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France: Credit Outlook & Investment Implications

Key Risks for Investors & Trustees

Key Takeaways / Quick Read:

> After some speculation of a downgrade, on Friday 25th October, Moody's affirmed the Government of France's credit rating at Aa2 but changed the outlook to negative, from stable.

> While no change to Moody's credit rating for France was somewhat unexpected, market reaction to the decision in terms of spread movements has been muted.

> We are of the view that further credit rating changes that will require immediate investment or fund management actions are unlikely within the next 6-12 months.

> However, in collaboration with our Fixed Income team, we have included a 4-step guide of key actions and considerations for our clients, their trustees and investment consultants to manage risks around potential downgrades in 2025.

Why did Moody's not downgrade?

In determining their view, Moody's noted that the credit rating affirmation is supported by:

> France's large, wealthy and diversified economy.

> The country's demographic profile being more benign than that of many other advanced economies.

> The competency of public institutions, and demonstration from previous governments to be willing and able enact economic reform.

> France's susceptibility to event risk being driven by political risk, rather than fiscal risk.

Moody's noted that the outlook change reflects a view that France's budget management is weaker than was previously assessed due to:

> The increasing risk that France's government are less likely to be able to curb sustained wider-than-expected budget deficits, combined with a deterioration in debt affordability.

> The fiscal deterioration seen as being beyond expectations and in contrast with public finance consolidation from governments in similarly rated countries.

> The risks to France's credit profile being heightened by a challenging political and institutional environment.

Moody's position is consistent with that adopted by other ratings agencies, and there are no immediate or short-term investment or fund management actions prompted. ILIM have similar views in respect of France's debt fundamentals and the supportive Euro-wide policy mechanisms in place.

What is next for French sovereign debt ratings and exposures?

A summary of the main agencies' ratings, outlooks and dates last considered are below. DBRS are included for information but are not relevant for index purposes.

Agency	France Rating	Outlook	Date Last Reviewed	Next Date
S&P	AA-	Stable	31 May 2024	29 Nov 2024
Fitch	AA-	Negative	11 Oct 2024	2025 TBC
Moody's	Aa2	Negative	25 Oct 2024	2025 TBC
DBRS	AA-High	Stable	20 Sept 2024	2025 TBC

With S&P the next agency to act in late November and having recently rated France as AA- in late May, while possible, we do not think it is likely that a change is made by them at the end of November. After that, we are into 2025 for the next reviews which typically take place every 6 months.

Key actions for clients & trustees

It remains our view that credit rating changes that prompt immediate investment or fund management actions are unlikely within the next 6-12 months. The team has been working closely with ILIM clients, their trustees and investment consultants in recent weeks to establish plans to manage risks around potential downgrades in 2025. In summary, we recommend:

1. Reviewing scheme specific country and credit rating exposure, in market value, interest rate and inflation sensitivity terms, and for trustees to determine whether they remain satisfied with the current mix of countries and credit ratings held.
2. Being aware of the profile (term) and nature (nominal vs inflation-linked) of available and liquid debt in the Eurozone, where alternative approaches or changes to portfolios are being considered.
3. Understanding the portfolio approach taken within funds that hold Eurozone government debt. ILIM manages Eurozone government debt in a variety of ways for clients, including:
   - For bespoke funds, there is unlikely to be immediately required action in the event of a downgrade.
   - For funds following country specific indices (as opposed to credit rating driven indices), there is unlikely to be immediately required action in the event of a downgrade.
   - For funds following credit rating-based indices, a downgrade of an issuer may result in that issuer falling out of the index. In that event, an investor would need to decide whether to:
     - Remain in the existing fund (and that fund subsequently reallocate capital following changes), or,
     - To invest in a fund that has an index that would continue to be able to hold the downgraded issuer.
     - Either of these choices would need to be understood by investors in terms of impact on yield level, credit and country mix, and duration, for example.
4. Engaging across scheme stakeholders to ensure alignment across investment providers, actuaries, risk managers and other function-holders.

If you have questions or client specific circumstances to consider, please engage further with your usual ILIM relationship manager.

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