French Republic
Rating Report

AA STABLE OUTLOOK

Credit strengths

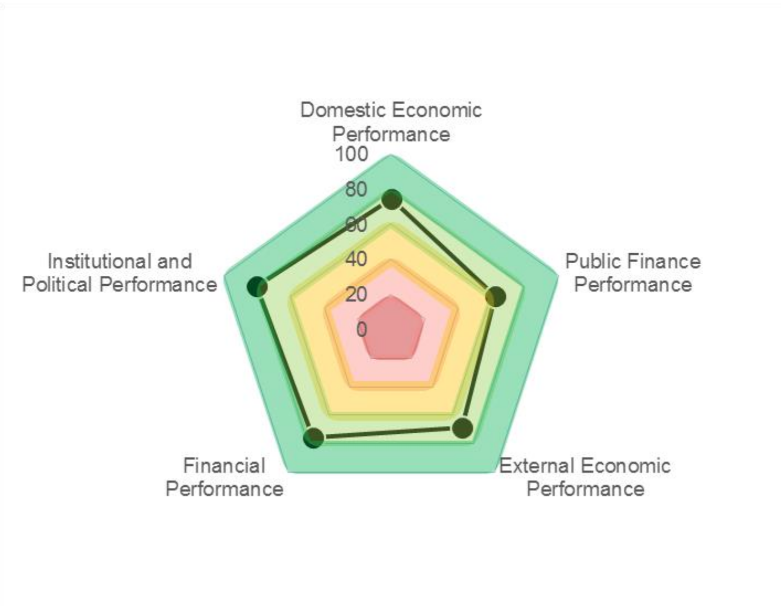
- Euro area membership
- Large and diversified economy
- Macro-financial stability
- Favorable debt structure

Credit weaknesses

- High public-debt stock
- High deficit ratios
- Labour market rigidities

Rating rationale and Outlook: France's AA sovereign ratings are supported by euro area membership, large and diversified economy, a track record of macro-financial stability and favorable debt structure support the rating. High public debt and deficit ratios, as well as labour market rigidities are constraints. The Stable Outlook reflects Scope's assessment that the challenges which France faces are manageable. The new government's priorities will be important for the rating, given the need for a sustained commitment to France's medium-term structural balance objective.

Figure 1: Summary of sovereign rating categories



Source: Scope Ratings AG

Positive rating-change drivers

- Sustained fiscal consolidation
- Strong reform implementation
- Stronger GDP recovery

Negative rating-change drivers

- Challenges in reforms implementation
- Weaker than expected medium term GDP growth

Ratings & Outlook

Foreign currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AA/Stable
Senior unsecured debt	AA/Stable
Short-term issuer rating	S-1+/Sable

Lead analyst

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings AG

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone + 49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

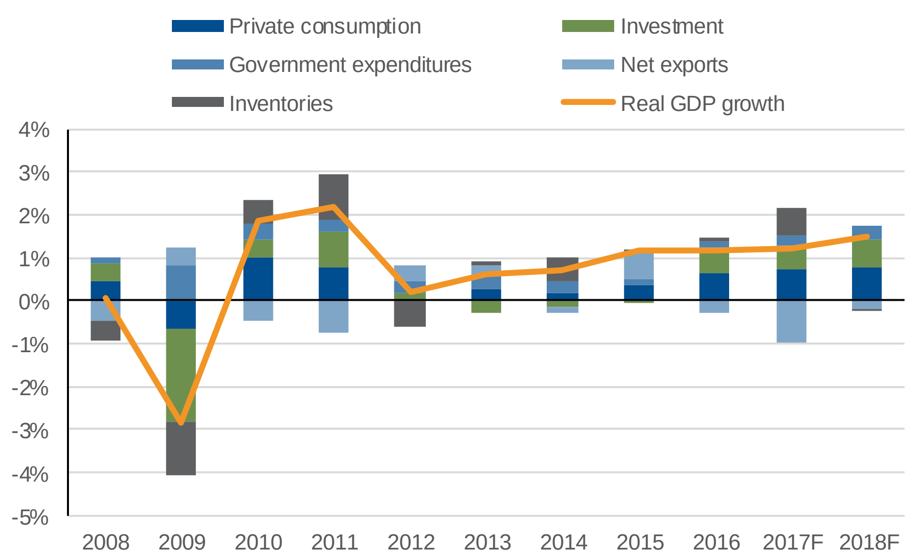
Domestic economic risk

Economic recovery may gain some strength

France's AA ratings are underpinned by it having one of the wealthiest economies in the world with a highly diversified economic structure, both of which have helped the country weather the financial and sovereign debt crisis reasonably well. Its private sector, especially households, is not overleveraged, indicating a fairly tempered reliance on credit growth in the pre-crisis years. The country has healthy demographics with a growing labour force, which distinguishes it from other major euro-area economies, and which could contribute positively to the country's economic growth and alleviate pressure on public finances. However, a number of structural issues have been partly responsible for a slowdown in economic growth in recent years. Since the economic restructuring of labour markets affects many vested interests, multi-sector reforms launched in the recent past and planned for the near future face implementation risks.

The growth rate of the French economy slowed down in the post-crisis period. Indeed, in 2000-2007 France grew at 1.9%, whereas in 2008-2014 it stagnated with average growth rate during this period of 0.3%. Economic activity has remained substantially below long-term averages in recent years. Scope believes there is potential for a stronger economic recovery in the near term. After real GDP growth of 1.2% in 2016, economic activity is set to accelerate thanks to a pick-up in euro-area and world trade. Scope expects real GDP to grow by 1.4% and 1.7% for 2017 and 2018 respectively, which should have a positive impact on employment, with the unemployment rate expected to keep decreasing below 10% of the workforce. This will help to strengthen domestic demand.

Figure 2: Real GDP growth components



Source: IMF, Calculations Scope Ratings AG

Employment growth is also supported by policy measures to foster job creation by reducing the cost of labour and some of the rigidities that traditionally raise the cost of doing business in France. Tax credits for employment and hiring subsidies have yielded positive results. The impact of recent government measures on corporate investment and competitiveness is credit-positive. A return of economic activity to potential GDP growth rates of around 2% would help to set the public-debt ratio back on a downward trend.

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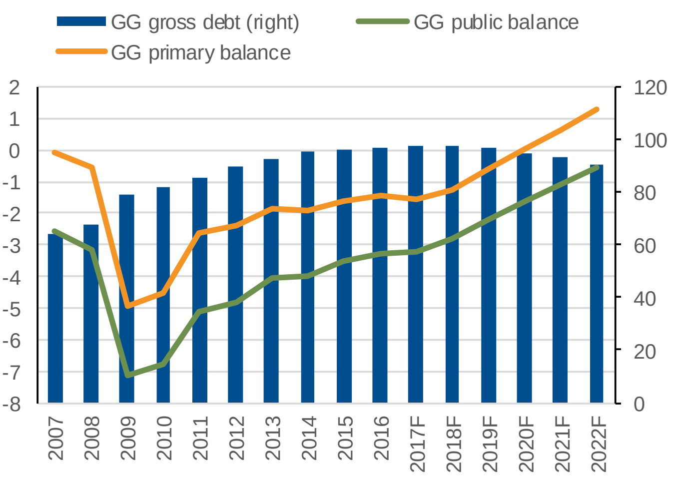
Public finance risk

Fiscal policy between consolidation and support for the recovery

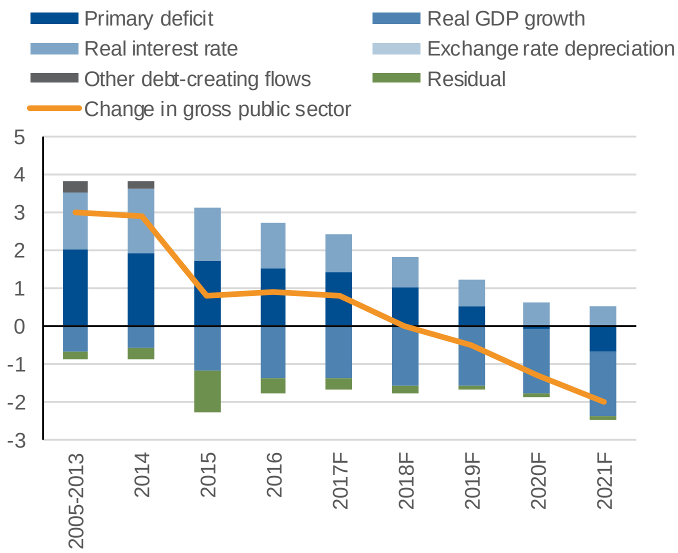
Subdued GDP growth and low inflation have led to rising general government debt in relation to nominal GDP over the past years. The debt ratio is expected to stabilize at around 97% until 2018, gradually decreasing afterwards. Stronger economic growth would also help to further support the downward trajectory of the general government deficit in relation to nominal GDP. This deficit ratio has averaged 3.7% in the past four years and is set to flatten out at around 3% in 2017 and 2018.

Figure 3: Fiscal developments, % of GDP



Source: IMF

Figure 4: Debt-creating flows, % of GDP



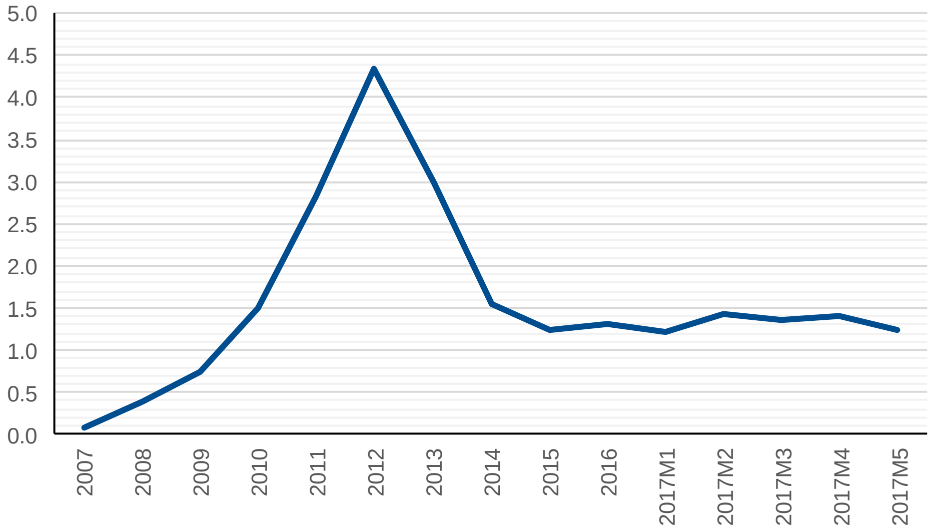
Source: IMF

The recent path of the deficit ratio at levels substantially above 3% is also a reflection of the gradual approach to fiscal consolidation taken during a fragile economic recovery. Still, the recovery firmed in the last two years, and France has continued to enjoy very low funding costs supported by unconventional European Central Bank monetary policy measures as well as by the 'flight to quality' trend on global bond markets. The favourable market conditions make France's public debt highly affordable.

The public expenditure-to-GDP ratio is set to decline only slightly, with public investment and interest-rate payments projected to increase. Scope believes that France is likely to continue treading a narrow path between fiscal consolidation and economic growth in the medium term, given the large share of public spending at around 56.2% of GDP – the largest in the EU.

France benefits from a relatively long average maturity of French securities (7.7 years in April), now minimizing rollover risks, an insignificant portion of foreign-currency debt, as well as a relatively high (although declining) gross national savings. 58.5% of France's sovereign debt is held by non-residents.

Figure 5: 10Y OAT spreads over 10Y Bund



Source: OECD

External economic risk

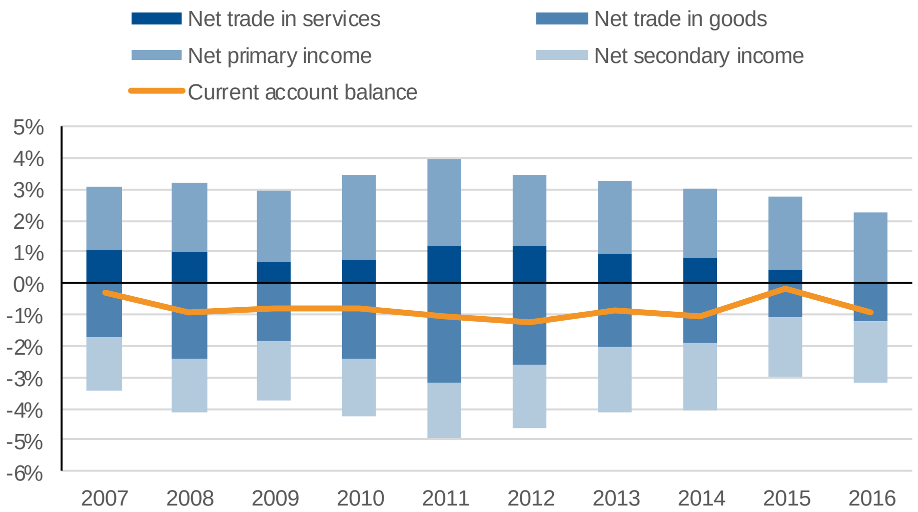
Challenges in international competitiveness

France's net international investment position has been stabilizing around -16% over the past four years, triggered by a small, yet persistent, current-account deficit and stagnating GDP in the post-crisis period. France faces challenges regarding international market competitiveness and productivity growth. The substantial improvement in export performance slowed down in 2016 with the current account deficit increasing to -1.1% of GDP. Current account deficit is expected to only gradually improve over the medium term.

The current-account deficit reflects a weakening trade balance associated with past declines in competiveness, which is only partially mitigated by surpluses in primary income (incomes from French investments abroad outpacing non-residents' income within France) and services. Should the reforms aimed at boosting competiveness prove insufficient, the current-account deficit may widen further, potentially leading to a weakening of the country's net international investment position. At present, however, France's current-account deficits and net international investment position are moderate compared to countries like Ireland or Spain.

Wage moderation is continuing, but the deterioration in productivity growth is preventing a faster recovery of France's cost competitiveness. Scope expects that recent product market reforms and continued efforts to reduce red tape for firms may contribute to improving cost competitiveness over the medium term.

Figure 6: Current-account balance % of GDP



Source: IMF, Calculations Scope Rating AG

Financial stability risk

Relative resilience of the banking sector

The French banking sector demonstrated relative resilience during the global financial crisis, and banks have increased capital ratios, with a Tier 1 ratio of 15.0%, broadly in line with the euro-area average. This reflects the fact that stability in the non-financial sector was less impaired by the crisis than it was in many other euro-area countries due to lower levels of indebtedness. The private sector has demonstrated relative resilience amid weak economic conditions. This has helped to keep risks to the government's balance sheet in check.

During the financial crisis, the French government provided support in three cases – BPCE, Dexia and Caisse Centrale du Credit Immobilier de France (3-CIF), which were severely affected by the bursting of the real estate bubble as well as rapid international expansion. This intervention took the form of capital injections and central government guarantees to retain access to wholesale funding.

Since the crisis, potential risk associated with the banking sector has diminished. The sector was very nimble in reducing its exposures to 'peripheral' countries in the euro area. All of the four large banking groups have been improving capitalisation and liquidity ratios, while maintaining sound profitability. The EU Bank Recovery and Resolution Directive (BRRD) limits the government's liabilities associated with troubled banks by passing potential costs to both creditors and shareholders.

Institutional and political risk

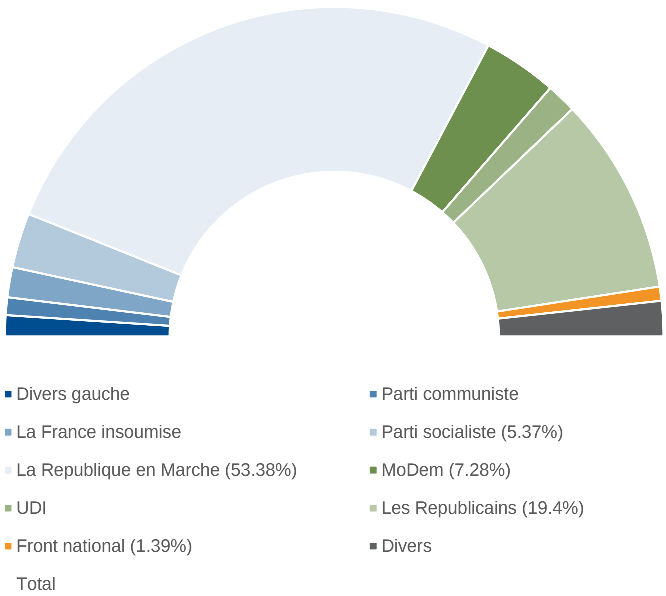
President Macron in a good position to pursue reforms

France benefits from very strong institutions and a stable political environment. After winning presidential and general elections Scope believes that President Emmanuel Macron may be in a relatively good position to pursue his reform agenda for the French economy and to promote free trade and further European integration. Since the global financial crisis erupted in 2008, French economic activity has remained largely below potential with average growth rates of around 1%. Mr Macron wants to act further on corporate and labour taxation to create incentives for business and jobs. As economy minister for two years under former president Hollande, he already deepened product and labour market reforms (the Macron Law) that were initiated in 2012.

In order to finance tax cuts, Mr Macron intends to reduce public spending to around 52% from a current 56.2% of GDP. This move should also help to keep the deficit ratio within the governing rules for the euro and to initiate a downward trajectory for the public-debt ratio.

Scope believes that there is potential for the implementation of reforms to bolster the economic recovery and public debt control. However, there is growing discontent in French society over the past decade following the 2008 crisis, with rising support for anti-establishment parties. This may complicate the reform process, despite Macron's comfortable parliamentary majority, which will have to strike a fine balance between continuity, reform and vested interests.

Figure 7: French legislative election results



Source: French National Assembly

Methodology

The methodology applicable for this rating and/or rating outlook "Public Finance Sovereign Ratings" is available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/governance-and-policies/regulatory/esma-registration.
Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

A comprehensive clarification of Scope's definition of default, definitions of rating notations can be found in Scope's public Credit Rating methodologies on www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

I. Appendix: CVS and QS results

Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on relative rankings of key sovereign credit fundamentals, signals an indicative AA (aa) rating range for the French sovereign. This indicative rating can be adjusted by the Qualitative Scorecard (QS) by up to three notches depending on the size of relative credit strengths or weaknesses versus peers based on the qualitative analysis. For France the QS signals relative credit strengths for the following analytical categories: i) market access and funding sources; ii) vulnerability to short-term shocks; iii) perceived willingness to pay; and iv) financial sector performance.

Relative credit weaknesses are signalled for fiscal performance. Combined relative credit strengths and weaknesses generate no adjustment and signal a sovereign rating of AA for France. The results have been discussed and confirmed by a rating committee.

Rating overview	
CVS indicative rating range	aa
QS adjustment	AA
Final rating	AA

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 22 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result is converted into an indicative rating range that is always presented in lower case rating notes.

As part of QS assessment, the analyst conducts a comprehensive review of the qualitative factors. This includes but is not limited to an economic scenario analysis, review of debt sustainability, fiscal and financial performance and policy implementation assessments.

There are three assessments per category for a total of 15. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment which forms the basis for the analyst recommendation to the rating committee.

Foreign- versus local-currency ratings

France's debt is predominantly issued in euros, or hedged. Because of its history of openness to trade and capital flows as well as the reserve currency status of the euro, Scope sees no reason to believe that France would differentiate among any of its contractual debt obligations based on currency denomination.

II. Appendix: CVS and QS results

CVS

Rating indicator	Category weight
Domestic economic risk	35%
Economic growth	
Real GDP growth	
Real GDP volatility	
GDP per capita	
Inflation rate	
Labour & population	
Unemployment rate	
Population growth	
Public finance risk	30%
Fiscal balance	
GG public balance	
GG primary balance	
GG gross financing needs	
Public debt	
GG net debt	
Interest payments	
External economic risk	15%
International position	
International investment position	
Importance of currency	
Current-account financing	
Current-account balance	
T-W effective exch. rate	
Total external debt	
Institutional and political risk	10%
Control of corruption	
Voice & accountability	
Rule of law	
Financial risk	10%
Non-performing loans	
Liquid assets	
Credit-to-GDP gap	
Indicative rating range	**aa**
QS adjustment	**AA**
Final rating	**AA**

QS

Maximum adjustment = 3 notches

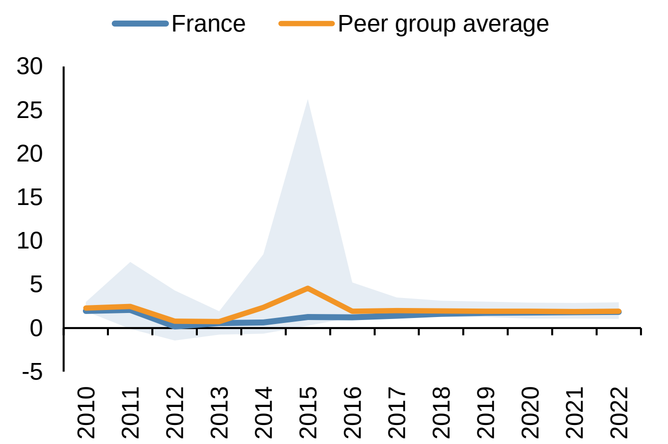
	+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Growth potential of the economy	○ Excellent outlook, strong growth potential	○ Strong outlook, good growth potential	◉ Neutral	○ Weak outlook, growth potential under trend	○ Very weak outlook, growth potential well under trend or negative
Economic policy framework	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macroeconomic stability and imbalances	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Fiscal performance	○ Exceptionally strong performance	○ Strong performance	○ Neutral	◉ Weak performance	○ Problematic performance
Debt sustainability	○ Exceptionally strong sustainability	○ Strong sustainability	◉ Neutral	○ Weak sustainability	○ Not sustainable
Market access and funding sources	○ Excellent access	◉ Very good access	○ Neutral	○ Poor access	○ Very weak access
Current account vulnerabilities	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
External debt sustainability	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Vulnerability to short-term shocks	○ Excellent resilience	◉ Good resilience	○ Neutral	○ Vulnerable to shock	○ Strongly vulnerable to shocks
Perceived willingness to pay	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Recent events and policy decisions	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Geo-political risk	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Financial sector performance	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Financial sector oversight and governance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macro-financial vulnerabilities and fragility	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate

* Implied QS notch adjustment = (QS notch adjustment for Domestic Economic Risk)*0.35 + (QS notch adjustment for Public Finance Risk)*0.30 + (QS notch adjustment for External Economic Risk)*0.15 + (QS notch adjustment for Institutional and Political Risk)*0.10 + (QS notch adjustment for Financial Stability Risk)*0.10

Source: Scope Ratings AG

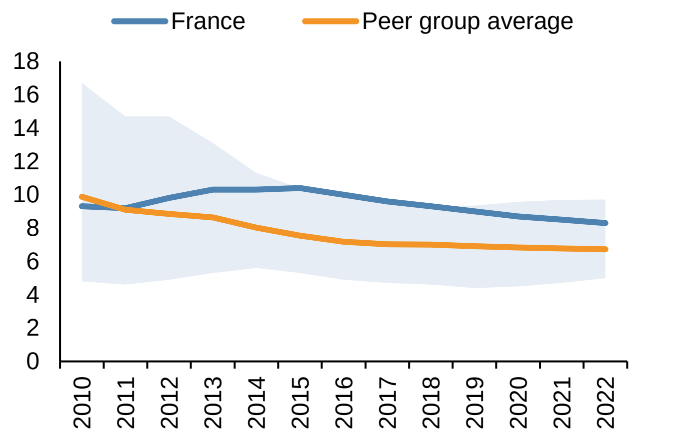
III. Appendix: Peer comparison

Figure 8: Real GDP growth



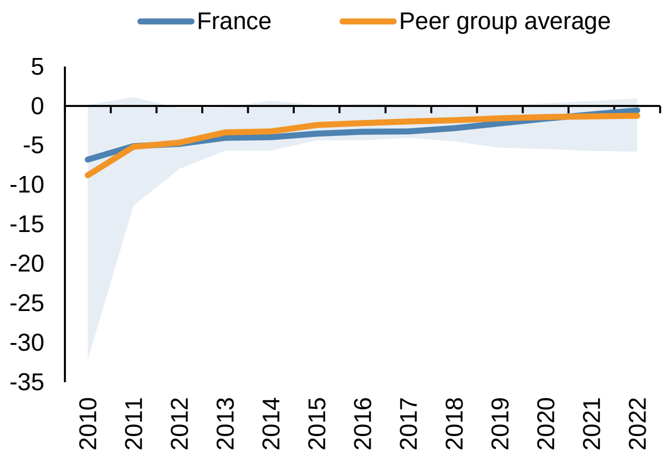
Source: IMF, Calculations Scope Ratings AG

Figure 9: Unemployment rate, % of total labour force



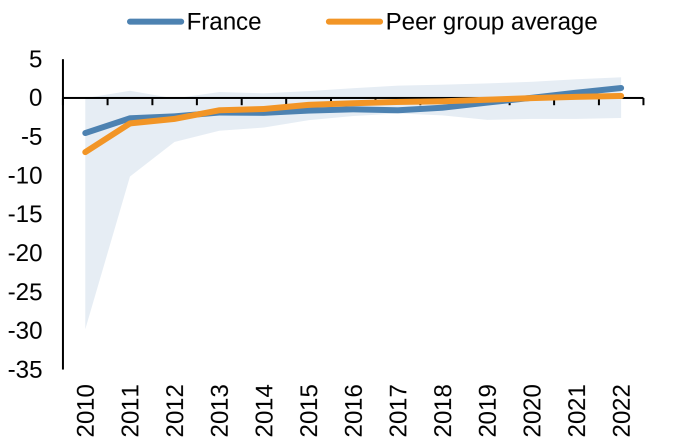
Source: IMF, Calculations Scope Ratings AG

Figure 10: General government balance, % of GDP



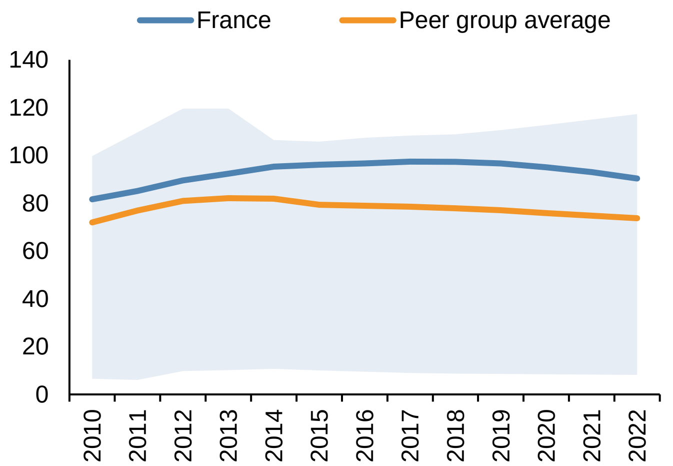
Source: IMF, Calculations Scope Ratings AG

Figure 11: General government primary balance, % of GDP



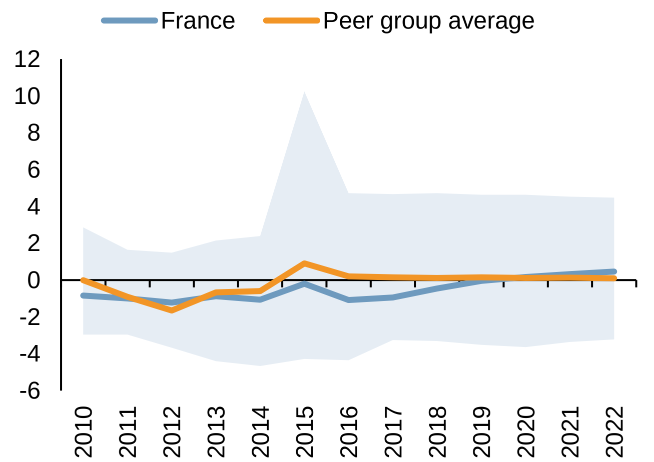
Source: IMF, Calculations Scope Ratings AG

Figure 12: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings AG

Figure 13: Current-account balance, % of GDP



Source: IMF, Calculations Scope Ratings AG

IV. Appendix: Statistical tables

	2012	2013	2014	2015	2016	2017E	2018F
Economic performance							
Nominal GDP (EUR bn)	2,086.9	2,115.3	2,140.0	2,181.1	2,225.9	2,278.7	2,344.9
Population ('000s)	63,639.9	63,919.9	64,190.6	64,457.2	64,720.7	64,979.5	65,233.3
GDP per capita PPP (USD)	37,645.3	39,539.4	40,151.8	41,016.7	-	-	-
GDP per capita (EUR)	32,929.3	33,207.6	33,422.4	33,897.0	34,454.5	35,110.1	35,966.6
Real GDP growth, % change	0.18	0.58	0.64	1.27	1.21	1.40	1.65
GDP growth volatility (10-year rolling SD)	1.7	1.7	1.6	1.6	1.5	1.4	1.4
CPI, % change	2.21	0.99	0.61	0.09	0.31	1.41	1.19
Unemployment rate (%)	9.8	10.3	10.3	10.4	10.0	9.6	9.3
Investment (% of GDP)	22.6	22.3	22.5	22.4	22.8	22.2	21.9
Gross national savings (% of GDP)	21.4	21.4	21.4	22.2	21.7	21.2	21.4
Public finances							
Net lending/borrowing (% of GDP)	-4.8	-4.0	-4.0	-3.5	-3.4	-3.0	-3.2
Primary net lending/borrowing (% of GDP)	-2.4	-1.9	-1.9	-1.6	-1.5	-1.6	-1.2
Revenue (% of GDP)	52.0	52.9	53.4	53.5	52.8	53.0	52.7
Expenditure (% of GDP)	56.8	57.0	57.3	57.0	56.2	56.0	55.9
Net interest payments (% of GDP)	2.4	2.2	2.1	1.9	1.9	1.4	2.0
Net interest payments (% of revenue)	4.7	4.1	3.9	3.5	3.7	2.7	3.7
Gross debt (% of GDP)	89.5	92.3	95.2	96.2	96.3	96.4	96.7
Net debt (% of GDP)	80.6	83.5	86.4	87.4	88.3	89.1	89.1
Gross debt (% of revenue)	172.1	174.4	178.5	179.8	182.4	181.9	183.6
External vulnerability							
Gross external debt (% of GDP)	200.0	193.9	209.8	209.7	212.8	-	-
Net external debt (% of GDP)	32.4	32.5	36.4	37.3	37.6	-	-
Current-account balance (% of GDP)	-1.2	-0.9	-1.1	-0.2	-1.1	-0.9	-0.5
Trade balance [FOB] (% of GDP)	-	-2.0	-1.7	-1.0	-1.2	-1.3	-1.3
Net direct investment (% of GDP)	0.7	-0.5	1.7	-0.1	0.7	-	-
Official forex reserves (EOP, USD m)	30,350.2	27,414.1	28,656.0	36,370.5	39,185.3	-	-
REER, % change	-3.2%	1.5%	0.4%	-4.6%	1.3%	-	-
Nominal exchange rate (EOP, USD/EUR)	1.3	1.4	1.2	1.1	1.1	-	-
Financial stability							
Non-performing loans (% of total loans)	4.3	4.5	4.2	4.0	-	-	-
Tier 1 ratio (%)	13.3	13.2	13.1	13.8	15.0	-	-
Consolidated private debt (% of GDP)	138.5	137.7	141.9	143.4	182.3	-	-
Domestic credit-to-GDP gap (%)	8.0	1.9	4.9	1.4	0.4	-	-

Source: IMF, European Commission, European Central Bank, World Bank, United Nations, Scope Ratings AG

V. Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings AG.

Rating prepared by Dr Giacomo Barisone, Lead Analyst

Person responsible for approval of the rating Dr Stefan Bund, Chief Analytical Officer

The ratings /outlook was first assigned by Scope as subscription rating on January 2003. The subscription ratings/outlooks were last updated on 05.05.2017.

The senior unsecured debt ratings as well as the short term issuer ratings were assigned by Scope for the first time.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on French Republic are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Sovereign Ratings Calendar of 2017" published on 30.06.2017 on www.scoperatings .com). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case the deviation was due to the recent revision of Scope's Sovereign Rating Methodology and the subsequent putting the ratings under review, in order to conclude the review and disclose these ratings in a timely manner, as required by the Article 10(1) of the CRA Regulation.

Rating Committee: the main points discussed were (1) France's economic outlook, (2) public deficit and debt sustainability analysis, (3) resilience of the financial sector, (4) structural reforms, (5) latest electoral outcome and political developments, (6) sovereign peers considerations.

Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: Ministry of Economy and Finance, Insee, Banque de France, Agence France Trésor, High Council on Public Finances, IMF, OECD, European Comission, United Nations, World Bank, Eurostat, and Haver Analytics.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds upon which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Conditions of use / exclusion of liability