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Review of the French Government's Economic Forecasts for 2023 and 2024

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- The macroeconomic scenario of the 2023 Budget Bill, presented in September 2022, was drawn up amid great uncertainty. The repercussions of the Russian offensive in Ukraine on energy supply in particular, and the impact of monetary tightening in response to soaring inflation were major unknowns when calculating forecasts.

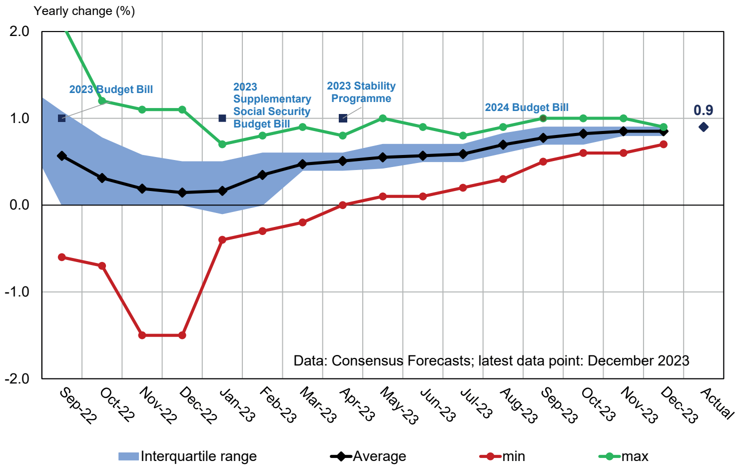
- Despite this uncertainty, 2023 GDP growth (0.9% based on annual INSEE accounts published in May 2024) nearly matched the 2023 Budget Bill forecast (1.0%). The Consensus Forecasts, which estimated growth of 0.6% in September 2022 and which had hit a low point of 0.1% in December 2022, gradually converged with the French government forecast.

- The main economic forecast assumptions were confirmed: winter 2022/2023 saw no energy supply shortages, and the French economy benefited from a catch-up effect, particularly in aircraft manufacturing and electricity generation. Growth drivers on the other hand were more balanced than envisaged in the Budget Bill: growth was sustained to a greater degree by foreign trade and to a lesser extent by consumption, with the savings rate remaining high. While business investment proved more resilient than expected, household investment fell further.

- The 2023 Budget Bill forecast predicted a peak in inflation in early 2023, followed by a gradual decrease. This forecast was correct, with inflation reaching its peak in February 2023 and declining for the rest of the year, due to a drop in energy prices and then in food prices. Overall inflation for the year was however higher (4.9%) than the 2023 Budget Bill forecast (4.2%), which itself was higher than the Consensus Forecasts (3.6%).

- The macroeconomic scenario underlying the 2024 Budget Bill, which was submitted in September 2023, forecast a pickup in growth in 2024 (1.4%). This growth forecast was reviewed downwards in February 2024: the adjusted economic scenario was set out in the 2024-2027 Stability Programme published in April 2024. This forecast for 2024 was adjusted upwards to 1.1% in the 2025 Budget Bill submitted in October 2024. The adjustment to the initial forecast was made primarily because of a less buoyant international environment and more sluggish consumption, despite faster disinflation than expected.

GDP forecasts for France in 2023 – change in Consensus Forecasts



Source: DG Trésor calculations.

1. For the 2023 Budget Bill submitted in October 2022, the French government forecast growth of 1.0% in 2023

1.1 A forecast made amid great uncertainty

The growth forecast for 2023 underlying the 2023 Budget Bill was made in summer 2022 amid great uncertainty. 2022 saw the ongoing economic recovery after the COVID-19 pandemic be undermined by the repercussions of the Russian offensive in Ukraine in February 2022, with three major factors requiring consideration for the economic forecast.

A key element to factor into the scenario was the continuity of energy supply in winter 2022-2023 given reduced Russian oil and gas imports compounded by vulnerable electricity generation due to programmed or corrective maintenance work in some of France's nuclear power plants. These pressures resulted in soaring energy prices, particularly for gas, the prices for which peaked on the European market in August 2022 (nearly €350/MWh, twenty times higher than the average price in 2019).

Rising energy and food prices as a result of the war in Ukraine accentuated pressure on supply triggered by the surge in demand in the wake of the COVID-19 pandemic, which brought up the price of manufactured goods. This resulted in soaring inflation of 6.1% year-on-year in July 2022, the highest level recorded since the 1980s. The knock-on effect of such high inflation levels on household and business behaviour was the second major factor for the 2023 Budget Bill macroeconomic scenario.

Lastly, the sharp rise in inflation led the ECB to start tightening its monetary policy from July 2022, initially raising its key interest rates by 50 basis points. The final factor taken into account for the forecasting was the monetary policy trajectory, together with the impact of key interest rate hikes and expectations of future increases in household and business investment.

1.2 The 2023 Budget Bill adopted a moderate-growth scenario in spite of shocks

For the Budget Bill, the French government forecast for GDP growth was 1.0% in 2023, driven primarily by household consumption as a result of increased purchasing power and a slight drop in the savings rate. The Budget Bill factored in the varying impact of interest rate hikes depending on the stakeholder: the scenario projected a drop in household investment – partly counterbalancing the very buoyant property market following the COVID-19 pandemic – but also an increase in business investment, with government support measures ensuring that profit margins would remain at a solid level. It was forecast that foreign trade would make no contribution to GDP growth, with a sharp increase in exports (as a result of the post-pandemic catch-up effect) and in imports (attributed to expectations of robust business consumption and investment).

The French economy's resilience in the face of shocks triggered by the war in Ukraine was due in particular to factoring in household[1] and business support measures introduced to address the energy crisis and also as a result of the adoption of energy-saving practices. Unlike other forecasts, the Budget Bill scenario assumed that the energy supply would be uninterrupted in winter 2022-2023.

The macroeconomic scenario also factored in the French economy's catch-up potential, particularly in relation to household consumption – with an expected drop in the savings rate given its very high level – and also exports, primarily as a result of an upswing in deliveries in the aerospace sector. This catch-up potential was in line with estimates of a negative output gap in 2022 (approximately –1% of GDP).

(1) Measures in the Purchasing Power Act, the Supplementary Budget Act and the 2023 Budget Bill provided for disposable income support targeting households for an amount of €18bn in 2022 and €15bn in 2023.

Lastly, it was forecast that inflation would reach 4.2% on average for 2024. Estimates projected an inflation peak in winter 2022-2023, followed by prices gradually slowing down over 2023. In particular, it was forecast that the initial phase of energy inflation – directly triggered by the conflict in Ukraine – would be followed by rising food and manufactured goods prices, in line with the leading indicators available at the time. This inflation would end up being reflected in the prices of services as a result of rising wages having a delayed response to inflation.

Box 1: The French Treasury's macroeconomic forecasts

The French Treasury (DG Trésor) prepares macroeconomic forecasts underlying the financial legislation presented by the French government.

Three kinds of macroeconomic forecasts are prepared by the Diagnosis and Forecasts Division (Prev):

- The short-term forecast, for the current or following quarter, which is formulated by using economic data. It attempts to replicate the quarterly accounts methodology using a dedicated model.[a]
- The forecast for the current and following year, constructed with the Opale model.[b] This model comprises approximately 800 variables and 500 equations and includes a considerable amount of "exogenous" data (i.e. data produced by other French Treasury departments that is based on the latest economic forecasts), particularly the short-term forecast, the international economic scenario, the public finance trajectory, the employment forecast and the interest rate trajectory. The forecast must also factor in economic judgments. The forecaster must address the key issue of the nature (temporary or structural) of unexplained previous shocks.
- Medium-term forecasts (usually a 4-5 year timeline), which are more stylised.

The macroeconomic scenario is exhaustively updated at least twice a year for the winter macroeconomic forecasts (for the Stability Programme, which is now the Medium-Term Fiscal-Structural Plan, and the annual progress report) and for the summer macroeconomic forecasts (for the Budget Bill). The forecasting process is structured into "rounds" during which:

- Updated exogenous variables are factored in (particularly the international scenario, INSEE's latest quarterly national accounts, the short-term growth scenario and the employment forecast).
- Iterations are run with public finance forecasts, as these forecasts and macroeconomic forecasts are interdependent.

Additional updates to the macroeconomic scenario are made when required, particularly with regard to the Supplementary Budget Bill.

a. E. Lalande and T. Rioust de Largentaye (2015), "La prévision de croissance de court terme à la DG Trésor", *DG Trésor Working Papers*, No. 2015/04 (in French only).
b. A. Daubaire, G. Lefebvre and O. Meslin (2017), "La maquette de prévision Opale 2017", *DG Trésor Working Papers*, No. 2017/06 (in French only).

2. 2023 growth almost matched the Budget Bill forecast, even if it was driven more by exports than consumption

2.1 The overall scenario was confirmed

The 2023 growth forecast of 1.0% was confirmed for financial legislation presented by the French government in 2023: the Supplementary Social Security Budget Bill of February 2023 linked to the pension reform, the Stability Programme of April 2023, the 2024 Budget Bill of September 2023 and the 2023 End-of-Year Budget Bill of October 2023.

However, there was considerable disparity between Consensus Forecasts, which also showed a great deal of volatility. In autumn 2022, the gloomiest forecasts expected a severe recession in 2023. In December 2022, the Consensus average was 0.1% for 2023, compared to 0.6% in September 2022. As the fears of energy supply disruptions were allayed, Consensus Forecasts were revised upwards, gradually converging with the French Government's forecast.

According to the national accounts published by INSEE on 31 May 2024, which constituted the preliminary overall estimate of economic trends for 2023, GDP growth stood at 0.9%, nearly matching the Budget Bill forecast.

The main assumptions underlying the 2023 Budget Bill forecast were confirmed: the energy supply capacity was maintained in winter 2022-2023 and the French economy demonstrated its catch-up potential. Growth was therefore particularly driven by a sharp upturn in electricity generation and in the production of transportation equipment (automotive and air transport). This upturn was partly the reason for robust exports (+2.5% in real terms for the year). The strong increase in exports was all the more remarkable as the international environment was considerably less favourable than expected in summer 2022. The growth in world demand for French goods, i.e. export market development, was finally negative (–2.1% compared to the +1.6% forecast in the Budget Bill scenario). This is particularly attributable to Germany's poor economic performance, which saw a drop in growth in 2023 (–0.3%).

2.2 Growth drivers were more balanced than forecast by the 2023 Budget Bill scenario

Even though the 2023 Budget Bill macroeconomic scenario assumed that growth would be primarily driven by household consumption, growth drivers were in fact more balanced.

France's growth in 2023 was driven more by foreign trade than by household consumption. Specifically, while consumption increased at a steady pace in line with rising aggregate purchasing power, the forecasted drop in the household savings rate in the wake of the COVID-19 pandemic never happened. This may be because of the negative effect of the inflation shock on consumption patterns, in addition to the direct impact on purchasing power: households therefore appear to be particularly vulnerable to price hikes for certain products, such as energy and food.

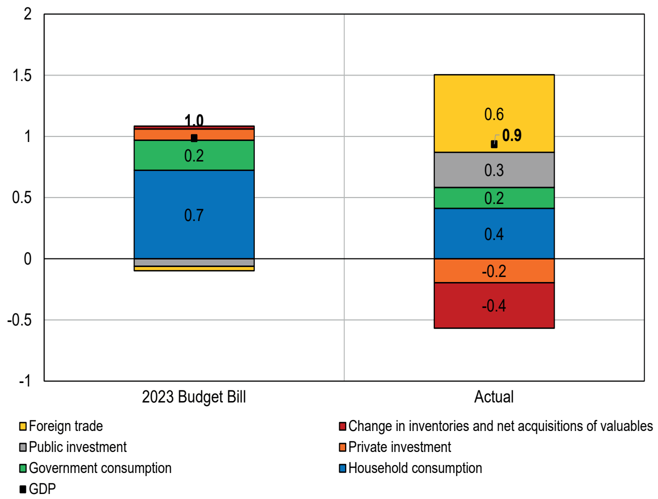
Household and business investment fell and rose respectively, with a disparity that was even greater than expected: non-financial company investment rose sharply particularly as a result of business expenditure for the digital transition. In contrast, household investment fell to a greater extent than forecast. Increasing borrowing costs put a significant drag on property transactions, which dropped by nearly 20% for the year. Overall, private domestic demand made a smaller contribution to growth than expected (+0.4 points versus +0.8 points).

Meanwhile, foreign trade made a strongly positive contribution of 0.6 points to growth despite forecasts of no contribution whatsoever: exports rose sharply (+2.5%), matching forecasts, but growth in imports was more moderate (0.7%). As a result, the foreign trade balance greatly improved – totalling –€56bn in 2023 compared to –€74bn in 2022 – primarily as a result of the upturn in net exports of electricity, deliveries in the aerospace sector and tourism. Sluggish imports seemed partly due to businesses drawing on their inventories to meet demand, with the contribution of changes in inventories standing at –0.4 points (compared to a forecast zero contribution).

Lastly, public demand contributed more than forecast by the Budget Bill (+0.5 points versus +0.2 points). The increase in government consumption[2] nearly matched forecasts. At the same time, while the Budget Bill forecast a decrease, public investment rocketed (+6.9%), driven in particular by the sharp rise in local government investment (over 10%).

This difference in the constituent elements of growth has a bearing on taxation and social security contributions. Specifically, consumption is a determining factor of VAT revenue; however, exports are subject to low tax rates. This is partly why the aggregate tax and social security contribution elasticity to GDP was low in 2023.

Chart 1: Contributions to GDP growth in 2023 – Forecast and actual



Source: DG Trésor.

2.3 French household and business income held up against shocks, in particular thanks to support measures taken by the French government

Household and business income proved resilient in 2023 against the shock of inflation on consumer prices and on production costs for businesses.

Aggregate purchasing power for households increased over the year (+0.8%) in line with forecasts. Household income in particular benefited from (i) robust employment – which bolstered earned income – (ii) an increase in property income with the interest rate hike, and (iii) measures implemented by the government to bolster purchasing power to cope with the energy crisis, such as energy vouchers.

Profit margins for French companies grew in 2023 to a far greater extent than forecast in the Budget Bill (1.7 points compared to the forecast 0.2 points). Businesses were able to pass on increased production costs to sales prices to a greater extent than predicted; they also reaped the benefits of support measures to soften the blow of the energy crisis which included the price cap and support for energy-intensive businesses.

(2) Final government consumption expenditure (GFCE) is a component of final demand in the national accounts. It covers services provided to households by government departments, including both the direct production of public services by central government, local authorities and social security bodies (such as education and defence) and expenditure incurred by government bodies for services provided by the private sector (such as healthcare reimbursements).

Table 1: Economic forecasts for France in 2023 and actual figures (INSEE, national accounts, May 2024)

	2023 Budget Bill forecast	Actual	Difference
GDP and main economic aggregates in real terms			
Gross domestic product	**1.0**	**0.9**	(–0.1)
Final household consumption	1.4	0.7	(–0.7)
Final government consumption	1.0	1.2	(0.2)
Gross fixed capital formation	0.1	0.4	(0.3)
Of which: non-financial companies	*0.9*	*2.7*	*(1.8)*
general government	*–1.6*	*6.9*	*(8.5)*
households excl. sole proprietorship	*–0.9*	*–8.5*	*(–7.6)*
Imports	2.5	0.3	(–2.2)
Exports	2.7	2.1	(–0.6)
Contribution to GDP growth in real terms			
Domestic private demand excluding inventories	0.8	0.2	(–0.6)
Public demand	0.2	0.5	(0.3)
Changes in inventories and net acquisition of valuables	0.0	–0.4	(–0.4)
External balance of goods and services	0.0	0.6	(0.6)
Prices			
Consumer price index (CPI)	**4.2**	**4.9**	(0.6)
Core inflation index, gross	4.1	5.1	(0.9)
Non-financial companies			
Value added (VA)	5.5	7.9	(2.4)
Gross operating surplus (GOS)	6.1	13.9	(7.7)
Profit margin (GOS/VA, change in percentage points)	0.2	1.7	(1.5)
Households			
Gross disposable income	5.1	8.0	(2.9)
Purchasing power of gross disposable income	0.9	0.8	(0.0)
Savings rate (savings/gross disposable income, change in percentage points)	–0.4	0.1	(0.5)

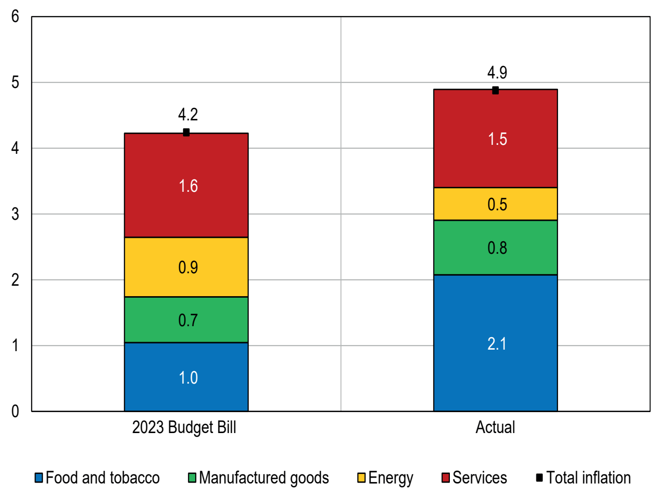
Sources: DG Trésor, INSEE.

2.4 The Budget Bill forecast matched the actual inflation profile in 2023, but underestimated the food price increase

The inflation profile and its triggers for 2023 were effectively anticipated: the initial shock on energy prices was reflected in food and manufactured goods prices through commodity price hikes, and subsequently in the prices of services as a result of wage increases related to past inflation. Inflation hit its peak in February 2023 (6.3%) to then gradually drop throughout the rest of the year: by December 2023, it stood at 3.7%.

However, price hikes proved to be greater than forecast in the 2023 Budget Bill. Average annual inflation only slightly decreased (4.9% in 2023 compared to 5.2% in 2022), and was considerably higher than the 2023 Budget Bill's forecast of 4.2%, which itself dwarfs the Consensus Forecasts figure of 3.6%.

Chart 2: Contributions to 2023 inflation



Sources: DG Trésor, INSEE.

This disparity in forecasting is primarily the result of high food inflation in early 2023: it peaked at a higher level and later than expected, causing a food price increase of 11.8% for 2023 as a whole – almost double the 2023 Budget Bill forecast figure. On the other hand, energy prices dropped quicker than forecast, mainly caused by a fall in petroleum product prices and, to a lesser extent, by a smaller increase in gas prices.

3. Growth and inflation in 2024 is expected to be slightly below 2024 Budget Bill forecasts

The macroeconomic scenario underlying the 2024 budget bills, submitted in October 2023, forecast an uptick in growth in 2024 at 1.4%, a pace that almost matches the forecasts of international institutions: the European Commission and the OECD forecast growth of 1.2%, while the IMF figure was 1.3%. Two main drivers of growth were expected for 2024: (i) household consumption following a drop in inflation that was already underway and would continue throughout the year and (ii) foreign trade providing a positive contribution as a result of global trade's recovery and a continued drive to make up for the export performance shortfall observed during the COVID-19 pandemic. However, a sharp slowdown in investment was expected due to the tightening of monetary policy through tougher financing conditions.

This growth forecast was revised downwards in February 2024 to 1.0% in light of a less favourable international environment than expected and a larger decline in household investment; these stumbling blocks meant that the preliminary estimates of the national accounts recorded sluggish growth in late 2023. Detailed information on the adjusted economic scenario was provided in the 2024-2027 Stability Programme published in April.

The 2025 budget bills presented in October 2024 came with a slight upwards revision of the growth forecast for 2024 to stand at 1.1%. This figure reflects carry-over growth following the third quarter and the Consensus Forecasts. In a departure from the 2024 Budget Bill scenario, growth is expected to be primarily driven by foreign trade and public demand, and less by private domestic demand. In spite of total growth nearly matching the spring forecast, this composition of growth – in which private demand accounts for a small share – adversely affects government revenue.

Forecasts also predict inflation to be lower than expected, which will reduce tax revenue in the short term. The 2024 Budget Bill forecast an average annual price increase of 2.6%, with inflation returning to about 2% by late 2024. Disinflation progressed at a faster pace than expected: inflation dropped below 2% from August 2024. Food prices in particular experienced a sharper slowdown than expected; the prices of services were also slightly less robust, particularly as a result of the fall in the prices of telecommunications. The inflation forecast was therefore revised downwards for the 2025 Budget Bill to 2.1% on average for 2024.

A preliminary growth estimate for 2024 based on the quarterly national accounts will be published by INSEE on 30 January 2025, and the estimate based on the annual national accounts will be published in May 2025. The final inflation figure for 2024 will be published by INSEE on 15 January 2025.

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