

Rating Update

Creditreform Rating affirms the credit ratings of the French Republic at “AA”, outlook “negative”

Rating Action

Neuss, 21 May 2021

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.

Reasons for the Rating Decision and Latest Developments¹

Macroeconomic Performance

France’s creditworthiness is buttressed by its generally favorable macroeconomic profile. In addition to a high degree of prosperity and diversification, the seventh-largest economy in the world also features a high level of productivity. Notwithstanding progress made prior to the outbreak of the Covid-19 pandemic, structural challenges related to the labor market, and elements that appear to constrain its business environment, constitute factors balancing these strengths somewhat. While the swift and powerful policy response to contain the spread of the coronavirus has prevented worse on the labor market, unemployment may yet have to peak, and the transition towards a greener and more digital economy comes with its own challenges for labor market inclusiveness in particular. However, if put to effective use, meaningful support via the Recovery and Resilience Facility (RRF) could considerably facilitate the initial phase of this transition. Ultimately, if the national recovery plan is effectively implemented, we think that potential growth could be lifted significantly in the medium- to longer term.

Following real GDP growth averaging 1.6% over the five years prior to the outbreak of the corona crisis (EA: 1.9%), the pandemic and the concurrent containment measures caused a fall of economic output by 8.1%, one of the most pronounced contractions among the euro area (EA) members (EA: -6.6%), although less severe than we had estimated in our last review in November. Declining household consumption took the heaviest toll on the sovereign’s growth performance (growth contribution -3.9 p.p.), followed by sharply dropping gross fixed capital formation (-2.4 p.p.). Contrary to a number of other euro area members and despite extensive support measures, government consumption posted a decline in 2020. Net exports posed a drag as well, taking a further 1.5 p.p. off GDP growth, with exports experiencing a steeper fall than imports.

With the quarterly growth profile very much shaped by epidemiological developments and three associated national lockdowns, as well as the easing thereof, the French GDP in Q1-21 still posted at 4.4% below the level registered in Q4-19, whilst faring better than the euro area economy overall by comparison (-5.5% vs. Q4-19). Against the preceding quarter, real GDP rose by

¹ This rating update takes into account information available until 17 May 2021.

0.4% in Q1-21, carried by domestic demand and in particular by gross fixed capital formation, which increased for a third consecutive quarter, although not yet making up for the ground lost since Q4-19 (-2.5%). While the French vaccination campaign seemed to be off to a rather slow start from the turn of the year, partly due to low initial levels of supply, inoculations have gained traction over the last few months. Notwithstanding the temporary hard lockdown including a curfew and school closures from 3 April in response to sharply rising infections at the time, a modest quarter-on-quarter GDP increase in Q2-21 may still be achievable, as businesses and consumers have adapted well to containment measures. Following a peak at the end of March, the infection rate amid the third wave has declined rapidly, almost halving to 414.5 (week 18, 14-day cumulative infection rate, ECDC data).

Easing of the containment measures is underway, as per a roadmap outlining de-confinement in four steps starting from 3 May. From 19 May, restaurants and cafes will be able to resume outdoor service, and museums, theatres and cinemas will be allowed to open subject to conditions. Further easing of restrictions is foreseen from 9 June, with the end of any curfews envisaged from 30 June. Against this backdrop, we think that the stage should be set for a sharp rebound of activities in the second half of the year, provided that broad vaccination coverage is achieved as planned. Support should also come via the industrial sector, as the capacity utilization rate has bounced back (Q2-21: 83.2%, Q4-19: 83.4%, Eurostat). Well-filled order books in the industrial sector and - slightly less so - in construction, add confidence here. That being said, in areas such as automotive, aeronautics, and other transport, the capacity utilization rate remained at a markedly lower level than before the health crisis, hinting that the recovery will be uneven across sectors.

Once restrictions are lifted, the recovery should be led by private consumption, in particular in 2022, as household income is still backed by the extended partial activity scheme maintaining employment. State support under this scheme is to be reduced from June 2021. Permanent cuts to social security contributions preceding the corona crisis may still exert a supportive effect as regards a rebound of household spending. Furthermore, as suggested by a historically high level of the saving rate of households in 2020 (21.3%, SP21), there seems to be significant pent-up demand waiting to be released. Having said that, we assume that households' dissaving will gain further traction in 2022, as the saving ratio will likely converge towards pre-pandemic levels.

The labor market has proved relatively resilient to the health and economic crisis, mainly thanks to the government's swift and forceful policy response including the short-time work scheme, which, at the peak in April 2020, shielded about 8.4mn employees from losing their workplaces (DARES). After falling to a transitory low at 1.1mn in August 2020, the number went up again to 3.1mn in November 2020 before moving at around 2.3mn since. According to the IMF, the French short-time scheme may be deemed generous from an international perspective, likely contributing to the annual unemployment rate's (LFS-adj.) falling further to an average of 8.0% in 2020 (2019: 8.4%), whereas unemployment in the euro area rose last year (2020: 7.8%).

Nevertheless, the French unemployment rate remains among the highest as compared to AA-peers in our rating universe (median 6.7%). While the French unemployment rate has been above the euro area average since 2014 in annual terms, the monthly unemployment rate has been hovering around 7.9% over the last few months (March 2021: 7.9%), slightly below the euro area level. On a cautionary note, we do see the risk that, against the backdrop of expiring support to companies, the number of firms having to file for insolvency might go up, thus also en-

tailing more job losses, as is the case in the euro area more generally. Current bankruptcy figures remain distorted by government policies to support companies and avoid pandemic-induced insolvencies, such as moratoria, state-guaranteed loans, and liquidity provision via the solidarity fund. Drawing on provisional Banque de France (BdF) data, we observe that the number of corporate insolvencies has fallen by 35.3% y-o-y in April 2021. Between February 2020 and March 2021 this number declined by 40.4%.

The rebound in gross fixed capital formation is likely to be somewhat less pronounced this year, as it had been somewhat more resilient to the Covid-19 shock. This being said, financial conditions remain favorable, and both private and public investment should also receive some tailwind from the EU's RRF later in the year, as the European Commission (EC) and the Council will presumably give their consent to the French Recovery and Resilience Plan (PNRR) within the next few months.

We expect corporate profit margins to benefit from production tax cuts and investment subsidies, translating into higher capital spending. The tax cuts should also have a positive effect on competitiveness, which appears to have suffered over the last few years as measured by France's dwindling global export market share in (2020: 3.38%, 2016: 3.76%), although we observe that unit labor costs have evolved somewhat more favorably than in some of the main European trading partners. Moreover, residential construction investment should continue to grow, facilitated by the government's building energy renovation aid (MaPrimeRenov).

Regarding external trade, which began to recover from the second half of last year, rebounding world trade boosted by swift recoveries in China and the US, with the latter likely to be accelerated through a massive stimulus package, looks set to foster French exports. Regardless of the fact that aeronautical and space equipment exports remained a drag earlier this year, and that services exports - especially related to tourism - will likely take longer to recover until a sufficient degree of immunity is achieved in most countries, we believe that net external trade's growth contribution will be slightly positive in 2021. Overall, we expect real GDP growth to rebound by 5.4% this year. With some momentum carrying over into next year, we currently pencil in GDP growth of 4.4% for 2022, notwithstanding waning government support measures.

As in other euro area peers, France's economic recovery remains fragile in the near term, as the rebound is highly dependent on wide vaccine coverage, and significant downside risks pertaining to virus mutations remain in place. Withdrawal of government support at some point may result in a rising number of bankruptcies, which would also entail increasing unemployment. Risks to the medium-term growth outlook thus include deeper scarring effects than currently envisaged. Judging by latest AMECO data, French potential growth may recover roughly in line with that of other major euro area economies this year and next (1.0% and 1.3%, EA: 1.0% and 1.4%). Still, we take note of the High Council of Public Finances' recent analysis, in which it considers the government's assumptions for a return of underlying growth to its pre-pandemic level from 2023 to be rather optimistic.

Notwithstanding our assumption that effective implementation of the PNRR would ultimately lift French potential growth, we would highlight some further risks to the medium-term growth outlook. Private sector balance sheets have become somewhat stretched by now, pointing to somewhat limited risk buffers, possibly curbing corporate investment in a less benign macroeconomic scenario. Non-financial corporate debt increased to 106.5% of GDP in Q4-20 (Q4-19: 91.8%, ECB data), moving among the higher ratios in the EU countries, while net debt levels give less reasons for concern. At the same time, the NFC's debt service ratio posts at a relatively high

level by global standards, as illustrated by BIS data (Q3-20: 72.4% of augmented sector gross disposable income, average 2015-2019: 55.3%). Furthermore, in some sectors such as retail, NFC cash balances tended to be thin before the pandemic hit, pointing to some sector-specific pockets of vulnerabilities, although cash positions in the corporate sector overall still seem relatively comfortable.

In addition, household debt has continued its upward trajectory too, reaching 102.0% of disposable income as of Q4-20 (Q4-19: 98.2%, ECB data), corresponding to an elevated level from a European perspective. Against this backdrop, we would also flag that potentially rising unemployment in the event of an increasing number of insolvencies could curtail private consumption dynamics over a medium-term horizon.

More generally, we see challenges relating to the necessity to (re-)train part of the labor force as more jobs will likely be reallocated in view of the greening and digitizing of the economy. While still grappling with other structural issues such as opening up regulated professions to more competition or, generally, liberalizing product and services markets to enhance competitiveness and increase productivity growth, such a transition will not come without challenges.

Institutional Structure

We continue to view the very strong institutional framework as a major pillar supporting our credit assessment of the sovereign, further backed by advantages from France's deep integration into the EU and the euro area, and its ability to have an impact on setting respective policies. While we have seen significant reform success prior to the outbreak of the pandemic, reform momentum has slowed significantly since then. Following through on the announced continuation of structural reforms such as the pension reform would contribute further towards the perception of a strong institutional set-up. In our view, the same applies to the implementation of proposed mechanisms to enhance fiscal governance, as put forward by the Commission sur l'avenir des finances publiques (CAFP).

Adding to the positive perception as regards France's governance, we recall good performance concerning the World Bank's Worldwide Governance Indicators, with last year's vintage (concerning the year 2019) either in line with or exceeding the euro area median. Moreover, we observe that the French authorities embarked upon various initiatives to further improve the country's high-quality and efficient justice system. Among others, steps have been taken to prevent and combat corruption both in the public and private sectors, e.g. a comprehensive framework protecting whistleblowers.

Meanwhile, the interim GRECO compliance report on corruption prevention regarding members of parliament, judges, and prosecutors, published in October 2020, concluded that five of eleven recommendations outlined in the fourth round evaluation report have been satisfactorily implemented or dealt with, while three were only partly implemented and three have not been implemented. As an example, the report points to a desirable increase in the transparency of declarations of assets and operational expenses by assembly members, as well as to a pending decision on a constitutional reform on the role of the Judicial Service Commission. A progress report on pending recommendations is due by 30 September.

While authorities appear committed to resuming work on the pension reform, we think the issue continues to present challenges, given considerable controversy over the reform already before the pandemic hit, to which may now be added potential scarring effects on the labor market and among society more generally, emanating from the health crisis. We would thus flag a risk

of further postponement or a watering down of the pension reform, also in light of an ambitious agenda on greening the economy, digitalization, and social inclusion that may be difficult to put in practice while seeking to limit any social discontent. This being said, there is progress as regards the unemployment insurance reform which is to enter into force on 1 July, aiming to reduce government expenditure and disincentivize temporary employment contracts.

With regard to France's political environment, we recall that regional elections have been postponed due to the pandemic and are to take place on 20 and 27 June 2021. Since this will offer voters an opportunity to give some verdict on the management of the corona crisis, and as the election may deliver first clues on tendencies regarding the presidential and the parliamentary elections in the coming year, we will be paying attention to the results.

As far as environmental policies are concerned, there seems to be strong and broad political consensus on prioritizing the issue of climate change, with the aim of achieving carbon neutrality by 2050. Increasing awareness and a sense of accountability in various areas of economic activity with regard to this topic pay testament to this commitment, including the introduction of a tool for analyzing the environmental impact of the state budget ('green budget') and an initial voluntary climate-related stress test in the banking sector, which deliver a glimpse of things to come. In this vein, we would also highlight that France can be considered a frontrunner when it comes to issuing green bonds. Drawing on IMF data, France has been the most important issuer of sovereign green bonds in volume terms over the period 2016-20 (USD 33.4bn). Apart from that, France ranks ninth regarding the EU's Eco-Innovation Index (excluding UK, 2019). In terms of GHG emissions per capita, France has been on a declining path, registering 6.9 tons of CO₂ equivalent in 2018 (Eurostat), less than Germany, Italy and the UK, and comparing relatively favorably among the EU-27 as a whole (EU-27: 8.7).

Fiscal Sustainability

The need to combat the pandemic has significantly deteriorated public finances, lifting the public debt ratio to a new high from an already elevated level. In the face of multiple infection waves and initially slow progress of the vaccination campaign, France's main credit weakness is thus exacerbated. Uncertainty over the timing and pace of a sustained reversal of the debt ratio remains very pronounced, especially given the need to finance the ambitious shift in economic policy priorities, but we acknowledge that authorities remain committed to maintaining a trajectory of sustainable public finances in the medium term. Pressure linked to unfavorable age-related cost developments continues to loom. Prudent debt management and high debt affordability, the latter substantially supported by the ECB's accommodative monetary policy as well as by RRF, remain factors mitigating risks to fiscal sustainability in the near future.

Following 3.1% of GDP in 2019, France's general government deficit soared to 9.2% of GDP in 2020, amid collapsing economic growth and a strong fiscal response in order to deal with the health and economic crisis, including four supplementary budget acts. Last year's outturn thus came in markedly below the deficit of 11.3% of GDP projected in the fourth Supplementary Budget Act for 2020, mainly owing to a less severe GDP decline, underscoring the exceptionally high degree of uncertainty in the context of the pandemic.

Total general government expenditure ultimately rose by 5.5% (2019: 2.6%) in 2020, with social benefits (8.0%, 2019: 2.7%) being a major driver. Amid declines in net social contributions and tax income, the latter also due to a reform of the lower income tax bracket as well as a reduction

in housing and corporate tax, total revenue fell by 5.0% (2019: +1.1%). According to the French authorities, the total impact of health and economic measures equaled roughly EUR 73.6bn in 2020 (SP21), mainly driven by the partial activity scheme, the solidarity fund assisting small businesses, the self-employed and liberal professions, companies particularly affected by the restrictions, and through health expenditure. The impact of extended or new measures associated with the pandemic for the current year is envisaged to amount to about EUR 55.8bn, the main channel then being the solidarity fund.

We gather that implementation of parts of the EUR 100bn stimulus plan presented on 3 September 2020 ('France Relance') started in 2020, and that the direct impact on the public balance of the combination of emergency support measures and measures of the Recovery and Resilience Plan (PNRR), net of European funding, would amount to roughly EUR 77.5bn in 2021. European funding under the recovery plan would amount to EUR 40bn in subsidies. The lion's share thereof, approx. EUR 20.2bn according to the PNRR, is dedicated to the environmental pillar, while EUR 15.2bn will go towards cohesion issues such as inclusive labor markets, as well as territorial cohesion and research. The remainder is to be used for enhancing the competitiveness of the French economy, among other things by boosting the degree of digitalization in central government, the regions, and companies.

With a number of support measures extended into 2021, such as the partial activity scheme, broadened access to the solidarity fund, and in view of the hard lockdown from 3 April with stricter restrictions to public life, we see the headline deficit remaining at its current high level. Despite still being subject to unusually high uncertainty, we expect only a slight decline in the deficit, to approx. 8.8% of GDP in 2021. For 2022, in light of the phasing out of many measures and of robust economic activity, we would cautiously estimate the deficit to diminish to about 4.8% of GDP.

Over the medium term, the deficit will likely remain elevated and decline rather gradually due to tax relief partly legislated prior to the pandemic, as well as to government outlays related to the efforts to place the economy on an environmentally and socially more sustainable foundation and enhance the degree of digitalization across all layers of its economy. According to the Ministry of Finance, tax measures in 2021/22 include the abolition of the housing tax (EUR 5.3bn), lower taxes on production (EUR 10.6bn) and a continued decline in the CIT rate from 33% to 25% (EUR 6.6bn). We are aware that the government intends to contain expenditure growth in volume terms in 2022-27 (0.7% p.a.), and to bring down the expenditure-to-GDP ratio to levels last seen before the global financial crisis. That said, we would point to significant challenges in this regard, not least owing to still considerable uncertainty surrounding the evolution of the pandemic and some political uncertainty due to the upcoming presidential election in 2022. We also note that prior to the Covid-19 pandemic, France displayed the highest expenditure-to-GDP ratio in the EU, suggesting a possible uphill battle as far as expenditure discipline is concerned.

General government debt leapt to 115.7% of GDP in 2020, corresponding to an almost 20 p.p. increase compared to the preceding year, owing to the soaring deficit and collapsing economic activity. With that, the debt ratio remains well above the euro area level (98.0% of GDP) and the highest among the AA-rated sovereigns in our rating universe (median of 83.9% of GDP). Taking into account the persistently high deficit in 2021 and recovering economic growth, we expect the debt-to-GDP ratio to continue to increase to about 117.3% of GDP this year before declining somewhat in 2022, as GDP growth should still be robust. However, amid normalizing economic

growth rates beyond next year, and an expected still elevated headline deficit, the debt-to-GDP ratio may only stabilize rather than pursue a downward trend in the medium-term.

We understand that sustainably stabilizing economic developments and a stronger focus on the quality of debt would be prioritized over a prospective fiscal consolidation at this stage, although reducing the debt ratio from 2027 remains part of the path envisaged by the government (SP21). Notwithstanding substantial uncertainty still associated with the evolution of this pandemic, we would flag some caution over the envisaged medium-to longer-term debt path, given the somewhat weak track record in terms of achieving fiscal targets.

With a view to reining in the French public debt ratio, we positively note that the government appointed a high-level commission (CAFP, see above) which considers a reduction in debt by 2030 as feasible at this stage, contingent on successfully limiting public spending growth and growth stimulus through the implementation of the envisaged reforms. We would monitor any developments regarding the CAFPP proposals concerning a governance reform that would include enhancing multi-year fiscal planning and implementing an expenditure target, as well as strengthening the role of the High Council of Public Finances.

As to contingent liability risks related to fiscal sustainability, we observe that the banking sector continues to be in relatively solid shape, given a further decreasing NPL ratio (Q4-20: 2.2%, EU: 2.6%, EBA data) and increasing capital buffers (CET1 ratio of 15.9% as of Q4-20, up from 15.3% in Q4-19). Moreover, the share of stage 2 loans remained rather low, despite having risen to 8.4% as of Q4-20 (EU average: 9.1%). Having said that, loans still under moratoria exceed the share of those under expired moratoria, thus pointing to a somewhat higher risk going forward.

Against the background of a rising debt trajectory among NFCs and households, we caution that a subdued recovery scenario would render debt repayments more difficult once government support is phased out, increasing the risk of rising bankruptcies and putting more pressure on banks to enhance risk provisions. The observation that activity in the residential real estate market seems to have been rather vivid lately suggests that such pressure might increase in an unfavorable macroeconomic scenario. Mortgage lending to households accelerated slightly to 6.9% y-o-y in March 2021, and we continue to monitor rising housing prices, whose annual rate of change has reached the highest level since 2011 (6.1% in Q4-20, Eurostat), with the rate of change over the three years to Q4-20 in double-digits (13.6%, Eurostat).

The substantial guarantees linked to the Covid-19 pandemic could worsen the public debt ratio significantly if called upon (public guarantees 2019: 8.4% of GDP). State guarantees associated with the corona crisis are capped at 13.1% of GDP. While the take-up, at 5.7% of GDP, has been relatively high and was mainly deployed by micro entities and SMEs, most of this has taken place last year, and we have seen no meaningful increase since then. In order to assist these firms' recovery and allow for gradual deleveraging, while also enabling banks to limit their exposure, French authorities intend to introduce some sort of securitization tool, at the center of which would be subordinated loans (prets participatifs) to SMEs. As these loans would involve a state guarantee of up to 30%, this would ultimately give rise to fiscal risks related to public guarantees.

In the medium-to-longer term, cost pressure linked to already high age-related spending and an unfavorable demographic outlook could hamper fiscal sustainability. According to the 2021 EU Aging Report, France displayed the lowest working-age population (20-64y) among the EU countries in 2020 (54.4% of total population). At the same time, France featured the highest level of age-related expenditure in the EU in 2019 (29.5% of GDP, EU: 24.0%), mostly due to pension

costs, and is estimated to continue to do so in 2030 (30.8% of GDP, EU: 25.4%), mainly driven by the costs for retirees. By 2070, fiscal pressure could abate somewhat, due to lower spending on education as measured against GDP, but is projected to remain high by European standards. We note that the labor participation of the elderly (55-64y) has been rising over the last two decades, also thanks to past reforms and in line with the euro area wide trend. In this respect, we will monitor developments around the delayed pension reform, as this could further alleviate aging-cost pressure.

With all that said, we continue to view the sovereign's very sound debt management, as well as high debt affordability, also backed by ongoing accommodative monetary policy, as factors mitigating risks to some degree, with debt servicing costs prospectively declining over the coming years. The average yield on France's medium- and long-term borrowing in 2020 was negative at -0.13%, after 0.11% in 2019. Interest rate payments declined further by 15.8% last year, after having fallen by 12.5% in 2019. Measured against GDP, they diminished to 1.3% last year, or 2.5% of total revenue. The weighted average maturity of negotiable outstanding debt stood at 8y and 73 days at the end of 2020, further increasing to 8y and 135 days at the end of March 2021 (AFT data), smoothing any refinancing risks. Despite the recent increase in 10-y government bond yields, which entered positive territory at the end of April (0.266%, weekly quote, 14 May), we believe that favorable borrowing conditions will persist, not least as the ECB's monetary policy will remain very accommodative going forward. Among other things, its purchase programs, in particular the PEPP, continue to foster benign financial market conditions. To this end, we recall that almost 80% of the debt issued by France in 2020 has been bought by central banks, according to CAFPP, while foreign official creditors and BdF held approx. 35% of French sovereign debt as of Q3-20 (IMF data).

Foreign Exposure

We see only limited risks pertaining to France's external position, as we view the widening current account deficit and the increasingly negative net international investment position (NIIP) as driven by transitory disruptions / distortions on account of the pandemic.

France's current account deficit widened by 1.2 p.p. to a moderate 1.9% of GDP in 2020, chiefly on account of a larger goods deficit (2020: -2.8% of GDP) as exports posted a stronger fall than imports. To a lesser extent, the increase was driven by a smaller services surplus (0.5% of GDP), as services exports associated with tourism and related services experienced large contractions due to the Covid-19 pandemic.

Data for Q1-21 show a slight narrowing of the deficit to 1.8% of GDP (moving four-quarter-sum). We expect the negative current account position to narrow over the medium term amid recovering trade activity and a presumably more gradual improvement of travel activity, as higher degrees of immunity against Covid-19 should enable some rebound for tourism. With more momentum in 2022, possibly also supported by a somewhat strengthening competitiveness of the corporate sector in view of production tax cuts, the deficit could continue to decline in 2022.

Meanwhile, France's negative net international investment position (NIIP) slightly widened to -26.7% of GDP on the back of a more negative net portfolio investment position and lower net direct investment. External liabilities remain dominated by the government and the financial sector, which presents some vulnerabilities, although we consider low external funding costs and a large volume of foreign assets as mitigating elements.

Rating Outlook and Sensitivity

Our rating outlook for France's long-term credit ratings is negative. Downside risks pertaining to the fiscal outlook in a macroeconomic environment still hampered by uncertainty linked to the pandemic outweigh otherwise prevalent macroeconomic and fiscal strengths at this point in time, although perspectives of a more stable recovery are improving on the back of progressing vaccinations. We would reiterate that the assessment and interpretation of economic developments in the near future is considerably more challenging than under normal circumstances, as is the case for other indicators, e.g. from the fiscal realm.

A downgrade could be triggered if, contrary to our assumption, the sovereign's public debt ratio continues to rise vividly over a prolonged period of time. This could be the case if the effectiveness of vaccines turns out to be futile, implying the need to consider renewed restrictions with negative reverberations for economic activity, or if plans to restrain public spending growth over the medium term prove elusive, implying that the deficit may fail to follow the envisaged path. We could also consider lowering our ratings if medium-term growth weakens substantially, possibly as the economy experiences deeper scarring from the health crisis. A significant delay in disbursing NGEU-related funds due to the ongoing assessment process of the national recovery plans could also be part of such an adverse scenario. Aside from pandemic-related risks, failure to fully address age-related spending pressures, lacking improvement or even a reversal of progress made as regards structural features weighing on the labor market and the business environment, could also have us contemplate a rating downgrade.

By contrast, we could consider a positive rating action in the case of a strong and sustained rebound in economic growth as confidence in herd immunity prevails, also backed by a timely disbursement of NGEU funds. A reversing debt trend and/or convincing signs of a likely sustainable fall in the public debt ratio could conceivably also lead to an upgrade of the rating and/or the outlook. Resuming reform momentum, including pension reform and working towards enhanced governance of public finances, would also seem beneficial.

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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

Economic Data

[in %, otherwise noted]	2015	2016	2017	2018	2019	2020e	2021e
Macroeconomic Performance							
Real GDP growth	1.1	1.1	2.3	1.8	1.5	-8.1	5.4
GDP per capita (PPP, USD)	42,289	44,422	46,370	48,216	49,696	46,062	49,492
Credit to the private sector/GDP	104.9	107.6	109.0	112.3	115.5	132.5	n/a
Unemployment rate	10.4	10.1	9.4	9.0	8.4	8.0	n/a
Real unit labor costs (index 2015=100)	100.0	100.1	100.4	100.4	98.7	101.3	n/a
Ease of doing business (score)	76.1	76.3	76.0	76.8	76.8	n/a	n/a
Life expectancy at birth (years)	82.4	82.7	82.7	82.8	83.0	82.3	n/a
Institutional Structure							
WGI Rule of Law (score)	1.4	1.4	1.4	1.4	1.4	n/a	n/a
WGI Control of Corruption (score)	1.3	1.4	1.3	1.3	1.3	n/a	n/a
WGI Voice and Accountability (score)	1.2	1.1	1.1	1.2	1.1	n/a	n/a
WGI Government Effectiveness (score)	1.4	1.4	1.4	1.5	1.4	n/a	n/a
HICP inflation rate, y-o-y change	0.1	0.3	1.2	2.1	1.3	0.5	1.2
GHG emissions (tons of CO2 equivalent p.c.)	7.1	7.1	7.2	6.9	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	-3.6	-3.6	-3.0	-2.3	-3.1	-9.2	-8.8
General government gross debt/GDP	95.6	98.0	98.3	98.0	97.6	115.7	117.3
Interest/revenue	3.7	3.5	3.2	3.2	2.8	2.5	n/a
Debt/revenue	179.8	184.7	183.6	183.6	186.7	218.8	n/a
Weighted average maturity of debt (years)	6.7	6.9	7.3	7.4	7.6	7.7	n/a
Foreign exposure							
Current account balance/GDP	-0.4	-0.5	-0.8	-0.6	-0.7	-1.9	n/a
International reserves/imports	0.2	0.3	0.3	0.2	0.3	0.4	n/a
NIIP/GDP	-12.9	-13.0	-20.1	-18.8	-22.9	-26.7	n/a
External debt/GDP	209.2	211.8	210.2	217.2	230.0	262.8	n/a

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

ESG Factors

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

Environmental Quality	Ecological Risks	Ressource Management	Education	Health	Demographics
Labor	Equality	Technology & Infrastructure	Safety & Security	Judicial System	Quality of Public Services
Integrity of Public Officials	Quality and Efficacy of Regulations	Civil Liberties/ Political Participation	Market Access	Business Environment	Data Transparency

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant
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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 such as the World Bank’s Ease of Doing Business index and the World Economic Forum’s Global Competitiveness Indicator 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.

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

Regulatory Requirements

In 2011 Creditreform Rating AG (CRA) 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 AFT commented on a draft version of the rating 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 CRA's ["Sovereign Ratings" methodology](#) (v1.2, July 2016) in conjunction with its basic document ["Rating Criteria and Definitions"](#) (v1.3, January 2018). CRA 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 CRA'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, European Centre for Disease Prevention and Control (ECDC), Blavatnik School of Government, Banque de France, Agence France Trésor, INSEE, Ministère de l'Économie et des Finances, DARES, Commission sur l'avenir des finances publiques (CAFP).

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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