Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
FRENCH REPUBLIC	Assigned Ratings/Outlook: **AA /negative**	Type: Monitoring, unsolicited with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	26-08-2016 20-05-2022 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 20 May 2022

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "AA" for the French Republic. Creditreform Rating has also affirmed France's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AA". The outlook is negative.

Key Rating Drivers

1. Very large and wealthy economy displaying a high level of productivity; while some structural challenges persist, the labor market has shown resilience throughout the crisis, with unemployment continuing to decline; strong economic recovery set to slow down but to continue; downside risks mainly due to fallout of the war in Eastern Europe and intensified supply shortages with a view to strict pandemic containment measures in China
2. The medium-term growth outlook remains by and large constructive, supported by the Recovery and Resilience Plan and additional envisaged investment and measures coming with the 'France 2030' plan, also aiming at improving competitiveness and driving innovation; we will monitor further developments in non-financial corprate debt
3. The sovereign boasts a high-quality institutional framework, including benefits associated with EU/EMU membership; following a phase of more or less stalling reform progress due to the pandemic and the re-election of the incumbent president, we expect a reinvigorated reform momentum; some risks to a timely implementation of major reforms if the upcoming legislative election results in a more fragmented political environment
4. While fiscal metrics have improved amid the economic recovery following the significant pandemic-related deterioration, economic risks linked to the recent geopolitical events and uncertainty over the domestic political context for the coming few years highlight challenges to a meaningful and sustainable improvement of the public debt ratio; fiscal risks associated with age-related costs remain an issue in the absence of a pension reform; high debt affordability and sound debt management remain vital risk-mitigating factors
5. Limited external vulnerabilities stemming from a moderately negative current account balance and a negative net international investment position, with the latter mitigated by considerable amount of external assets as well as relatively low external funding costs

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

France's generally strong macroeconomic profile is underpinned by the large size and wealth of the economy, as well as by a high level of productivity. Its well-diversified services sector provides for some resilience to economic shocks. In the short term, there are downside risks to the growth performance from the adverse consequences of the war in Ukraine, although vulnerabilities appear less pronounced than in other large euro area (EA) economies in terms of dependency on energy commodity imports. In view of the considerable investment envisaged to drive the green and digital transition whilst aiming to enhance social inclusiveness along this path, the medium-term growth outlook still appears constructive, although some structural challenges with regard to the labor market remain in place. Despite considerable cash buffers, private sector balance sheets represent a pocket of vulnerability in some corporate segments in a context of uncertain economic prospects.

France's pre-pandemic real GDP growth performance was somewhat below the average growth rate registered by the euro area as a whole over the period from 2015 to 2019, posting at 1.6% against 2.0% in the euro area. Following a steep decline in economic output amid the Covid-19 pandemic in 2020, exacerbated by comparatively tight restrictions as suggested by the stringency index provided by the Blavatnik School of Government, the French economy however saw a sharp rebound by 7.0% in 2021 (EA: 5.4%) - a significantly better outcome than expected at the time of our last review (May-21). The rebound was primarily driven by recovering gross fixed capital formation (growth contribution: +2.7 p.p.) and private consumption (+2.5 p.p.). Net exports made a slight positive contribution to GDP growth as well last year (+0.2 p.p.).

While negatively affected by corona infection waves in the respective autumn/winter seasons, total economic output largely continued to expand since the beginning of 2021, but stagnated in Q1-22 compared to the preceding quarter, chiefly on account of contracting private consumption. Nevertheless, real GDP stood 1.0% above its pre-pandemic level (Q4-19) in Q1-22, comparing favorably against the euro area (Q1-22 vs. Q4-19: +0.4%).

First signs of the fallout from the Russian war in Ukraine were visible from March 2022. While the French economy is less reliant on imports from Russia and Ukraine than other major euro area countries, recent surveys regarding business tendency relating to March/April show that supply difficulties are on the rise again, especially in the industry sector, partly exacerbated by rigorous lockdowns in parts of China amid new corona infection cases. Production may thus be hampered with a view to the short term, despite still apparently well-filled order books. INSEE's business climate indicator deteriorated in March and April, but remained above its long-term average, as there was little change in construction, and market services continued to expand.

Investment had remained relatively resilient throughout last year, partly thanks to extensive government support including subsidies and lower taxes on production. Looking ahead, gross fixed capital formation should remain supported by the EUR 100bn stimulus package ('France relance') presented in Sep-20, which is partly covered by funds from the EU's Recovery and Re-

[1] This rating update takes into account information available until 13 May 2022.

silience Facility (RRF), and EUR 72bn of which had already been committed as of Dec-21. According to estimates by the European Commission, full and timely implementation of France's Recovery and Resilience Plan (RRP) could lift GDP by between 0.6% and 1.0% by 2024.

Prospectively improving the outlook for investment further, the French president announced a green investment plan ('France 2030') in Oct-21, aiming to decarbonize the economy while driving innovation and high-tech development and thus strengthen France's competitiveness. Among other things, the plan foresees to foster hydrogen-based technology as well as building on innovations regarding nuclear reactors. However, uncertainty over near-term economic developments, especially in Europe, may pose some constraints.

The near-term outlook for private consumption seems to be more mixed at present, and we expect household expenditure to expand less strongly than in 2021. Given that French consumer confidence continued to decline in April after a sharp fall in March (INSEE data), moving below its long-term average, risks to private consumption seem skewed to the downside. Backed by special terms for the partial activity scheme in the context of the pandemic, household spending remained well-supported last year.

Generally, companies affected by the economic fallout from the war in Ukraine are eligible for the benefit of partial activity, which is likely to exert a cushioning effect to private consumption despite the burden of increasing commodity prices. Furthermore, a still high level of household savings could potentially back household expenditure in the current year, although consumers may prefer to act more cautiously at this stage, as declining confidence seems to suggest.

Whilst rising consumer prices thus pose downside risks to private consumption, price increases regarding gas and electricity have been capped for 2022 to bring relief to consumers, and fuel prices were subsidized from Apr-22. Moreover, positive labor market development remains supportive for the time being. The annual average unemployment rate has continued to fall from 10.3% in 2015 to 7.9% in 2021, remaining only slightly above the euro area level (7.7%), but well above the level observed in our AA-rated universe. In quarterly terms, the seasonally adjusted rate dropped to 7.3% in Q1-22 (LSF-adj., INSEE), continuing the favorable trend. Labor participation reached a high at 73.0% in 2021, remaining significantly lower than in Germany but close to the euro area level. Despite remaining higher than in the euro area overall, youth unemployment dropped markedly to 18.9% in 2021 (EA: 16.8%).

Due to existing indexation mechanisms of the minimum wage, the latter is likely to further increase this year, given ongoing upward pressure on consumer prices. The monthly minimum wage increased by 1.0% in 2021, and by a further 3.1% in the first half of 2022 compared with the same period last year. Adding to this, recent wage negotiations in some sectors seems to point to increasing wage growth (Banque de France, BdF). As reflected by a higher number of vacancies for a given level of unemployment, the labor market seems to have become tighter, thus underscoring the expectation of upward pressure on wages.

Government consumption is likely to aid domestic demand in the short term, whilst exports should be hampered by a weaker economic performance of France's European trade partners as a result of geopolitical events. This said, the RRF boost to investments among the EU partners should act as a stabilizing factor in those countries, alongside their respective fiscal support to compensate for higher commodity prices. What is more, economic growth in important non-EU trading partners such as the US appears to be better shielded from the repercussions of Russia's

aggression against Ukraine. We thus still assume a moderately positive growth contribution from net exports this year.

Overall, we expect real GDP to expand by about 2.9% this year, followed by some deceleration to about 1.8% in 2023. Risks associated with possibly resurging corona infections and related containment measures currently appear less threatening, given advancing vaccination and other medical progress on this front as well as the adaptation of behavior. However, supply bottlenecks are intensifying in the face of the war in Ukraine and drastic Covid-19-related restrictions in China, and risks of a further widening and/or longer duration of the conflict in Eastern Europe seems to have grown larger, adding considerably to uncertainty and posing headwinds to economic development.

Despite these downside risks, we view the medium-term outlook as constructive if the envisaged reform measures and investments set out in the RRP and the France 2030 plan are implemented in a timely and effective manner, which will, however, also depend on the political environment (see below). The initiatives could contribute to lifting potential growth, estimated to be at around 1.5% and 1.6% in 2022 and 2023, moving just under the estimated euro area level and exceeding the estimated average of 1.0% over the 10-year-period from 2010-19 (AMECO). Reiterating more structural credit strengths, the French economy is the seventh-largest in the world. Its estimated GDP per capita rose to USD 51,364 in 2021 (IMF, PPP). Nominal labor productivity per hour worked and per person remains among the highest in the EU, posting at 123.7% and 115.1% of the 2021 EU level respectively.

Judging by the development of unit labor costs over the last few years, France's cost competitiveness has developed relatively favorably recently, although less so when comparing 2021 to 2020 against the main European trading partners. Going forward, mitigation of the impact of inflation on compensation per employee may have to be monitored alongside any potential productivity gains. Having said that, we note that France's global export market share dropped by 0.20 p.p. to 3.43% in 2020 vs. 2019, driven down by a lower share in goods exports. By contrast, the global share of services exports climbed significantly, by 0.29 p.p. to 5.17%, a level last reached in 2016.

In terms of non-price competitiveness, we continue to pay some attention to components included in the World Bank's Ease of Doing Business report and the World Economic Forum's Global Competitiveness Index, which suggest a middle-range position of the French economy among the EU countries. More recent comparisons, such as the IMD World Competitiveness Ranking, seem to come to similar conclusions, ranking France 29th out of 65 countries overall, hinting at some room to catch up with the European leaders in this respect.

With regard to plans to promote its digitalization agenda, we recall that France ranks 15th among the EU members in the 2021 DESI digital economy and society index, maintaining its 2020 rank, thus still well behind top performers. Despite having improved with regard to connectivity, it continues to lag behind the EU average, whereas further headway in terms of digital public services has contributed to maintaining an above-EU performance. Of the RRP funds, 21% are allocated to enhance the digital transition, while with 46%, the bulk is earmarked for investments and reforms with a view to the green transformation.

Indebtedness of the private sector remains elevated, pointing to possible constraints when it comes to shock-absorbing capacities, although there are important mitigating factors in place. Private sector debt has risen over the course of the pandemic, with non-financial corporate debt

to GDP reaching 101.1% as of Q4-21 (Q4-19: 90.6% of GDP, ECB), constituting one of the higher ratios among EU countries. We are aware that enterprises increased their cash positions, leaving a smaller increase in net debt positions, and that interest on the debt is fixed and low. Moreover, the debt increase can be partly attributed to the take-up of state-guaranteed loans. Outstanding loans to non-financial corporations posted an annual growth rate of 4.2% in Mar-22 (BdF), having moderated from double-digit rates in early 2021. Debt of private households set against disposable income has continued to climb, reaching a high of 103.0% as of Q3-21 (ECB).

As the global competition for talent is becoming stiffer in light of synchronized efforts to move towards a more digital and greener economy, the aspired reskilling and upskilling of workers and improving access to training and qualifications should be conducive to reducing constraints to growth stemming from a tightening labor market amid a reported shortage of skilled workers. Irrespective of the progress made, further challenges to medium-term growth remain with regard to some product and service markets, which partly come with restrictive regulations continuing to create high entry barriers, hampering competition.

Institutional Structure

France's credit rating is underpinned by its very strong institutional framework, including extensive benefits drawn from its profound integration into the EU and the euro area, as well as its ability to shape relevant policies for these areas. Following previous progress, reform momentum has stalled since the outbreak of the Covid-19 pandemic, as illustrated by the delay of the pension reform. While President Macron was re-elected, which we expect to be conducive to a resumption of France's ambitious reform agenda, the political climate remains challenging. If this is also reflected in the upcoming legislative election, pushing through any major reform initiatives may become more complicated. More generally, potentially resurfacing social unrest may be a risk to be monitored.

The French presidential election held on 10 and 24 April 2022 resulted in a second term for incumbent president Macron, who won in the second round over Rassemblement National candidate Le Pen. Having obtained 27.8% of the votes in the first round, the decisive second round resulted in a 58.55% share of the votes for Macron vs. 41.45% for Le Pen. Even though this corresponds to a comfortable margin, the outcome represents a narrower win than seen in 2017, hinting at a persistently challenging political climate.

It remains to be seen whether the latter is also reflected in the upcoming election of the National Assembly on 12 and 19 June, for which recent polls suggest a more fragmented seat allocation in the lower chamber at this stage. In a latest development, the more left-wing and green parties have decided to form an alliance (NUPES), challenging elements of the envisaged pension reform and nuclear policy. Policy-making may turn out to be arduous in the event that the prime minister has to be chosen from an opposition party ('cohabitation'), which cannot be ruled out entirely.

Having said this, we expect policies to remain focused on driving the green and digital transition. Apart from this, the pension reform looks set to make a return on the agenda, which is likely to prove more controversial than intended reforms in the areas of education and health care. In terms of energy security, the President Macron not only remains committed to further use of nuclear power, but aims at building new and more modern plants as well as engaging in the construction of small modular reactors.

The latest set of Worldwide Governance Indicators (WGIs) provided by the World Bank and concerning the year 2020 backs our assessment of France's high institutional quality. When it comes to the four dimensions on which we put the most emphasis, France's relative position among all the economies considered is roughly in line or even slightly better than the median of the euro area members.

Still, we observe some deterioration across these four dimensions, noting that concerning 'voice and accountability', the sovereign has slipped to relative rank 37 out of 208 economies, the weakest result since inception of the indicators in 1996. The latter also holds for the perception of the extent to which public power is exercised for private gain ('control of corruption'), with regard to which the sovereign now occupies rank 33 out of 209 economies, deteriorating by 9 ranks compared to the prior year. In terms of 'government effectiveness' (rank 29 out of 209) and 'rule of law' (26 out of 209), the declines in the ranking were more minor.

Further corroborating our assessment of France's institutional strength, the European Commission's (EC) Rule of Law Report (Jul-21) pays testament to France's high-quality and efficient justice system, pointing to ongoing reforms for further improvement, while also mentioning pending decisions to further strengthen judicial independence. A law aiming to enhance citizens' trust in the judicial institution and covering a broad range of measures such as professional secrecy for lawyers, broadcasting hearings for educational purposes, and development of mediation became effective in December 2021.

We observe ongoing advancements with regard to combating and preventing corruption both in the public and the private sector, among others concerning the reorganization of the National Financial Prosecutor. As highlighted by GRECO, a number of steps remain to be taken when it comes to the 18 recommendations set out in the group's fifth Round Evaluation Report, as nine of these are yet to be implemented, e.g. regular publication of a list of lobbyists met by persons with top executive functions and the subjects discussed.

As far as greening the economy is concerned, the government remains highly committed to pursuing climate protection objectives. According to its National Energy and Climate Plan (NECP), France aims for a 20% reduction of its energy consumption by 2030 compared to 2012 levels. As outlined in the NECP, the upgrading of its building stock alone, accounting for about a quarter of the greenhouse gas emissions, is estimated to require annual investments in the magnitude of about EUR 45 to 85bn until 2030.

Underscoring its status as one of the more advanced EU countries in terms of ECO innovation, France maintained its ranking of 7th among the EU-27 in 2021 with regard to the respective index compiled by the EC. Its overall share of energy from renewable sources has increased further to 19.1% in 2020, roughly in line with Germany and Italy and below the EU average (2020: 22.1%, Eurostat). While in line with the EU level with regard to its share of renewable energy in heating/cooling, it is well ahead of Germany and Italy in this respect (2020: 23.4%, DE: 14.8%, IT: 19.9%, EU: 23.1%). On the other hand, the share of renewables in gross electricity consumption is lagging markedly behind the EU in terms of gross electricity consumption, while roughly matching the share of renewable energy sources in transport. Looking at the level of greenhouse gas emissions per capita, France compares favorably against the EU overall (2019: FR: 6.7 tons, EU-27: 8.4 tons, Eurostat).

Fiscal Sustainability

We continue to assess France's public finances as its main credit weakness. The already elevated pre-pandemic debt level has been exacerbated by the pandemic-related fallout, and prospects for a sustained decline of the debt ratio have deteriorated in light of recent geopolitical events and the related economic repercussions. Maintaining a trajectory of sustainable public finances in the medium term, as detailed in the latest available Stability Program (dating from April 2021), might prove more challenging under such circumstances. Pressure associated with unfavorable age-related cost developments could add to the challenges if not tackled convincingly. At the same time, prudent debt management and high debt affordability, the latter substantially supported by the ECB's still accommodative monetary policy as well as by financing through the RRF, remain key factors mitigating risks to fiscal sustainability in the near to medium term, although refinancing terms look set to become less favorable going forward.

Following a deficit of 8.9% of GDP in the first year of the pandemic, general government net borrowing declined to 6.5% of GDP last year, representing a markedly more favorable outcome than we had estimated in our last review, boosted by better-than-assumed fiscal revenue. Total government revenue ultimately rose by 8.4% in 2021 (2020: -4.8%), driven by recovering income and wealth tax receipts (+6.2%) as well as production/import tax revenues (+6.5%) and net social contributions (+6.7%). At the same time, expenditure growth moderated to 4.0% (2020: 5.1%). By contrast, interest payments rose by 16.9% in 2021 (2020: -16.4%), although corresponding to a still relatively low 1.4% of GDP (2.6% of total revenue).

As to the current year, uncertainty over the fiscal outcome has risen amid the latest events around Russia's war in Ukraine. While most of the pandemic emergency support was phased out by Oct-21, support to cushion the burden placed on businesses and consumers by rising commodity prices and other fallout from the events in Eastern Europe has moved into focus. Already prior to Russia's invasion in Ukraine, the French budget bill 2022 was amended to take into account measures mitigating in particular the effects of higher energy prices, in addition to adjustments to expenditure related to labor market integration and the France 2030 plan, indicating a continued expansionary fiscal stance this year.

In Mar-22, the government announced financial aid to ease the pressure on private households and businesses from the economic consequences of Russia's aggression in Ukraine. According to government estimates, these additional measures would bring total costs for relief from higher inflation and energy costs to about EUR 25bn. Overall, we estimate the fiscal deficit will narrow somewhat in 2022, to about 5.2% of GDP, and further to about 4.0% in 2023, acknowledging high uncertainty around this.

The medium-term outlook remains somewhat blurred by the unpredictability of the duration and potential further economic repercussions of the war in Ukraine. New corona virus variants and waning effectiveness of available vaccines still adds to uncertainty. Pending the result of the legislative election in June, which could potentially complicate policy-making, we expect only a gradual reduction of the deficit over the medium term at present.

Having said that, we highlight political commitment to sustainable public finances and assess as positive the adoption of the law of 28 Dec 2021 on the modernization of public finance management. The organic law establishes a new framework for the governance of public finances and the evaluation of the effectiveness of public expenditure, seeking to strengthen the multi-year

management of public finances, improve public finance transparency and to streamline and improve parliamentary work.

In light of current downside risks to GDP growth and a likely slow reduction of the deficit, we assume a more or less stable debt ratio this year and next, penciling in 112.4% of GDP for 2022 and 112.4% of GDP for 2023 as well. Having leapt by 17.2 p.p. to 114.6% of GDP in 2020 due to the pandemic, France's debt-to-GDP ratio dropped slightly to 112.9% last year, thanks to stronger-than-expected GDP growth, remaining well below our estimates in our last review and below assumptions presented in the updated DBP22. Nevertheless, at this level, France's public debt ratio is the highest among our AA-rated sovereigns.

In terms of contingent liabilities, we flag that public guarantees have gone up substantially due to the pandemic, potentially putting further strain on public finances if called upon. That said, out of the maximum amount of state guarantees of EUR 300bn in connection with the Covid-19 pandemic, EUR 148bn was taken up as of 31-Mar-22. The estimated loss (net of premium, 2020-2027) amounts to EUR 1.4bn.

In a more recent step, in order to limit any adverse effects from the war in Ukraine, the Cap Francexport scheme was extended beyond the end of Mar-22. Also, companies are allowed to stretch the repayments of their state-guaranteed loans (PGE) linked to the pandemic across ten years rather than the initially announced six years. We will continue to pay attention to developments here, as the government allows firms most affected by the war in Ukraine to ask for additional funding through the so-called Resilience PGE, which will likely be extended until Dec-2022.

France's banking sector has remained resilient over the course of the pandemic. With regard to asset quality, the share of non-performing loans (NPLs) has continued its downward trend, not least as government support helped to prevent any significant number of corporate insolvencies. As of Q4-21, the NPL ratio declined to 1.9% (Q4-20: 2.2%, EBA data), remaining slightly below the EU level. Bank capitalization as measured by the CET1 ratio seems relatively comfortable, coming to 15.9% as of Q4-21 (stable compared to Q4-20, EBA data) and as such roughly in line with the EU level. As regards return on assets (EBA), the French banking sector is on par with the EU-level (Q4-21: 0.5% each), while holding up slightly better in the initial phase of the pandemic.

We will monitor banks' exposure to Russia, although risks appear to be contained at this stage. Profitability may have to be monitored in view of possible larger price correction on the property market and with regard to any conceivable increase in banks' financing costs, bearing in mind a likely less accommodative stance of monetary policy in the euro area. However, macroprudential developments seem to keep up with any emerging risks in this regard. On 7 April 2022, the High Council for Financial Stability (HCSF) adopted the proposal of the Governor of the Bank of France to raise the counter-cyclical capital buffer rate for France to 0.5%, from 0% previously. Banks will have to comply with the new requirement from 7 April 2023.

Prior to this, HCSF made somewhat more restrictive credit standards for mortgage loans legally binding, with effect from Jan-22. Credit to private households had expanded by 5.5% y-o-y as of Feb-22, maintaining a relatively dynamic pace, with outstanding mortgage lending rising by 6.3% y-o-y (ECB data). As suggested by BdF, there are pockets of overvaluation when it comes to residential property trends. Affordability metrics such as the price-to-income indicator provided by OECD seem to back this, with the latter moving in excess of 20% above its long-term average

(Q4-21: 21.1%). Overall, house prices have continued to trend upward during the pandemic, with the annual growth rate mounting to 7.0% as of Q4-21 (ECB). The 3y-rate of change has currently climbed to 17.5%, albeit from comparatively low base levels.

With a longer-term view, age-related cost pressure may intensify if a dedicated pension reform is continuously postponed. While re-elected president Macron has put pension reform high on the agenda, proposing to overhaul the fragmented system and increasing the minimum retirement age, any advancements seem to depend on the composition of the new National Assembly following the June election, as well as on the appetite among the wider society to accept any major changes, recalling street protests during the incumbent president's first term concerning this sensitive issue.

That said, we continue to view the sovereign's very sound debt management, as well as high debt affordability that should remain in place for some time despite a less accommodative monetary policy stance, as factors mitigating fiscal risks to some degree. What is more, 37% of France's sovereign debt was held by the foreign official sector and the BdF as of Q3-21 (IMF data). The weighted average maturity of negotiable outstanding debt stood at 8y and 141 days at the end of Mar-22, roughly the level reached in Mar-21 (AFT data), smoothing any refinancing risks.

Nevertheless, public debt refinancing should prospectively become less affordable, even though we expect the ECB to take a cautious approach in tightening monetary policy going forward. The yield on 10y government bonds has climbed to 1.465% as of 13 May-22 (weekly quote), constituting the highest level since August 2014. According to estimates by BdF, a one percentage point rise in interest rates would correspond to additional interest outlays of roughly EUR 40bn each year.

In light of the significantly heightened uncertainty, the ECB is likely to maintain a high degree of flexibility at this stage. As announced, the PEPP was terminated at the end of Mar-22. Cumulative net purchases of French government bonds under this program amounted to approximately EUR 302.3bn (12.2% of 2021 GDP) by that time, while under the PSPP the ECB had accumulated net purchases to the tune of EUR 528.08bn as of Apr-22 (21.3% of 2021 GDP).

While the tapering of the monthly net asset purchases (APP) looks likely to be concluded in this year's third quarter, the Governing Council also signaled readiness to delay such a decision if deemed necessary. However, a first rate hike in Q3-22 rather than towards the end of the year seems more likely currently, although we acknowledge that the probability of this happening is heavily dependent on the events around the war Ukraine.

Foreign Exposure

In the absence of any major imbalances, and notwithstanding an increasingly negative net international investment position (NIIP) of late, we deem risks pertaining to France's external position as limited. The current account deficit narrowed last year following its expansion in the first year of the pandemic, in light of a gradual normalization of temporary factors related to the corona crisis, but may remain subject to higher volatility due to the fallout from the war in Eastern Europe.

After a temporary widening to 1.9% of GDP in 2020 due to the pandemic, France's current account deficit shrank to 0.6% of GDP last year, broadly in line with the average deficit over the period 2010-2019 (0.7% of GDP). The main driver for normalization was a widening surplus in

the service balance, as service exports including tourism saw some recovery. The deficit in the goods balance was broadly stable compared to the preceding year (2021: -2.7% of GDP), remaining somewhat more pronounced than its average 2010-19. As of Q1-22, the current account position was reported to have displayed a deficit of 0.8% of GDP (BdF), measured as a four-quarter cumulated sum.

Looking ahead, we do not expect any major trend changes as regards the current account balance over the next few years. In the near term, apart from potentially resurfacing volatility owing to pandemic-related developments, the current account deficit may grow larger on account of higher commodity prices related to the war in Ukraine, as well as some supply shortages intensified by pandemic restrictions in China. If the economy's competitive stance can be strengthened over the coming years, as is aimed for, this should help to moderate the negative external balance.

France's negative NIIP continued to widen last year, expanding by 4.3 p.p. to -34.5% of GDP, driven by a smaller positive net direct investment position and a more pronounced negative position regarding other investment. The former seems to be primarily a result of rebounding inflow of direct investment last year. While we would flag some vulnerabilities related to external debt being dominated by the government and the financial sector, we assess overall external risks as limited, as they remain mitigated by a large volume of foreign assets and relatively low external funding costs.

Rating Outlook and Sensitivity

Our rating outlook for the French Republic's long-term credit ratings is negative. While risks related to the corona pandemic seem to abate, and acknowledging a relatively strong economic rebound as well as continued labor market improvements, uncertainty over the geopolitical situation and related economic consequences in light of Russia's aggression against Ukraine is very high, highlighting challenges to sustainably bringing down the elevated debt ratio under these circumstances. Adding to this, there is uncertainty over the ability to implement envisaged economic policies and reform initiatives depending on the composition of the political legislative after the upcoming election.

A positive rating action could be triggered if the French economy proves largely resilient to the current geopolitical woes, possibly backed by progressing implementation of the RRP measures, thus strengthening underlying growth prospects. Convincing signs of a likely sustainable fall in the public debt ratio could also lead to an upgrade of the rating and/or outlook. Resuming reform momentum, including pension reform and working towards enhanced governance of public finances, would also seem beneficial.

By contrast, a downgrade could be considered if, contrary to what we expect, the sovereign's debt-to-GDP ratio trends upward. This could be the case if GDP growth remains well behind our projections and any efforts to restrain public spending over the medium term fail. Further delay of a pension reform convincingly improving prospects for fiscal costs could contribute to such a scenario. We could also consider lowering our ratings if medium-term growth weakens substantially, possibly as the implementation of measures and reform initiatives as per RRP and France 2030 falls significantly short of expectations

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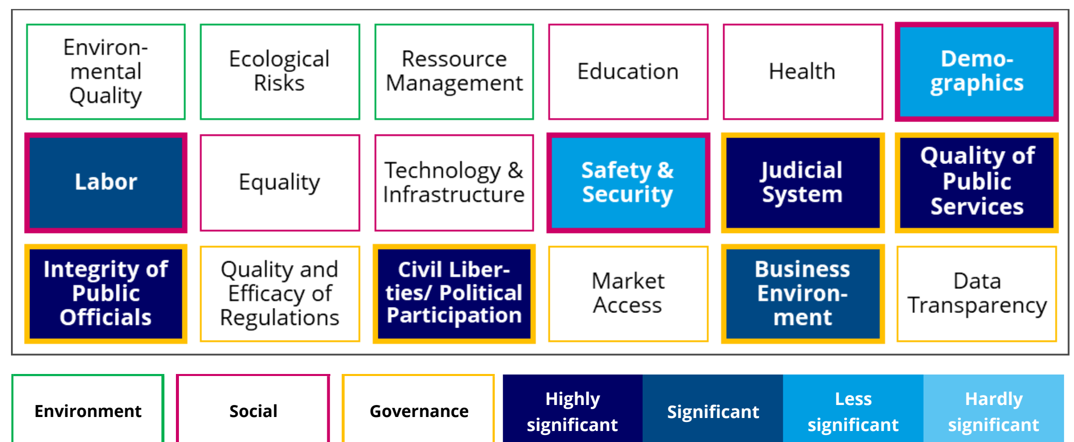
Ratings*

Long-term sovereign rating	AA /negative
Foreign currency senior unsecured long-term debt	AA /negative
Local currency senior unsecured long-term debt	AA /negative

*) Unsolicited

ESG Factors

ESG Factor Box



Creditreform Rating has signed the ESG in credit risk and ratings statement formulated within the framework of the UN Principles for Responsible Investment (UN PRI). The rating agency is thus committed to taking environmental and social factors as well as aspects of corporate governance into account in a targeted manner when assessing creditworthiness.

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In what follows, we explain how and to which degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the competitive stance of the sovereign, e.g. the World Bank's, the World Economic Forum's, and the OECD's assessments of the business environment, add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Labor market metrics constitute crucial goalposts in Creditreform Rating's considerations on macroeconomic performance of the sovereign, and we regard the ESG factor 'Labor' as significant to the credit rating or adjustments thereof. Indicators or projections providing insight into likely demographic developments and related cost represent a social component affecting our rating or adjustments thereof. Hence, we regard the ESG factor 'Demographics' as less significant in our ESG framework. What is more, cases of relatively frequent and/or broad based social protest in response to government policies would touch upon the social dimension as well, which is reflected among other things by the WGI "Political Stability", and would ultimately affect fiscal performance, so that we regard the ESG factor 'Safety and Security' as less significant.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2016	2017	2018	2019	2020	2021e	2022e
Macroeconomic Performance							
Real GDP growth	1.1	2.3	1.9	1.8	-7.9	7.0	2.9
GDP per capita (PPP, USD)	44,422	46,370	48,198	49,769	46,213	51,364	56,036
Credit to the private sector/GDP	107.6	109.0	112.2	114.9	131.2	126.3	n/a
Unemployment rate	10.1	9.4	9.0	8.4	8.0	7.9	n/a
Unit labor costs (index 2019=100)	100.1	100.4	100.3	98.3	100.0	n/a	n/a
World Competitiveness Ranking (rank)	32.0	31.0	28.0	31.0	32.0	29.0	n/a
Life expectancy at birth (years)	82.7	82.7	82.8	83.0	82.3	82.5	n/a
Institutional Structure							
WGI Rule of Law (score)	1.4	1.4	1.4	1.4	1.3	n/a	n/a
WGI Control of Corruption (score)	1.4	1.3	1.3	1.3	1.2	n/a	n/a
WGI Voice and Accountability (score)	1.1	1.2	1.1	1.1	1.1	n/a	n/a
WGI Government Effectiveness (score)	1.4	1.3	1.5	1.4	1.2	n/a	n/a
HICP inflation rate, y-o-y change	0.3	1.2	2.1	1.3	0.5	2.1	4.8
GHG emissions (tons of CO2 equivalent p.c.)	7.1	7.2	6.9	6.7	n/a	n/a	n/a
Default history (years since default)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Fiscal Sustainability							
Fiscal balance/GDP	-3.6	-3.0	-2.3	-3.1	-8.9	-6.5	-5.2
General government gross debt/GDP	98.0	98.1	97.8	97.4	114.6	112.9	112.4
Interest/revenue	3.5	3.2	3.2	2.8	2.4	2.6	n/a
Debt/revenue	184.7	183.3	183.3	186.3	218.3	214.0	n/a
Total residual maturity of debt securities (years)	6.9	7.3	7.4	7.6	7.7	8.1	n/a
Foreign exposure							
Current account balance/GDP	-0.5	-0.8	-0.8	-0.3	-1.9	-0.6	n/a
International reserves/imports	0.3	0.3	0.2	0.3	0.4	0.4	n/a
NIIP/GDP	-13.0	-20.1	-19.3	-25.3	-30.2	-34.5	n/a
External debt/GDP	211.8	210.2	221.8	234.0	261.7	257.8	n/a

Source: IMF, World Bank, Eurostat, AMECO, ECB, INSEE, IMD Business School, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	26.08.2016	AA- /stable
Monitoring	28.07.2017	AA- /positive
Monitoring	01.06.2018	AA /stable
Monitoring	05.06.2019	AA /stable
Monitoring	29.05.2020	AA /negative
Monitoring	27.11.2020	AA /negative
Monitoring	21.05.2021	AA /negative
Monitoring	20.05.2022	AA /negative

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. Agence France Tresor (AFT) participated in the credit rating process as the authorities provided additional data and information, held a conference call with Creditreform Rating staff, and commented on a draft version of the report. Thus, this report represents an updated version, which was augmented in response to the factual remarks of AFT during their review. However, the rating outcome as well as the related outlook remained unchanged.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	YES
With Access to Management	YES

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Bank for International Settlement, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, European Investment Bank, Blavatnik School of Government, ECDC, International Institute for Management Development, Banque de France, Agence France Trésor, INSEE, Ministère de l'Économie et des Finances, DARES.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG's "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as “initial rating”; other updates are indicated as an “update”, “upgrade or downgrade”, “not rated”, “affirmed”, “selective default” or “default”.

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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