French Republic
Rating Report

SCOPE AA NEGATIVE OUTLOOK

Credit strengths

- Large and diversified economy
- Core euro area member
- Favourable debt profile and excellent market access
- Sound and resilient banking sector

Credit challenges

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

Rating rationale:

Large and diversified economy: France has a large economy, high GDP per capita, and a diversified economic structure driven by high value-added activities. The economy also benefits from supply-side reforms introduced before the Covid-19 crisis.

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

Favourable debt profile and excellent market access: France benefits from a favourable debt profile and an excellent market access, providing partial mitigants to risks associated to a high debt stock in a higher interest rate environment.

Sound and resilient banking sector: The French banking sector displays favourable capitalisation ratios supported by comfortable profitability, underpinning its good capacity to absorb external shocks.

Rating challenges include: i) high public debt-to-GDP ratio, sustained primary fiscal deficits and weak track record of fiscal consolidation; ii) growing political fragmentation and polarisation, which limits the government's capacity to boost GDP growth potential through structural reform; and iii) persistent labour market bottlenecks compromising a further 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%	aa+	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%	a		+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 Negative Outlook reflects our opinion that risks to the ratings are skewed to the downside over the next 12-18 months.

Positive rating-change drivers

- Sustained budgetary consolidation exceeds expectations and the trajectory of public debt-to-GDP stabilises
- Growth outlook improves significantly

Negative rating-change drivers

- The public debt-to-GDP ratio steadily increases due, for example, to the failure to deliver adequate fiscal consolidation
- Growth outlook deteriorates significantly

Ratings and Outlook

Foreign and local currency

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

Lead Analyst

Thomas Gillet
+33 186 261 874
t.gillet@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

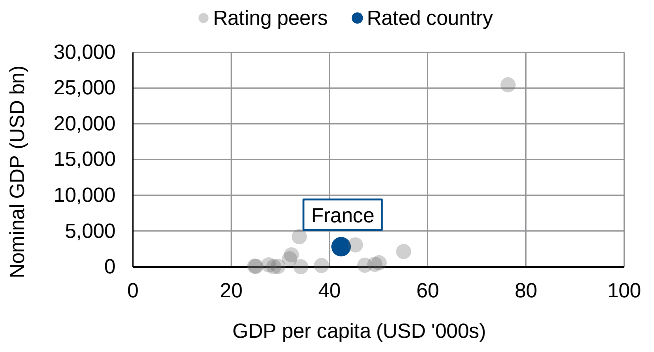
Domestic Economic Risks

- **Growth outlook:** Real GDP growth remained comparatively robust in 2022, at 2.6%, though primarily resulting from a strong carry-over effect from the previous year. The economic momentum decelerated markedly in H2 2022, as rising inflation, tightening funding conditions and high uncertainty weighed down private demand. Growth remained sluggish in Q1 2023, at 0.2% QoQ, mostly reflecting an improvement in net trade amid easing supply chain disruptions and a normalisation of global energy prices. We expect the growth momentum will remain subdued over the near-term and pick up around H2 2023, as easing price pressures, normalising savings rates and stabilising funding conditions should allow for a gradual recovery in household consumption and business investment. Real growth should decline further, to 0.7% this year, before picking up to 1.4% in 2024.
- **Inflation and monetary policy:** CPI inflation has stabilised at around 6% since the beginning of the year (5.9% YoY in April), while remaining below the euro area average. The contribution of energy inflation is expected to decline only gradually, owing to the impact of the tariff shield on electricity and gas prices. Core inflation has continued to increase in recent months (6.3% YoY in April), signalling persistent underlying price pressures and the continued feed-through of higher energy prices to the rest of the economy. Lower economic growth, a more favourable external environment and the ECB's tightening of monetary policy (with rate hikes totalling 375 bp since July 2022) should lead to a moderation in price pressures over the coming months. We expect inflation to decline to 5.3% in 2023 and 2.7% in 2024.
- **Labour market:** The labour market is resilient despite the slowdown in economic momentum, with the unemployment rate remaining near multi-decade lows (7.1% in Q1 2023). Recent labour market reforms, including a revamp of the apprenticeship and unemployment benefit systems, have supported robust employment rates, reaching a record high of 68.6% in Q1 2023 (up by 1.8 pp from Q4 2019), though it remains below the peer average. Difficulties related to labour shortages persist, with around half of corporates reporting recruitment difficulties and job vacancy rates remaining high relative to pre-pandemic averages, though the implementation of the unemployment benefit reform should help alleviate labour supply bottlenecks in the medium-term.

Overview of Scope's qualitative assessments for France's *domestic economic risks*

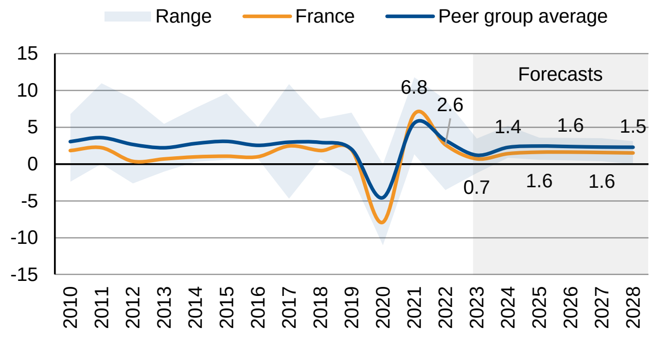
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa+	Growth potential of the economy	Neutral	0	Moderate growth potential supported by improving labour markets and robust foreign investment
	Monetary policy framework	Neutral	0	The ECB is a highly credible and effective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

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings

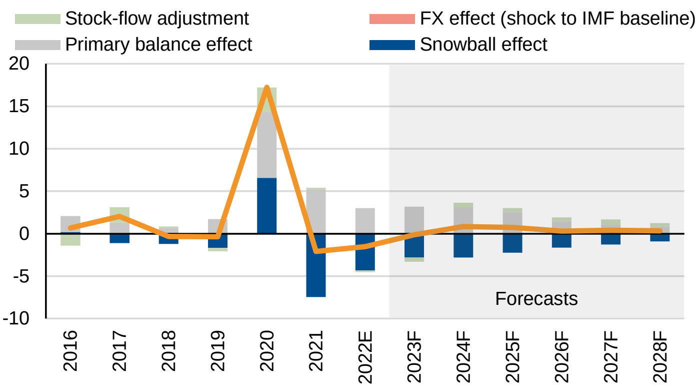
Public Finance Risks

- **Fiscal outlook:** The general government deficit declined to 4.7% of GDP in 2022, down 1.8 pp YoY, while remaining well above pre-pandemic levels and among the largest within the euro area. This improvement was driven by the phasing out of pandemic measures and stronger-than-anticipated revenue growth in a context of high inflation, which outweighed spending pressures related to measures aimed at alleviating the impact of the energy crisis (for a net fiscal cost of about 1% of GDP) and rising interest expenses related to inflation-linked bonds. We expect the fiscal deficit to widen slightly in 2023 at 4.8% of GDP because of lower growth and amidst sustained spending pressures related to inflation-linked items (social benefits, pensions), as well as the extension of some energy support measures. The general government deficit is expected to decline gradually over the medium term, ending our forecast horizon above 3.0% of GDP, based on a weak track record in fiscal consolidation, a rising interest burden, and risks surrounding the execution of the reform agenda.
- **Debt trajectory:** The general government debt declined to 111.6% of GDP in 2022, slightly down from the previous year, while remaining 14 pp above its end-2019 level. It is expected to remain broadly stable this year before gradually increasing from 2024 onward, hovering to around 114% by 2028. Prospects of large, albeit declining, primary deficits; a gradual rise in the interest burden; and moderate output growth weigh on the debt trajectory.
- **Debt profile and market access:** Gross financing needs are high, at an estimated 20% of GDP in 2023, but debt affordability compares favourably with peers thanks to a large and stable revenue base. After rising markedly over the course of 2022, funding rates have stabilised in recent months, around 3% for 10-year bonds. Strong public financial management, a large share of fixed-rate securities (88% of total), long average maturity (8.5 years) and significant Eurosystem holdings of government debt securities (22%) mitigate liquidity risks stemming from high public debt amid higher interest rates.

Overview of Scope's qualitative assessments for France's *public finance risks*

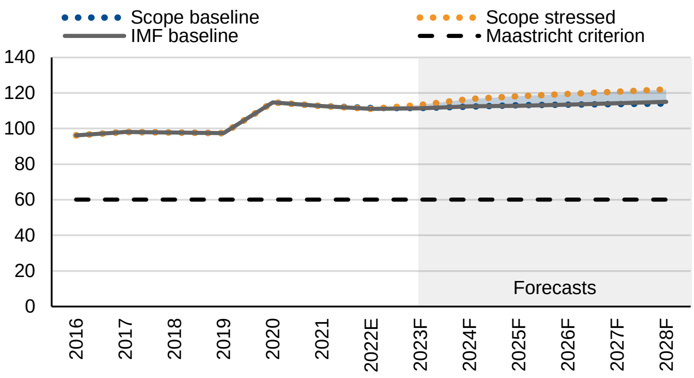
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Fiscal policy framework	Neutral	0	Enhanced fiscal governance framework, but limited room for additional spending; gradual reduction of deficits
	Debt sustainability	Neutral	0	High public debt; sustainability underpinned 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

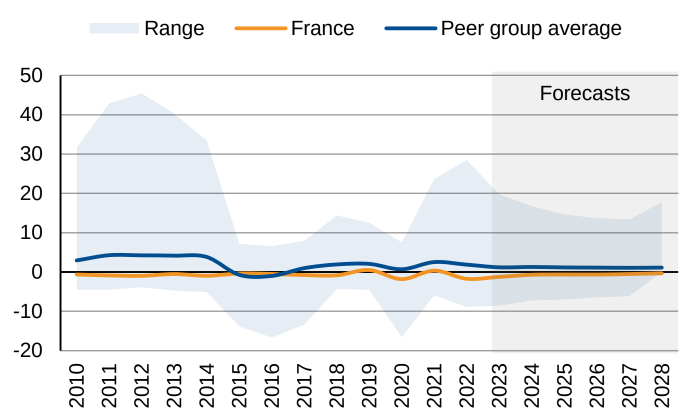
External Economic Risks

- **Current account:** After recording a moderate surplus in 2021 (0.4% of GDP), the current account deficit dipped to a 1.7% of GDP deficit in 2022. This primarily reflects the widening of the deficit in the trade of goods balance, which nearly doubled to 5.1% of GDP in the context of a sharp deterioration of the terms of trade following the escalation of the Russia-Ukraine war. Still, the moderation in global energy prices and the easing of supply chain bottlenecks should continue to support the gradual reduction of the current account deficit, which the IMF forecasts at 1.2% of GDP this year. The recovery is expected to be gradual, however, as the subdued economic outlook among euro area trade partners hinders export growth. In the long run, persistent challenges around competitiveness and productivity are material vulnerabilities to external performance, reflected in the steady decline in export market shares.
- **External position:** France's sustained current account deficit should maintain pressure on the net international investment position (-26% of GDP as of end-2022), including a large, negative net portfolio investment position (around 39% of GDP). Gross external debt is high, at around 245% of GDP as of end-2022, remaining around 11 pp above end-2019 levels. More than half of external debt is owed by financial institutions (53% of total) and public-sector entities (26%). A significant share of outstanding foreign debt (47%) 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*

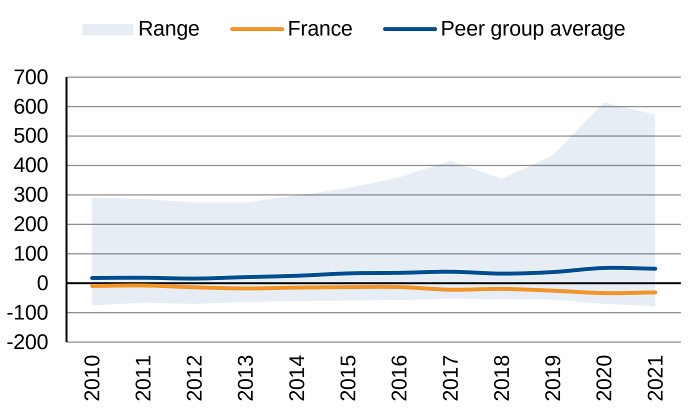
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b+	Current account resilience	Neutral	0	Diversified and high-technology industries, moderate current account deficits
	External debt structure	Neutral	0	High external debt mitigated by moderate cost of debt, high amount 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

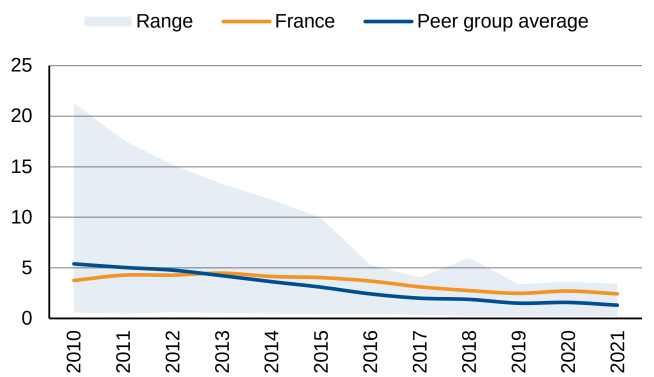
Financial Stability Risks

- **Banking sector:** Banking sector resilience is underpinned by robust capitalisation and liquidity metrics, as reflected in sector-wide CET-1 and liquidity coverage ratios of respectively 15.4% and 150.2% as of end-2022. Banking sector profitability is adequate (aggregate return-on-equity ratio of 6.1% as of Q4 2022) and is set to improve over the medium term, as lending margins benefit from the rise in interest rates. At the same time, potential headwinds result from the low economic growth, inflation-induced high returns on regulated savings, and pressures on asset quality. Still, non-performing loans remain moderate, broadly in line with the euro area average, at 1.9% of gross loans. In December 2022, the High Council for Financial Stability announced it would raise the countercyclical capital buffer rate to 1.0% by January 2024, from 0.5% presently.
- **Private debt:** Private sector leverage is high, at around 228% of GDP as of Q4 2022, 66 pp above the euro area average. The debt of non-financial corporates is particularly high, at about 162% of GDP (121% of GDP in Q4 2012). Additionally, debt service ratios for corporates are some of the highest among advanced economies, at around 58% of income as of Q3 2022 according to the Bank for International Settlements. High energy costs and lending rates exert material downward pressure on corporate margins, though risks will be partially offset by predominantly fixed-rate corporate debt and high liquidity. Financial vulnerabilities for households are contained by medium indebtedness (66% of GDP, against 57% for the euro area), moderate debt-servicing ratios, and a low share of variable-rate mortgage loans.
- **Financial imbalances:** Residential real estate activity decelerated in 2022, with rising mortgage rates and higher uncertainty causing a decline in the number of transactions. This in turn led to a deceleration of price growth (+4.8% YoY in Q4 2022), which remains above the pre-pandemic average (+1.7 over 2015-2019). Risks of a sharp correction in housing prices are partially mitigated by robust borrower quality, in line with the implementation of prudential measures including limits on loan maturity and debt-service ratios.

Overview of Scope's qualitative assessments for France's *financial stability risks*

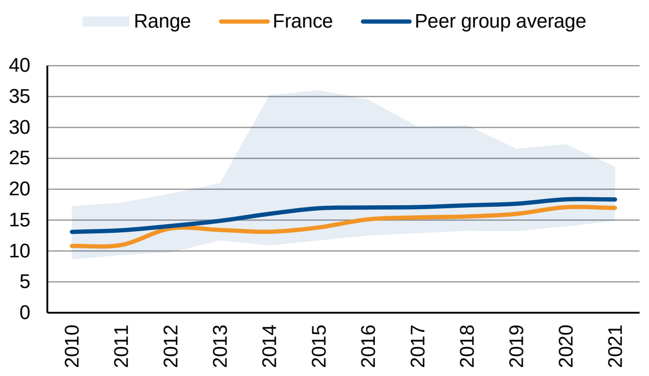
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Banking sector performance	Strong	+1/3	Consolidated banking sector with strong capitalisation and liquidity buffers
	Banking sector oversight	Neutral	0	Oversight under the national supervisory authority (ACPR, under Banque de France) and the ECB as part of the Single Supervision Mechanism
	Financial imbalances	Neutral	0	Moderate household indebtedness; high 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

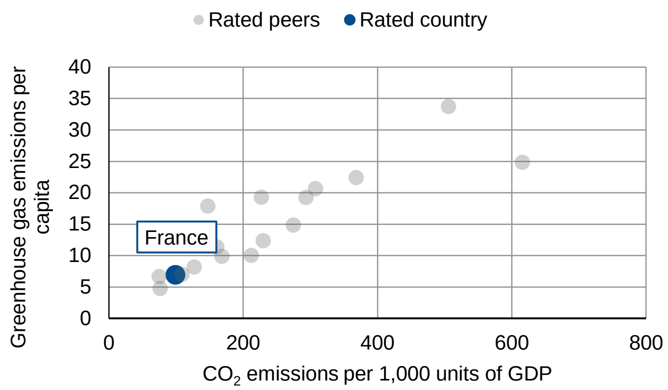
ESG Risks

- **Environment:** A nuclear-dominated energy mix is the main driver of the economy's low carbon intensity and partially mitigates supply risks related to external developments. However, the French nuclear sector has experienced significant operational issues in the recent period. Extending the lifespan of the nuclear fleet and replacing ageing reactors remains crucial for France's comparatively low carbon-intensity and climate objectives. Nuclear energy is expected to remain at the core of the government's green transition strategy, alongside renewables, to reach carbon neutrality by 2050. Still, the long-term horizon of the nuclear investment plan could make the country vulnerable to technological breakthroughs, while major euro area peers are rolling out large investment plans in renewables.
- **Social:** French demographics compare favourably to most European peers, though the steady increase of the old-age dependency ratio weighs on long-term growth and fiscal outlooks. The IMF estimates the net present value of additional healthcare and pension spending over 2022-2050 at 52% of GDP, well below most peers. Labour force participation (73.6% of the population aged 15-64) is lower than the EU average, reflecting persistent bottlenecks in the labour market, including a complex pension system and insufficient re-skilling measures.
- **Governance:** France benefits from mature institutions that underpin policy predictability and continuity, though a fragmented parliament weighs on the government's ability to implement reforms. High degrees of political polarisation, as reflected in recent episodes of social unrest in the context of the pension reform, increase governance risks. Senatorial elections are due in September 2023 (half of the seats to be renewed through indirect universal suffrage) and local elections in 2026.

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

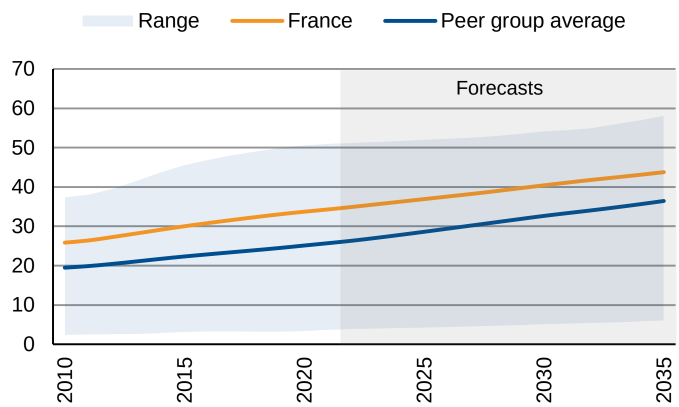
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Environmental factors	Strong	+1/3	Relatively strong resilience to climate risk and ambitious climate targets
	Social factors	Neutral	0	Large social safety nets, but public protests limit ability to implement structural reforms
	Governance factors	Neutral	0	High-quality institutions, but risks of fading momentum on reforms following the Covid-19 crisis and the 2022 electoral cycle

Emissions per GDP and per capita, $mtCO_2e$



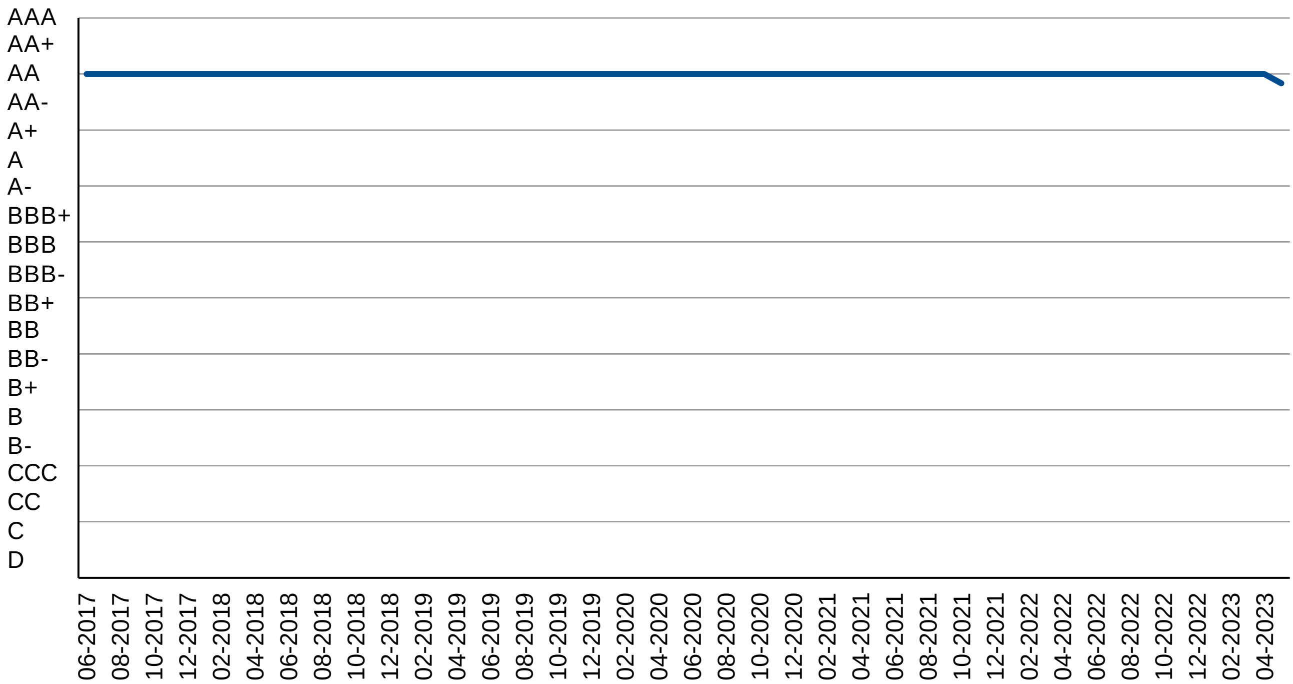
Source: European Commission, Scope Ratings

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
Japan
Lithuania
Malta
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	2019	2020	2021	2022	2023
Domestic economic	GDP per capita, USD '000s	IMF	41.9	40.4	45.2	42.4	44.4
	Nominal GDP, USD bn	IMF	2,729.2	2,635.9	2,957.4	2,784.0	2,923.5
	Real growth, %	IMF	1.9	-7.9	6.8	2.6	0.7
	CPI inflation, %	IMF	1.3	0.5	2.1	5.9	5.0
	Unemployment rate, %	WB	8.4	8.0	7.9	-	-
Public finance	Public debt, % of GDP	IMF	97.4	114.7	112.6	111.1	111.4
	Interest payment, % of revenue	IMF	2.6	2.3	2.5	3.4	3.1
	Primary balance, % of GDP	IMF	-1.7	-7.8	-5.2	-3.0	-3.7
External economic	Current account balance, % of GDP	IMF	0.5	-1.8	0.4	-1.7	-1.2
	Total reserves, months of imports	IMF	2.1	2.9	2.7	-	-
	NIIP, % of GDP	IMF	-24.7	-33.0	-30.7	-26.5	-
Financial stability	NPL ratio, % of total loans	IMF	2.5	2.7	2.4	-	-
	Tier 1 ratio, % of RWA	IMF	15.6	15.7	16.9	16.4	-
	Credit to private sector, % of GDP	WB	107.1	122.0	-	-	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	104.5	97.9	99.1	-	-
	Income share of bottom 50%, %	WID	22.7	22.7	22.7	-	-
	Labour-force participation rate, %	WB	71.8	-	-	-	-
	Old-age dependency ratio, %	UN	33.1	33.7	34.3	35.0	35.6
	Composite governance indicators*	WB	1.2	1.1	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 22 May 2023	26.96

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30 31 58 14

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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