slow down in 2019, because of the lower vigorousness of global demand. After a fast increase since 2015, business investment would be gradually normalized, as the international environment is less supportive and as the interest rates gradually increase. Households' investment, especially construction, would decrease in 2019. […]

Inflation would decrease to 1.3% for the years 2019 and 2020, as volatile prices and regulated tariffs would be less dynamic. […] Oil products would not contribute to inflation for both years. Core inflation would increase to 1.1% in 2019 and 1.2% in 2020, after 0.8% in 2018. It would be mainly supported by the inflation of the service sector, that is to say the component which is the most sensible to the past acceleration of wages."

2- Opinion of the High Council

a) About GDP growth

The GDP growth for 2019 planned by the Government in the Stability programme is 1.4%. It is revised downwards since the budget bill for 2019 (1.7%).

This forecast lies on a hypothesis of international trade growth (+3%) that corresponds to the average of international institutions (see part I).

The mechanisms described by the Government are consistent with the information that is available in the beginning of the year. Households' consumption might be supported by the significant gains in purchasing power (year-on-year increase by +2.9% for the first quarter of 2019, according to Insee) resulting in the pursuit of the income growth, the slowdown of inflation and the social and fiscal measures taken in the end of 2018[2].

These gains, which are concentrated during the fourth quarter of 2019 and the first quarter of 2019, have been so far absorbed for a large part by the increase in the savings rate, which reached a particularly high level. Consumption will depend on the households' perception of the evolution of their purchasing power and on their faith in the future. The High Council considers that the Government's hypothesis of a savings rate increasing from 14.4% in 2018 to 14.7% in 2019 is prudent.

[2] The High Council did not give an opinion on the effects of these policies, since the Government did not refer to it, despite their significant impact on public finances. This is due to the writing of the High Council's mandate in the constitutional bylaw in 2012: it states that "during the examination by the Parliament of a budget bill", the High Council shall be "referred to" only when "the Government choses to revise the macroeconomic forecasts on which lied its bill initially".
But despite the significant feature of the policies that have been incorporated in December in the budget act for 2019 and in the law n°2018-1213 of 24 December 2018 on the economic and social emergency policies, the Government did not change its macroeconomic forecasts for 2019.

Several studies are indicating a pursuit of the increase in business investment, which is consistent with still high capacity utilization rates.

During the last two quarters of 2018, French growth was at 0.3% per quarter (that is to say a carryover for 2019 at 0.4% in the end of the year). In order to reach the growth forecast for 2019 of the Stability programme, and without revision of growth for these last quarters, quarterly growth shall be slightly over 0.4% in 2019. This number is consistent with Insee's forecasts on March 2019 for the first semester.

Government's growth forecast for 2019 is in line with international institutions' forecasts (1.3% according to the European Commission in February 2019, the OECD in March and the IMF in April) and with the other national forecasts (1.5% according to OFCE, 1.4% for the Banque de France and 1.3% for Rexecode). The Consensus Forecasts' average for France, which gathers the estimates of twenty-three economic forecasters, is at 1.3% in March, with a minimum of 1.0% and a maximum of 1.8%.

The High Council considers that the growth forecast for 2019 of the Stability programme is realistic.

b) About employment and payroll

The growth of **paid employment in the non-agricultural market sector** would be less sustained in 2019 (+ 145,000 in annual average) than in 2018 (+ 241,000) because of the activity slowdown. According to the Government, the impact of employment policies would be more significant in 2019 than in 2018 thanks to the transformation of the "CICE" (competitiveness and employment tax credit) and to the increase in the reduction of social contributions.

The **average nominal wage** would accelerate in 2019 (+2.3% after 1.9%), due to especially the introduction of an exceptional bonus, exempted from social contributions.

Breakdown of the wage bill in the non-agricultural market sector

(% changes)

	2017	2018	2019 (forecast)
Salaried employment	1,8	1,6	0,9
Average wage per capita	1,9	1,9	2,3
Wage bill	3,6	3,5	3,1

Source : stability programme 2019 – 2022

Overall, the **market sector payroll** would increase by 3.1% in value in 2019, which is lower than the forecast of the budget bill for 2019 (3.5%).

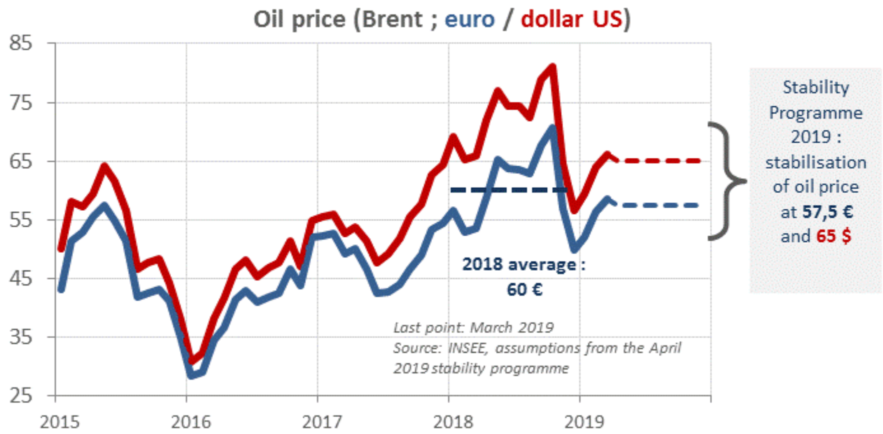
The High Council considers that the employment and payroll forecasts for 2019 are realistic.

c) About consumer prices

With a hypothesis stating a stabilization of oil prices[3], the Stability programme predicts an increase in the **consumer price index[4]** by an annual average rate of 1.3% in 2019, after 1.8% in 2018 and 1.0% in 2017.

This forecast for 2019 corresponds to the average of the Consensus Forecasts.

The contribution of energy prices would be around zero in 2019 (after 0.8 point in 2018), as the decrease in oil prices is offset by the increase in gas and electricity prices. The contribution of tobacco would reach 0.2 point (0.3 point in 2018).



Core inflation, which excludes volatile commodities (energy, tobacco, food), would keep on increasing in 2019 (1.1%, after 0.8% in 2018 and 0.5% in 2017), mainly due to an acceleration of service prices. The increase in some industrial prices and in agricultural raw material prices would contribute to it as well.

However, the available information in March suggests that the expected increase in core inflation might be slower than forecast by the Government.

Nevertheless, the High Council considers that the Government's inflation forecasts for 2019 are plausible.

III- Remarks on the macroeconomic scenario for the years 2020 to 2022

The growth and inflation forecasts until 2022 included in the Stability programme shall be examined with respect to the position of the French economy in the business cycle. In order to do so, the output gap, which is the gap between current and potential GDP, shall be estimated. The potential GDP is defined as the so-called sustainable production, which is the production that can be reached without triggering any inflationist or disinflationist effect. In theory, a negative output gap is an indicator for the ability of growth to increase, whereas a positive output gap reflects the possibility of a slowdown.

[3] The Stability programme is based on a hypothesis stating a stabilization of oil prices at 65$ in 2019 (against 73$ in the budget bill for 2019). The hypothesis for the euro/dollar exchange rate is 1.13 $.
[4] Consumer price index (CPI) from the Insee.

A. The potential growth and the output gap in the beginning of the period

1- The Government's scenario

According to the Government, *"potential growth […] would be at 1.3% in 2021 and 1.35% in 2022, after 1.25% for the years 2019 and 2020. […]Potential growth would increase until 2022 thanks to the positive impact of the structural reforms implemented during the five-year term. […]*

After a negative output gap for seven years (from 2012 to 2018), the output gap would close in 2020. Then the current growth would be almost equal than the potential growth in 2021 and 2022."

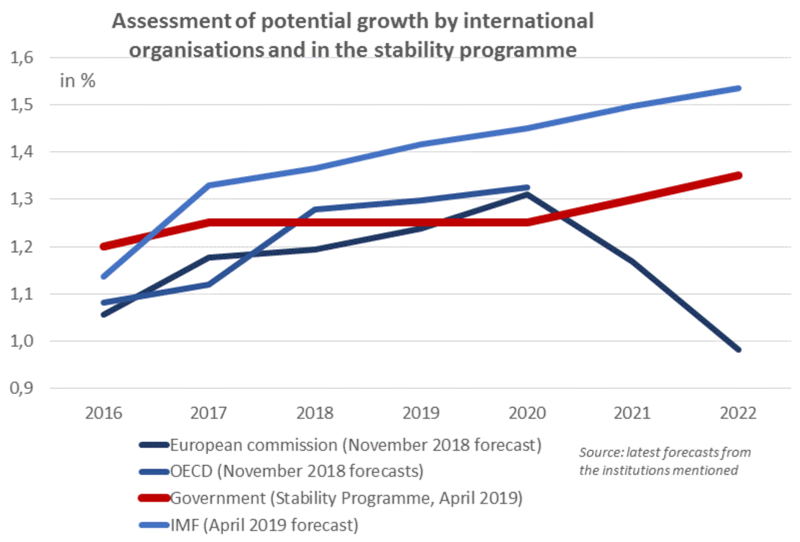
2- Opinion of the High Council

a) The potential growth for the next years

The hypothesis are unchanged in comparison with the public finance programming law for the years 2018 to 2022[5], which states a potential growth at 1.25% for the years 2018 to 2020, then a slight increase in 2021 (1.3%) and in 2022 (1.35%).

The potential growth estimates of the international institutions are diverging. The IMF takes into account a strong impact of the structural reforms on potential growth. The European Commission predicts a stronger slowdown of the active population (from an increase by 0.5% to 0.0%)[6].

The potential growth estimate of the Stability program is in line with the forecasts of OFCE and Rexecode.



The High Council deems the Government's estimates of potential growth for the years 2019 to 2022 reasonable, as they are within the available estimation range.

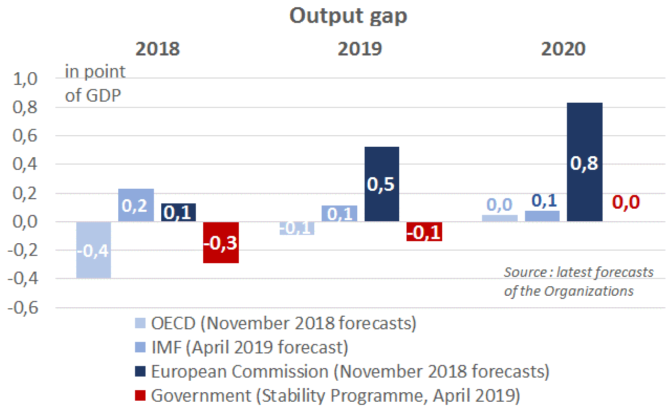
[5] Law n°2018-32 of 22 January 2018.

[6] In comparison, Insee's forecasts of the active population are indicating a significantly lower slowdown between 2018 and 2022: from 0.3% to 0.1% (Insee Première n°1646 of 9 May 2017 about the projection until 2070).

b) The output gap in the beginning of the period

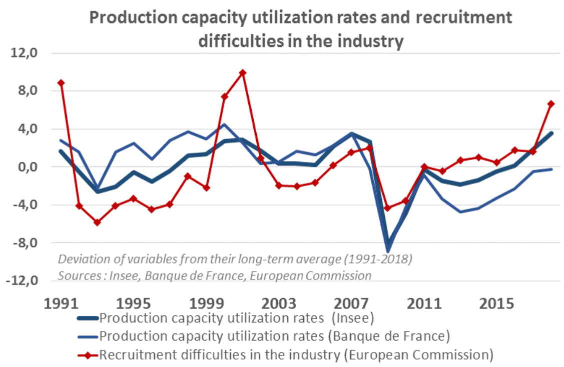
For 2018, the Government's estimate of -0.3 GDP point is included between the estimate of the OCDE (-0.4), the European Commission (+0.1) and the IMF (+0.2).

For the years 2018 to 2022, the Government's output gap estimates are in the lower part of the international institutions' estimation range.



The output gap is neither an observable nor a countable data, and its estimates are subject to significant revisions[7]. It is possible to complete the analysis of output gaps by a direct observation of situation and price indicators that are linked with the business cycle. They provide contrasting messages.

The capacity utilization rates in manufacturing and the recruitment difficulties are still above their long-term average at the beginning of 2019, suggesting that the French economy might be more advanced in the business cycle than indicated by the output gap estimates. These tensions are not reduced despite the activity slowdown observed during the year 2018. However, core inflation stays low and does not show any signs of tensions.



The High Council deems the Government's estimates of output gap for the years 2019 to 2022 reasonable, as they are within the available estimation range.

[7] For France, the output gap estimates are subject to significant revisions. See the second annex in the Opinion n° HCFP-2018-1 about the macroeconomic forecasts of the Stability programme for the years 2018 to 2022.

However, as in April 2018, it points out that the uncertainty surrounding the estimates of output gap is significant. Particularly, the tension and inflation indicators provide divergent messages. Indeed, although capacity utilization rates in manufacturing and recruitment difficulties are above their long-term average at the beginning of 2019, underlying inflation, which faintly fluctuates and stays at a low level, does not show any signs of tension.

B. Observations on the macroeconomic scenario for the years 2020 to 2022

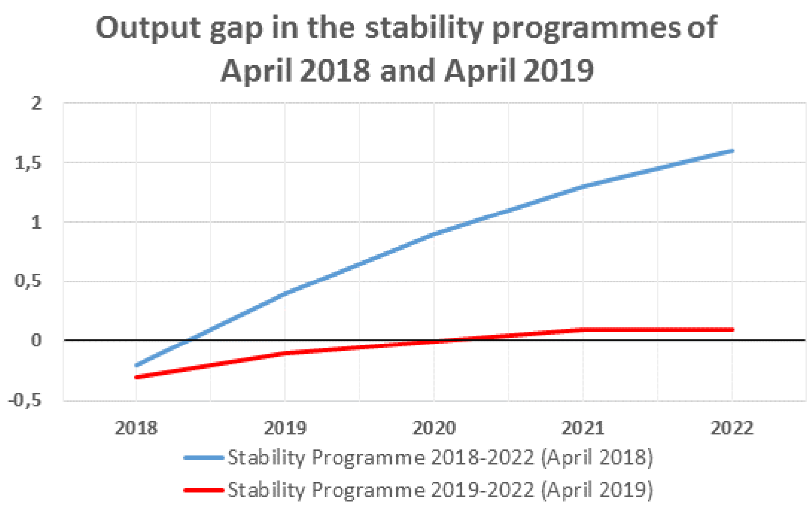
1- The scenario of the Government

According to the Government, *"growth would be at 1.4% in […] 2020. […] For the years 2021 to 2022, the economic activity would grow at the same pace. For this period, growth would be slightly above potential growth (1.3% in 2021 and 1.35% in 2022). […] Inflation would gradually recover to reach the inflation target of the European Central Bank in the medium term, on which expectations would be based. In France, it would gradually increase to reach 1.5% in 2021 and 1.75% in 2022."*

2- Opinion of the High Council

The Stability program forecasts a 1.4% growth for the years 2020 to 2022, as for 2019. Therefore, they do not include cyclical elements.

These forecasts for the years 2020 to 2022 have been revised downwards since the Stability program from last year and the economic, social and financial report of the budget bill for 2019 (growth was expected to be at 1.7% each year).



In its opinion on the Stability program of April 2018, the High Council considered "*that the adopted scenario, which [stated] an actual growth staying steadily above potential growth* *until 2022 [was] optimistic*". This scenario led to a sharply positive output gap in the end of the period.

From now on, the Stability program of April 2019 adopts a growth assumption close to potential growth. As a consequence, the output gap, which is slightly negative in 2018, would be close to 0 over the period.

The High Council stresses that Government's growth forecasts for the years 2020 to 2022 have been revised downwards since the Stability program of April 2018, which had been considered "optimistic" by the High Council.

The adopted scenario, which states an actual growth being close, but slightly above the potential growth until 2022, corresponds to a stable output gap around zero. The High Council notes that this scenario is a more reasonable basis for multi-year public finance programming.

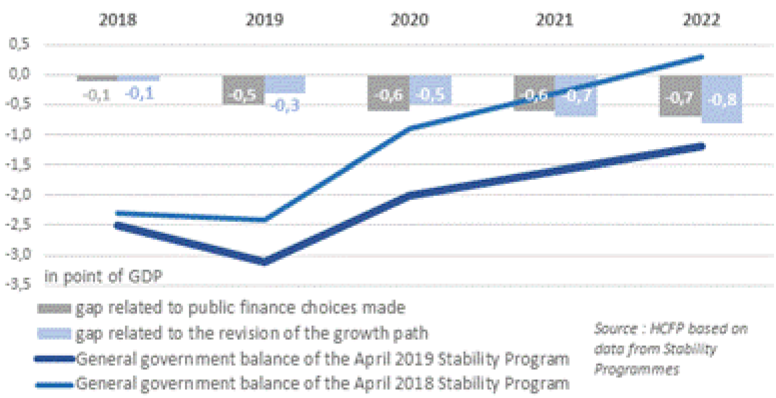
The hypothesis stating a recovery of the inflation on the horizon of the projection is consistent with the growth scenario. However, the extent of the increase (from 1.3% in 2019 to 1.75% in 2022 for consumption prices) is uncertain.

3- Impact of the macroeconomic scenario on public finance

The stability programme of April 2019 predicts that the public deficit in 2022 would be 1.5 higher than the forecast included in the Stability programme of April 2018. From now on, the general government balance would be at 1.2 GDP point in 2022, compared with +0.3 forecast in the Stability programme of April 2018.

This deterioration is explained on one hand by the revision of the growth path for the years 2018 to 2022 (0.8 GDP point), and on the other hand by the decisions regarding public finance (0.7 GDP point), especially the tax reduction.

Breakdown of the change in the general government balance between the April 2018 stability programme and the April 2019 stability programme



Source : HCFP based on data from Stability Programmes

The structural budget balance, which was drawing closer to the medium-term budgetary objective (-0.4 GDP point)[8] in 2022 according to the Stability programme of April 2018 (-0.6

[8] The medium-term budgetary objective (MTO) regarding structural balance is determined by the public finance programming law of January 2018 at -0.4 GDP point.

GDP point), is now markedly more away from it according to the new programme (1.3 GDP point in 2022).

The deterioration of the public deficit and the downwards revision of the GDP would affect the path of the decrease in the debt to GDP ratio. Over the 2018-2022 period, this ratio would decrease by only 1.6 point according to the Stability programme of April 2019, compared with 7.2 points according to the former Stability programme, although the French economy would grow at a pace slightly above its potential growth.

The High Council of Public Finance notes that the Government chose to build a more credible medium term macroeconomic scenario.

However, it points out that, due to the revision of the macroeconomic scenario and to the more significant tax reduction in comparison with the previous Stability programme, the current one leads to a significantly lower reduction of actual and structural deficits in 2022 and, as a consequence, of public debt. Therefore, a rigorous respect of public expenditure objectives is even more required.

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This opinion has been published in the *Official Journal* of the French Republic and attached to the Stability Program transmitted by the Government to the European Commission and the European Council.

ANNEX 1

Macroeconomic scenario for the stability programme

	2018*	2019	2020	2021	2022
Goods and services, real terms					
Gross domestic product	**1,6**	**1,4**	**1,4**	**1,4**	**1,4**
Household final consumption	0,8	1,7	1,4	1,4	1,4
Government consumption expenditure	1,1	1,0	1,0	0,5	0,2
Gross fixed capital formation	2,9	2,1	1,4	1,2	1,6
Imports	1,3	2,4	2,3	2,3	2,3
Exports	3,3	2,4	2,7	3,1	3,1
Contributions to real GDP growth					
Final domestic demand excluding inventories	1,4	1,6	1,3	1,1	1,2
Changes in inventories and net acquisition of valuables	-0,4	-0,1	0,0	0,0	0,0
Foreign trade	0,6	0,0	0,1	0,2	0,2
Prices and nominal aggregates					
Consumer price index	**1,8**	**1,3**	**1,3**	**1,5**	**1,75**
Gross domestic product deflator	1,0	1,2	1,2	1,5	1,7
Nominal gross domestic product	2,5	2,6	2,6	2,9	3,1
Employment and wages					
Non-farm market sectors:					
- Salaried employment (persons employed)	1,6	0,9	0,7	n.d.	n.d.
- Average wage per capita	1,9	2,3	2,1	n.d.	n.d.
- Wage bill	3,5	3,1	2,9	3,1	3,4
Total employment	0,9	0,6	0,5	0,3	0,2
Potential growth and output gap					
Potential growth in GDP	**1,25**	**1,25**	**1,25**	**1,30**	**1,35**
Output gap	**-0,3**	**-0,1**	**0,0**	**0,1**	**0,1**