French banks 2024 outlook

Resilient credit profiles underpinned by recovering retail margins

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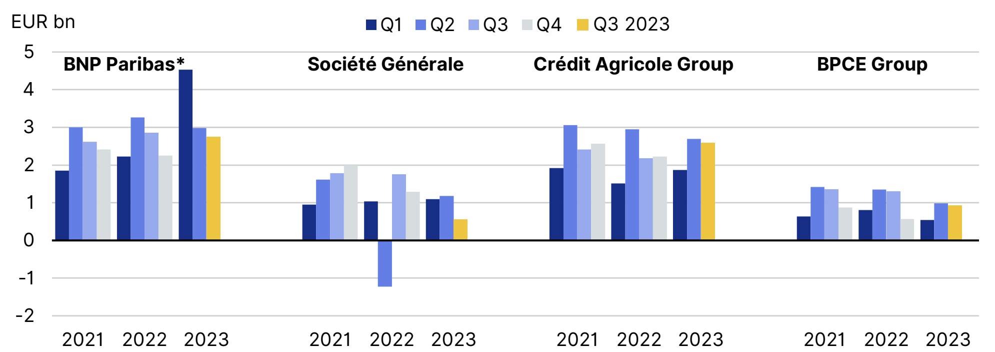
The normalisation of French banks' net interest income is set to continue in 2024. Unlike for some European peers, rising interest rates have not yet translated into higher profits. Instead, revenues from domestic retail activities are under pressure because liabilities have repriced more quickly than assets. While this led French banks' revenue to underperform in 2023, we believe it will protect borrowers, and hence asset quality, in the future. Moreover, we expect a catch-up in asset repricing in 2024, which will support margins.

Easing margin pressures in domestic retail will mitigate lower loan production as high interest rates are putting a brake on economic growth and lending dynamics. Our baseline economic scenario points to only moderate economic activity in 2024 with real GDP growth of 1% in 2024 in France, very close to 2023. The slower increase in interest rates has been a protective feature for customers, especially in mortgage lending. Pockets of credit risk in vulnerable sectors such as commercial real estate or SMEs already weakened by the pandemic-era economic slump and now facing margin compression will remain challenges. We do not anticipate broad-based asset-quality deterioration, however, given expectations of still-moderate economic activity.

The ability of French banks to compensate for margin pressures as a result of business or geographic diversification has been key yet uneven: solid for banks like BNPP and CA; weak for others. Only the largest and most diversified groups reported positive earnings momentum in 2023. This will remain a differentiating factor in 2024. Cost control will remain high on the agenda.

Figure 1: contrasting net results to date



*BNPP: Exceptional items include EUR 2.947bn capital gain from the sale of Bank of the West in Q1.
Not restated for accounting changes. Source: banks, SNL, Scope Ratings

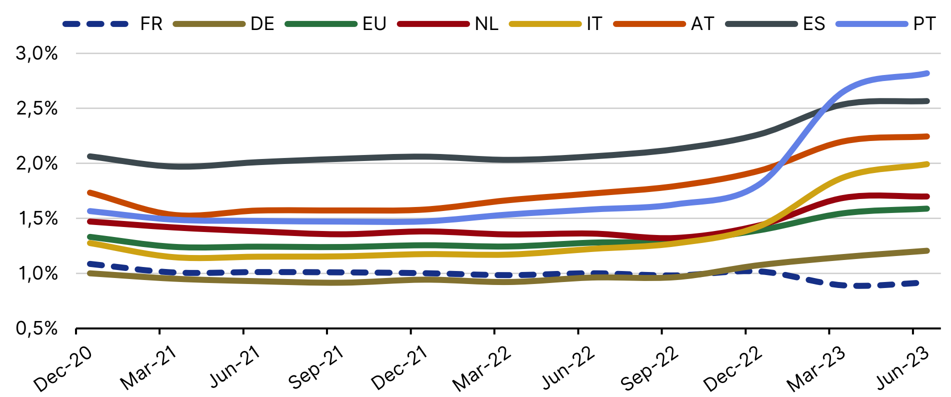
Trends for French banks		
Profitability	Mildly Negative in 2023 due to French retail; Stable or improving in 2024	↗
Asset quality	Stable in 2023; Mildly negative in 2024 as rates stay high for longer	→
Funding and liquidity	Mildly Negative in 2023 as customers search for yields; less volatility in 2024 as rates stabilise	↘
Capital and resolution buffers	Stable buffers, marginal increase of regulatory requirements	→

Profitability: expectations of improving revenue in French retail in 2024

Pressure on NIM will persist until mid-2024

Domestic retail banking is a key driver of French banks' financial performance, and a sector where banks continue to face weak net interest margins and subdued loan origination. The gradual increase in the maximum interest rate (usury rate), which is now at 6.29% for 20-year fixed-rate mortgages, and the stabilisation last summer of the benchmark rate for regulated savings accounts provided some relief. Banks anticipate that by the middle of 2024, the benefits of balance-sheet repricing should be more visible. Net interest margins in France are the lowest in the EU, EBA data show. Margins even fell below 1% in the first half of 2023 while the EU average had risen to 1.6%.

Figure 2: the rise of net interest margin across selected EU countries



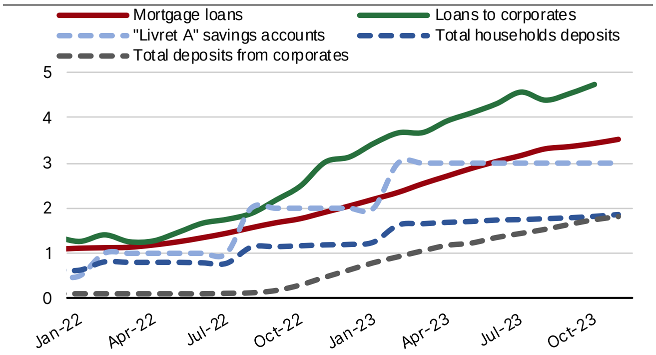
Source: EBA risk dashboard, Scope Ratings

Business diversification is key

Business diversification was the key differentiating factor behind diverging profitability trends in 2023. Well-integrated insurance activities mitigated pressure on core retail banking thanks to cross-selling and operational synergies. Corporate and investment banking business lines, which can be a source of earnings volatility, experienced another strong year thanks also to geographic and business diversification. There were positive effects too from other international activities, such as higher interest margins in Italy for Crédit Agricole and BNP Paribas.

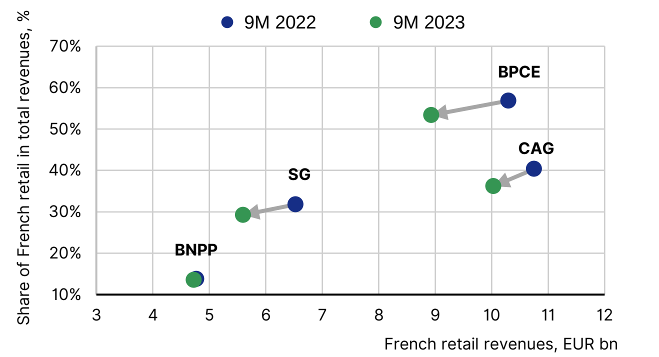
In 2024, we anticipate a soft economic landing in most of the countries where French banks operate (see our Sovereign Outlook 2024), although economic activity in France will again be below growth potential with real GDP growth of 1% in 2024. Lending dynamics will likely mirror this trend. Operating expenses increased less than inflation but the average cost-to-income ratios of French banks are 65%, much higher than the European average of 60%.

Figure 3: Interest rates on loans (straight lines) and deposits (dashed lines) (%)



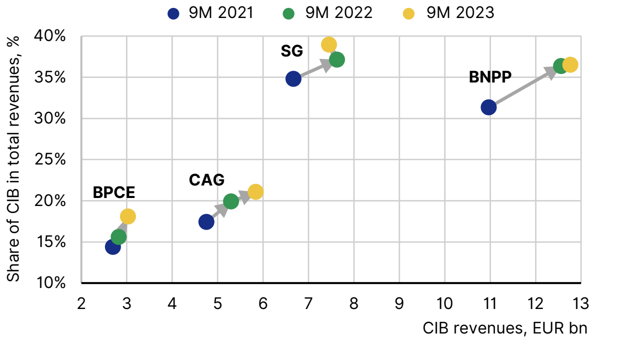
Interest rates on loans: all maturities, annualised agreed rate. Average rate on total households' and corporates' deposits, annualised agreed rate.
Source: Banque de France, Scope Ratings

Figure 4: Revenues from French retail, YoY change



2022 proforma. Source: banks, Scope Ratings

Figure 5: CIB revenues again at high level



2022 restated for IFRS 17 and IFRS 9. Source: banks, Scope Ratings

Figure 6: Cost-to-income ratios

9M 2023 vs. 9M 2022 % change	BNPP	SG	CAG	BPCE
Operating revenue	1.2%	-6.8%	6.8%	-7.6%
Operating expense*	3.5%	2.4%	3.7%	-1.7%
Operating income	-2.9%	-24.5%	11.8%	-20.5%
Cost-to-income ratio, 9M 2023	66.3%	72.4%	59.2%	72.9%
Cost-to-income ratio, 9M 2022	64.8%	65.9%	61.0%	68.5%
Cost-to-income ratio, ppt change	1.4%	6.5%	-1.8%	4.4%

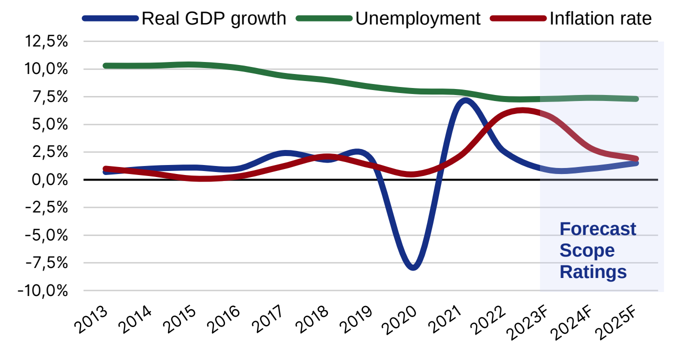
Not adjusted for SRF contributions and other exceptional items.
Source: banks, Scope Ratings

Asset quality: broadly stable with expected normalisation in 2024

Credit dynamics were broadly positive for the first nine months of 2023. Demand for mortgages in France remained well below 2022 levels (down 40% in November) but did not disappear. As banks tighten their underwriting criteria, credit growth will likely mirror moderate economic growth in 2024. But importantly, we do not foresee any material increase in unemployment under our baseline economic scenario.

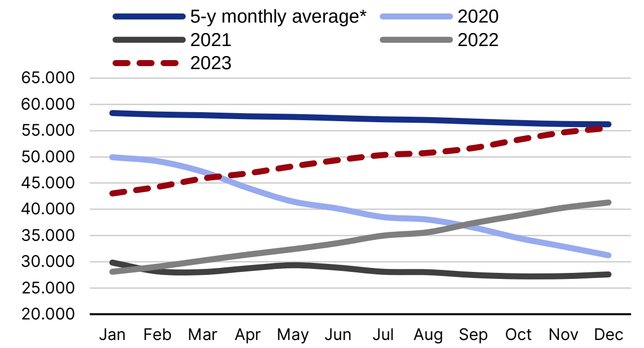
Corporate bankruptcies continue to normalise given the end of support measures and are now close to long-term averages. In this context, we note that the ability of struggling companies to renegotiate the terms of state-guaranteed loans (prêts garantis par l'Etat) has been extended by three years. As of end September 2023, about EUR 67.7bn of loans granted under the PGEs, leaving EUR 75.3bn outstanding.

Figure 7: Macroeconomic projections for France



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: Corporate bankruptcies now in line with 2019

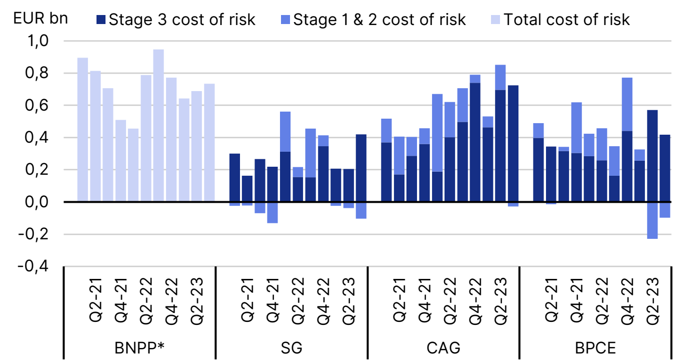


* Source: Banque de France, Scope Ratings

Cost of risk was volatile in 2023, albeit from a low base. Banks guided to metrics that are in line with their initial targets or their medium-term averages of 20bp-30bp. Banks maintain sector or management overlays. We do not see any signs that banks are anticipating materially worse asset quality by increasing precautionary buffers.

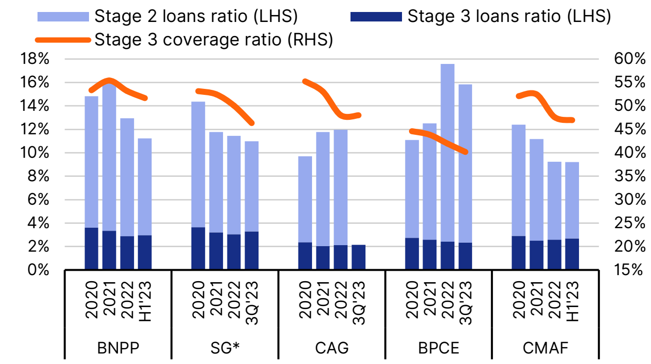
During the third quarter of 2023, impairment charges mostly related to known risks. So far, there has been no broad-based deterioration in asset quality. Based on EBA data, the ranking of the top three corporate sectors by NPL ratios – health services (10.6%), accommodation and food services (9%) and construction (7.1%) – did not change in the first half of last year. Those sectors represent a limited share of total corporate loans: 2%, 2.5% and 4.6% respectively.

Fig/ure 9: Modest cost of risk mainly on Stage 3 loans



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

Figure 10: Stable asset-quality indicators



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

Property markets are among the most sensitive to rising rates. In France, real estate activities account for the largest corporate sector exposure (23.1%), based on EBA country data, with a 2% NPL ratio, which is broadly stable compared to end 2022. With the heightened regulatory and market scrutiny on commercial real estate exposures, several banks have provided more details on the risk characteristics of their CRE portfolios.

Gross sector exposures are material in absolute terms but less so in relative terms given the split by sub-segments, foreign exposures, and the overall granularity of corporate sector exposures. Given the reduced appetite for this sector and the tightening financial conditions, commercial property prices are likely to remain under pressure in 2024.

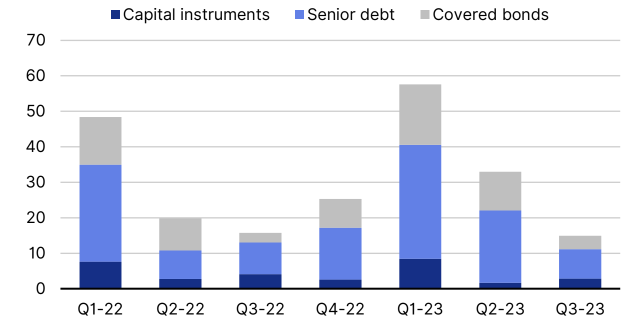
Funding and liquidity: mildly negative due to financial tightening

TLTRO repayments have been gradual and French banks have increased their reliance on the wholesale market. Thanks to very active debt issuance in the first quarter of 2023, funding plans were completed well ahead of schedule. Reimbursement of TLTRO did not translate into balance-sheets contraction, which shows the dynamism of underlying activities.

While the share of customer deposits in the liabilities structure has not changed, the mix has changed, with a greater share in remunerated time deposits. The likely end of policy rate hikes thanks to declining inflation will clearly help stabilise funding costs. We believe most central banks have reached peak rates and that the first cuts will start in the second half of 2024 at the latest.

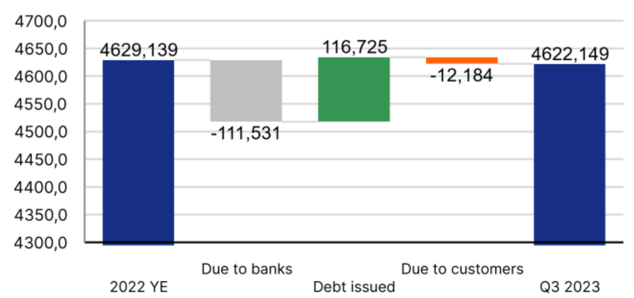
We note the lower dispersion of French banks' Liquidity Coverage Ratios. At the 9M2023 stage, they averaged 150%. The forced takeover of Credit Suisse and the failure of Silicon Valley Bank and other banks in the US in 2023 was a reminder of the paramount importance of sound liquidity management. Banks endeavoured to demonstrate first that TLTRO repayment was neutral in terms of liquidity management, and second to optimise liquidity buffers, which became more expensive to maintain.

Figure 11: Active debt issuance in 2023 YTD



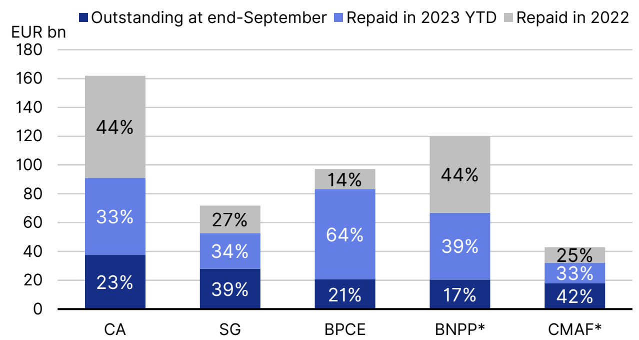
Issuance activity of French banking groups in our sample. Only large public international bond issues predominantly in EUR, USD and GBP. Excludes private placements, retained issuance, debt documented and sold privately. Source: Bond Radar, Scope Ratings

Figure 12: Dynamic changes in liability structure (EUR bn)



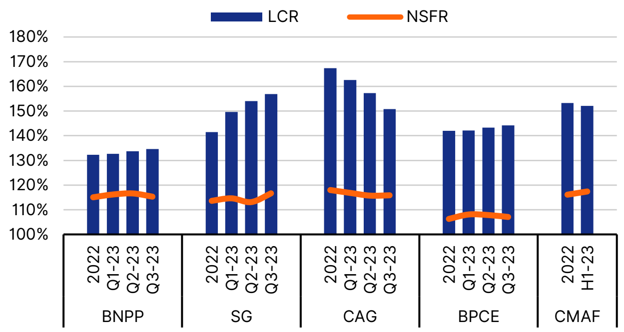
Source: Aggregated data including BNPP, CAG, BPCE and SG. Source: banks, Scope Ratings

Figure 13: TLTRO III repayment largely executed



*As of June 2023. Source: banks, Scope Ratings

Figure 14: Funding and liquidity ratios



LCR: Liquidity Coverage Ratio; NSFR: Net Stable Funding Ratio. Source: banks' Pillar III reports, Scope Ratings

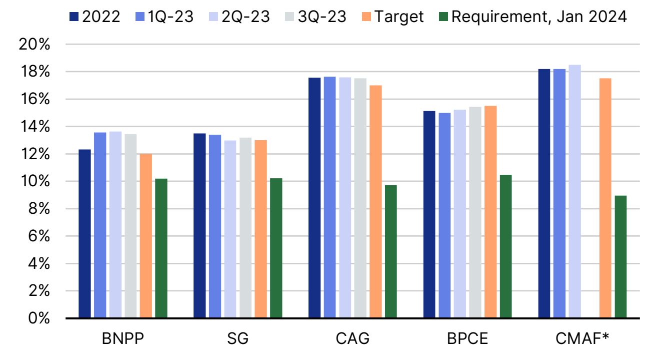
Capital buffers stable, in line with conservative approach

French banks maintain stable and predictable core capital policies. None of the large French banks is on a path to materially adjust their current capital positions. Given moderate economic growth and a cautious approach towards M&A, we do not anticipate big changes in 2024. Moreover, as CET1 ratios are close to targeted levels, we expect capital buffers to remain stable.

Higher capital requirements for 2024

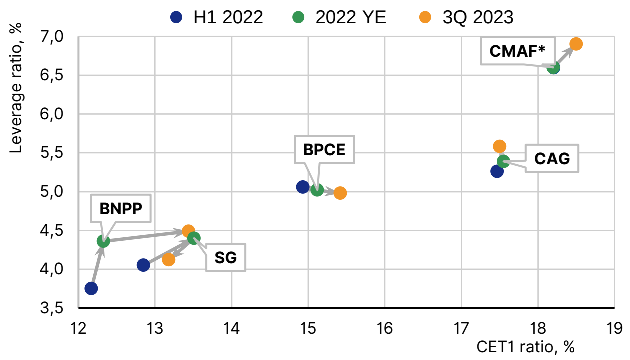
Increases in Pillar 2 requirements as well as higher countercyclical capital buffers for France (1% since January 2, 2024) have led to slightly higher capital requirements in 2024 but strong capital ratios provide solid buffers to accommodate incremental changes in regulatory requirements.

Figure 15: generally conservative management of CET1 ratios



*CMAF: mid-point of 17%-18% target range; CET1 requirement as of June 2023.
Source: banks, ECB, Scope Ratings

Figure 16: CET1 and leverage ratios



*CMAF: as of June 2023. Source: banks, Scope Ratings

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