French Republic
Rating Report

AA STABLE OUTLOOK

Credit strengths

- Large and diversified economy
- Core euro area member
- Favorable 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
- Persistent labour market challenges
- Growing political fragmentation and polarisation

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 a major architect and guarantor of the European institutional framework, and a key State in preserving and driving the consolidation of European integration.

Favorable debt profile and excellent market access: France benefits from a favorable 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 high profitability, which reinforce their capacity to absorb large external shocks.

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

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		+1/3	
Public Finance Risk		25%	bbb-		+1/3	
External Economic Risk		10%	bb-		0	
Financial Stability Risk		10%	a		+1/3	AA
ESG Risk	Environmental Risk	5%	aaa		+1/3	
	Social Risk	5%	bb		0	
	Governance Risk	10%	aa-		0	
Overall outcome		**a+**		**+1**	**+1**	

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

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 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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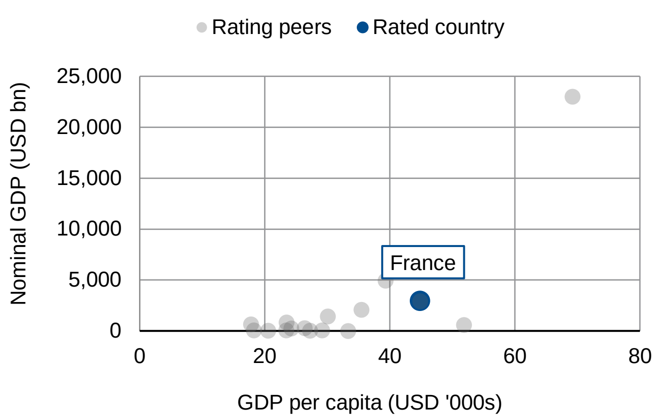
Domestic Economic Risks

- **Growth outlook:** Real GDP growth is forecasted at 2.4% in 2022, based on strong carry-over from the post-Covid rebound (6.8% in 2021), and at 1.2% in 2023. Scope expects short-term economic activity to slow down further (following -0.2% in Q1 2022) as rising consumer prices weigh on real wages and household consumption, despite the large support measures rolled out by the government. In addition, global supply chain disruptions, higher financing costs, and heightened uncertainty are expected to hamper investment. Scope estimates the growth potential to be around 1.3-1.5%, a slight decline from previous forecasts, reflecting our view that structural reforms supporting productivity and competitiveness gains are likely to be more difficult to deliver following legislative elections that saw the ruling alliance securing only a relative majority at the National Assembly.
- **Inflation and monetary policy:** Inflation has picked up markedly in recent months, up to 5.8% year-on-year in June 2022, a record high since 1980's. Even so, it remains significantly more benign that in most of euro area countries. This mostly reflects France's lower exposure to external energy shocks, thanks to its largely nuclear-oriented electricity mix. The government has also introduced measures aimed at taming energy prices, including a freeze on regulated gas prices and a cap on electricity price increases – enabling to reduce inflation by around 2 percentage points in May 2022.
- **Labour market:** Following a period of steady improvement of labour market metrics, Scope expects the unemployment rate to pick up to around 8% by 2023, given the gradual withdrawal of job retention schemes, the slowdown in economic activity, and persistent rigidities related to youth and long-term employment. Still, the unemployment rate would remain below the 2000-19 average (9%), in part owing to the persistent impact of reforms related to the unemployment benefits system and professional training schemes.

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

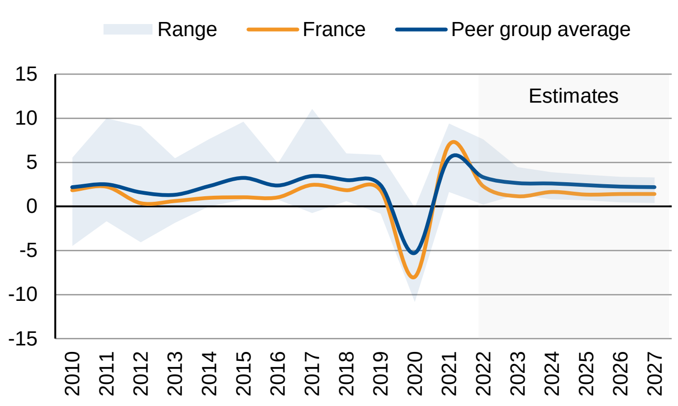
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential supported by improving labour markets and robust foreign investment
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central 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

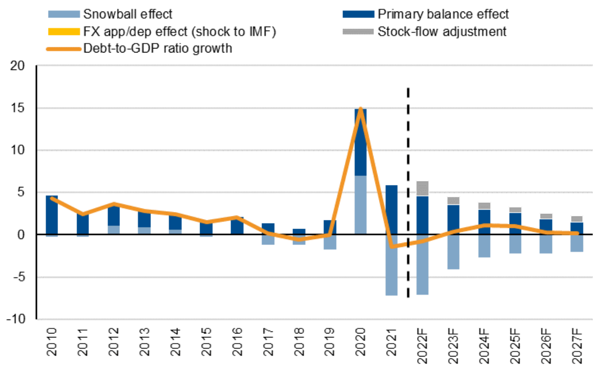
Public Finance Risks

- **Fiscal outlook:** The general government primary deficit should remain elevated in the medium-term, with a gradual decline from 4.6% of GDP in 2022 to about 1.5% in 2027. This results from extensive public transfers to cushion the impact of inflation (resilience plan for corporates, energy and purchasing package for households – estimated at EUR 50bn). The government's weakened position at the National Assembly will weigh on reform momentum and constrain the government's ability to deliver on a material reduction in public expenditures, especially with regards to the pension system, or on revenue supporting supply-side policies. In addition, large public investment needs related to the green transition constitute impediments to the government's plan to bring the deficit below 3% of GDP in 2027, despite an enhanced governance framework for public finances to be fully implemented for the 2023 budget bill. This framework improves multiannual management and reinforces budgetary accountability.
- **Debt trajectory:** Scope sees the public debt to GDP ratio rising from 111.8% in 2022 to around 115.0% by 2027. This upward trend results from primary deficits, a gradual rise in the interest burden from 1.2% of GDP in 2022 to around 2.0% of GDP in 2027, and lower GDP growth. This steady but moderate rise reflects also a weakened ability to bring indebtedness back on a firm downward path in the short term, with the government planning to start reducing public debt only in 2026, a trend that could aggravate the divergence observed with euro area and rating peer averages. In addition, Scope notes that France's did not materially reduce public debt during periods of negative interest rate-growth differentials, a situation that is less likely over the forecasting period.
- **Market access:** Net issuances of medium and long-term debt are expected to amount to EUR 260bn in 2022 (or 9.9% of GDP), 61% of which had already been issued as of June. Planned issuances are unchanged from the initial budget bill, despite the upwards revision of the State's financing needs, as additional expenditures will be funded through a drawdown of about EUR 51bn of existing liquidity holdings. The May 2022 inaugural issuance of an inflation-linked green OAT€i (EUR 4bn; 0.10%; 2038) demonstrates major innovative leadership and excellent market access. In the near term, a large share of fixed-rates securities (88% of debt), long average maturity (8.4 years in 2021) and significant Eurosystem holdings of government debt securities (around 25%) mitigate funding risks.

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

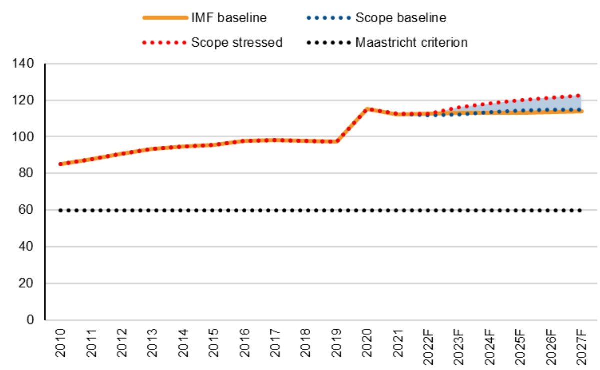
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Fiscal policy framework	Neutral	0	Enhanced fiscal governance framework, but limited room for additional spending; gradual reduction of deficits by 2027
	Debt sustainability	Neutral	0	High public debt levels; sustainability 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 diversified bond portfolio

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings

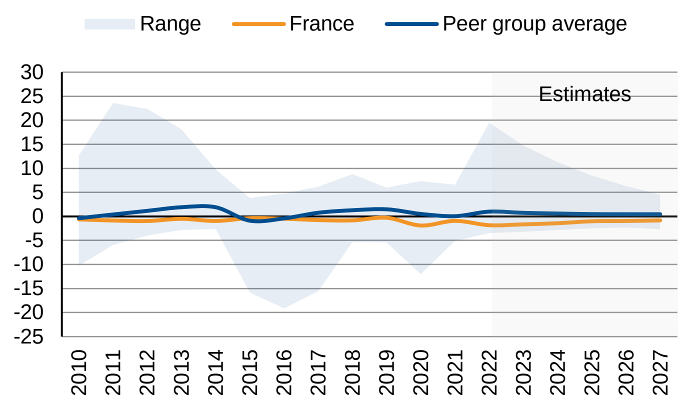
External Economic Risks

- **Current account:** Following a period of sustained current account deficits, averaging 0.8% of GDP over 2011-20, France recorded a modest current account surplus in 2021 of EUR 9bn (0.4% of GDP), resulting from exceptionally high nominal maritime transport export receipts. Still, Scope expects the current account balance to return to moderate deficits from 2022 on, resulting from higher energy prices and France's structurally weak goods exports performance. The weakened reform momentum should make it harder for the government to implement policies that materially improve competitiveness, among which non-wage costs. Sectors contributing traditionally to exports (such as aeronautics, automotive, chemicals) benefit from a strong post-Covid rebound, although they are among those reporting acute supply chain difficulties. Direct investments should continue to register a net positive balance, based on permanent gains resulting from lower production taxes.
- **External position:** Sustained current account deficits will add pressure on the net international investment position, which reached a record low of EUR -802bn in Q4 2021 (about -32% of GDP), approaching the European threshold for the excessive imbalance procedure (-35% of GDP). Persistent external imbalances will add pressures on the external debt, from an already elevated level of 266% of GDP as of Q1 2022, though risks are partially offset by a favorable composition, with long maturities and 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*

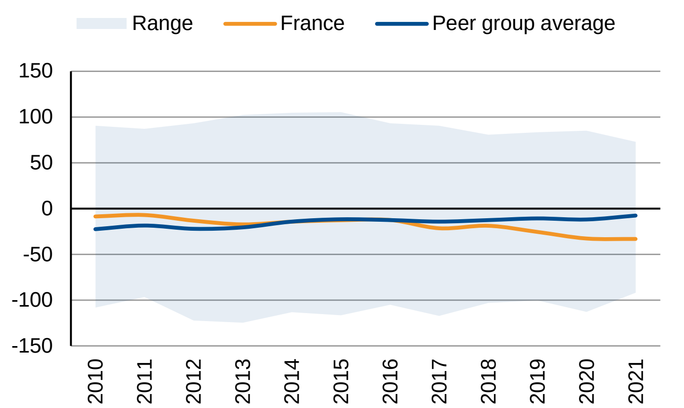
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Current account resilience	Neutral	0	Diversified and high-technology industries, moderate current account deficits
	External debt structure	Neutral	0	Elevated levels of external debt mitigated by moderate cost of debt,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

Current account balance, % of GDP



Source: IMF, Scope Ratings

NIIP, % of GDP



Source: IMF, Scope Ratings

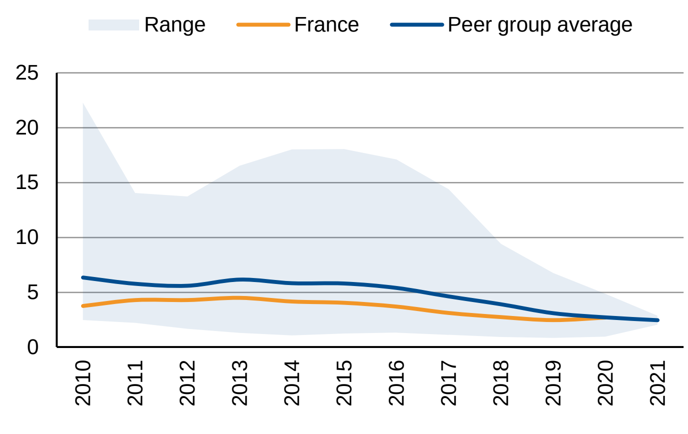
Financial Stability Risks

- **Banking sector:** Banks have a good level of loss-absorbing capacity thanks to a comfortable capitalisation ratio (CET-1 of 15.4% as of Q1 2022). This provides the sector with sufficient buffers to cope with a deterioration of households' and/or corporates' credit quality resulting from higher interest rates and the withdrawal of State's support measures. The NPL ratio remains on a firm downward trend (1.8% according to the European Banking Authority) and below its pre-Covid level. Banking sector profitability is stable with an aggregate return on equity ratio of 5.1% as of Q1 2022. Lending margins should be supported by rising interest rates, but constrained by lower credit volumes, among which mortgages (85% of household loans as of April). Interest rates on regulated savings ('Livret A'), expected to double to 2% from August, are seen as a benchmark that will drive the repricing of banks' loans.
- **Private debt:** Monetary policy tightening should moderate credit growth to households and corporates. Households' debt (66% of GDP as of Q4 2021) remains above pre-Covid levels (61%) and euro area average (60%). Still, risks are mitigated by elevated household financial wealth (188% of GDP) and by saving rates (15.6% of gross disposable income as of Q1 2022) that remain significantly higher than pre-Covid averages. In addition, most of household loans (97%) are on fixed rates terms, which limit risks related to increasing interest rates. Non-financial corporates' debt (83% of GDP as of Q4 2021) is also higher than pre-Covid (73%) and euro area average (64% as of Q4 2021). Still, corporates' insolvencies remain contained and well below pre-Covid levels.
- **Financial imbalances:** Heightened capital market volatility in the wake of the Russian invasion of Ukraine could impact households' financial wealth, mostly composed of life insurance and stock market shares (around 55-60% of total). Persistent pressures on property price index (+8.4% YoY in Q1 2022) constitute another risk as rising interest rates make prices adjustment more likely after a period of sustained rise (+13% between 2015 and 2019).

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

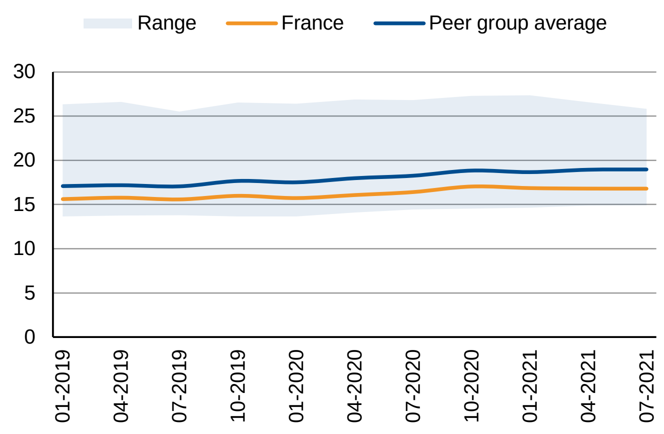
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Banking sector performance	Strong	+1/3	Consolidated banking sector with strong capitalisation and liquidity buffers
	Banking sector oversight	Neutral	0	Oversight under the National Supervisory Authority (ACPR, under Banque 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

NPLs, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

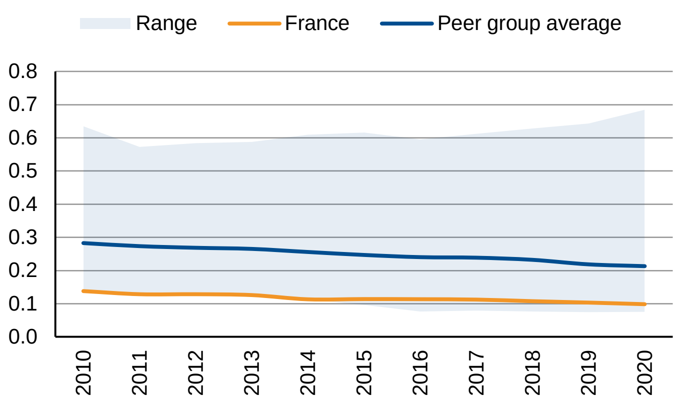
ESG Risks

- **Environment:** A nuclear-dominated energy mix (around 40% of the total energy supply) largely contributes to the French economy's lower carbon intensity and mitigates the impact of rising global energy prices. However, the nuclear park has met a series of maintenance issues in recent months, leading to the shutdown of half of the country's nuclear reactors and significantly raising energy import needs. In the longer run, nuclear is expected to remain at the core of green transition strategy, alongside renewables, to reach carbon neutrality by 2050 – a strategy supported by the European Parliament's vote in favor of nuclear inclusion in the EU Green Taxonomy. Still, the long-term horizon of France's nuclear investment plan (estimated at EUR 50bn) could make the country vulnerable to technological breakthroughs and larger investment in renewables among euro area peers. To roll-out this strategic plan, the government plans to purchase the remaining 16% of energy company EDF's shares it does not yet own, for a cost estimated at EUR 10bn.
- **Social:** We expect inequalities and wealth distribution to remain high in the public debate as the government intends to pass controversial reforms, notably around the pension system. France benefits from more favorable demographic trends compared to most European peers, but the old age dependency ratio is set to increase to 55% by 2050 according to the OECD, structurally weighing on public expenditures and economic growth over the long-term.
- **Governance:** The presidential and legislative elections revealed a higher degree of political polarisation and fragmentation that is now reflected at the National Assembly, with the left green alliance (131) and far-right party (89) holding 38% of seats. Despite ad hoc agreements that could be concluded between the ruling coalition (245) and members of the center-right party (61) to reach absolute majority (289 out of 577), the risk of political instability in the form of early legislative elections has increased. Policy predictability has also diminished as the current parliamentary set up would likely prevent the government to advance its agenda as planned, either by postponing or narrowing down structural reforms.

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

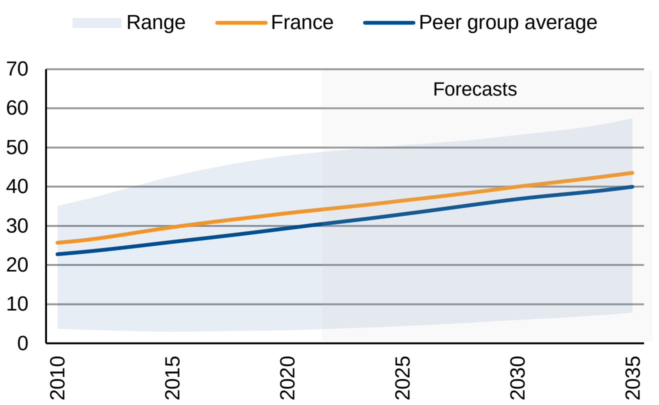
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Environmental risks	Strong	+1/3	Relatively strong resilience to climate risk and ambitious climate targets
	Social risks	Neutral	0	Large social safety nets, but public protests limit ability to implement structural reforms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

CO2 emissions per GDP, mtCO2e



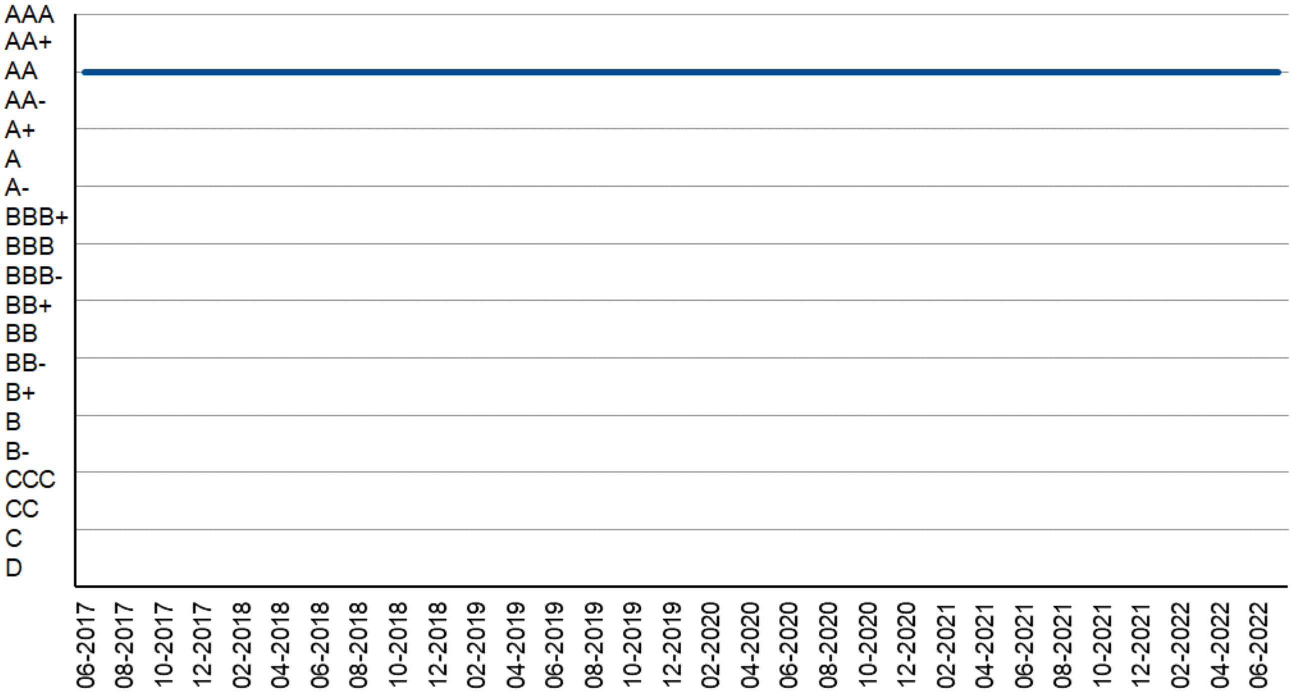
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

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
Belgium
Czech Republic
Estonia
Italy
Japan
Latvia
Lithuania
Malta
Poland
Portugal
Slovenia
Spain
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 29) used in Scope's quantitative model, the Core Variable Scorecard.

	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk							
GDP per capita, USD '000s	40.1	43.0	41.9	40.2	44.9	44.7	46.9
Nominal GDP, USD bn	2589.0	2789.7	2730.1	2622.0	2935.5	2936.7	3086.2
Real growth, %[1]	2.4	1.8	1.8	-7.8	6.8	2.4	1.2
CPI inflation, %	1.2	2.1	1.3	0.5	2.1	4.1	1.8
Unemployment rate, %[1]	9.4	9.0	8.4	8.0	7.9	7.5	7.8
Public Finance Risk							
Public debt, % of GDP[1]	98.1	97.8	97.4	115.0	112.5	111.8	112.2
Interest payment, % of government revenue	3.0	3.0	2.6	2.3	2.3	2.0	1.6
Primary balance, % of GDP[1]	-1.3	-0.7	-1.7	-7.9	-5.8	-4.6	-3.5
External Economic Risk							
Current account balance, % of GDP	-0.8	-0.8	-0.3	-1.9	-0.9	-1.8	-1.7
Total reserves, months of imports	1.9	1.8	2.1	2.9	-	-	-
NIIP, % of GDP	-21.4	-18.7	-25.4	-32.6	-33.0	-	-
Financial Stability Risk							
NPL ratio, % of total loans	3.1	2.7	2.5	2.7	-	-	-
Tier 1 ratio, % of risk-weighted assets	15.4	15.6	16.0	17.1	16.8	-	-
Credit to private sector, % of GDP	101.4	104.3	107.1	122.4	-	-	-
ESG Risk							
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	112.7	107.9	103.7	98.9	-	-	-
Income quintile share ratio (S80/S20), x	4.9	5.1	-	-	-	-	-
Labour-force participation rate, %	71.6	72.0	71.8	-	-	-	-
Old-age dependency ratio, %	31.2	31.9	32.6	33.3	33.9	34.5	35.1
Composite governance indicator[2]	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

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 19 July 2022	29.1

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