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2012 French budget

No new austerity measures but 2012 deficit target confirmed

- **The French government confirmed its target of reducing the public deficit to 4.5% of GDP in 2012…**
- **…but has still not detailed the EUR1bn of spending cuts announced in August or added any additional measures**
- **EFSF loans will increase the public debt, but the government estimates it will only need EUR182bn in financing in 2012**

2012 French budget confirms deficit reduction targets…

The French government presented its 2012 budget proposal this morning. The budget confirms the government's target of reducing the deficit from 5.7% of GDP in 2011 to 4.5% in 2012. As we expected, the government's 2011 deficit reduction target was realistic. The public deficit was reduced through cutbacks in government spending on interventions and operations and through smaller tax credits as well as reasonable growth.

The 2012 budget proposal is less convincing because it does not completely spell out how it plans to reduce the deficit by EUR21bn next year. In August, the government already planned for an additional EUR11bn in tax revenues to lend credibility to its fiscal targets, as well as EUR1bn in additional spending cutbacks. Yet the 2012 budget proposal does not specify the measures that will be used to reduce public spending by EUR1bn. The budget is also built around a GDP growth forecast of 1.75%, which assumes that the sovereign debt crisis in the Eurozone will not carry over to the real economy. If GDP growth were only 1.2% in 2012, for example, then the government would have to find an additional EUR23bn in tax revenues or spending cuts.

The good news is that the government has pledged to respect its target of reducing the deficit reduction to 4.5% of GDP in 2012, even if growth falls short of current expectations. Moreover, with public spending accounting for 56.3% of GDP in 2011, it should be easier to reduce spending than if they were less substantial.

The French government confirms that it has opted for an intermediate path: reducing the deficit and respecting its budget commitments without allowing these efforts to strain growth. According to the government, real public spending is still expected to increase by 0.9% and will make a positive contribution to GDP growth in 2012.

28 September 2011

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Issuer of report: HSBC France

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…but without providing details of the means of public spending cuts, which could soon prove insufficient

During the press conference of 24 August 2011, the French prime minister announced new measures in order to lend credibility to the target of reducing the deficit in 2011 and 2012. These measures consisted of tax increases of EUR11bn (EUR1bn in 2011 and EUR10bn in 2012). Among the 20 tax measures, the main ones were as follows (for more details see *France: Government announces more austerity to try to meet the 2012 deficit target*, 25 August 2011*):*

- limits on losses that companies may carry over to the following financial year (to raise EUR0.5bn in 2011 and EUR1.5bn in 2012)
- higher capital gains tax on property excluding principal residences (EUR0.2bn in 2011 and EUR2.2bn in 2012)
- the abolition of the partial exemption from the tax on insurance agreements for so-called "citizen responsibility" schemes
  (EUR0.1bn in 2011 and EUR1.1bn in 2012)
- an exceptional 3% surtax on incomes greater than €500,000

It was also planned that public spending would be cut by a further EUR1bn in 2012 but details of the measures were postponed until the draft budget bill. However, the draft budget bill presented this morning still does not provide any details of measures that will deliver this small EUR1bn reduction in public spending. It is planned that these measures will be specified during the review by parliament.

This vagueness about public spending cuts is the weak point of the fiscal consolidation programme presented by the French government, as it shows that tax rises continue to be favoured over spending cuts. However, the most solid and durable fiscal consolidation measures are those that favour spending cuts. When public spending reaches 56.6% of GDP, like in France in 2011, cutting spending is the only way to prevent households and businesses anticipating tax rises, which would lead to higher saving rates and weaker consumer spending.

Therefore, if growth is weaker than expected by the government in 2012 and closer to our forecast of 1.2%, additional public spending cuts of EUR23bn would be needed in order to meet the target of a public deficit of 4.5% of GDP in 2012.

However, if the government decides to reactivate the Société de Financement de l'Economie Française (SFEF) to help French banks with refinancing in the event of an increase in interbank tensions, this would not impact public debt. Only recapitalisation of a bank via the Société de Prise de Participation de l'Etat would increase France's public debt.

French government's financing requirements will not be affected by loans granted by the EFSF

When the EFSF issues bonds in order to lend to Eurozone governments that are no longer able to borrow on the markets, this increases the public debt of the Eurozone country guaranteeing the loan. Taking account of the EFSF's loan commitments to Ireland and Portugal - and soon Greece, when all Eurozone

parliaments vote in favour of the agreement of 21 July – France's debt would be 1.9% points of GDP higher than it would have been without these loans. These estimates may of course be revised upwards if new loans are granted.

However, this does not impact the French government's financing requirements, estimated by the government at EUR182bn in 2012 following EUR190.9bn in 2011 if the target of public debt of 4.5% of GDP is achieved. The debt issuance requirements for financing is planned to reach EUR179bn according to the government's forecast.

To conclude, the public debt crisis in Europe has changed things as, contrary to the usual situation, optimistic GDP growth forecasts are no longer a means of avoiding the need for a turnaround in growth in public debt. As we said at the end of August, a downward revision in GDP growth forecasts is likely to result in tax rises or additional spending cuts. However, the government believes that the planned deficit reduction in 2012 will not be enough to stabilise the debt-to-GDP ratio before 2013. Furthermore, because of the high primary deficit (tax revenues – public spending excluding interest payments), which according to the French government represents -3.1% of GDP in 2011, France's public finances are vulnerable to any increase in borrowing rates.

French budget deficit and debt forecasts

	2010	2011f	2012f	2013f
Government forecasts				
Budget deficit (% of GDP)	-7.1	-5.7	-4.5	-3.0
Government debt (% of GDP) incl EFSF loans	82.3	85.5	87.4	n.a
Government debt (% of GDP) excl EFSF loans	82.1	84.1	85.5	85.4
Real GDP growth (%Yr)	1.5	1.75	1.75	2
Nominal GDP growth (%Yr)	2.3	3.4	3.6	n.a
HSBC forecasts				
Budget deficit (% of GDP)	-7.1	-5.8	-5.6	-4.6
Government debt (% of GDP) incl EFSF loans	82.3	85.8	89	90.5
Real GDP growth (%Yr)	1.5	1.6	1.2	2.0
Nominal GDP growth (%Yr)	2.3	4.0	2.9	3.7

Sources: French ministry of Finances, HSBC

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