French banks: sound credit profiles resilient against tighter financial conditions

The French banks' recent round of results were solid and demonstrated that temporary pressure on core profitability from ECB tightening is not denting their credit profiles. Asset quality is holding up, and the build-out of accumulated provisions will protect profitability against a moderate increase in bad loans. The prospect of slightly better macroeconomic conditions in Europe is credit positive for the rest of 2023.

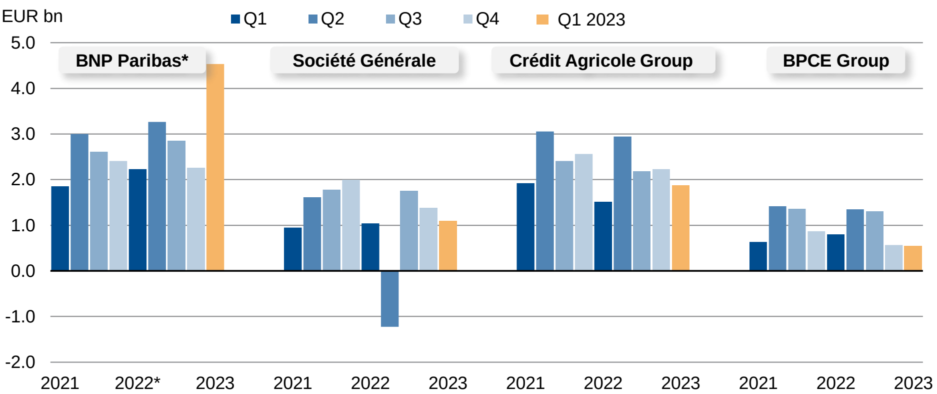
Unlike for some European peers, rising interest rates have not translated into windfall profits for French banks. Revenues from domestic retail activities are under pressure because liabilities reprice more quickly than assets. This gradual rebalancing will last until 2024. While it is impacting revenues now, it will protect borrowers in the future.

Overall, credit risk should not change materially. Strong business diversification mitigated pressure on interest revenues in the first quarter and this was a differentiating factor among the banks. Loan production is slowing rather than contracting and asset quality remains unaffected. Cost of risk is well controlled at low levels.

The main focus of investors regarding first-quarter results related to:

- Potential contagion of weak confidence that surfaced in the US and Switzerland in March and April, in particular deposit outflows.
- The future of debt capital instruments, their riskiness and the reopening of wholesale markets after a very active start but a sudden stop.
- Banks' ability to protect net interest margins in the context of rising rates, persistent inflation and TLTRO repayments.
- The impact of some non-recurring but large expected items, such as the completion of BNP Paribas' sale of BankWest and contributions to resolution funds.

Figure 1: Quarterly net income



* Not restated. Exceptional items include EUR 2.947bn capital gain from the sale of Bank of the West.
Source: banks, SNL, Scope Ratings

Figure 2: quarterly trends for French banks	
Macroeconomic conditions	Mildly Positive ↗
Lending dynamics	Mildly Negative ↘
Asset quality	Stable →
1st line of defence: profitability	Mildly Negative ↘
2nd line of defence: capital and resolution buffers	Stable →
Funding and liquidity	Mildly Negative ↘

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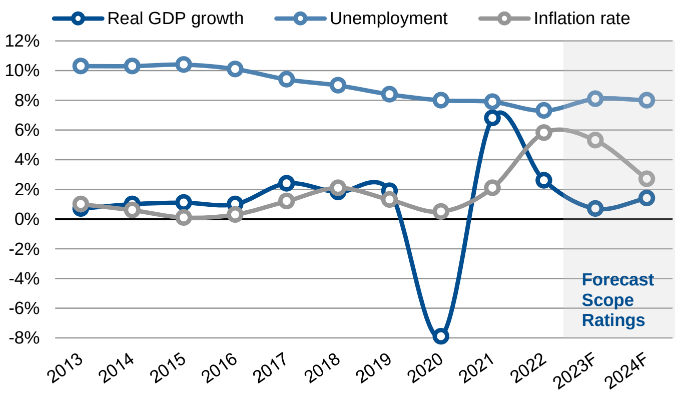
Bloomberg: RESP SCOP

Mildly positive macroeconomic environment for banks: improving prospects amid slowdown

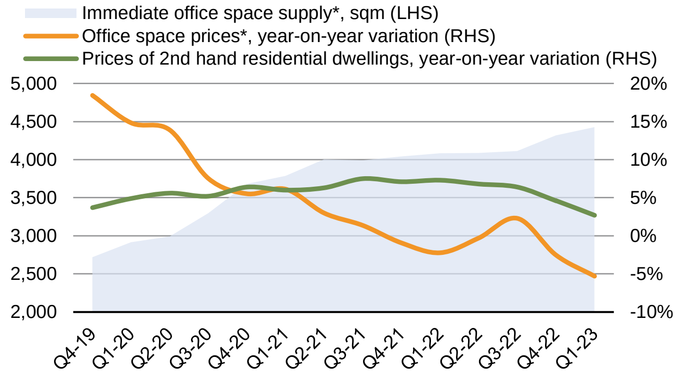
- **Macroeconomic trends**: we expect GDP to continue to slow in 2023 (0.7% growth) before picking up to 1.4% in 2024. Unemployment remains near multi-decade lows, although it is still higher than the euro area average. Inflation is also expected to ease gradually. Weakening public finances and risks to implementation of the reform agenda have led us to revise the outlook on France's AA long-term credit rating to negative from stable. We see no direct linkages with French banks' credit standing.
- **Asset prices:** domestic property markets are showing signs of slowing. Supply of immediately available commercial property around Paris continues to increase and is around 60% higher than it was at the end of 2019. We expect the slowdown of residential property prices to be more pronounced, but we do not expect a sharp correction in the absence of over-supply. The CAC 40 is trading near its all-time highs, increasing its sensitivity to negative market sentiment.
- **Bankruptcies and payment incidents:** corporate bankruptcies are approaching pre-pandemic levels but at a slow pace, which is supportive for banks. Household credit payments are in line with 2019 levels.

Figure 3.11: France main economic indicators



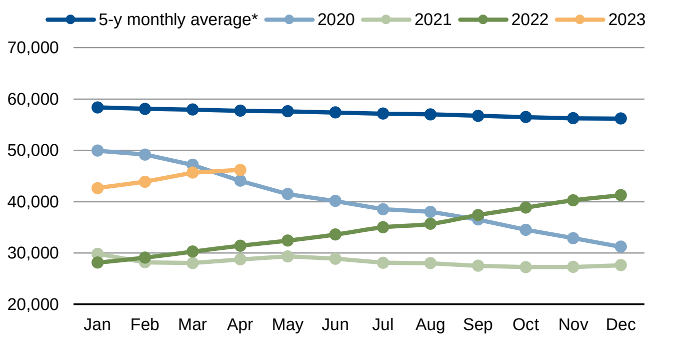
Grey area: forecast as of May 2023. Source: Scope Ratings

Figure 3.2: Residential and commercial real estate prices



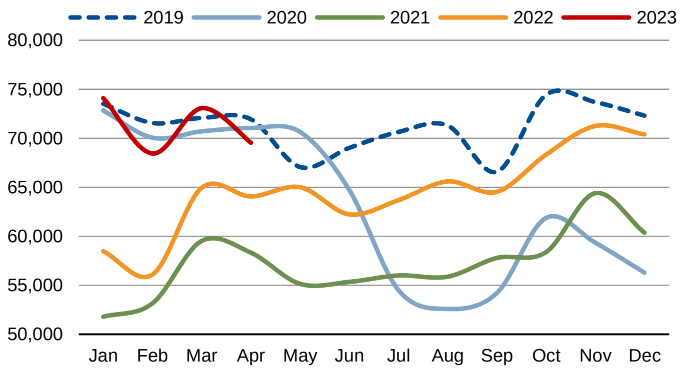
*Greater Paris region. Source: Immostat, INSEE, Scope Ratings

Figure 3.32: Normalising corporate bankruptcies in France



Source: Aggregate number of monthly corporate bankruptcies over the last 12 months. *Average for 2015-19. Source: Banque de France, Scope Ratings

Figure 3.43: Household credit repayment incidents

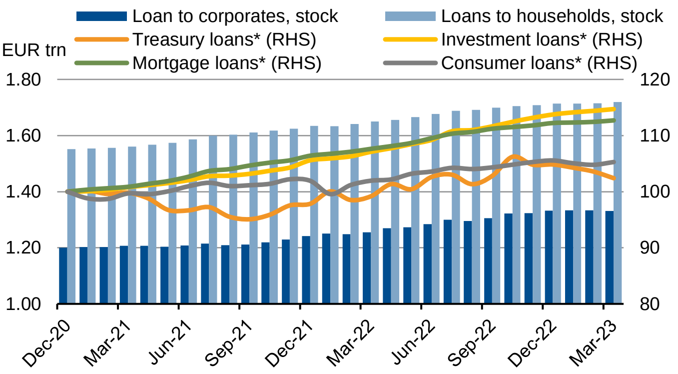


Source: Banque de France, Scope Ratings

Mildly negative lending dynamics: softening demand

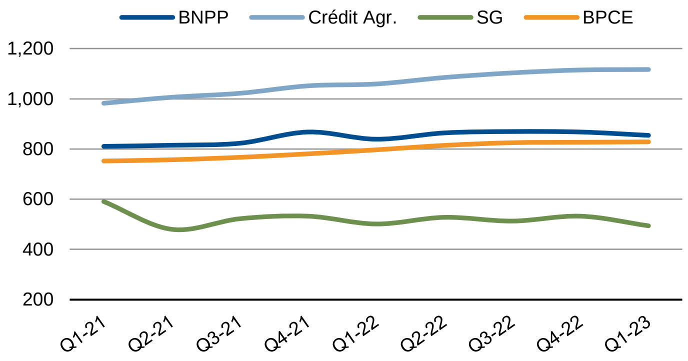
- **Retail lending dynamics**: demand for mortgages is declining but remains high in light of the rapid increase in interest rates. At country and individual bank level, the decline is moderate and is not yet a contraction, bearing in mind customer loans outstanding. Mortgage and consumer loan origination has continued to slow since mid-2022, with total outstandings in March 2023 growing by 4.5% and 3.8% respectively on an annualised basis. The large base effect mitigates fluctuations. The decline in credit affordability is less pronounced than in other European countries.
- **Corporate lending dynamics**: while outstanding corporate loans remained stable at high levels, the slowdown in monthly corporate loan growth in the first quarter was mainly due to a reduction in treasury loans.
- **Interest revenues**: margins are being squeezed by the faster repricing of liabilities, the fixed-for-life nature of mortgage rates and the effective usury rate caps. Little relief is expected before 2024. Average interest rates on new mortgages have almost tripled in roughly a year but are in line with 2015 levels. The market remains open at these levels.

Figure 4.14: Loans to private sector: stock and growth



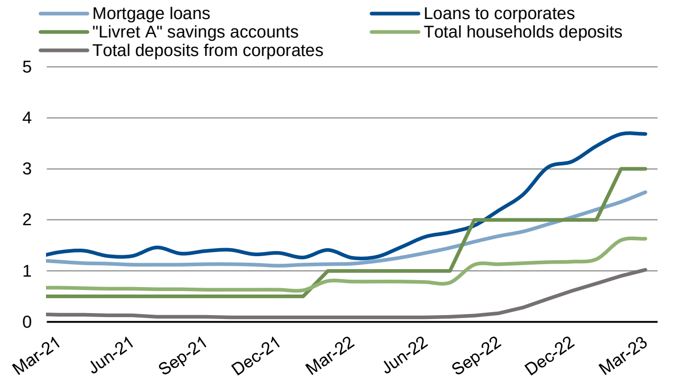
*Change of stock, Dec 2020 = 100. Source: Banque de France, Scope Ratings

Figure 4.2: Customer loans as reported, EUR bn



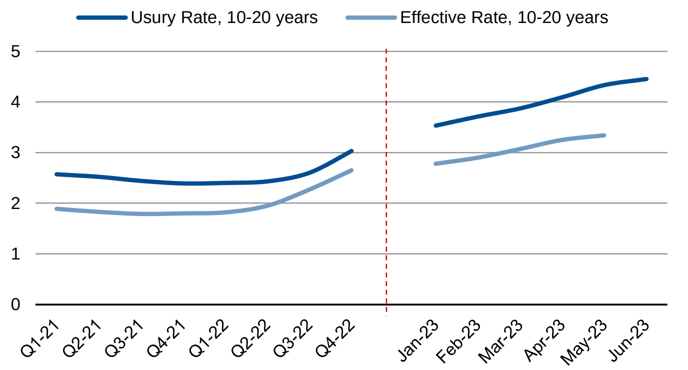
Net customer loans as reported by banks. Source: banks, SNL, Scope Ratings

Figure 4.3: Interest rates on loans and deposits (%)



Interest rates on loans: all maturities, annualised agreed rate. Average rate on total households' and corporates' deposits, annualised agreed rate. Source: Banque de France, Scope Ratings

Figure 4.4: Usury rates adjusting slowly (%)

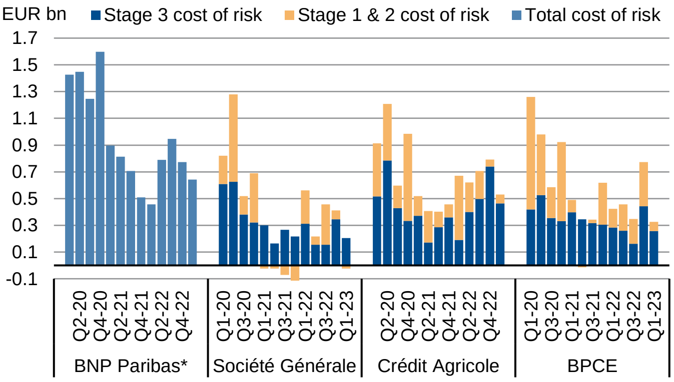


Fixed-rate loans for house purchase. Effective rate: average rate over the past three months, used in setting usury rate. Quarterly series were replaced by monthly data starting from February 2023. Source: Banque de France, Scope Ratings

Stable asset quality: no sign of deteriorating credit risk

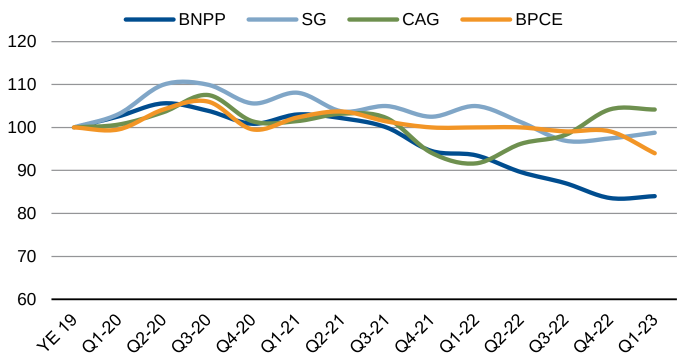
- **Cost of risk**: credit impairment charges were modest in Q1 and mainly related to Stage 3 loans. As macroeconomic prospects have stabilised, there has been no major shift in provisioning policies, including management overlays. The banks released a limited amount of provisions as they maintained significant levels of unallocated provisions. Taking into account the fungibility of the unallocated provision buffers built up and maintained over the past three years, overall coverage is significant. Cost of risk guidance is below or in line with historical averages.
- **Non-performing loans**: the stock of problem loans has plateaued or improved thanks to proactive management and limited new NPL formation. At around 2%-3%, French banks' reported NPL ratios are in line with the European average, with modest changes relating to specific files, and no signs of a pronounced trend reversal. The percentage of Stage 2 loans is also controlled, in the 8%-13% range.

Figure 5.1: Cost of risk by stage, EUR bn



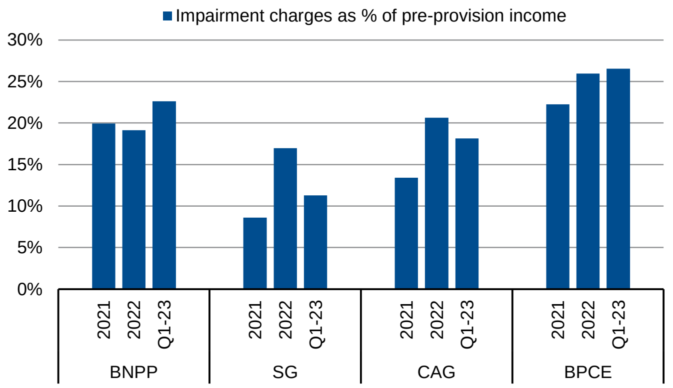
*Quarterly breakdown not available. Source: banks, Scope Ratings

Figure 5.25: Stock of problem loans (Q4 2019 = 100)



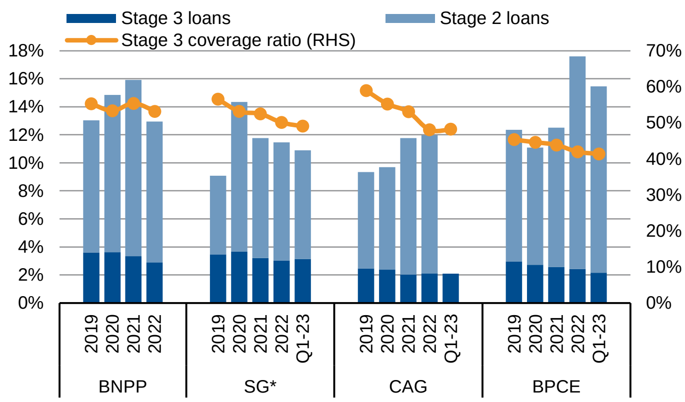
As reported by banks. Source: banks, Scope Ratings

Figure 5.3: Impairment charges as a % of pre-impairment income



Source: SNL, Scope Ratings

Figure 5.4: Stage 3 ratios and coverage of Stage 3 loans

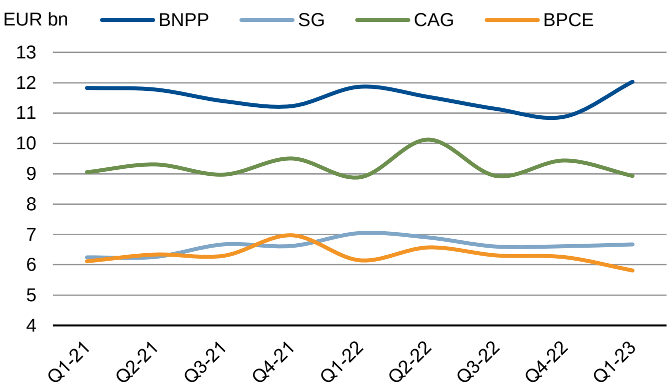


*SG: estimated evolution of Stage 1 and 2 customer loans. Source: banks, Scope Ratings

Mildly negative profitability: margin squeeze in retail continues

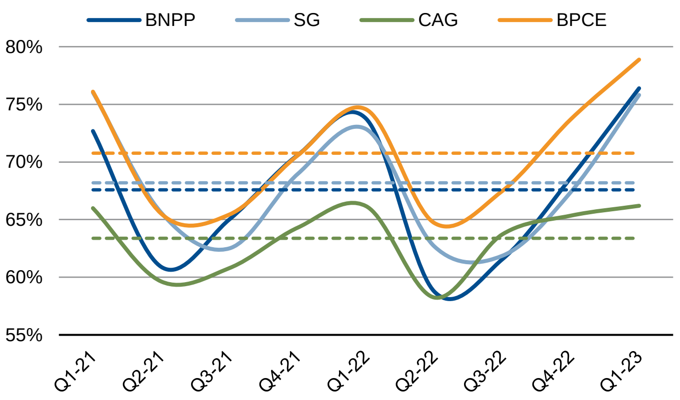
- **Operating revenue**: Results in retail banking in France were negatively impacted by weaker interest margins and a slowdown in home loan production. Banks reported strong results in CIB and insurance businesses on the back of sustained activity.
- **Cost base**: expenses are contained, below inflation for most banks and growing more slowly than operating revenues. Despite improving operating leverage, cost-to-income ratios are rising, although this is due mainly to the seasonal effects of contributions to resolution funds.
- **Exceptional items**: non-recurring items had a material impact on earnings in Q1 but they were all expected:
  - BNP Paribas recorded the completion of its sale of Bank of the West
  - Contributions to resolutions funds are recorded in the first quarter and this has the largest seasonal effect on cost-to-income ratios. Although lower than last year, the contributions are still material (EUR 2.9bn for the four largest reporting banks vs EUR 3.9bn in 2022). We do not expect regulatory contributions of this magnitude next year and this will help to improve banks' direct loss absorption capacity.

Figure 6.1: Operating revenues



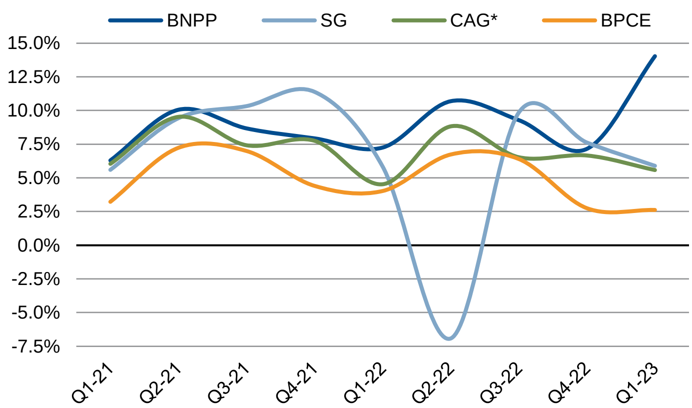
Source: banks, Scope Ratings

Figure 6.2: Cost-to-income ratios



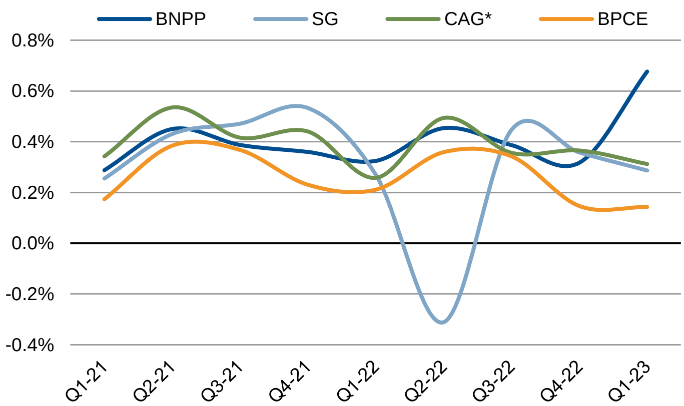
Dotted lines: average over the period of the quarterly cost-to-income ratios.
Source: banks, Scope Ratings

Figure 6.3: Return on average shareholder equity



*Equity at end Q1 2023 not available, Scope estimates. Source: SNL, Scope Ratings

Figure 6.4: Return on average assets

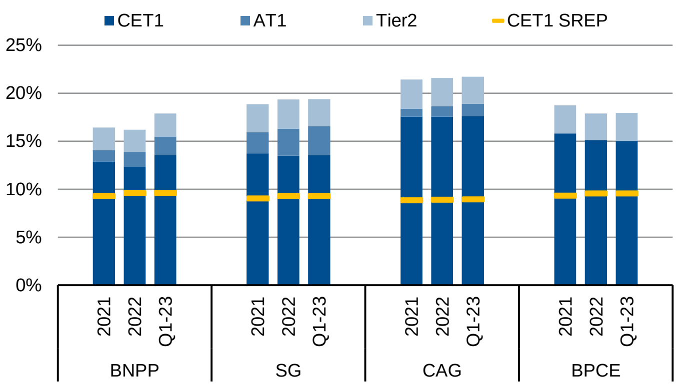


Source: SNL, banks, Scope Ratings

Stable loss absorption buffers

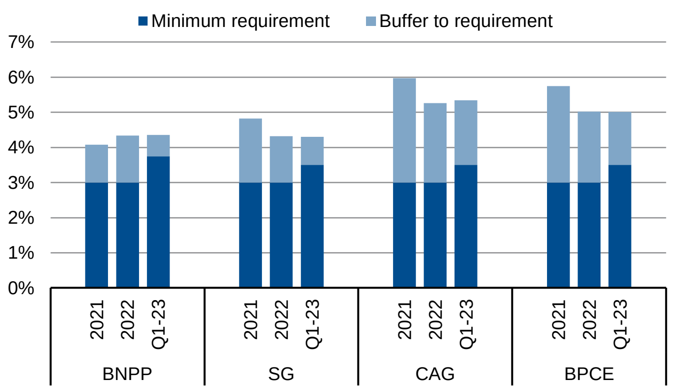
- **Core capital trajectories**: there was no major change in terms of distance to regulatory requirements, or revision of medium-term targets. Minimum leverage ratio requirements went up due to the introduction of the G-SIB add-on. The other most impactful event was the completion of BNPP's sale of Bank of the West in February with a +170bp impact on its CET1 ratio.
- **Capital distribution policies**: dividend policies remain unchanged, in the 50%-60% range. BNPP launched the first tranche of its share buyback programme (EUR 5bn planned in 2023, EUR4bn of which to compensate for the dilution related to the sale of Bank of the West).
- **Debt capital instruments**: French banks actively tapped the market for capital instruments at the start of the year and, after a turbulent period, are back; Societe Generale and Credit Agricole both raising Tier 2 capital on 30 May and 1 June respectively. French banks do not face material refinancing risk anyway in the coming quarters considering the limited amount of maturing or callable instruments (see appendix).

Figure 7.1: Capital ratios



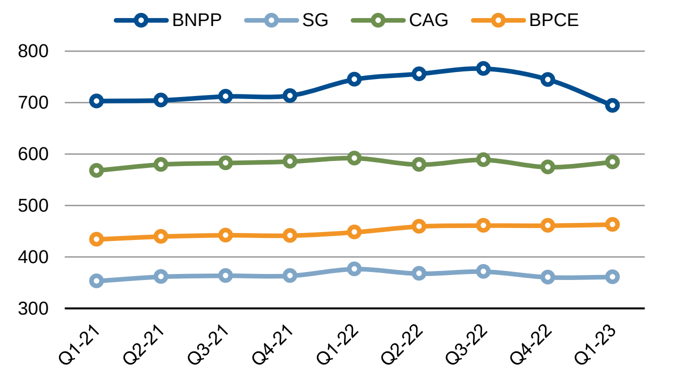
Source: banks, Scope Ratings

Figure 7.2: Leverage ratios



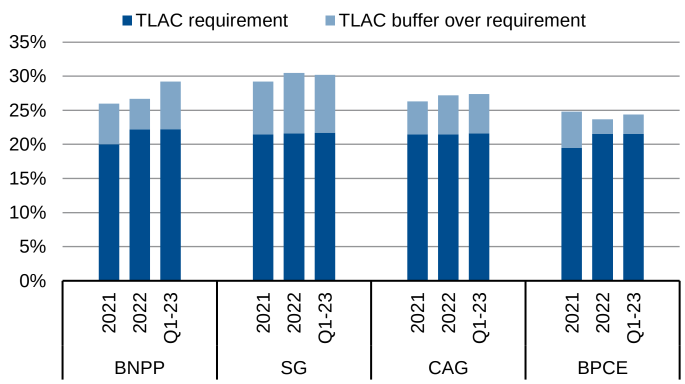
Source: banks, Scope Ratings

Figure 7.3: Risk weighted assets, EUR bn



Source: SNL, Scope Ratings

Figure 7.4: TLAC ratios



Source: banks, Scope Ratings

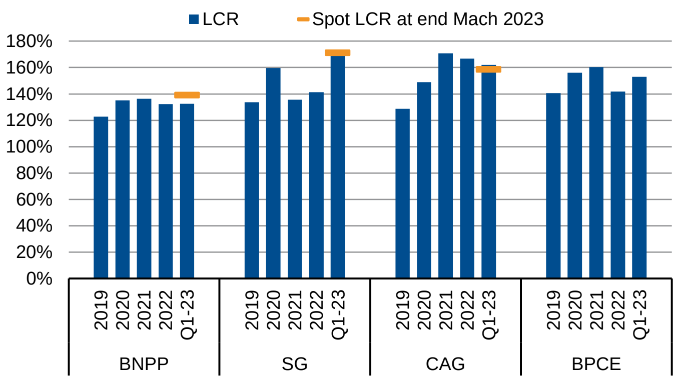
Mildly negative funding and liquidity: supportive metrics but TLTRO repayment looming

- **Liquidity management:** the gradual reduction in excess liquidity in the system is the result of the ECB's financial tightening policy. TLTRO III outstandings are still significant but will reduce materially in June. Liquidity positions may end up lower than pre-Covid 19 levels, however. First, holding large liquidity buffers is more costly now with higher interest rates. Second, a full redemption of TLTRO III means that recourse to the ECB will be lower than before the Covid crisis: there is not even a rollover up to TLTRO II levels.

  Initiatives to manage down excess liquidity do not fundamentally change our view on liquidity profiles. Recourse to TLTRO III was opportunistic and repayment is mainly a profitability issue. The ECB's capacity and willingness to address potential liquidity problems is intact (if not strengthened by TLTRO repayments). However, market expectations may be more demanding than regulatory expectations. This may limit the appetite to optimise liquidity positions.

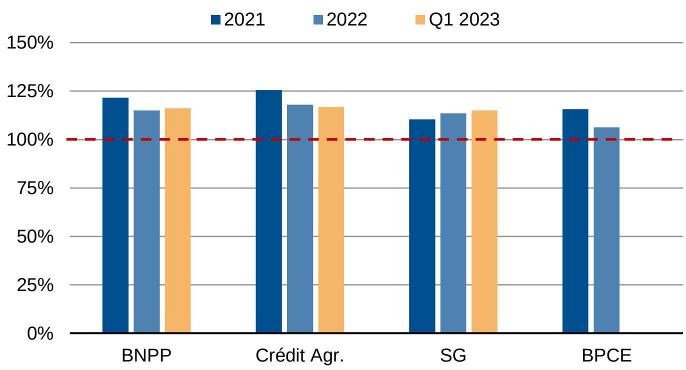
- **Funding dynamics**: deposit outflows and the quality of deposit bases were sensitive issues for investors in Q1. French banks' customer deposit bases are stable, largely retail and insured or guaranteed (e.g. Livret A). Good market access is another credit strength, as evidenced by the already high percentage of wholesale debt issued so far compared with annual issuance plans (see appendix).

Figure 8.16: Liquidity coverage ratios



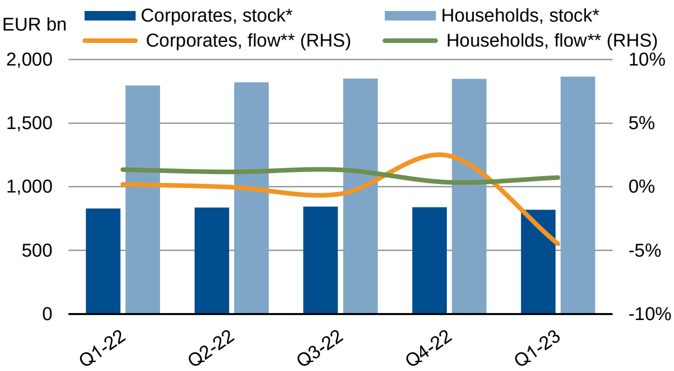
BPCE spot LCR: not available. Source: banks, SNL, Scope Ratings

Figure 8.2: Net stable funding ratios



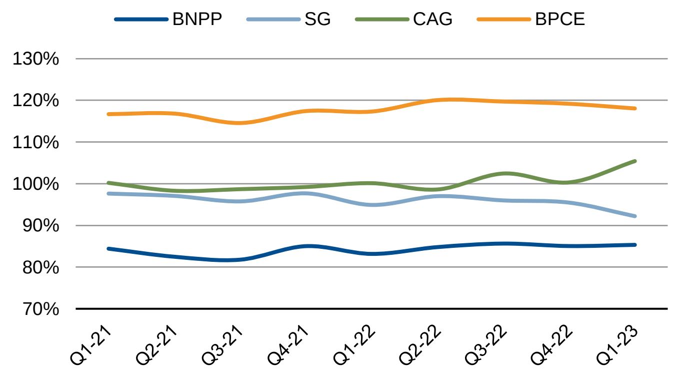
BPCE: Q1 2023 not available. Source: banks, Scope Ratings

Figure 8.3: Deposits, EUR bn



*Stock: average monthly stock over the quarter. **Flow: sum of monthly flows over the quarter as % of stock at beginning of period. Source: Banque de France, Scope Ratings

Figure 8.4: Loan to deposit ratio



Source: banks, SNL, Scope Ratings

I. Appendix

Progress with 2023 MLT issuance plans

	2023 issuance plan	Issued by mid-April 2023	% of the 2023 funding plan realised by mid-April 2023
BNP Paribas[1]	EUR 18.5bn	EUR 12.7bn	**68%**
Crédit Agricole SA	EUR 19bn	EUR 10.7bn	**56%**
BPCE Group	EUR 29bn	EUR 18.3bn	**63%**
Société Générale	EUR 24bn	EUR 18bn	**75%**

[1]As of 25 May 2023. Source: banks, Scope Ratings

Capital issuance year to date (as of 1 June 2023)

	Tier 2			AT 1		
	Called / Matured (date – amount)	Issued, USD m equiv.	Maturing/callable within 12 months (date – amount)	Called/ Matured	Issued, USD m equiv.	Callable with next 12 months
BNP Paribas	-	-	15.10.24 EUR 900m 18.10.23 EUR 64m (call) 22.01.24 EUR 174m (call) 24.09.23-EUR 90m (call)	-	1,774	25.03.24 - EUR 1.3bn
Crédit Agricole	-	441	18.12.23 EUR 438m 22.12.24 EUR 625m	-	1,318	23.01.24 - EUR 1.7bn
BPCE Group	-	2,156	3.6.23 EUR 10m 18.7.23 EUR 1bn 22.10.23 USD 1.5bn	-	-	-
Société Générale	6.04.23 EUR 590m 15.04.23 EUR 400m	2,067	7.06.23 EUR 1bn 30.06.23 EUR 40m 12.6.23 EUR 300m 20.07.23 EUR 200m 24.10.23 EUR 93m (call) 17.01.24 USD 1bn (call) 24.01.24 EUR 127m (call)	-	1,076	4.10.23 - EUR 1.2bn 18.12.23 - EUR 1.6bn 16.04.24 - EUR 0.5bn

Source: Bond Radar, banks, Scope Ratings

Selected research available on ScopeRatings.com:

Scope affirms France's AA long-term credit ratings; revises Outlook to Negative from Stable, May 2023

European banks: tighter supervision of liquidity risks not a substitute for structural improvements, May 2023

Spanish banks: net interest income boost more than compensates for bank levy, May 2023

Italian banks: strong Q1 results pave the way for a promising 2023, May 2023

Asset-quality review: falling NPL ratios hide rising vulnerabilities, May 2023

European Bank Capital Quarterly: Capital remains important support for sector, April 2023

Italian banks: solid funding and liquidity against challenging backdrop, April 2023

French banks and the benefits of rising rates: the risk of slow-motion 2023, March 2023

Tight rules and strong oversight should buffer European banks against contagion, March 2023

Issuer rating reports available to ScopeOne subscribers:

Banque Fédérative du Crédit Mutuel

BNP Paribas S.A.

BPCE S.A.

Crédit Agricole S.A.

Société Générale S.A.

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