French Republic
Rating Report

SCOPE AA STABLE OUTLOOK

Credit strengths

- Status as a core euro area member
- Large and diversified economy
- Good record of structural reform and high investment levels
- Favourable debt structure and excellent market access

Credit challenges

- High public debt, persistent deficits and weak fiscal consolidation record
- Labour market challenges

Rating rationale:

Core euro area member: France is a major architect and guarantor of the European institutional framework. As the second-largest euro area economy, the country is decisive in preserving and driving the consolidation of European integration.

Large and diversified economy: France benefits from its large economic size, high wealth levels and diversified economic structure driven by high value-added activities.

Good record of structural reform: The French government under President Emmanuel Macron has enacted major supply-side oriented reforms designed to lower wage costs, reform corporate taxation, broaden the tax base, improve the equity and quality of education as well as enhance the competitiveness of the French economy. Strong reform momentum is critical to raising France's growth potential.

Debt profile and market access: The French treasury benefits from excellent market access, facilitated by the ECB's accommodative monetary policy, including its asset purchases which have turned the ECB into the largest holder of French government debt.

Rating challenges include: i) high public debt, persistent fiscal deficits and a weak fiscal consolidation record, resulting in limited prospects for spending reductions to place the debt-to-GDP ratio on a firm downward trajectory post-crisis; and ii) the implementation of additional reforms to raise productivity, employment and the economy's growth potential.

France's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	aaa		+2/3	AA
Public Finance Risk		25%	bb		+1/3	
External Economic Risk		10%	bb-		0	
Financial Stability Risk		10%	a+		+1/3	
ESG Risk	Environmental Risk	5%	aaa		+1/3	
	Social Risk	5%	bb+		0	
	Governance Risk	10%	aa		0	
Overall outcome		**a**		**+1**	**+2**	

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and 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 GmbH

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

- Growth outlook improves
- Sustained fiscal consolidation places debt on a firm downward path

Negative rating-change drivers

- Growth outlook weakens
- Fiscal outlook deteriorates, resulting in an increase of public debt

Ratings and Outlook

Foreign currency

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

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Bloomberg: RESP SCOP

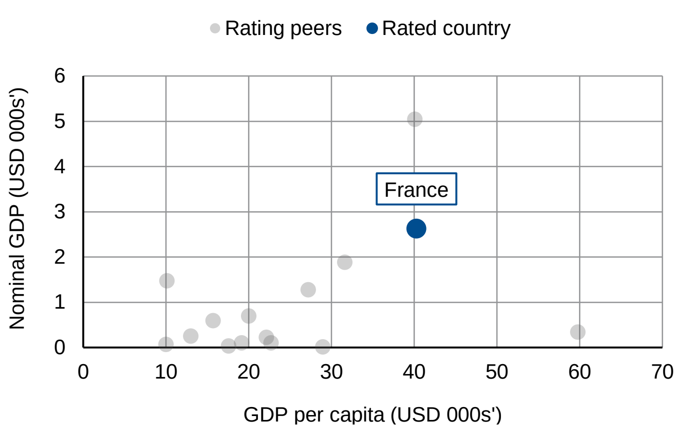
Domestic Economic Risks

- **Growth outlook:** France was among the most severely hit countries by the Covid-19 pandemic, recording a recession of -8.0% in 2020, worse than Germany (-4.9%) or the euro area (-6.8%). We expect a strong rebound, with growth of around +6.5% of GDP in 2021 and +4% in 2022, supported by household consumption and private investment, as well as by the government's investment plans. Economic activity has returned to pre-pandemic levels in Q3 2021, according to estimates by INSEE.
- **Reform momentum:** The French government has enacted major supply-oriented reforms to stimulate the country's growth potential, which we now estimate at around 1.50% to 1.75%. Reforms include tax cuts for employers and employees, reduced ancillary wage costs, and a reform of the tax system which broadened the tax base. The unemployment insurance reform, effective since 1 October 2021, should strengthen work-incentives and eliminate distortions, favouring short-term contracts.
- **Investments:** The government's *Plan France Relance*, a EUR 100bn (4.1% of GDP) recovery plan is targeted at environment policy (EUR 30bn), competitiveness (EUR 34bn) and social cohesion (EUR 36bn), with EUR 40bn to be financed by Next Generation EU funds. In addition, in October 2021, the government announced a EUR 30bn investment plan *France 2030*, aimed mostly at the energy sector (EUR 8bn) and transportation (EUR 4bn). A key challenge in our view relates to the effective implementation of the government's investment strategy, as past public investment failed to deliver significant results on potential growth.
- **Labour market:** The economic recovery should reduce unemployment to pre-crisis levels and stabilise below 8% at year end. Despite improvements, unemployment in France remains above the EU average (7.5% as of August 2021), which, along with skilled labour shortages, points to persisting rigidities in the French labour market.

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

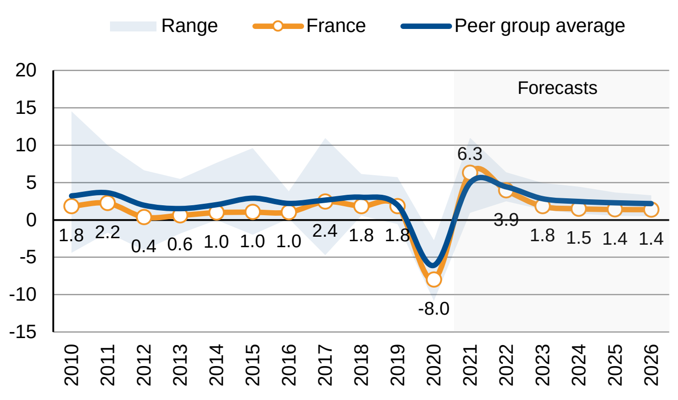
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential, reflecting strong investment and labour market-related challenges
	Monetary policy framework	Strong	+1/3	ECB is a highly credible and effective central bank; high weight in the Governing Council's monetary policy decisions
	Macro-economic stability and sustainability	Strong	+1/3	Diversified economy reflects resilient economic structure; shock-absorbing wealth levels relative to peers

Nominal GDP and GDP per capita, USD thousands



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

Public Finance Risks

- **Fiscal outlook:** The general government deficit jumped to 9.2% of GDP in 2020 and is expected to reach 8.1% in 2021 before declining to 5% in 2022, given the progressive withdrawal of Covid-related support measures and the strong economic recovery. The large deficits are driven by the appropriate public support to companies, households and the health system, which amounted to EUR 69.7bn in 2020 and EUR 63.8bn in 2021, and an additional EUR 23.5 bn (net of EU funding) allocated from the *France Relance* recovery plan.

  Looking ahead, we expect deficits to gradually decline but remain above 3% of GDP, even by 2026. While the Stability and Growth Pact remains suspended until end-2022, any reforms before its re-introduction in 2023, which must be agreed at the European level, are likely to be limited in our view, raising the possibility of excessive deficit procedures over the medium-term.

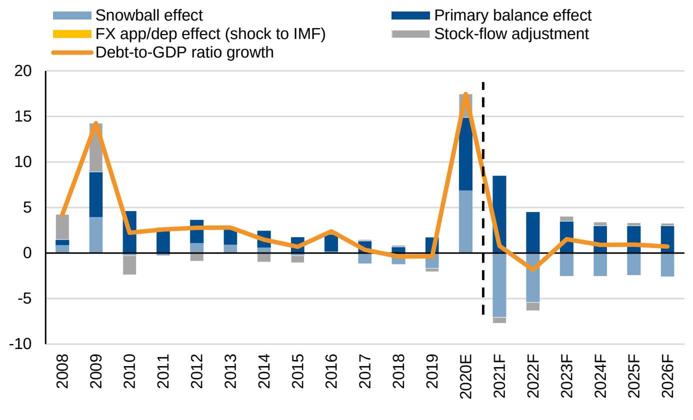
- **Debt trajectory:** The government debt-to-GDP ratio increased by almost 20pp from 97.6% in 2019 to 115% in 2020. Given the strong recovery this year and next, a gradual return of economic growth to a now slightly higher growth potential of around 1.50%-1.75%, and a gradual decline in primary deficits, we expect the public debt ratio to remain broadly stable between 115%-120% over the coming years.

- **Market access:** While gross financing needs are elevated, with France issuing EUR 260bn of net debt in 2020 and planning to raise the same amounts in 2021 and in 2022, we note that the ECB's asset purchase programmes covered almost the totality of French public debt issuance during the health crisis. As a result, more than 25% of French public debt was held by the Eurosystem as of May 2021. France also benefits from a favorable debt profile, with a long debt maturity of 8.5 years and low average cost of debt of around 1.3%.

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

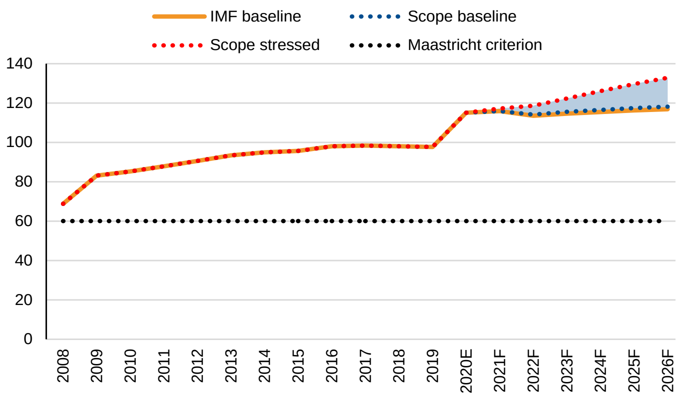
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Fiscal policy framework	Neutral	0	Appropriate budgetary response to 2020 crisis; limited room for additional spending; gradual reduction of deficits until 2026
	Debt sustainability	Neutral	0	High public debt levels; sustainability ensured by low interest burden and large tax base
	Debt profile and market access	Strong	+1/3	Excellent market access, negative yields, high investor demand

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

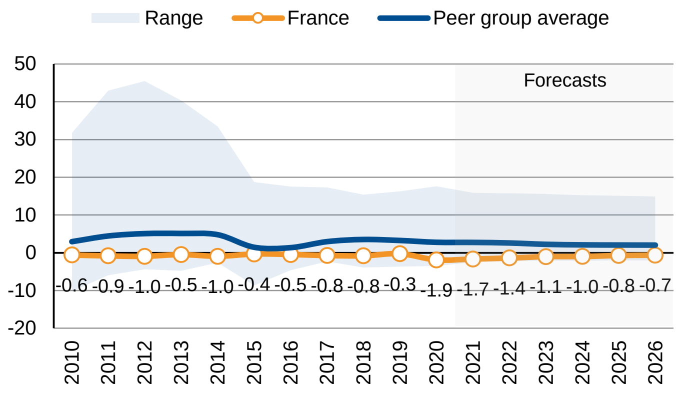
External Economic Risks

- **Current account:** France has had an annual current account deficit averaging -0.9% of GDP since 2010. While services and primary income contributed positively, a persistent deficit on traded goods drives the overall negative figures. In addition, the composition of France's exports dominated by aerospace and tourism, together with its main export-destination being European countries, led to a harder hit from global demand during the pandemic. While exports should recover in 2021, they are likely to remain constrained by the slow recovery in aerospace and travel restrictions. Looking ahead, while competitiveness gains from lower production taxes are expected to contribute toward a gradual improvement in the current account, it is likely to remain in deficit over the coming years.
- **External position:** Following small, but persistent, current account deficits, France's net international investment position (NIIP) decreased to a new low of -32.5% of GDP in 2020. While its current level and projected trajectory raise no sustainability concerns, some vulnerabilities may arise due to the high stock of external debt, whose increase contributed to the deterioration of the NIIP in the past decade. In 2020, France's external debt, at 258.4% of GDP, was well above the euro area average (122.9%), with the highest shares for government and financial institutions.
- **Euro as global reserve currency:** France, along with all euro area members, benefits from the euro's status as a global reserve currency, significantly mitigating risks to external shocks.

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

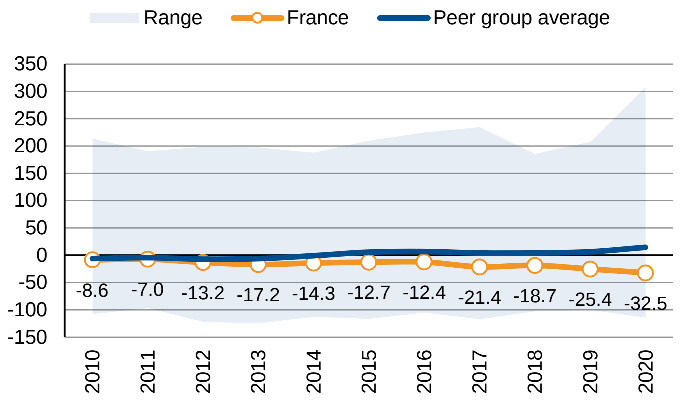
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Current account resilience	Neutral	0	Diversified and high-technology industries, moderate but persistent current account deficits
	External debt structure	Neutral	0	Elevated external debt mitigated by low cost of debt,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

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

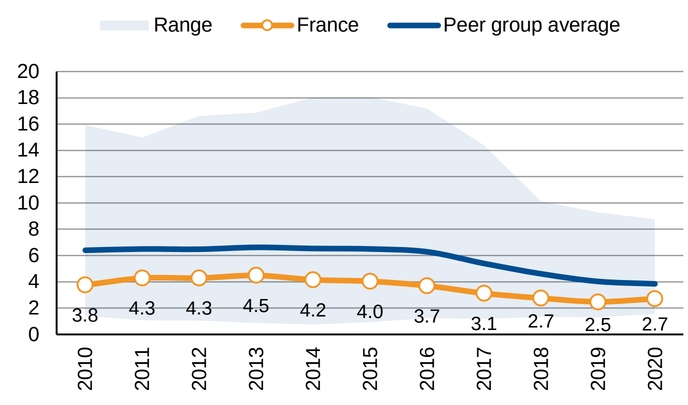
Financial Stability Risks

- **Banking sector:** French banks entered the crisis with comfortable capital buffers (CET-1 ratio at 16% at end-2019), low NPL ratios (2.5%) and a liquidity coverage ratio of about 140% on average. The banking sector has weathered the crisis well, despite falling profitability driven by loan provisions. France's major banking groups improved their liquidity coverage ratios (at 157.4% as of June 2021) and capital positions, mainly resulting from state support measures and dividend retention. While profitability remains a challenge, planned consolidation in the sector (Credit du Nord take-over by Société Générale, sale of ING France) could support bank margins. Finally, the EBA's 2021 stress tests covering France's seven biggest banking groups, confirmed that all banks but one (HSBC Continental Europe) would maintain capitalisation levels compliant with prudential standards under its adverse scenario.
- **Private debt:** At 101.1% of GDP, non-financial corporate (NFC) debt is high compared to the euro area average (80.5%) as of 2021 Q2. In 2020, NFC gross financial indebtedness rose by +12%, although net financial indebtedness only increased by about 0.65% due to the significant increase in liquidity positions (+30%) over the same period. While state support measures reduced corporate insolvencies (-39% in 2020), uncertainty remains as support is gradually withdrawn. Household debt, at 67.1% of GDP, increased moderately during the pandemic, remaining close to the euro area average (61.1%) as of 2021 Q2. Savings rose by about EUR 100bn over 2020, driven by lower consumption and government support measures.
- **Housing market:** Property prices continue to rise, albeit following the typical dynamics in Europe, with prices spiking in large cities and mostly stagnating in the countryside. Risks for a housing bubble, even in cities, remain contained however, given a moderate slow-down in housing loans growth since 2020.

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

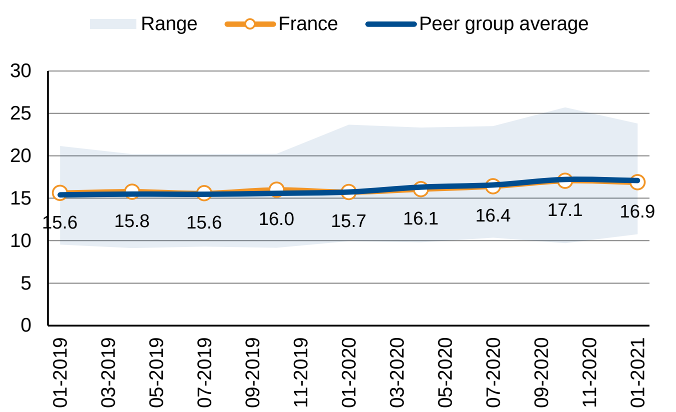
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Banking sector performance	Strong	+1/3	Competitive banking sector, strong capitalisation and moderate exposure risks to NFC debt
	Banking sector oversight	Neutral	0	Oversight under the National Supervisory Authority (ACPR, under Banque de France) and the ECB as part of Banking Union
	Financial imbalances	Neutral	0	Moderate household indebtedness, elevated corporate debt mitigated by high net wealth, rise in corporate defaults expected, resilient and mature financial system

NPLs, % of total loans



Source: IMF, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

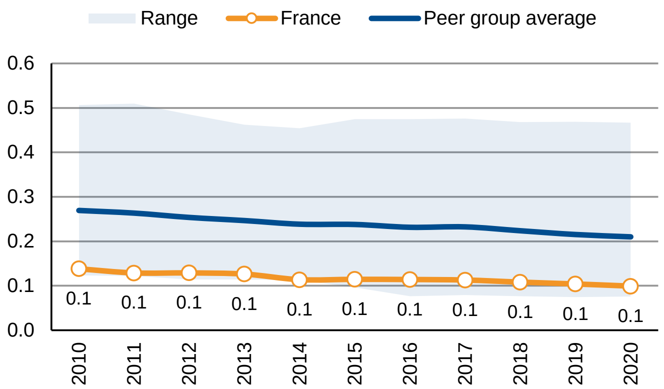
ESG Risks

- **Environment:** While the government has committed to reduce greenhouse gas emissions by 40% by 2030 and to achieve carbon neutrality by 2050, the Council of State ruling of 1 July 2021 notes that current efforts are insufficient to meet these targets. The government's *Plan France Relance*, which targets a EUR 30bn effort to finance the green transition of the French economy, including investments for energy-retrofitting, sustainable mobility, decarbonisation of the industry, and development of green technologies, will likely have a positive impact in this regard. Critically, the pending European Commission decision on the classification of nuclear energy as a sustainable energy source, will inform our view on France's transition risks as the country derives about 40% of its total energy supply from nuclear power.
- **Social:** Relatively weak social mobility and high regional inequality compared to peers, despite the large role of the state, remain key structural challenges. While France benefits from more favorable demographic trends compared to most European peers, the old age dependency ratio is set to increase to 50.5 by 2060, structurally weighing on public finances and economic growth over the long-term.
- **Governance:** La Republique En Marche (LaREM) and its centrist ally, the Movement Démocrate (MoDem), hold 413 of the 577 seats. Still, reform momentum has faded following the yellow vests movement and the Covid-19 shock and is unlikely to resume ahead of the presidential and parliamentary elections in April and June next year. The next government's ability to balance fiscal consolidation, structural reforms and popular support will be key to address the credit-relevant challenges of France. Given the increased fragmentation of the political landscape, it may be more difficult to form a clear parliamentary majority to implement ambitious reforms.

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

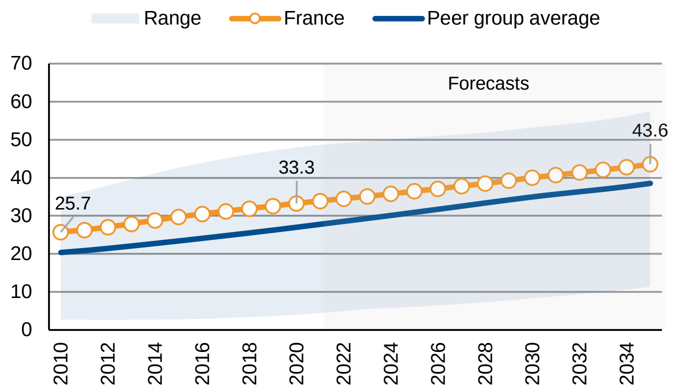
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Environmental risks	Strong	+1/3	Relatively strong resilience to climate risk and ambitious climate targets
	Social risks	Neutral	0	Large social safety nets, public protests limit ability to implement reforms; comparatively more favourable demographics
	Institutional and political risks	Neutral	0	High-quality institutions and stable political environment; fading reform momentum given Covid-19 crisis and 2022 presidential elections

CO2 emissions per GDP, mtCO2e



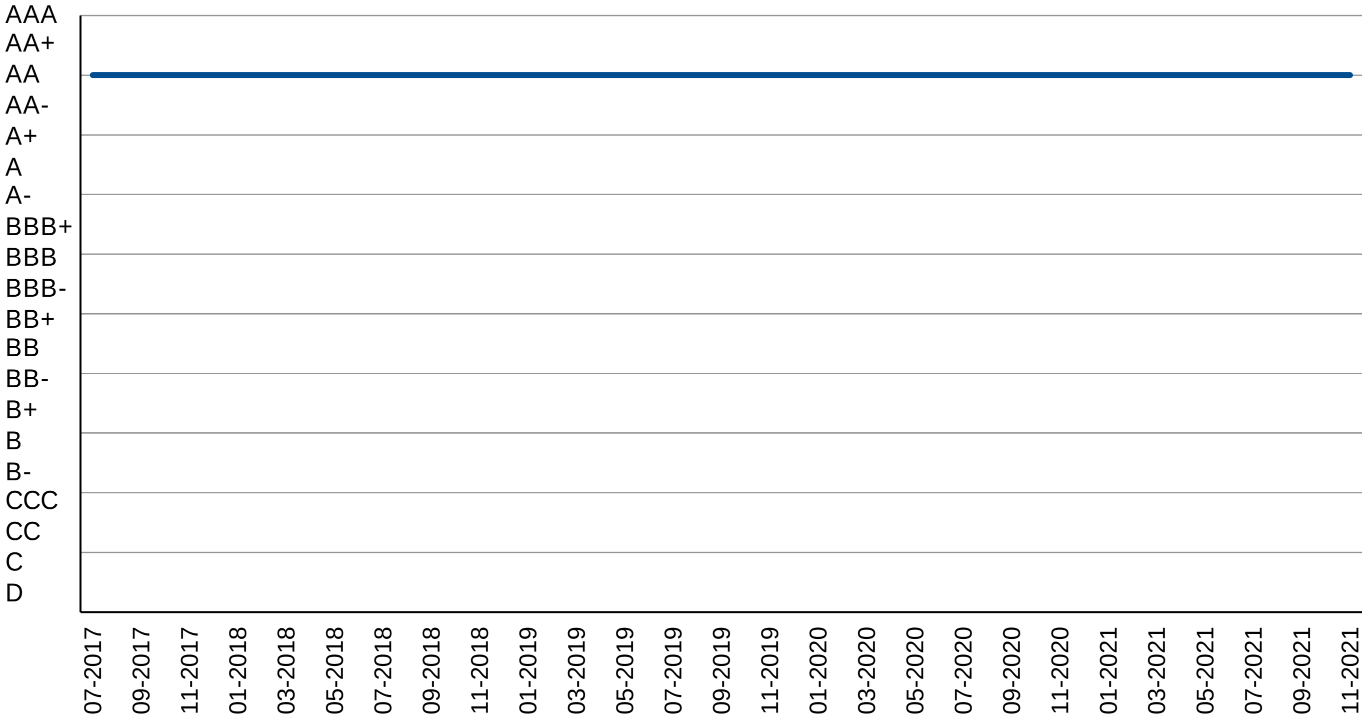
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



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.

Peer group
Bulgaria
France
Italy
Japan
Latvia
Malta
Poland
Portugal
Russia
Slovakia
Spain

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 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021F	2022F
Domestic Economic Risk							
GDP per capita, USD 000s'	38.3	40.1	43.0	42.0	40.3	45.0	48.0
Nominal GDP, USD bn	2,471.3	2,589.0	2,789.7	2,728.8	2,624.4	2,940.4	3,140.0
Real growth, %[1]	1.0	2.4	1.8	1.8	-8.0	6.5	4.0
CPI inflation, %	0.3	1.2	2.1	1.3	0.5	2.0	1.6
Unemployment rate, %[1]	10.1	9.4	9.0	8.4	8.0	7.9	7.7
Public Finance Risk							
Public debt, % of GDP[1]	98.0	98.3	98.0	97.6	115.1	115.9	114.1
Interest payment, % of government revenue	3.3	3.0	3.0	2.6	2.3	2.2	1.6
Primary balance, % of GDP[1]	-1.9	-1.3	-0.7	-1.7	-8.0	-8.5	-4.5
External Economic Risk							
Current account balance, % of GDP	-0.5	-0.8	-0.8	-0.3	-1.9	-1.7	-1.4
Total reserves, months of imports	1.9	1.9	1.8	2.1	2.9	-	-
NIIP, % of GDP	-12.4	-21.4	-18.7	-25.4	-32.5	-	-
Financial Stability Risk							
NPL ratio, % of total loans	3.7	3.1	2.7	2.5	2.7	-	-
Tier 1 ratio, % of risk weighted assets	15.1	15.4	15.6	16.0	17.1	16.9	-
Credit to private sector, % of GDP	97.4	101.4	104.4	107.6	123.7	-	-
ESG Risk							
CO^2 per EUR 1,000 of GDP, mtCO^{2}e	113.8	112.7	107.9	103.7	98.9	-	-
Income quintile share ratio (S80/S20), x	5.0	4.9	5.1	-	-	-	-
Labour force participation rate, %	71.4	71.6	72.0	71.8	-	-	-
Old age dependency ratio, %	30.5	31.2	31.9	32.6	33.3	33.9	34.5
Composite governance indicator[2]	1.0	1.1	1.1	1.2	1.1	-	-

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: European Commission, IMF, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 1 November 2021	21.8

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