French Republic
Rating Report

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
- Growing political fragmentation and polarisation

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, as highlighted currently by France's leadership in the presidency of the Council of the European Union.

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

Good record of structural reform: The French government under President Emmanuel Macron has enacted major supply-side oriented reforms designed to increase GDP growth potential, while reforming the governance framework for public finances to ensure fiscal sustainability. However, the reform momentum has been interrupted by the Covid pandemic and mounting social contestation. Strong reform momentum is critical to raising France's growth potential.

Debt profile and market access: The French treasury benefits from an 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 Covid-crisis; and ii) the need for additional reforms to raise productivity, employment and GDP growth potential, despite growing political fragmentation.

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	
Public Finance Risk		25%	bb		+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**	**+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 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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Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** France was among the most severely hit countries by the Covid-19 crisis, recording a recession of -8.0% in 2020, but government's large emergency measures proved efficient to shield corporates and households. Growth reached an above consensus 7.0% in 2021 on the back of gradual release of pent-up household consumption, amid large vaccination campaign and easing of sanitary restrictions. The recovery is expected to continue, although at a much slower pace (+4.2% in 2022 and +2.4% in 2023), thanks to a sturdy household consumption and private investment, as well as to large public investment programmes (EUR 100bn *France Relance*, and EUR 30bn *France 2030*).

  Since 2017, the French government has enacted major supply-oriented reforms to increase GDP growth potential, which we estimate around 1.5%, including the unemployment insurance reform that took effect in December 2021. Nonetheless, the pace of reforms has slowed due to the Covid-crisis and mounting social tensions. Looking ahead, growing political fragmentation and polarisation could weaken the capacity to deliver structural reforms post-elections.

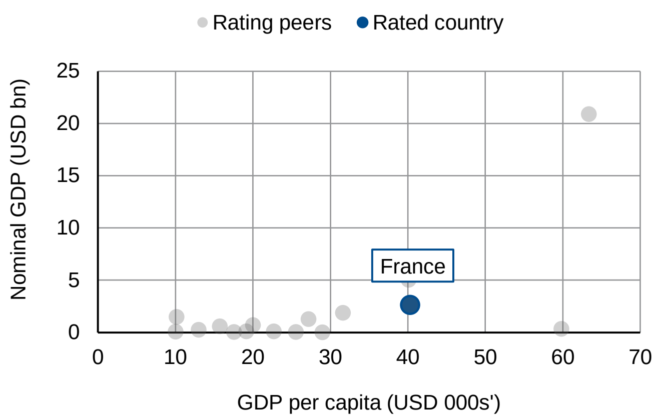
- **Inflation and monetary policy:** Inflation has increased to 1.6% in 2021, up from 0.5% in 2020, on the back of a firm economic rebound. Inflationary pressures have been exacerbated further in January 2022 (+2.9% YoY) in the context of higher international energy prices.

- **Labour market:** Labour market indicators have improved significantly, with the employment rate reaching a historical high (67.8% in Q4 2021), alongside a raising participation rate notably among the youth. Notwithstanding this cyclical upturn, the unemployment rate (7,4% as of Q4 2021, down from 8.0% in Q3) is expected to remain broadly stable and above the EU average (6.4% in December 2021) given structural labour market frictions and skill shortages. Job vacancies are relatively high, as around half of corporates report hiring difficulties, reflecting persistent skill mismatches.

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

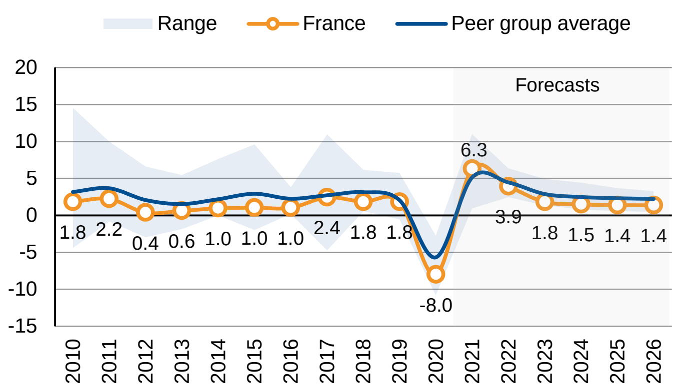
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential, reflecting strong investment, labour market-related challenges and low productivity growth
	Monetary policy framework	Strong	+1/3	ECB is a highly credible and effective central bank; appropriate central bank response to the 2020 global crisis; high weight in the Governing Council's monetary policy decisions
	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 GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

Public Finance Risks

- **Fiscal outlook:** The general government deficit is expected to gradually decline from 9.1% of GDP in 2020 to 7.8% in 2021 and 5.3% in 2022, supported by a firm economic rebound and the progressive withdrawal of large public policy support (EUR 70.7bn in 2020 (or 3.1% of GDP), EUR 90.2bn in 2021 (3.6% of GDP), and EUR 28.9bn in 2022 (1.1% of GDP)). Lower health expenditures will also support the gradual decline in deficits, although uncertainty surrounding the pandemic is a major risk to the fiscal outlook. Similarly, temporary measures introduced in response to rising energy prices could further weigh on public finances.

  The fiscal stance is expected to remain accommodative over the forecasting period to support the economic recovery and spur potential growth, amid green and digital transformations. Delivering gradual but ambitious fiscal consolidation will be challenging and contingent on this year's elections. As such, we expect the fiscal deficits to remain above 3.0% of GDP by 2026. The Stability and Growth Pact has been suspended until end-2022, and any reform at the European level seems to be unlikely before end-2023.

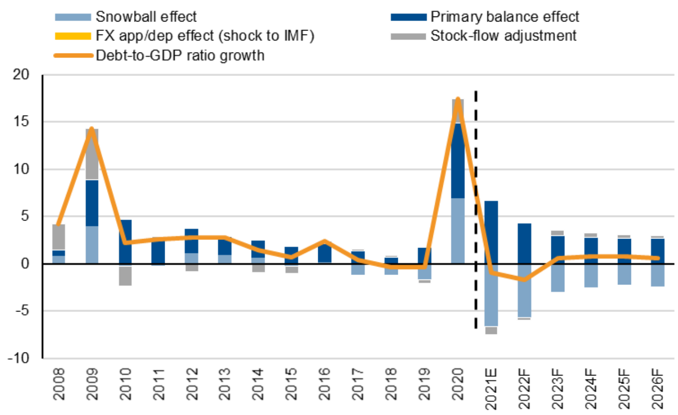
- **Debt trajectory:** The government debt-to-GDP ratio has increased by more than 15 percentage points since the start of the pandemic, to reach 114.2% in 2021. We expect the public debt ratio to hover around 115.0% of GDP through 2026, based on a strong economic rebound, a gradual return of GDP growth to its potential, and a progressive decline in primary deficits. Even so, France's public debt could diverge further from the European average. In that regard, recent reform to strengthen the governance framework for public finances makes the stabilisation of public debt more likely over the forecasting period.

- **Market access:** Gross financing needs are elevated, with France planning to issue EUR 260bn of net debt in 2022, in line with 2021 and 2020 issuance. Risks attached to high public debt are mitigated by ECB's still-accommodative monetary policy and a strong market access, based on a favorable debt profile, with a long debt maturity of 8.4 years, and a low average cost of debt.

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

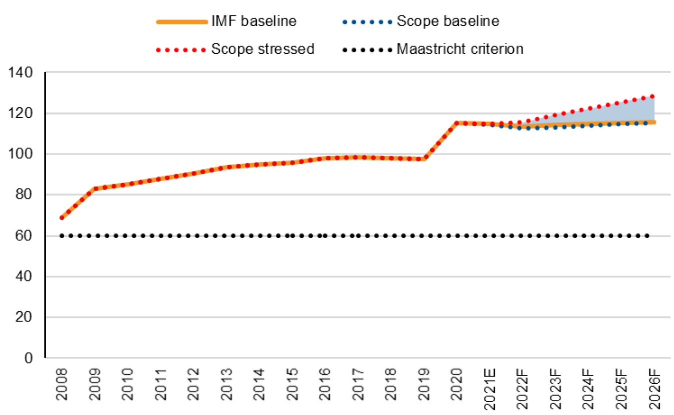
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Fiscal policy framework	Neutral	0	Appropriate budgetary response to 2020 crisis; limited room for additional spending; gradual reduction of deficits until 2026
	Debt sustainability	Neutral	0	High public debt levels; sustainability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

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings GmbH

Debt-to-GDP forecasts, % of GDP



Source: Scope Ratings GmbH

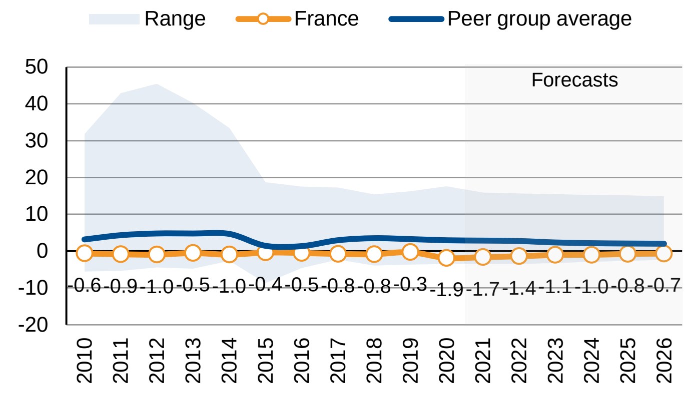
External Economic Risks

- **Current account:** France's structural current account deficit, averaging -0.8% of GDP between 2010 and 2020, has been driven by a persistent deficit on traded goods. The country lost about one third of its world export market share since 2000, a performance which contrasts with that of most euro area peers. In 2021, trade deficit reached a historical low of EUR 84.7bn in the context of higher international energy prices, despite trade services recovering to a record level. Even so, exports, mostly dominated by transport equipment and tourism, are expected to stabilise with the gradual dissipation of supply-chain disruptions and the ease of travel restrictions. Competitiveness gains resulting from lower production taxes are also expected to contribute toward a gradual improvement in the current account, though it is likely to remain in deficit over the coming years.
- **External position:** Persistent current account deficits have pushed France's net international investment position (NIIP) to a low of -32.4% of GDP in Q2 2021, though it remains above the European threshold for the excessive imbalance procedure (-35% of GDP). A rising external debt stock (265.5% of GDP), which is above the euro area average (122.9%), contributed to the deterioration of the NIIP. More recently, the NIIP has been impacted by higher debt issuances, over half of French long-term debt securities being owned by non-residents. The NIIP level and projected trajectory raise no sustainability concerns, but vulnerabilities may arise due to large gross positions in assets (321% of GDP) and liabilities (354% of GDP).
- **Resilience to shocks:** 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*

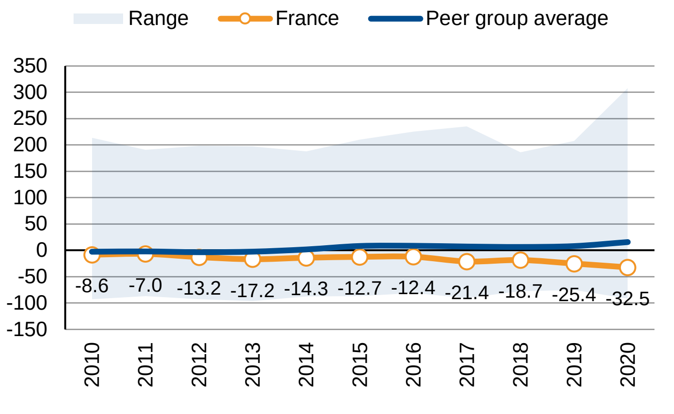
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Current account resilience	Neutral	0	Diversified and high-technology industries, moderate current account deficits
	External debt structure	Neutral	0	Elevated levels of external debt mitigated by low cost of debt, high 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

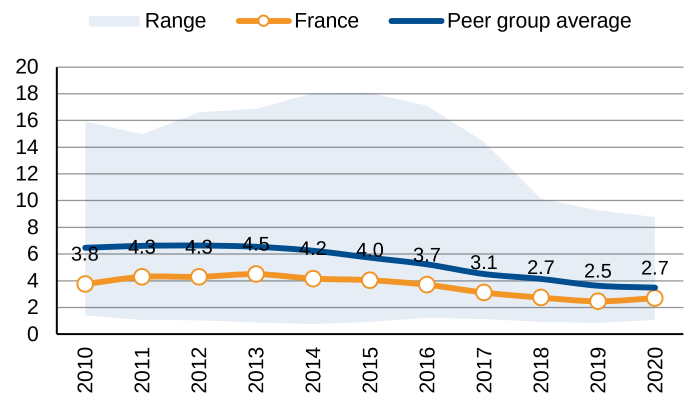
Financial Stability Risks

- **Banking sector:** Banks have played a pivotal role in keeping the economy afloat, by extending state-backed loans (EUR 143bn as of December 2021). Swelling balance sheets resulted also from excess household savings (around EUR 170bn) and high public debt issuances, in which domestic banks are strongly involved. Looking ahead, the repayment of state-backed loans (20-30% of the credit risk being covered by banks for major corporations, 10% for SMEs) and the rundown of household savings are not expected to pressure balance sheets. Banks have comfortable capital buffers (CET-1 ratio at 15.7% as of end-2021) and high liquidity coverage ratios (156.4%) that have been consolidated by record profits in 2021. The High Council for Financial Stability (HCFS) has so far maintained the countercyclical capital buffer rate for banks unchanged at 0% since March 2020. However, it intends to normalise the buffer rate to its pre-crisis level (0.25%), which could be decided in March 2022.
- **Private debt:** Non-financial corporate debt remains elevated (82.0% of GDP as of Q3 2021) in comparison to pre-Covid levels (73.0%) and euro area peers (64.7%). Even so, corporates, which have accumulated cash, are expected to be able to gradually repay state-backed loans and cope with the withdraw of public policy support, which enabled to contain insolvencies (-7.0% YoY in January 2022). Household debt (66.4% of GDP as of Q3 2021) is moderately higher than the euro area average (61.2%), but the rise during the Covid-pandemic has been broadly in line with peers. In addition, excess savings accumulated by households provide an adequate buffer if a new shock occurs.
- **Financial imbalances:** Property prices index (base 100 in 2015) has continued to rise (126 in Q3 2021), albeit following the typical dynamics across Europe with prices spiking in large cities. Risks for a housing bubble have been somewhat mitigated by recommendations issued by the HCFS, effective since September 2021, to cap mortgage length (at 25 years) and debt service to disposable income (at 35%).

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

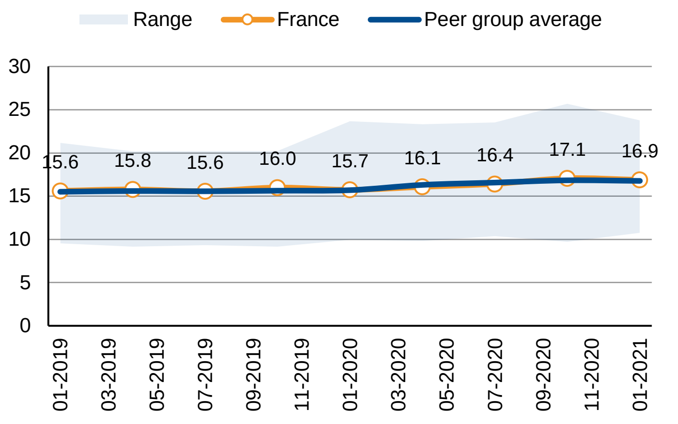
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a	Banking sector performance	Strong	+1/3	Competitive banking sector and strong capitalisation
	Banking sector oversight	Neutral	0	Oversight under the National Supervisory Authority (ACPR, under Banque de France) and the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

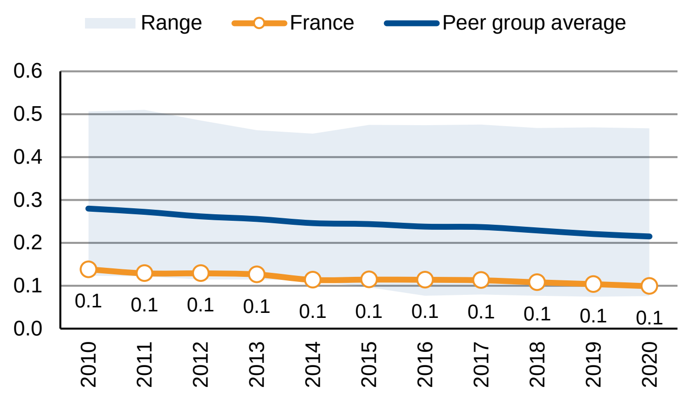
ESG Risks

- **Environment:** France has recently committed to reduce greenhouse gas emissions by 55% by 2030 and to achieve carbon neutrality by 2050. Even so, a recent Council of State ruling noted 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, including investments for energy-retrofitting, sustainable mobility, decarbonisation of the industry, and development of green technologies, will likely contribute to accelerate the green transformation. Critically, the pending European Commission decision on the classification of nuclear energy as a sustainable energy source could be credit positive. France derives about 40% of total energy supply from the nuclear power and has announced in February 2022 a large ramping-up of its nuclear program, including by investing in advanced versions of the European Pressurised Reactor.
- **Social:** Relatively weak social mobility and high regional inequality compared to peers, despite a large welfare state, remain 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 55% by 2050 according to the OECD, structurally weighing on public expenditures and economic growth over the long-term.
- **Governance:** France's presidential and legislative elections, in April and June respectively, will be crucial to get insight on the future momentum behind reform. The current political landscape tends to be increasingly fragmented and polarised, which could be a source of fragility to effectively deliver gradual but ambitious reforms. The next government's ability to balance the fiscal consolidation, structural reforms and popular support will be critical for France's credit outlook.

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

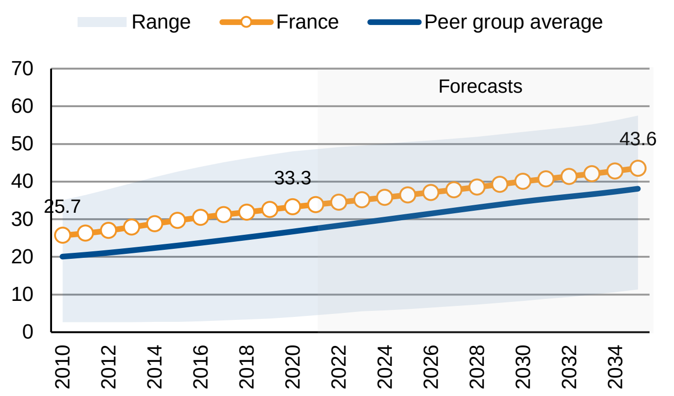
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Environmental risks	Strong	+1/3	Relatively strong resilience to climate risk and ambitious climate targets
	Social risks	Neutral	0	Large social safety nets, public protests limit ability to implement reforms
	Institutional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

CO2 emissions per GDP, mtCO2e



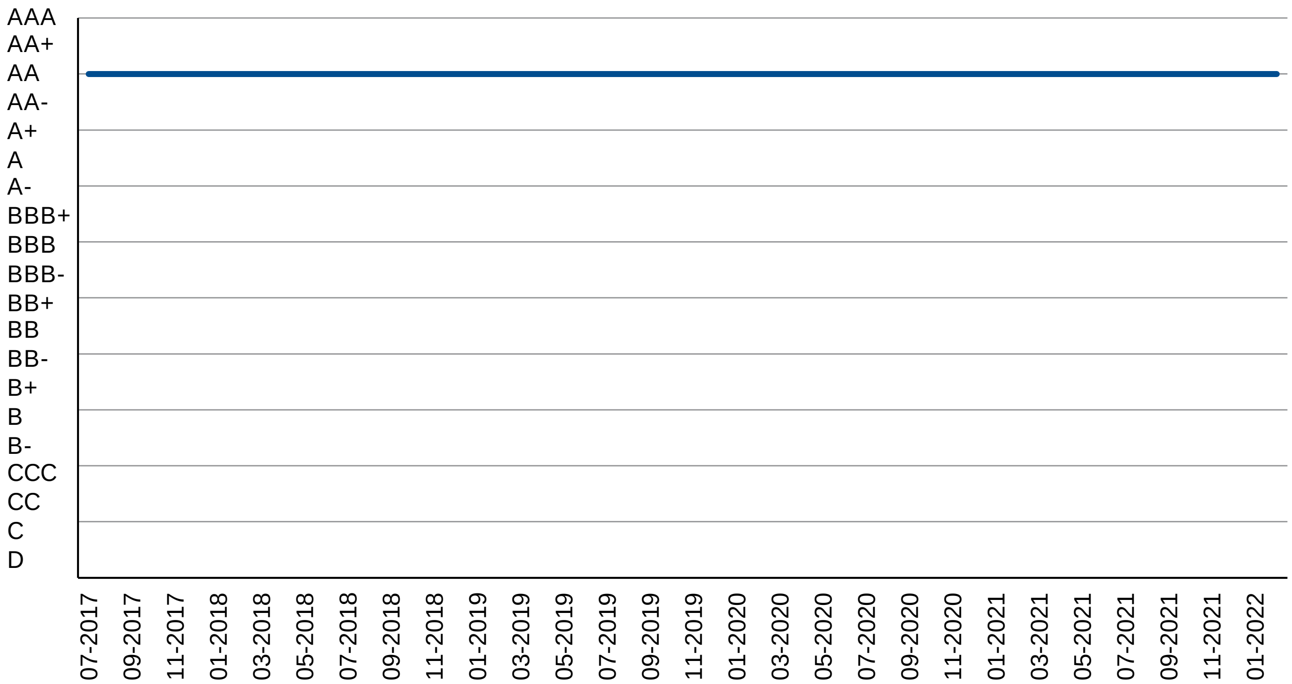
Source: European Commission, Scope Ratings GmbH

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
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.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD 000s'	38.3	40.1	43.0	42.0	40.3	45.0	48.0	50.0
Nominal GDP, USD bn	2471.3	2589.0	2789.7	2728.8	2624.4	2940.4	3140.0	3281.7
Real growth, %[1]	1.0	2.4	1.8	1.8	-8.0	7.0	4.2	2.4
CPI inflation, %	0.3	1.2	2.1	1.3	0.5	2.1	2.8	1.7
Unemployment rate, %[1]	10.1	9.4	9.0	8.4	8.0	7.4	7.7	7.7
Public Finance Risk								
Public debt, % of GDP[1]	98.0	98.3	98.0	97.6	115.1	114.2	112.5	113.1
Interest payment, % of government revenue	3.3	3.0	3.0	2.6	2.3	2.2	1.6	1.5
Primary balance, % of GDP[1]	-1.9	-1.3	-0.7	-1.7	-8.0	-6.6	-4.3	-3.0
External Economic Risk								
Current account balance, % of GDP	-0.5	-0.8	-0.8	-0.3	-1.9	-1.7	-1.4	-1.1
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	16.8	-	-
Credit to private sector, % of GDP	97.4	101.4	104.3	107.1	122.4	-	-	-
ESG Risk								
CO^2 per EUR 1,000 of GDP, $mtCO^2e$	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	35.1
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 21 February 2022	20.8

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