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 21-04-2023 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating Action

Neuss, 21 April 2023

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. Wealthy and very large economy featuring a high level of productivity; labor market developments have remained favorable, with some added resilience on the back of previous reforms; somewhat abating adverse effects of the energy price shock are likely to give way to increasingly dampening effects of tighter monetary policy on GDP growth over the coming months, constraining generally more positive expectations for 2024 in the absence of further escalation of geopolitical tensions, following likely subdued growth this year
2. The medium-term growth outlook remains supported by roll-out of measures under the Recovery and Resilience Plan (RRP) and France 2030, which should strengthen France's potential growth, including extensive investment and initiatives to drive the green and digital transformation, further tackle labor market rigidities and enhance competitiveness
3. Exceptionally strong institutional framework including advantages associated with EU/EMU membership, as also corroborated by the World Bank's Worldwide Governance Indicators; due to the government's lack of an outright parliamentary majority following last year's elections, we see increased challenges to timely implementation of the ambitious reform agenda and risks of prolonged phases of social discord; notwithstanding a challenging political process, the landmark pension reform was eventually adopted this April
4. Fiscal metrics unlikely to see a clear downward trend, underscoring the sovereign's main credit weakness; we expect debt-to-GDP to hover close to current elevated levels in the short-to-medium term, given ongoing energy support measures and an expected dampening impact of monetary policy tightening on economic activity going forward, with uncertainty over the pace of reform implementation adding to this; fiscal risks remain mitigated to an extent by sound debt management and still favorable debt affordability, despite conditions becoming less benign; the outlook regarding age-related costs could brighten in light of the pension reform

5. Risks related to external exposure continue to be limited, with the negative net international investment position not excessive and decreasing somewhat of late, while the currently more pronounced current account deficit should move slightly towards a more balanced position over the medium term

Reasons for the Rating Decision and Latest Developments[1]

Macroeconomic Performance

We view the sovereign's very high creditworthiness as buttressed by its generally strong macroeconomic profile, featuring a wealthy and large-sized economy which boasts a high level of productivity. Moreover, the sovereign benefits from a well-diversified service sector, adding to underlying economic resilience. Supported by swift and extensive government support, the economy saw comparatively strong recovery following the pandemic, and economic growth has continued despite the energy price shock as a consequence of Russia's military attack on Ukraine. Whilst direct trade exposure to Russia and Ukraine is limited, in particular in terms of energy import dependency, the adverse economic consequences of the war in Ukraine continue to pose downside risks to near-term growth. Medium-term growth prospects remain generally supported by planned investment to drive the twin transition, boost human capital and enhance labor market inclusion, while a comparatively high level of non-financial corporate debt in the European context entails pockets of vulnerability given the aggressive monetary policy tightening cycle. The pension reform, in our view, represents a meaningful step toward improving the longer-term economic outlook, if any watering-down can be avoided going forward.

Following its strong rebound in 2021 amid the easing of pandemic restrictions, France's economy continued to grow robustly last year, recording an increase of 2.6%, with private consumption representing the strongest contributor (1.5 p.p.). Investment and government consumption contributed positively as well, whereas net exports posed a drag on GDP growth, notwithstanding vividly expanding French exports (7.0%, 2021: 8.8%, Eurostat data).

While the negative repercussions of Russia's attack on Ukraine left their mark on economic activity over the course of 2022, the French economy should have avoided a technical recession in the winter season 2022/2023, with the quarter-on-quarter growth rate in Q1-23 likely having remained at the 0.1% pace registered in Q4-22. Regarding the current quarter, high-frequency indicators give a somewhat mixed picture. While new orders and export expectations softened in Q1-23, the Economic Sentiment Indicator compiled by the European Commission (EC) moved to a somewhat higher level in the first two months of 2023, mainly driven by the improving climate in the service and retail sectors, whereas the business climate in the construction sector cooled somewhat.

Strike action in various industries over recent weeks, partly due to higher wage demands and expressed social discontent over the government's pension reform, which caused some disruption, adds to expectations of rather sluggish economic performance in the first half of the current year. Given that a dry winter season added to upward pressure on prices, private consumption looks set to remain burdened by high consumer prices, although government measures to

[1] This rating update takes into account information available until 20 April 2023.

cushion the adverse effects from the energy price shock should pose some counterweight. In fact, France's 2022 annual average inflation rate (HICP) was the lowest in the EU, continuing to remain well below double-digit territory over recent months. Mitigating measures by the government, including the price shield, are estimated to amount to about EUR 110bn over the years 2021-2023. This notwithstanding, consumer confidence remains rather dampened.

Energy prices have decreased lately, bringing some relief, but food inflation is likely to be more persistent in the first half of the current year, potentially boosted by prices paid by large retailers to major food brands. That said, nominal wages are likely to continue to see strong increases, although real wage growth should be rather modest. In 2022, the annual average of year-on-year base wage increases was 6.4% (excluding agricultural sector, Dares data).

The labor market has proved resilient, with employment continuing to rise and unemployment stable at a low level. That said, at an average 7.3% in 2022, France's unemployment rate remained above the level recorded for the euro area (EA) as a whole (6.7%, LFS-adj.). Looking at monthly data, French unemployment has stabilized at about 7.1% over recent months.

Having trailed the euro area in terms of job creation in the phase prior to the pandemic, France registered a more moderate decline in employment at the most acute phase, partly thanks to extensive support measures, and posted stronger increases both in 2021 and 2022 (2.5% and 2.4% vs. EA: 1.4% and 2.2%). The 2017 labor market reforms concerning unemployment insurance, tax policies for low earners and ultimately permanent cuts in social security contributions have exerted positive effects as well. Following a dip during the pandemic, the participation rate has climbed to a multi-annual high at 73.7% as of Q4-22. At 2.4% as of Q4-22, the vacancy rate stands at a relatively elevated level by domestic standards, and according to recent business surveys (EC), labor shortages as a factor limiting production remain pronounced.

Looking at further structural characteristics, France continues to display by and large average performance in the EC's Social Scoreboard, with a rather mixed picture in the category 'social protection and inclusion'. The latter ties in with a comparatively low employment rate of persons with lower educational attainment (2021: 38.0% vs. 45.7% in the EA, ISCED levels 0-2, Eurostat data). While the participation rate of elderly workers in the age cohort 55-64 years was increased by roughly 10 p.p. from 2013 to 2022 (2022: 60.3%, Eurostat data), it only moves in the lower middle-range among the EU members (EU 2022: 65.5%). Youth unemployment dropped further, to 17.3% in 2022 (15-24y, EA: 14.6%), whilst remaining above the euro area level, and the percentage of overall long-term unemployment (15-74y) counts among the lower figures in the euro area (2022: 27.4%, EA: 39.7%).

Prospects for investment appear less favorable against a backdrop of tighter financing conditions, higher costs and ongoing shortages of materials, although supply bottlenecks have eased somewhat, not least as China has lifted Covid-19 restrictions. Construction investment seems set to post a decline this year in light of the described challenges. However, gross fixed capital formation should generally remain supported by investment related to the ongoing green and digital transformations. We recall that the 'France Relance' plan comes with EUR 100bn, of which EUR 39.4bn is to be financed via the EU's Recovery and Resilience Facility (RRF). The long-term investment strategy 'France 2030' is endowed with an additional EUR 34bn. Of the RRF grants, France has so far received a first payment of EUR 7.4bn, apart from EUR 5.1bn in pre-financing in 2021.

The outlook for exports has brightened in light of China's eased coronavirus policies, likely giving way to some acceleration of global GDP growth and thus external demand, while the US economy may expand more moderately. Tourism continues to recover, with the export of travel services having risen by 64.3% in 2022. That said, the number of non-resident arrivals in hotels remained about 12% below pre-pandemic levels in 2022 (vs. 2019, INSEE data). Other key export services also posted significant increases in 2022, with the 'other business services' category registering a plus of 7.9% last year, while transport (+38.3%) also benefited from higher prices. Exports of telecom and financial services recorded double-digit percentage increases as well. Notwithstanding some cooling of export expectations in the current year's first quarter (EC survey), we expect French exports to continue to increase, although net exports may still pose a drag on GDP growth this year.

At this stage, we expect France's real GDP to expand by a modest 0.6% in 2023, carried by moderate growth in domestic demand. For 2024, we expect an acceleration to 1.5%, supported by some easing of adverse effects from the war in Ukraine, while government measures are likely to be curtailed, and dampening effects from monetary policy tightening should be more pronounced. The level of uncertainty around current forecasts remains rather high, and is currently exacerbated by substantial noise and strike action around the pension reform, although the effects of this on economic growth over the full year 2023 should be limited.

We generally deem the medium-term growth outlook to be constructive, bolstered by the abovementioned investment plans and underlying strength and resilience of the French economy, which encountered the recent energy shock from a considerably lower level of dependency on energy imports from Russia than other EU peers, given an energy mix more reliant on nuclear energy. In this context, we note that France is to build six new nuclear reactors by 2035.

Key deliverables from the RRP concerning the current year include continuation of building renovation, investment in railway infrastructure, additional buildings connected to fiber, and R&D projects on low carbon aircraft. In a second evaluation report on the France relance plan by France Strategie (Dec-22), operational objectives, e.g., relating to energy renovation projects and ecological bonuses for purchases of electric cars, are broadly seen as close to being achieved, and there are hints that the '1 young person, 1 solution' offer to bring young people into work or training is seeing a good turnout, while challenges in other areas remain. Drawing on the Draft Budgetary Plan 2023 (DBP23), since its launch in 2021, France 2030 commitments of EUR 7.5bn were made between 1 January and 1 September 2022.

We believe that the medium-term outlook is also supported by reform steps taken prior to the pandemic to enhance economic competitiveness, among them a reduction in production taxes, and steps taken to address rigidities in the labor market. After having to deal with the successive shocks presented by the pandemic and Russia's war in Ukraine, we assess resuming reform efforts to tackle long-standing challenges such as the pension reform as positive, not only from a perspective of fiscal sustainability (see below), but also in terms of underlying growth.

Key elements of the reform were greenlighted by the Constitutional Court very recently. Apart from lifting the legal retirement age in stages to 64 years by 2030 and raising the minimum contribution period for full pension in stages to 43 years by 2027, the reform also abolishes main special pension regimes for future hires, beginning with Sep-23, affiliating new recruits to the general pension scheme. At the same time, compensatory measures, such as lifting full-career minimum pensions, are to be implemented. If the reform is, as envisaged, implemented by the end of this year, longer-term growth prospects would appear markedly improved. Potential output could be lifted by about 1.1% by 2035 (Oxford Economics).

Generally, we view France's creditworthiness as underpinned by the large size of its economy, constituting the seventh-largest in the world at approximately USD 2,784bn (2022, IMF data). Its position as a strong innovator is underscored by the 2022 European Innovation Scoreboard, and, on the global level, by the broader-based Global Innovation Index provided by the World Intellectual Property Organization. With regard to the latter, France climbed to rank 12 out of 132 countries considered in 2022 (2019: rank 16). Its potential growth is estimated to be at 1.1% in 2023 and 2024 (AMECO data), and is thought to have held up better than - and remained above - estimates for other major economies such as Germany, Italy and the UK since the outbreak of the pandemic.

Headwinds regarding the medium-term growth outlook continue to relate to challenges concerning lackluster productivity growth, whereas the productivity level is relatively high. The average annual increase in real labor productivity per hour over the ten years to 2022 was at 0.4% versus 0.7% for the euro area as a whole and 0.8% in Germany. The European Commission's Digital Economy and Society Index (DESI) presents France as moving in the middle range (2022: rank 12) among the EU members, pointing to room to catch up with perceived frontrunners and possible potential to step up productivity growth.

Similarly, some qualitative indicators on the business environment and (non-cost) competitiveness measures suggest there remains scope to improve further. France occupies only a middle-range position among EU members regarding the 2022 Global Competitiveness Index compiled by IMD Business School (rank 28/63 countries), held back by government and business efficiency. Apart from that, regulatory restrictiveness of professional services, which partly weighs on competition, have been long-standing issues, and in the 2023 OECD Services Trade Restrictiveness Index, France remains below the OECD average in this respect.

Looking at France's cost competitiveness, most recent unit labor cost developments (2022 vs 2021) seem to have been somewhat less favorable compared to the euro area as a whole and those of its main European trade partners, while comparisons over a five-year period point to a more favorable picture. The sovereign's global export market share remained below pre-pandemic levels in 2021, standing at 3.33%, with the share in goods exports dropping to 2.85%, whereas the share in service exports climbed to 5.11%, the highest since 2016 (Eurostat data).

We continue to monitor French non-financial corporate debt, which continues to be relatively high from a European angle, and generally exposes some vulnerabilities given the ongoing monetary policy tightening cycle. As of Q3-22, NFC debt-to-GDP stood at 97.4% of GDP (ECB data), with the ratio remaining somewhat above pre-pandemic levels despite having decreased somewhat. While the repayment capacities of companies seem supported by comparatively favorable levels of profitability, cash reserves declined recently (Banque de France, BdF, Dec-22). Private household debt measured against disposable income may be about to stabilize, having continued to rise throughout the pandemic. As of Q3-22, the respective ratio stood at 103.9%, moving amid EU economies exhibiting more elevated private indebtedness.

Institutional Structure

France's exceptionally strong institutional framework, including substantial advantages associated with the deep integration into the EU and the euro area, as well as the sovereign's ability to shape *relevant policies, constitutes a vital pillar of its credit rating. Following stalling reform momentum during the acute phases of the pandemic, and the economic shock caused by Russia's war in Ukraine, the ambitious reform agenda, in particular pension reform, was resumed. However, the fact that president Macron's political alliance no longer holds a majority in the National Assembly following the elections in June 2022 complicates policymaking, in our view, with the controversial pension reform the most recent case in point. The reform was pushed through by the government's activating article 49, paragraph 3, of the constitution, allowing it to adopt the reform bill without a final vote by the parliament, albeit at the cost of two no-confidence votes initiated by opposition parties, which the government won, and of expressed discontent among parts of society.*

We view France's high-quality institutional set-up as being underpinned by the World Bank's Worldwide Governance Indicators (WGIs), with the sovereign's relative rankings comparing favorably against the median rank of the euro area members and moving close to the median rank of our AA-rated sovereigns with regard to the four dimensions we consider particularly relevant to our assessment of a sovereign's creditworthiness. When it comes to 'voice and accountability', we would highlight a notable improvement compared to the preceding few years (reference year 2021: rank 26, 2020: rank 37), which seems to tie in with findings in the EC's Rule of Law report.

Perception of the extent to which public power is exercised for private gain ('control of corruption') has improved following some deterioration in 2020, leaving France occupying rank 28 out of 209 economies considered (euro area median: 45). Perceived performance in terms of 'government effectiveness' and 'rule of law' has remained relatively stable compared to the preceding year, mirrored by ranks of 30 (2020: rank 29) and 27 (2020: rank 26), and moving roughly in line with the respective median ranks of our AA-rated sovereigns.

As mentioned above, in the June 2022 election of the National Assembly, president Macron's political alliance ('Ensemble') fell 44 seats short of an outright majority, obtaining 245 of the 577 seats, with both the political left and the political far right seeing gains. More controversial reforms may thus take more time to make their way through parliament, possibly undergoing more changes in this process. We thus see higher risks for the president's reform agenda being watered down at this stage. Policymaking appears considerably more challenging under these circumstances, with potentially adverse repercussions to social cohesion.

Against this background, we note that France's rank of 93 in 2021 on the WGI 'political stability' constituted the weakest among our AA-rated sovereigns (median rank AAs: 64) and the second weakest among the euro area members (median rank: 64), whilst having maintained a stable rank among all economies considered over the last few years. Hence, we will continue to monitor developments around potentially resurfacing social unrest.

On a more positive note, and illustrating ongoing efforts to further improve France's very strong institutional framework, France's National anti-corruption plan 2020-22, developed by the French Anti-Corruption Agency (AFA), continued to be implemented, as also highlighted by the EC's Rule of Law report (Jul-22). More recently, AFA, in collaboration with the National Financial Prosecutor's Office (PRF), published a guide on internal anti-corruption investigations for companies (Mar-23).

As regards application of the regulation of lobbying, a law on enhanced whistleblower protection came into force in September 2022, offering clearer definitions, as well as more effective reporting mechanisms and protection of whistleblowers. Apart from this, an independent authority (ARCOM) with increased powers over the field of audiovisual and digital content was established at the beginning of 2022, resulting from a merger of two entities entrusted with these matters.

Further corroborating the very high quality of the sovereign's institutional set-up, the Financial Action Task Force on Money Laundering's (FATF) latest evaluation (May-22) pays testament to France's effective systems regarding anti-money laundering and countering the financing of terrorism, including robust and sophisticated respective legal frameworks.

Apart from the pension reform elaborated above, the government remains committed to implementing measures and initiatives as set out in the France Relance and the France 2030 strategies. In addition to educational matters, major projects to be launched and/or legislation to be reviewed in 2023 include the Defense Planning Act, immigration legislation, and measures to achieve full employment. On top of funding attributed via France Relance and France 2030 for higher education and research, the Research Planning Act 2021-2030 comes with investment of EUR 25bn over ten years in order to strengthen innovation potential.

The green and energy transitions remain a priority for government action, to be driven by the National Low-Carbon Strategy (SNBC) and the Multiannual Energy Plan (PPE). Besides investment to develop small modular nuclear reactors, the France 2030 plan also provides investment to boost France's hydrogen strategy, further underscoring commitment to fostering low-carbon strategies whilst strengthening energy security. The previous target of a minimum 40% reduction in gross greenhouse gas emissions by 2030 compared to 1990 levels is to be raised with regard to the upcoming Energy and Climate Planning Act, envisaged to be enacted by 1 July 2023, in order to match EU level goals of a 50% reduction. Greenhouse gas emissions per head stood at 5.9 tons of CO_2 equivalent in 2020, comparing favorably against the EU overall (2020: 7.5 tons, Eurostat).

With regard to overall shares of energy from renewable sources in the EU, France was close to the EU average in 2021 (EU: 21.8%), with the respective share having continued to climb, reaching 19.3%. Regarding renewables used for gross electricity consumption, the gap towards the EU is more pronounced, with France exhibiting a share of 25% of renewables for this purpose in 2021, versus 37.5% for the EU overall. That said, when it comes to ecological innovation capabilities, France remains close to frontrunners among the EU countries, ranking 7th with regard to the EC's 2022 eco innovation index.

Fiscal Sustainability

Risks to fiscal sustainability remain the sovereign's main credit weakness in our assessment, partly reflected by fiscal slippages in the pre-pandemic past. In our view, a return to the already elevated pre-pandemic debt level measured against GDP remains a distant prospect at this stage, given extensive fiscal support to deal with the quick succession of global shocks. Instead, we expect the public debt ratio to hover around current levels over the medium term, with the headline deficit assumed to decrease only gradually over the coming few years. The pension reform, if fully implemented as envisaged, should have a positive impact on the longer-term fiscal outlook through expected longer working lives and lower age-related costs. However, due to the increased degree of political fragmentation in France and the resulting challenges to effective policymaking, we think that uncertainty *around the medium-and-longer-term fiscal outlook remains pronounced. Very sound debt management and a still high level of debt affordability – albeit prospectively less favorable – are key factors mitigating fiscal risks.*

France's headline deficit has continued to shrink since the acute phase of the pandemic, coming in at 4.7% of GDP in 2022 (2021: 6.5% of GDP, preliminary results, INSEE data), lower than we had assumed in our last review (May-22: -5.2% of GDP). While awaiting the breakdown for the full year 2022, quarterly data available until Q3-22 suggest that general government expenditure increased to a lesser extent than in the preceding year, partly due to lower subsidies and transfers as pandemic support was cut back, whereas public wages and interest payments likely saw stronger increases. Taking into account Q1-Q3 2022 compared to the respective period in 2021, total revenue was on course to record a stronger outturn, boosted by further rising tax revenue and social contributions.

After a second supplementary budget for 2022, uncertainty over public finances in 2023 remains high, with the amendment to the social security financing bill for the year 2023 presented this January, concerning the pension reform, a case in point. That said, according to the High Council of Public Finance (HCFP), the reform project would come with a net cost of about EUR 0.4bn in 2023, thus a relatively small immediate effect.

Further uncertainty continues to relate to government support measures to cushion high energy costs, not least as these partly depend on actual market prices for energy in light of the government's cap on gas and electricity prices to shield the private sector from excessive burden. In its DBP23, the government estimated the energy-related support to households and companies, including early increase in pensions and social benefits, to come at a cost of approximately EUR 49.5bn for the year 2023, which would correspond to roughly 1.8% of our estimated GDP in 2023. Measures related to France Relance are estimated to cost around EUR 4.8bn net of EU financing this year.

At this stage, we would tentatively pencil in a headline deficit of about 5.2% of GDP for the current year, also in light of the expected slowdown in GDP growth compared to last year. In 2024, amid some acceleration of economic activity, we expect the deficit to come in slightly lower, at about 4.9% of GDP. With regard to the medium-term, we note that the government aims to reduce the deficit to below 3% of GDP in 2027. While the government expresses its commitment to gradual fiscal consolidation over the coming few years, suggested efforts to restrain expenditure appear somewhat vague, as also the HCFP highlights, and might prove challenging against a backdrop of the abovementioned fragmented political landscape. In addition, we take note of HCFP's assessment that objectives as set out in recent successive multiannual programming laws have rarely been achieved.

Prior to the pension reform, the government chose to use the constitutional clause 49.3 to be able to adopt parts of its 2023 budget bill due to failure to reach a majority in the National Assembly (see above). The public finance programming bill 2023-2027 had been rejected by this chamber. We reiterate that an organic law on the modernization of public finances management has been in force since last year, and we gather that ministries are requested to put forward proposals entailing 5% spending cuts.

Given our estimates for nominal GDP growth and the expected very gradual pace of fiscal consolidation, general government debt measured against GDP looks unlikely to pursue a downward path over the medium term. Following a decrease of the debt-to-GDP ratio to 112.9% in

2021 on the heels of a spike to 114.6% in 2020, the ratio dwindled to 111.6% of GDP last year (INSEE data). We expect public debt to remain close to this level in 2023 and 2024 (111.9% of GDP and 112.4% of GDP, respectively), highlighting that France's general government debt is thus likely to remain the highest among our AA-rated sovereigns. That said, we take note that, in its upcoming Stability Program 2023, the government expresses the expectation to reduce the public debt ratio to 108.3% of GDP in 2027, as compared to 112.5% of GDP envisaged in the 2022 Stability Program.

In terms of contingent liabilities, the uptake of Covid-19-related guarantees came to 5.8% of 2021 GDP (DBP23), out of a maximum of 12.2% of 2021 GDP. We will continue to monitor the development of public guarantees vigilantly, since overall public guarantees were reported as amounting to an elevated level of 12.8% of 2021 GDP. Moreover, we take note of the government increasing its stake held in the energy company EDF, which came to 95.94% of voting rights as of 28-Feb-23, as per EDF (company information), in a bid to fully nationalize the company, adding to contingent risks.

Contingent liability risks relating to France's large banking sector appear limited, given the sector's continued resilience in light of the recent shocks and with direct exposure to Russia and Ukraine not a major point of concern. Banks' asset quality and capital buffers point to a sound situation of the sector as a whole, with the NPL ratio at a relatively low 1.9% and the CET1 ratio standing at 15.4% as of Q4-22 (EBA data), each broadly in line with the EU-level (Q4-22: 1.8% and 15.5%, respectively). Return on assets as an indicator of profitability continued to remain slightly below the EU over 2022, having held up better over the acute pandemic phase. With regard to recent market tensions on the back of perceived deficiencies of US and Swiss financial institutions, BdF additionally points to comfortable liquidity ratios and a relatively high share of cash (56%) regarding high-quality liquid assets.

The ECB raised its main policy rates by a further 50 basis points in March 2023. From their current level of 3.75%, 3.50% and 3.00% (marginal lending facility, main refinancing rate, deposit rate), we still expect the ECB to raise its policy rates by an additional 50bp, presumably in two 25bp steps, by the end of the current year. However, uncertainty around these expectations has arguably become more pronounced in view of the abovementioned market tensions.

For the time being, the ECB will continue to reinvest the principal payments from maturing securities purchased under the Pandemic Emergency Purchase Program (PEPP) until at least the end of 2024, whereas a gradual wind-down of the Asset Purchase Program portfolio began in March 2023, with an initial monthly portfolio reduction of EUR 15bn until June 2023. The subsequent pace of the reduction will be determined over time.

In light of the ongoing monetary policy tightening cycle, more aggressive than initially assumed, and the elevated level of NFC debt, increased credit risks from potentially vulnerable enterprises may have to be monitored. While the annual increase in outstanding loans to NFCs has decelerated slightly since the middle of last year, it posted at a relatively dynamic 6.5% in Feb-23 (Feb-22: 3.6%). Macroprudential policies have been stepped up to counter such risks, including the decisions to raise the countercyclical capital buffer to 0.5% with effect from Apr-23 and to 1.0% with effect from Jan-24, flanked by a limit, at least temporarily, to the exposure of systemically important banks to the most heavily indebted major companies, and strengthened lending standards as regards home loans to private households.

Apart from this, banks tightened their credit standards in net terms for loans to enterprises and for loans to private households, including housing loans, in Q4-22, according to the latest ECB Bank Lending Survey (Jan-23). Moreover, a preference for fixed-rate financing mitigates interest rate risks to some extent, as 66% of outstanding NFC loans were subject to fixed interest rates as of Sep-22, with 44% displaying a residual maturity of over five years (BdF intelligence). Reflecting a reported decrease of demand by private households for housing loans, the annual increase in outstanding mortgage loans to households slowed to 4.3% in Feb-23 (Feb-22: 6.3%, ECB data), continuing a downward trend. House prices have started to moderate as well, as suggested by a somewhat slower annual increase of 4.9% in Q4-22 (Q4-21: 6.9%, Eurostat data).

We continue to view risks to fiscal sustainability as mitigated to some extent by persistently very sound debt management, the sovereign's large institutional investor base, the long maturity profile of its debt portfolio, as well as modest levels of foreign currency debt. The weighted average maturity of negotiable outstanding debt stood at 8y and 189 days at the end of Feb-23 (AFT data), smoothing refinancing risks. While debt affordability is still comparatively high, interest payments saw a second considerable increase last year, having mounted by 47.5% in the first three quarters of 2022, as compared to the same period a year before, and following an increase of 17.3% in the full year 2021. From 1.4% of GDP, interest payments may have increased to roughly 1.8% of GDP in 2022. The yield on 10-year French government bonds rose to about 2.8% at the end of Mar-23 (weekly quote), having climbed by about 180 basis points compared to the end of Mar-22.

On the back of the pension reform, which should improve prospects for age-related costs that are among the highest in Europe (2021 Ageing report). With regard to the pension system balance, French authorities point out that the gross gain is estimated to come to EUR 10.3bn in 2027 and EUR 17.7bn in 2030. The expected increase in activity is assumed to improve the general government balance by an additional EUR 9bn in 2027 and EUR 15bn in 2030. Oxford Economics suggests that the reform in its current version could have a lowering effect on the public debt ratio to the tune of 3.5 p.p. by 2035.

Foreign Exposure

We assess risks pertaining to the sovereign's external position as limited. Following its temporary increase over the pandemic phase, the negative net international investment position (NIIP) has returned to levels prior to the pandemic. While the pandemic effects are fading, the current account balance is currently impacted to a large extent by the energy price shocks linked to the war in Ukraine and related repercussions on terms of trade and foreign demand. Over the medium term, we expect the recently more pronounced current account deficit to narrow, as the adverse effects from the recent succession of shocks should dissipate.

France's current account balance fell back into negative territory last year. At -2.1% of GDP, the deficit stood well above its average deficit recorded over the ten years to 2021 (-0.6% of GDP) and followed a small surplus of 0.4% in 2021. Last year's net position was dragged down by a larger goods deficit (-5.2% of GDP) in light of higher energy costs and slower foreign demand, and compounded by France - likely temporarily - becoming a net importer of electricity last year. The service balance, on the other hand, posted a further increased surplus in 2022, which, however, was far from offsetting the negative effect exerted by the larger goods deficit. At 1.8% of GDP, the surplus in trade in services was the highest on Eurostat records.

Going forward, we assume further progress in adjusting to the shock presented by the war in Ukraine, both with regard to France and its main trading partners, which we think will cause France's current account deficit to decrease. Successfully strengthening its competitive stance, as currently assumed in our baseline scenario, could add to this.

The sovereign's negative NIIP, which had increased to -32.1% of GDP in 2021, dwindled to -26.2% of GDP at the end of 2022, moving closer to levels registered before the outbreak of the pandemic. This position remains characterized by underlying large gross positions both regarding assets and liabilities, in particular regarding portfolio investment. In the event that competitiveness should improve, net direct investment (2022: 17.3% of GDP) may display a less positive position over the medium term.

Rating Outlook and Sensitivity

Our rating outlook for the French Republic's long-term credit ratings is negative. While macroeconomic risks related to the war in Ukraine appear manageable, acknowledging unpredictability of any further escalation of geopolitical tensions, extended government support highlights ongoing challenges to sustainably bringing down the elevated debt ratio. Adding to fiscal sustainability risks in our view, the ability to implement envisaged economic policies and reform initiatives seems subject to increased challenges due to a more fragmented parliament following the elections in 2022.

We could consider an upgrade of the rating and/or outlook if France's medium-term economic growth comes in stronger than expected, possibly flanked by progressing implementation of the RRP measures and further reform initiatives strengthening underlying growth prospects and the medium-term outlook. Ongoing reform momentum, despite the challenging current political constellation, would seem beneficial. Convincing signs of a sustainable fall in the public debt ratio could also trigger a positive rating action, with a timely and full implementation of the pension reform strengthening prospects for this to happen.

A negative rating action could be prompted if the sovereign's debt-to-GDP ratio continues to trend upward unabatedly, in contrast to our assumptions, possibly amid macroeconomic developments falling substantially short of current expectations, and possibly compounded by failure to contain expenditure over the medium term. We could also consider a downgrade of our ratings if, e.g., due to either delayed or incomplete reform implementation, including failure to strengthen competitiveness, medium-term growth weakens substantially.

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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

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 the following, we explain how and to what 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 to 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.

ESG Factor Box

Environ-mental Quality	Ecological Risks	Ressource Management	Education	Health	Demo-graphics
Labor	Equality	Technology & Infrastructure	Safety & Security	Judicial System	Quality of Public Services
Integrity of Public Officials	Quality and Efficacy of Regulations	Civil Liber-ties/ Political Participation	Market Access	Business Environ-ment	Data Transparency

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant

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 assessment of an economy's competitive stance by e.g. the World Bank, the World Economic Forum, the European Commission, and IMD Business School and the World Intellectual Property Organization (UN) 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 exert 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 on public finances. To be sure, we will follow ESG dynamics closely in this regard.

Economic Data

[in %, otherwise noted]	2017	2018	2019	2020	2021	2022e	2023e
Macroeconomic Performance							
Real GDP growth	2.3	1.9	1.8	-7.8	6.8	2.6	0.6
GDP per capita (PPP, USD)	46,370	48,198	49,793	46,331	51,547	56,426	58,828
Credit to the private sector/GDP	109.0	112.2	114.9	130.7	125.4	125.6	n/a
Unemployment rate	9.4	9.0	8.4	8.0	7.9	7.3	n/a
Real unit labor costs (index 2015=100)	100.5	100.3	98.4	100.3	99.5	99.7	98.8
World Competitiveness Ranking (rank)	31	28	31	32	29	28	n/a
Life expectancy at birth (years)	82.7	82.8	83.0	82.3	82.4	n/a	n/a
Institutional Structure							
WGI Rule of Law (score)	1.4	1.4	1.4	1.3	1.3	n/a	n/a
WGI Control of Corruption (score)	1.3	1.3	1.3	1.1	1.3	n/a	n/a
WGI Voice and Accountability (score)	1.2	1.1	1.1	1.1	1.1	n/a	n/a
WGI Government Effectiveness (score)	1.3	1.5	1.4	1.2	1.3	n/a	n/a
HICP inflation rate, y-o-y change	1.2	2.1	1.3	0.5	2.1	5.9	5.0
GHG emissions (tons of CO2 equivalent p.c.)	7.2	6.9	6.7	5.9	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	-3.0	-2.3	-3.1	-9.0	-6.5	-4.7	-5.2
General government gross debt/GDP	98.1	97.8	97.4	114.6	112.9	111.6	111.9
Interest/revenue	3.2	3.2	2.8	2.4	2.6	n/a	n/a
Debt/revenue	183.3	183.3	186.3	219.0	214.9	n/a	n/a
Total residual maturity of debt securities (years)	7.3	7.4	7.6	7.7	8.1	8.3	n/a
Foreign exposure							
Current account balance/GDP	-0.8	-0.8	0.5	-1.8	0.4	-2.1	n/a
International reserves/imports	0.3	0.2	0.3	0.4	0.3	n/a	n/a
NIIP/GDP	-20.1	-19.3	-24.6	-30.7	-32.1	-26.2	n/a
External debt/GDP	210.2	221.8	234.5	263.2	256.2	245.2	n/a

Sources: 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	21.04.2023	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 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	NO
With Access to Management	NO

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, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, IMD Business School, 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 the event 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.

Disclaimer

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