French Republic
Rating Report

AA STABLE OUTLOOK

Credit strengths

- Large and diversified economy
- Core euro area member
- Favourable debt profile and excellent market access
- Good record of structural reforms
- Sound and resilient banking sector

Credit challenges

- High public debt, persistent deficits, and weak fiscal consolidation record
- Growing political fragmentation and polarisation
- Persistent labour market bottlenecks

Rating rationale:

Large and diversified economy: France has a large economic size, high GDP per capita, and diversified economic structure driven by high value-added activities.

Core euro area member: France is an EU founding member and leading guarantor of the European institutional framework, and a key State in preserving and driving the consolidation of European integration.

Favourable debt profile and excellent market access: France benefits from a favourable debt profile and an excellent market access, which are strengths to cope with high debt and rising interest rates.

Good record of structural reforms: France has a recent positive track record of delivering supply-side oriented reforms, which have started addressing long-standing structural challenges, though the outcome of legislative elections put this momentum at risk of slowing down.

Sound and resilient banking sector: French banks have elevated capitalisation ratios supported by comfortable profitability, which underpins their capacity to absorb large external shocks.

Rating challenges include: i) elevated public debt to GDP, sustained primary fiscal deficits, and weak fiscal consolidation record; ii) growing political fragmentation and polarisation reducing the capacity to materially raise GDP growth potential through structural reforms; and iii) persistent labour market bottlenecks undermining a firm decline in unemployment.

France's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aaa	EUR [+1]	+1/3	AA
Public Finance Risk		20%	bb		+1/3	
External Economic Risk		10%	b+		+1/3	
Financial Stability Risk		10%	a+		+1/3	
ESG Risk	Environmental Factors	5%	aaa		+1/3	
	Social Factors	7.5%	b		0	
	Governance Factors	12.5%	aa		0	
Indicative outcome			**a+**		**+2**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- Sustained fiscal consolidation puts public debt on a firm downward path
- Growth outlook improves significantly

Negative rating-change drivers

- Fiscal outlook deteriorates, resulting in a firm upward trajectory of public debt
- Growth outlook weakens significantly

Ratings and Outlook

Foreign and local currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

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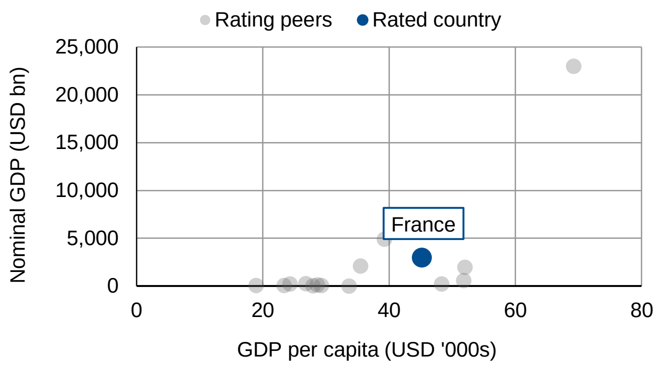
Domestic Economic Risks

- **Growth outlook:** Following a strong post-Covid-19 rebound (+6.8% in 2021), Scope forecasts real GDP growth at 2.6% in 2022, primarily reflecting strong carry over from the previous year and better-than-anticipated quarterly growth in the Q2 and Q3 2022, at 0.2% and 0.5% respectively. Scope expects the economic momentum to slow down, with real growth declining to 0.5% in 2023 as inflation takes a toll on real wages and household consumption, while higher financing costs and heightened uncertainty hamper investment. The economic momentum benefits from structural improvements that resulted from pre-Covid-19 reforms, which helped raise the employment rate, the continued recovery of the tourism industry, as well as the significantly more benign price dynamics relative to peers.
- **Inflation and monetary policy:** CPI inflation is expected to average at 5.8% in 2022, 4.3% in 2023, well below euro area averages, which the European Commission forecasts at 9.3% and 7.0%, respectively. This results primarily from the country's lower exposure to energy shocks thanks to its nuclear-oriented electricity mix, despite uncertainties on electricity supply in Q1 2023, and from the large government support measures, including a freeze on regulated gas retail prices and a cap on electricity price increases for households and small businesses, which is gradually scaled down (a 15% price increase cap in 2023, after 4% in 2022) and increasingly targeted to the most vulnerable. According to estimates from the national statistical office INSEE, the 'tariff shield' on energy reduced CPI inflation by around 3 percentage points between Q2 2021 and Q2 2022.
- **Labour markets:** The headline unemployment rate has declined to multi-decade lows (7.3% in Q3 2022) in a context of resilient economic activity and following significant policy changes, including a revamp of the apprenticeship system and the 2021 reform of unemployment benefit system. The government aims to deepen the latter by modulating the length of the benefits (between 24 to 26 months currently) depending on prevailing labour market conditions. This could support a further reduction in unemployment, in a context of significant labour shortages, with more than half corporates reporting recruitment difficulties.

Overview of Scope's qualitative assessments for France's *Domestic Economic Risks*

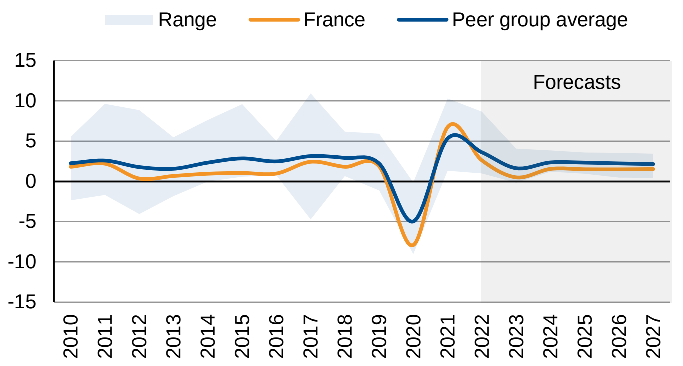
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential supported by improving labour markets and robust foreign investment
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank; effective policy framework and transmission over the cycle
	Macro-economic stability and sustainability	Strong	+1/3	Diversified economy reflects resilient economic structure; good shock absorbing wealth levels relative to peers

Nominal GDP and GDP per capita, USD thousands



Source: IMF, Scope Ratings

Real GDP growth, %



Source: IMF, Scope Ratings

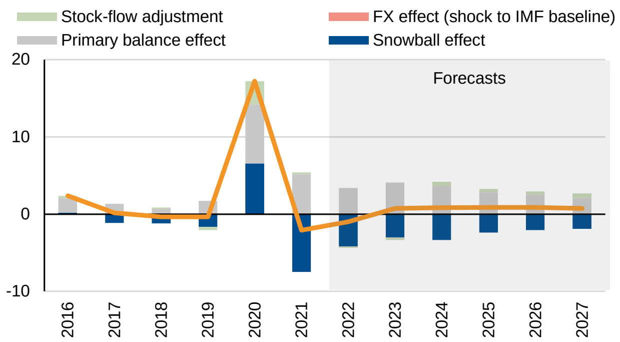
Public Finance Risks

- **Fiscal outlook:** The withdrawal of countercyclical measures introduced by the French government to offset the rise in energy prices (estimated at EUR 30bn in 2022, net of indirect tax revenues from renewable producers) could be delayed given rising demand for social safety nets. Notwithstanding the enhanced governance framework for public finances introduced in 2021 to strengthen multiannual management, budgetary transparency, and accountability, fiscal consolidation could be slower than expected as the government's ability to deliver on a material reduction in expenditures has been weakened by this year's legislative election with the ruling coalition losing absolute majority in the National Assembly. Long-term investments among which the green transition also constitute impediments to the government's plan to bring the budget deficit below 3% of GDP in 2027, despite the EU Recovery and Resilience Facility (EUR 39.4bn of grants) that contributes to climate investments.
- **Debt trajectory:** Public debt is expected to rise moderately, from 111.6% of GDP in 2022 to 115.6% of GDP by 2027, or 18 percentage points above pre-Covid-19 level. Higher GDP deflator provides a cushion in the near-term, but sustained primary deficits, a rising interest burden, and modest GDP growth weigh on debt dynamics. Similarly, inflation-linked bonds (EUR 252bn as of end-September 2022), around two-thirds of which are indexed on the eurozone inflation, present an additional near-term challenge. In our view, the government's ability to bring public debt back on a firm downward path has weakened since the Covid-19 and the energy price shocks, which is reflected in the modest decline in public debt projected by the government in 2026 (-0.1pps of GDP) and 2027 (-0.7pps to 110.9% of GDP).
- **Debt profile and market access:** Gross financing needs (27.3% of GDP in 2021) are relatively high, but debt affordability compares favorably with peers thanks to a large and stable revenue base. Issuance of medium- and long-term debt (net of buybacks) has been revised to EUR 270bn in 2023. Funding conditions have tightened markedly in recent months, but remain favourable, including relative to euro area peers. Strong public financial management, a large share of fixed-rates securities (88% of total), long average maturity (8 years) and significant Eurosystem holdings of government debt securities (22%) mitigate liquidity risks stemming from high public debt amid rising interest rates.

Overview of Scope's qualitative assessments for France's *Public Finance Risks*

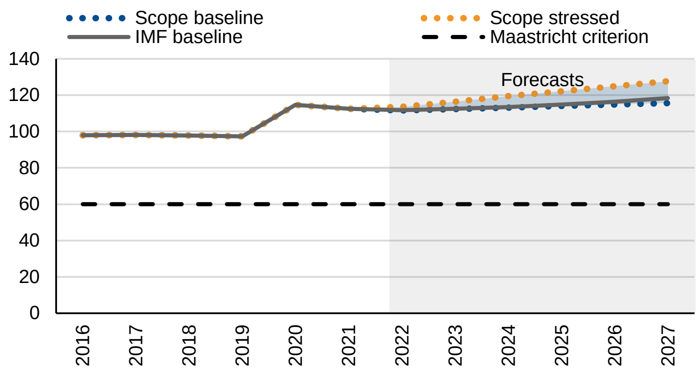
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Fiscal policy framework	Neutral	0	Enhanced fiscal governance framework, but limited room for additional spending; gradual reduction of deficits
	Debt sustainability	Neutral	0	High public debt levels; sustainability underpinned by still low interest burden and large tax base
	Debt profile and market access	Strong	+1/3	Excellent market access, long maturity, and high investor demand for a diversified bond portfolio

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

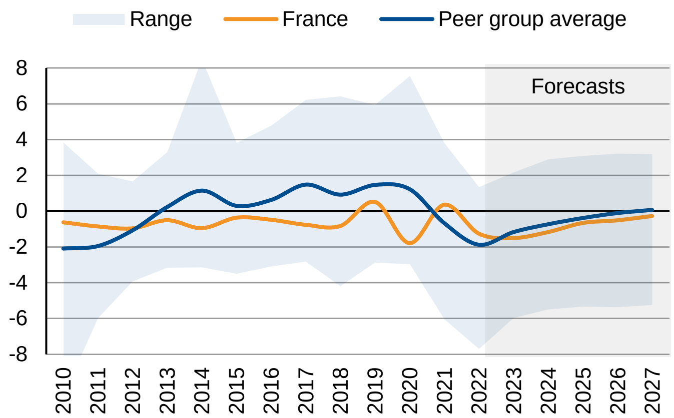
External Economic Risks

- **Current account:** After recording a surplus in 2021 of EUR 9bn (0.4% of GDP), primarily owing to a temporary rise in nominal transportation services exports, the current account is expected to return to a deficit in 2022, estimated at 1.3% of GDP by the IMF. The trade deficit reached record highs of EUR 47.6bn in Q3 2022 (around 7.2% of GDP), nearly doubling from the same period last year, in a context of soaring nominal energy and raw material imports and depreciating euro. Despite limited direct trade exposure to Russia, the Ukraine conflict is negatively impacting France's external balance, notably due to supply chain difficulties impacting the aerospace and the automotive sectors, as well as a marked slowdown among euro area trading partners. In the long run, persistent challenges around competitiveness and productivity constitute material vulnerabilities to the external performance.
- **External position:** Sustained current account deficit should maintain pressure on the net international investment position (-27% of GDP as of Q2 2022), close to the European threshold for the excessive imbalance procedure (-35% of GDP). Gross external debt is elevated, at 261% of GDP in Q2 2022, remaining around 27pps above its end-2019 level. Most external debt is owed by financial institutions (52% of total) and public sector entities (28%). A significant share of outstanding foreign debt (49%) is short-term. Risk mitigants include a low foreign currency exposure.
- **Resilience to shocks:** France, along with all euro area members, benefits from the euro's status as a global reserve currency, significantly mitigating the impact of shocks on external accounts.

Overview of Scope's qualitative assessments for France's *External Economic Risks*

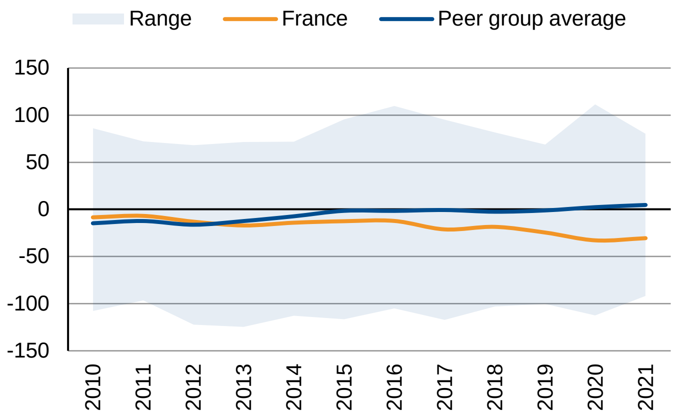
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b+	Current account resilience	Neutral	0	Diversified and high-technology industries, moderate current account deficits
	External debt structure	Neutral	0	Elevated levels of external debt mitigated by moderate cost of debt, high amount of foreign assets, and limited share of foreign currency-denominated debt
	Resilience to short-term external shocks	Strong	+1/3	Resilience against shocks with mature and large domestic market

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

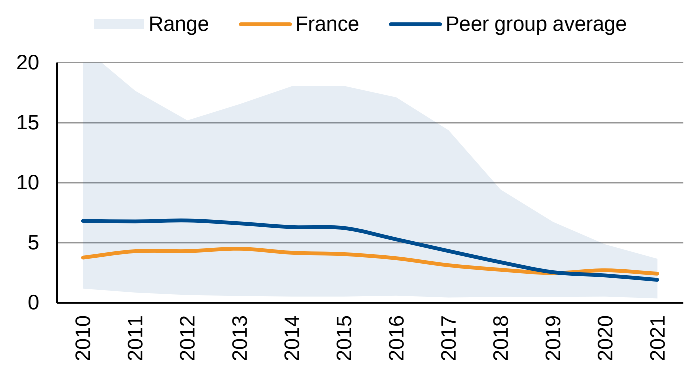
Financial Stability Risks

- **Banking sector:** Banks have a good level of shock-absorption capacity (CET-1 and liquidity coverage ratios of 15.3% and 147.2% as of Q2 2022) that could increase further as the High Council for Financial Stability signaled its intention to raise the countercyclical capital buffer rate from 0.5% to 1.0%. The aggregate return on equity recovered close to pre-pandemic averages (6.2% as of Q2 2022) and the tightening of monetary policy moderately supports higher interest margins. Still, near-term headwinds, including rapidly rising deposit rates on regulated savings and higher cost of risk, as well as structural challenges, relating to elevated cost-to-income ratios, weigh on profitability. The banking sector's strong financial position should enable to accommodate a tighter access to liquidity, as the ECB recalibrates the TLTRO III, and support credit growth, as support measures introduced during the pandemic (*Prêts Garantis par l'Etat*) are withdrawn. Non-performing loans, which are broadly in line with the euro area average (at 1.8% of gross loans as of Q2 2022), could rise moderately as the economic growth outlook deteriorates.
- **Private debt:** Private sector leverage is high, at around 231% of GDP as of Q2 2022, 64pps above the euro area average. The debt of non-financial corporates is particularly elevated, at about 165% of GDP. Additionally, debt service ratios for corporates are some of the most elevated among advanced economies, at around 55% of income according to data published by the Bank for International Settlements. High energy costs, rising lending rates will exert material downward pressures on corporate margins, though risks will be partially offset by predominantly fixed-rate corporate debt and elevated liquidity holdings. Financial vulnerabilities for households are contained in view of average levels of indebtedness, moderate debt-servicing ratios, and a low share of variable-rate mortgage loans.
- **Financial imbalances:** After picking up from H2 2021, residential real estate activity has decelerated markedly in recent months, with rising mortgage rates and higher uncertainty causing a decline in the number of transactions, in turn leading to a sharp deceleration of price dynamics. While a sharp correction in the housing market remains a risk to financial stability, it is largely mitigated by the implementation of prudential measures, which have improved borrower quality, as well as by the widespread use of mortgage insurance.

Overview of Scope's qualitative assessments for France's *Financial Stability Risks*

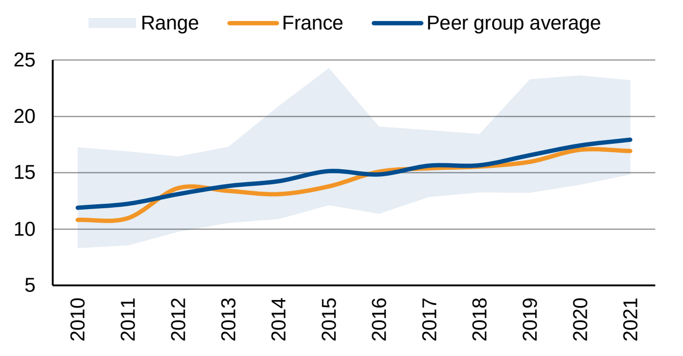
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Banking sector performance	Strong	+1/3	Consolidated banking sector with strong capitalisation and liquidity buffers
	Banking sector oversight	Neutral	0	Oversight under the National Supervisory Authority (ACPR, under Banque de France) and the ECB as part of the Single Supervision Mechanism
	Financial imbalances	Neutral	0	Moderate household indebtedness, elevated corporate debt mitigated by high net wealth, resilient and mature financial system

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

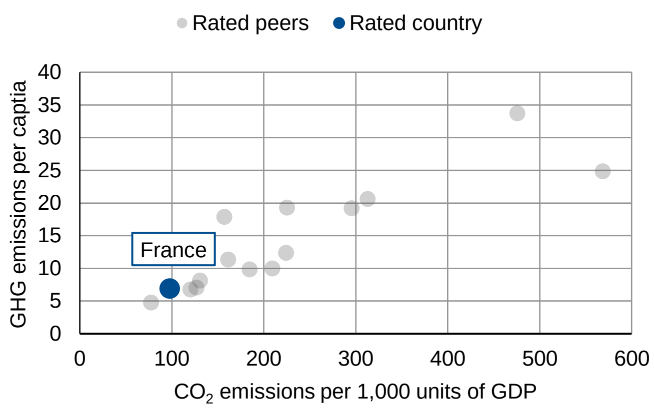
ESG Risks

- **Environment:** A nuclear-dominated energy mix largely contributes to the French economy's lower carbon intensity and mitigates to some extent higher global energy prices. However, the fleet of nuclear reactors – 56 nuclear reactors generating on average 70% of the electricity supply – faces operational issues. Extending the lifespan of the existing fleet and replacing ageing reactors remains crucial for France's comparatively low carbon-intensity and climate objectives. Nuclear is expected to be at the core of the government's green transition strategy, alongside renewables, to reach carbon neutrality by 2050. This strategy recently benefitted from the European Parliament's vote in favor of nuclear inclusion in the EU Green Taxonomy. Still, the long-term horizon of nuclear investment plan (EUR 50bn) could make the country vulnerable to technological breakthroughs and larger investment in renewables among euro area peers.
- **Social:** The steady increase of the old-age-dependency ratio over the long term remains a key credit challenge, as the outcome of the pension reform remains uncertain. Still, demographic trends compare favorably to most European peers. The IMF estimates the net present value of additional health care and pension spending over 2021-50 at 41% of GDP, well below peers. Labour force participation is lower than most of peers, reflecting persistent bottlenecks in the labour market, including a complex pension system and insufficient re-skilling measures, though we expect the reform of the unemployment benefit system to support flexibility.
- **Governance:** This year's presidential election supports policy predictability and continuity. The next elections are due in 2023 (senatorial; half of the seats to be renewed through indirect universal suffrage) and 2026 (municipalities). Even so, the risk of political instability has increased. The government overcame multiple no-confidence votes in H2 2022 prompted by opposition lawmakers, including in the form of opportunistic alliance between the far right and the green-left coalition. Growing fragmentation and polarisation lowers policy effectiveness and makes early legislative elections more likely.

Overview of Scope's qualitative assessments for France's *ESG Risks*

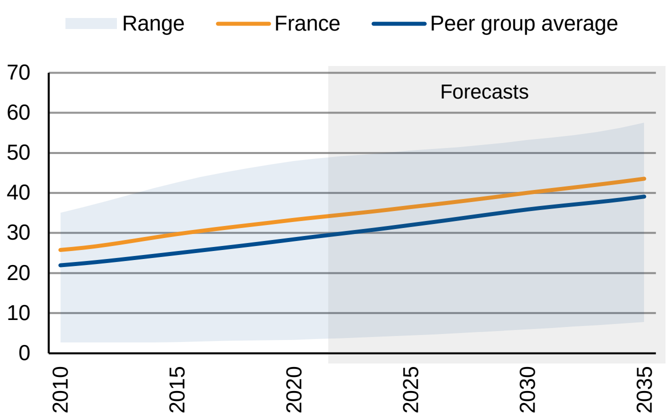
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Environmental factors	Strong	+1/3	Relatively strong resilience to climate risk and ambitious climate targets
	Social factors	Neutral	0	Large social safety nets, but public protests limit ability to implement structural reforms
	Governance factors	Neutral	0	High-quality institutions, but fading momentum on reforms following the Covid-crisis and 2022 electoral cycle

Emissions per GDP and per capita, $mtCO_2e$



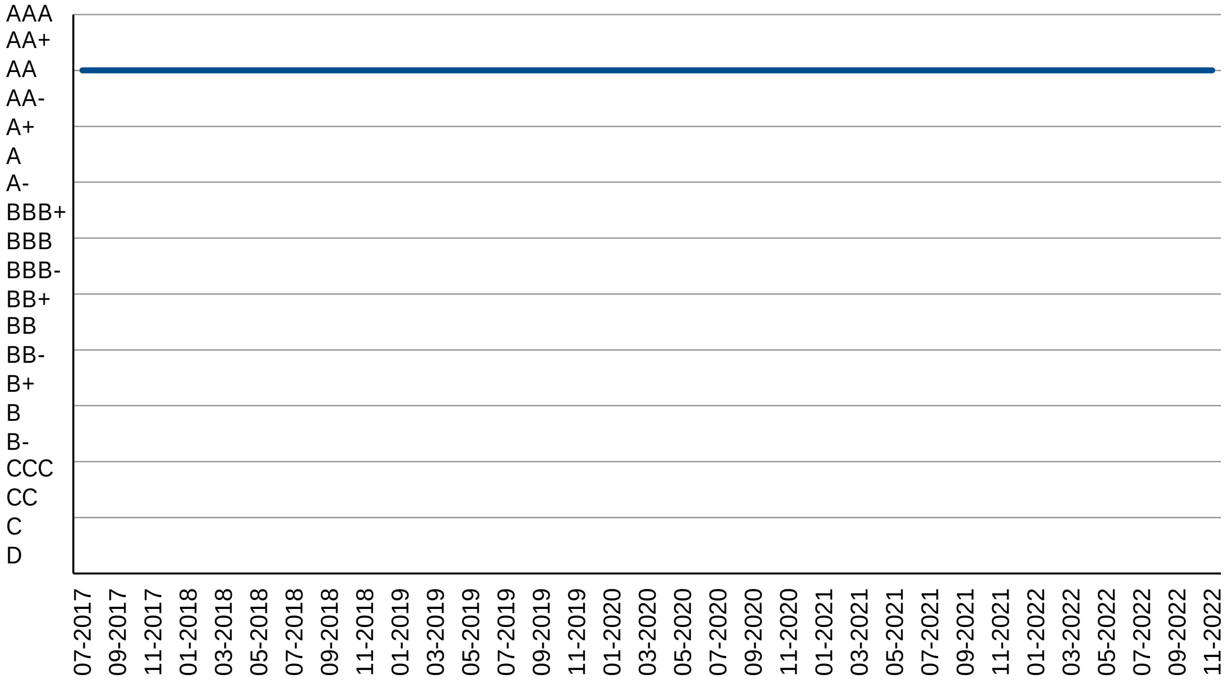
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Belgium
Czech Republic
Estonia
Italy
Japan
Lithuania
Malta
Portugal
Slovenia
United Kingdom
United States

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021
Domestic Economic	**GDP per capita, USD '000s**	IMF	40,134	43,061	41,925	40,378	45,188
	Nominal GDP, USD bn	IMF	2,594.2	2,792.2	2,729.2	2,636.0	2,957.4
	Real growth, %	IMF	2.4	1.8	1.9	-7.9	6.8
	CPI inflation, %	IMF	1.2	2.1	1.3	0.5	2.1
	Unemployment rate, %	WB	9.4	9.0	8.4	8.0	8.1
Public Finance	**Public debt, % of GDP**	IMF	98.1	97.8	97.4	114.7	112.6
	Interest payment, % of revenue	IMF	3.0	3.0	2.6	2.3	2.4
	Primary balance, % of GDP	IMF	-1.3	-0.7	-1.7	-7.7	-5.1
External Economic	**Current account balance, % of GDP**	IMF	-0.8	-0.8	0.5	-1.8	0.4
	Total reserves, months of imports	IMF	1.9	1.8	2.1	2.9	2.7
	NIIP, % of GDP	IMF	-21.4	-18.7	-24.7	-33.0	-30.7
Financial Stability	**NPL ratio, % of total loans**	IMF	3.1	2.7	2.5	2.7	2.4
	Tier 1 ratio, % of RWA	IMF	15.1	15.2	15.6	15.7	16.9
	Credit to private sector, % of GDP	WB	101.4	104.3	107.1	122.4	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	114.4	108.8	104.5	97.9	99.1
	Income share of bottom 50%, %	WID	22.9	22.8	22.7	22.7	22.7
	Labour-force participation rate, %	WB	71.6	72.0	71.8	-	-
	Old-age dependency ratio, %	UN	31.2	31.9	32.6	33.3	33.9
	Composite governance indicators*	WB	1.1	1.1	1.2	1.1	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of November 28, 2022	27.49

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