French banks quarterly

Heading into a more volatile business environment

Analysts

Nicolas Hardy

n.hardy@scoperatings.com

Tatiana Fomenko

t.fomenko@scoperatings.com

Team leader

Marco Troiano

m.troiano@scoperatings.com

Media

Keith Mullin

k.mullin@scopegroup.com

Stalling economic growth in France could herald a more difficult period for French banks. Lacklustre fourth-quarter bank results, which already cast a shadow over otherwise satisfactory full-year performance, look increasingly less like an anomaly.

Sluggish business prospects from the downward revision of French economic growth are likely to cancel out the positive impact of rising interest margins, which are set to continue.

Two scenarios have emerged for French banks this year:

1. a moderate recovery, with 2024 economic growth of 0.8% coinciding with a gradual decline in interest rates;
2. a prolonged contraction in business activity with little sensitivity to the expected fall in interest rates in the second half of the year.

Both scenarios are equally plausible in view of current macroeconomic and credit dynamics. But neither will change the banks' risk profiles in the short term so financial performance will be affected rather than their structural soundness. Based on Q4 results and guidance for this year, neither the provisioning policies and cost-of-risk forecasts for 2024 nor capital management suggest substantial adverse pressures, though.

Figure 1: quarterly or half year net income

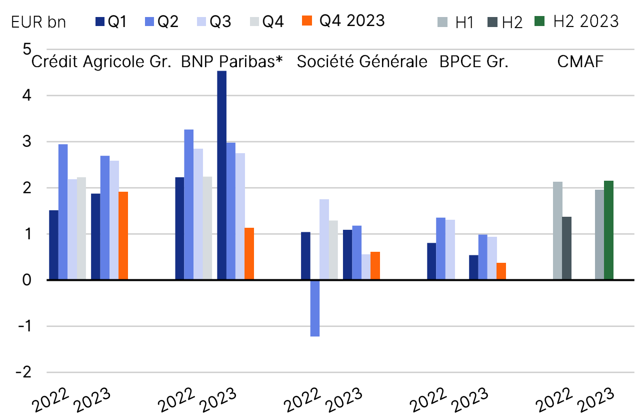
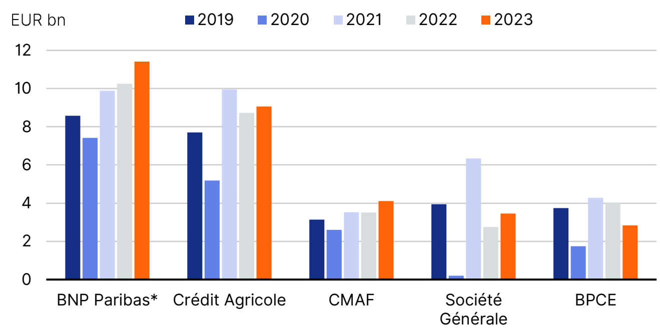


Figure 2: full year net income



*BNPP: Q1 2023 included EUR 2.947bn capital gain from the sale of Bank of the West. CMAF's H2 2022 figure impacted by goodwill impairment at Targobank Germany (EUR 958m). Not restated for accounting changes Source: SNL, banks, Scope Ratings

Trends for French banks		
Profitability	Mildly Negative because of a potentially muted loan demand	↘
Asset quality	Mildly negative given the economic slowdown	↘
Funding and liquidity	Stable thanks to lower deposit migration, limited additional funding and maintenance of liquid balance-sheets	→
Capital	Stable buffers, marginal increase of regulatory requirements	→

Interest revenue to improve in 2024 with margin squeeze easing

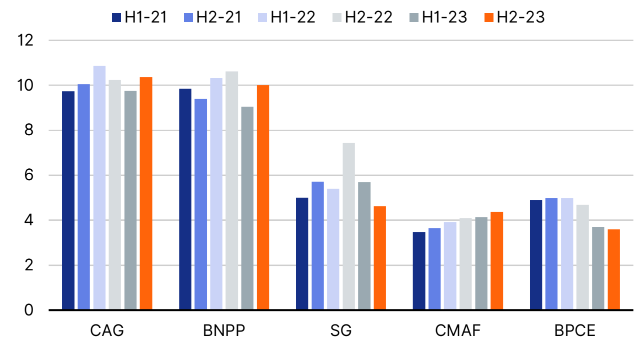
In Q4 2023, interest rates on loans finally caught up with deposit rates, which had risen more quickly in previous quarters. However, the improvement in French banks' net interest margins was barely noticeable and they remain one of the lowest in Europe. French banks have missed out on retail revenue gains compared to European peers. For some banking groups, geographic diversification, particularly in Italy, helped offset slow repricing in France.

The upward revision of usury rates (effectively caps on what banks can charge) is providing more room for banks to reprice their assets. The maximum legal rate on residential mortgages with a duration of more than 20 years is 6.39% now compared with an average market rate of 4.79% in Q1 2024. Unfortunately, market rates are declining for the first time since Q1 2022, according to January data on new mortgages and new business loans across all maturities. This is happening well ahead of any policy rate cut and at a time of increasing competition for clients.

On the liabilities side, the rate applicable to the benchmark passbook savings accounts (Livret A) has been locked until February 2025 at its current level of 3%. Banks initially welcomed this stabilisation but with the prospect of policy rate cuts later in 2024, such a freeze could trigger renewed customer interest in costly Livret A deposits. Banks also expect that deposit migration will slow this year, a trend that was already visible during the second half of 2023 (Figure 6).

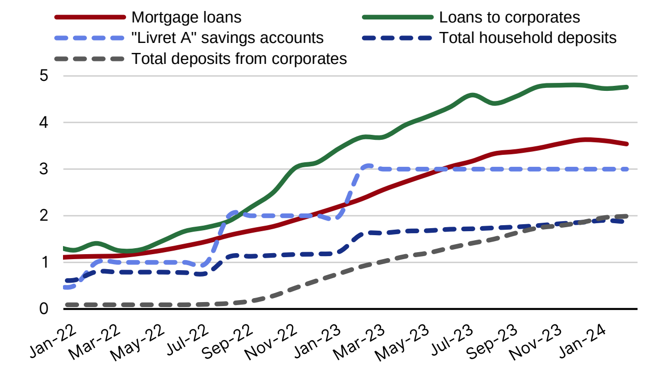
A lot of attention has been paid to the slow repricing of loans and deposits and deposit migration to explain pressure on margins. But the breakdown of 2023 net interest revenue also indicates that the increase of wholesale funding costs had an equally adverse effect on revenue generation.

Figure 3: Net interest income, EUR m



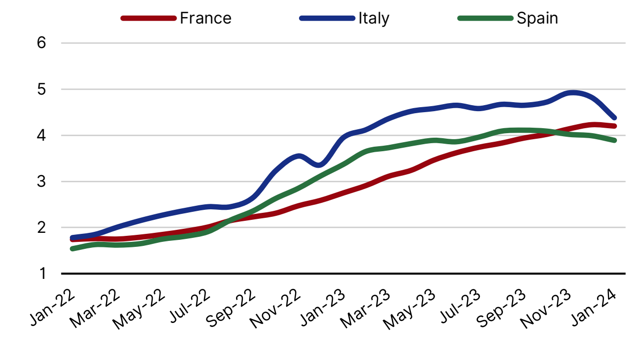
Source: SNL, banks, Scope Ratings

Figure 4: Interest rates on loans (straight lines) and deposits (dashed lines) (%)



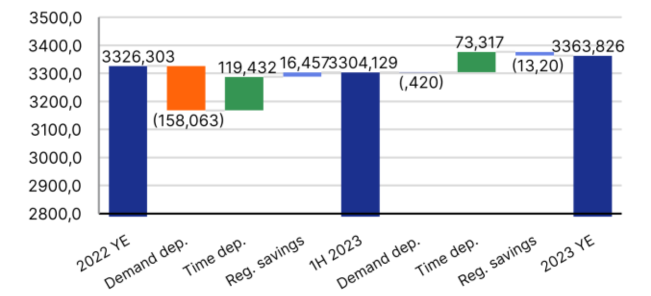
Interest rates on loans: new business, all maturities, annualised agreed rate. Source: Banque de France, Scope Ratings

Figure 5: Interest rates for new housing loans



Source: Banque de France, Loans to individuals - France, March 2024 edition, Scope Ratings

Figure 6: Deposit movements



Aggregated data for the four largest French banks. Source: banks, Scope Ratings

Higher rates but muted loan demand? The risk of a bad timing

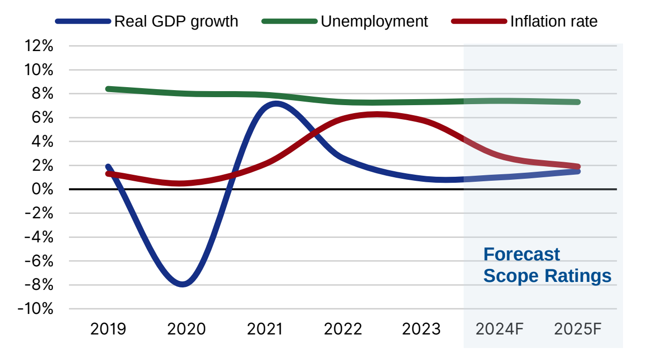
With interest rates on loans having materially increased, banks now have to adapt to slowing economic momentum. France's 2023 GDP growth of 0.9% was below previous estimates. Forecasts for 2024 are just 0.5% before a potential rebound in 2025.

In this environment, credit demand will stagnate. The prospects of rate cuts later this year is likely to incentivise clients to postpone investment decisions but at the same time they provide stimulus for a more pronounced rebound toward the end of this year and into 2025.

The revenue decline French banks experienced in 2023 and higher cost-income ratios across the board once again highlighted the work they need to do on their cost bases. From a credit standpoint, the deterioration is not a major source of concern as long as it is driven by investments to improve core performance, such as restructuring charges to adapt their large physical retail networks or in IT. CMAF explained the stability of its retail banking revenues (Figure 9) as the balancing effect of higher loan income and efficient interest-rate risk management.

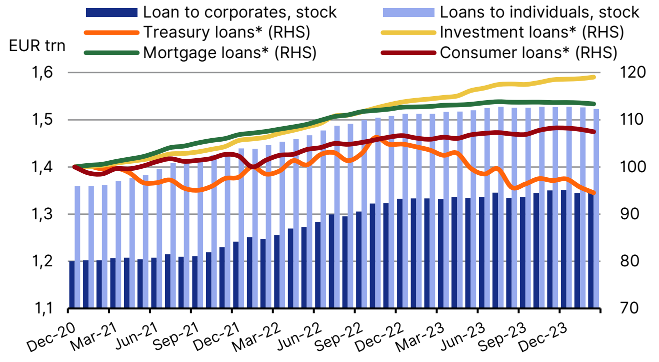
But a sustained economic slowdown could make it even harder for banks to restore earnings. We maintain a constructive view, however, because operational efficiency is less of a pressure point as long as banks maintain conservative loss-absorption buffers and maintain robust asset quality with limited credit-impairment charges.

Figure 7: Economic slowdown becomes more evident



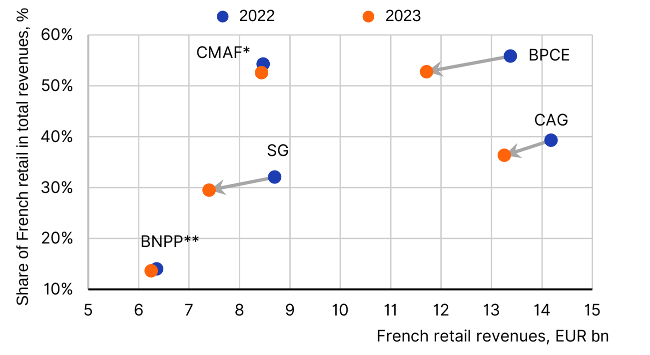
Scope Ratings forecasts as of December 2023. Shaded area represents forecasted values. Inflation rate: annual average Harmonised Index of Consumer Prices. Source: IMF, Scope Ratings

Figure 8: Loans to private sector: stock and growth



*Change of stock, Dec 2020 = 100. Source: Banque de France, Scope Ratings

Figure 9: Revenues from French retail, YoY change



2022 proforma. *CMAF: net revenue for retail banking networks. **BNPP: reporting at CPBF level (Commercial & Personal Banking in France) does not separate retail banking.
Source: banks, Scope Ratings

Figure 10: Cost-to-income ratios FY

2023 vs. 2022 % change	BNPP	SG	CAG	BPCE	CMAF
Operating revenue	1.0%	-7.6%	4.8%	-7.3%	2.8%
Operating expense*	3.7%	2.9%	4.6%	-1.9%	6.5%
Operating income	-4.2%	-28.2%	17.3%	-16.1%	-1.8%
Cost-to-income ratio, 2023	67.5%	73.8%	60.5%	73.5%	57.1%
Cost-to-income ratio, 2022	65.7%	66.3%	60.6%	69.4%	55.1%
Cost-to-income ratio, ppt change	1.7%	7.5%	-0.1%	4.1%	2.0%

Not adjusted for SRF contributions and other exceptional items.
Source: banks, Scope Ratings

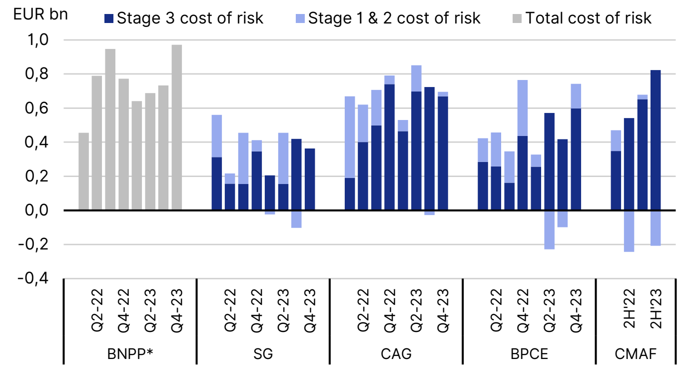
Asset quality: cost-of-risk guidance stable but clouds gather

French banks ended 2023 with controlled asset-quality indicators showing no widespread pick-up of Stage 2 or Stage 3 or sizable increases in forward-looking provisions. The overall increase in bad loans remained modest, and some banks were still able to release provisions (Figure 11). Cost-of-risk expectations for 2024 are in line with medium-term averages, in the 25-40bp range, depending on lending mix and the relative share of low-risk mortgages.

France's unemployment rate has increased slightly in recent months but stands at historically low levels (below 8%). The number of corporate bankruptcies is now in line with the pre-Covid historical average. While bankruptcies are unlikely to stabilise at this level given the economic slowdown, they are still measured and well spread among sectors. But they are certainly entering a turbulent zone.

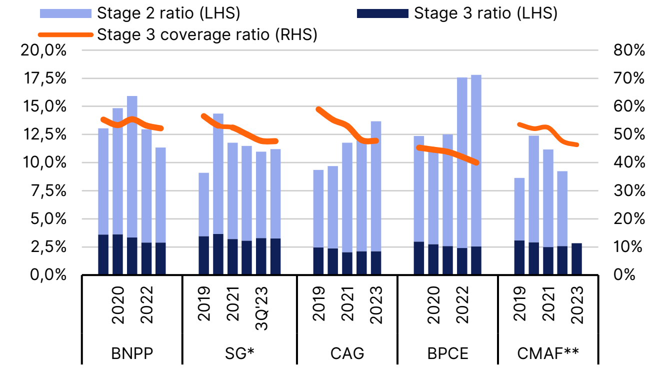
Risks attached to the real estate and construction sectors remain in focus. The two sectors represent about 25% of banks' corporate exposure, in line with the European average. Thus far, bankruptcies in the two sectors compared to the average for all sectors are not noticeably higher (Figure 14). The granularity of real-estate exposures by sub asset class (offices, retail, etc) is an important mitigating factor. There is no evidence that the preparation of the Olympic Games has artificially inflated the performance of the sector, or concealed a more substantial slowdown.

Figure 11: Modest cost of risk mainly on Stage 3 loans



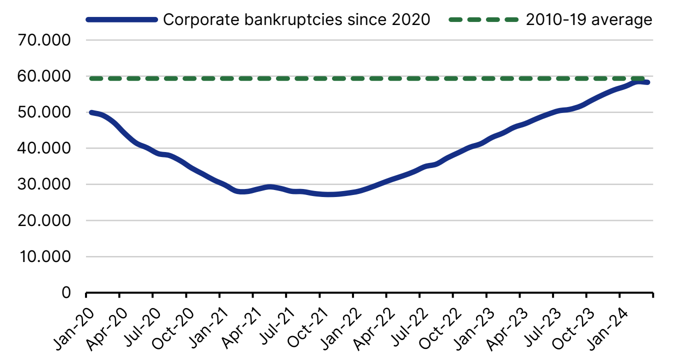
*BNPP: Quarterly breakdown not available. Source: banks, SNL, Scope Ratings

Figure 12: Stable asset-quality indicators



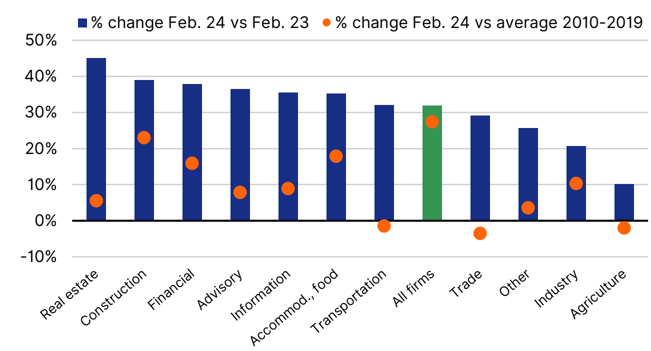
*SG: estimated evolution of Stage 1 and 2 loans. **CMAF: Stage 2 ratio not yet available. Source: banks, Scope Ratings

Figure 13: Corporate bankruptcies now in line with pre-Covid levels



*For the period from 2015 to 2019. Source: Banque de France, Scope Ratings

Figure 14: Bankruptcies by corporate sector



Source: Banque de France, Scope Ratings

Distance to regulatory requirements maintained at cruising speed

No major change to capital policies

French banks have maintained capital positions close to medium-term targets and we expect limited changes in coming quarters. Excess capital already accumulated and organic capital generation will balance the anticipated higher capital impacts of Basel 3. Following the sale of Bank of the West, BNP Paribas is in the process of redeploying capital gradually, indicating a total potential -70bp impact in 2024 (equivalent to EUR c.4.6bn). Société Générale's plan to sell its equipment finance activities to BPCE is expected to have a moderate impact on the banks' respective CET1 ratios (less than -50bp for BPCE, around +25bp for Société Générale). Banks have not announced large share buyback programmes.

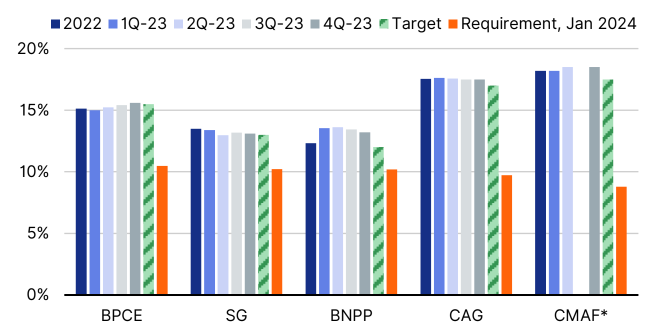
Some leverage ratios are more tightly managed

Listed French banks manage leverage ratios tightly compared to their European peers. Their diversified business models allow for a flexible reduction in balance-sheets as required. Some exposures with short-term maturities can be downsized relatively quickly but this implies a reactive not proactive approach. Crédit Agricole S.A.'s leverage ratio is the lowest at 3.8% but it must be seen in the context of the total group perimeter (ratio at 5.5% at end-2023). Société Générale reported a fully loaded leverage ratio of 4.2% versus a requirement of 3.5%, increasing to 3.6% from January 2024. BNPP's leverage ratio peaked at 4.6% at end-2023, with a stated objective of 4.3% by end-2025.

Tighter central bank liquidity but good market access

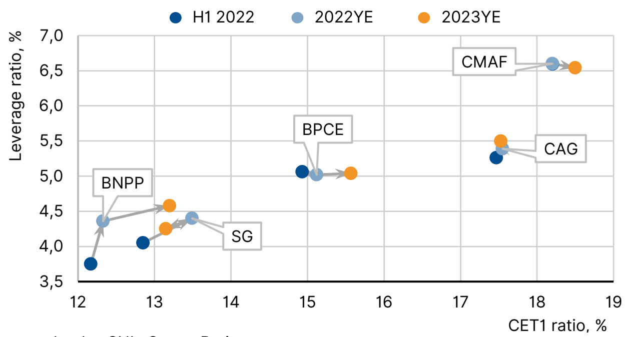
French banks manage their liquidity in a conservative manner, mainly in the form of deposits at central banks. The significant reduction of Crédit Agricole's Liquidity Coverage Ratio since end-2022 reflects the gradual repayment of TLTRO and the reduction in excess liquidity. Its LCR is now on a par with other French banks (Figure 17). Banks were increasingly active in securing funding at attractive rates in the first quarter (Figure 18). Despite all the concerns raised a year ago about the potential loss of investor appetite for Additional Tier 1 instruments, all banks issuing these instruments (BNPP, SG, CASA) tapped the market in Q1.

Figure 15: CET1 (ranking by requirement)



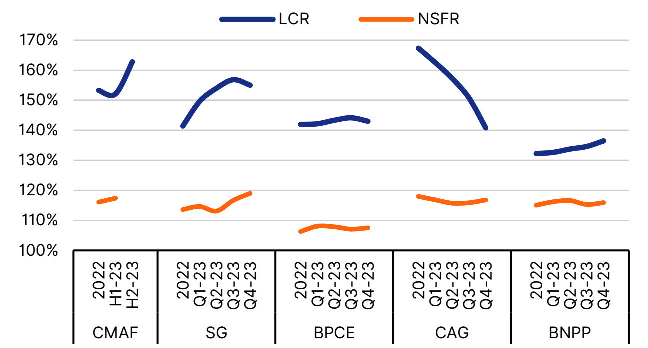
*CMAF: 3Q 2023 capital ratios not published CMAF. Source: banks, Scope Ratings

Figure 16: CET1 and leverage



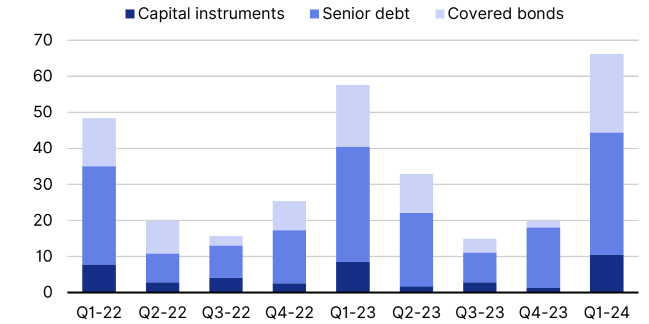
Source: banks, SNL, Scope Ratings

Figure 17: Funding and liquidity ratios (ranking by LCR)



LCR: Liquidity Coverage Ratio, based on 12-month average; NSFR: Net Stable Funding Ratio. CMAF: NSFR ratio not yet published. Source: banks' Pillar III reports, Scope Ratings

Figure 18: Active debt issuance



Issuance activity of French banking groups in our sample. Only large public international bond issues predominantly in EUR, USD and GBP. Excludes private placements, retained issuance, debt documented and sold privately. Source: Bond Radar, Scope Ratings

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Scope Ratings GmbH

Lennéstraße 5
D-10785 Berlin
scoperatings.com

Phone: +49 30 27891-0
Fax: +49 30 27891-100
info@scoperatings.com

Bloomberg: RESP SCOP
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