SCOPE Scope Ratings

French bank quarterly

Net interest margins to remain low for longer

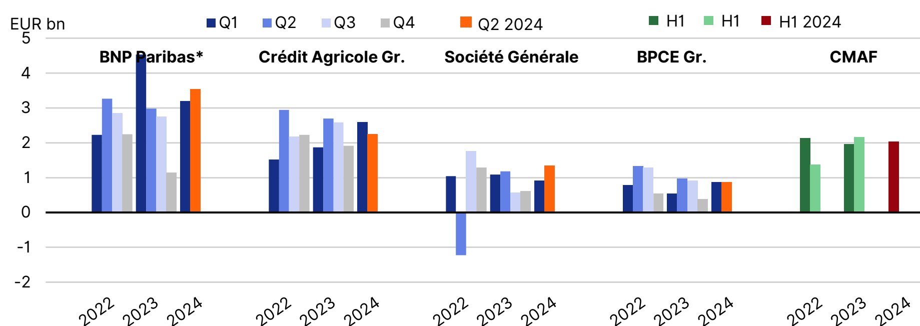
The repricing of French banks' balance sheets is taking longer than anticipated, putting persistent pressure on profitability. Earlier this year, banks were forecasting the second or third quarter as the beginning of a new era, with more evident signs of a recovery in net interest margins. However these expectations have not yet materialised. Efforts to improve cost efficiency, a structural weakness compared to other EU banks, are delivering limited progress.

While interest revenue from domestic retail banking activities remains a key driver of this trend, any uptick in margins is unlikely to become more pronounced before the fourth quarter. We also expect further reductions in policy rates, which will limit upside potential for earnings. The benefits of the repricing will be less pronounced than in other EU countries that have adjusted more rapidly, like Spain for example.

Muted loan demand combined with a less supportive deposit beta was a common theme in French banks' interim earnings reports. The robust performance of corporate and investment banking (CIB) and the absence of excessive pressure on asset quality eased pressure on profitability in the second quarter. But CIB is volatile and the gradual deterioration in asset quality may continue, having already converged towards historical averages. While employment in France is resilient, corporate bankruptcies have been rising and are at their highest level for years.

Nevertheless, two trends are providing some comfort to French banks' creditworthiness. First, the unabated pressure on margins is encouraging banks to adapt their business models. All banks have retained their ability to make strategic moves to either develop or reinforce leading market positions. Second, the banks are maintaining excess buffers to regulatory requirements, which has helped to preserve investor confidence.

Figure 1: Quarterly net income (EUR bn)



*BNPP: Q1 2023 included EUR 2.947bn capital gain from the sale of Bank of the West. Not restated for accounting changes.
Source: SNL, banks, Scope Ratings

Our expectations of 2024 trends for French banks		
Profitability	Mildly negative because of muted loan demand	↘
Asset quality	Mildly negative given the economic slowdown and inflationary pressure	↘
Funding and liquidity	Stable thanks to slowing deposit migration, limited additional wholesale funding needs, liquid balance sheets	→
Capital	Stable buffers, relatively low distribution to shareholders	→

Analysts

Nicolas Hardy
n.hardy@scoperatings.com

Tatiana Fomenko
t.fomenko@scoperatings.com

Carola Saldias Castillo
c.saldias@scoperatings.com

Team leader

Marco Troiano
m.troiano@scoperatings.com

Media

Keith Mullin
k.mullin@scopegroup.com

Profitability: delayed improvement of interest revenue

Lacklustre profitability continues to affect French banks' performance. This summer was supposed to have heralded the start of a new era of rising net interest margins (heavily influenced by domestic retail banking) that would close the gap to other EU banks. But it is taking more time because of two strong headwinds:

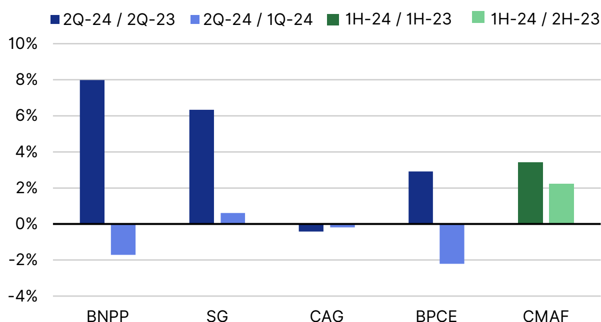
1. Limited new loan production, particularly in domestic retail, which is key to loan repricing;
2. Ongoing migration of customer deposits from non-remunerated to remunerated accounts, which has an impact on deposit beta.

Also, the economic outlook for France (AA/Neg) remains uncertain, especially set against the tense political backdrop following recent snap elections. And while deposit migration will slow as depositors will want to keep some of their funds highly liquid, the consensus is skewed towards lower monetary policy rates going forward, which in turn will impact deposit beta regardless of customer behaviour. We recently revised up our forecast to two 25bp ECB cuts from one by the end of the year to an end-year deposit facility rate of 3.25%.

Despite these challenges, corporate and investment banking delivered solid results and largely explained the resilience of second-quarter earnings. Banks have also made decisive efforts to contain their cost bases, although all-in jaws effects were modest in Q2.

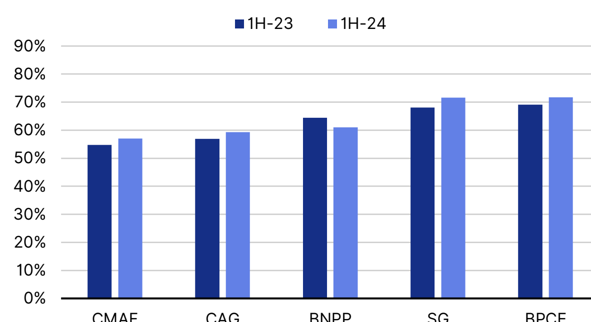
On a positive note, the prolonged period of low interest margins has encouraged banks to adjust and diversify their business models beyond their strongholds in domestic retail banking. BPCE's decision to adopt a more pan-European approach in equipment finance illustrates this trend. BNP Paribas made progress with its plan to reinvest the proceeds from the sale of the Bank of the West; its negotiation to acquire AXA Investment Managers meeting its aim of strengthening its presence in asset management.

Figure 2: Revenue growth, %



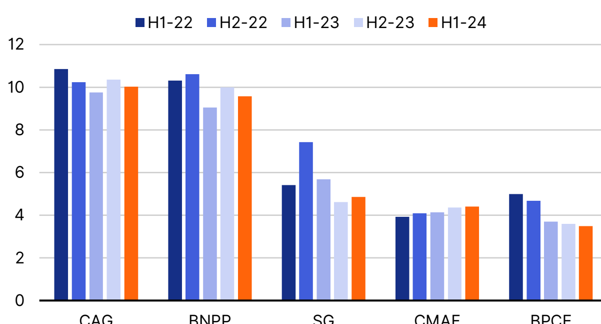
Source: banks, Scope Ratings

Figure 3: Cost-to-income ratios



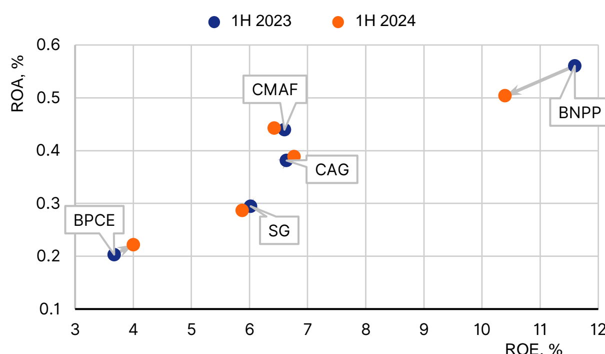
Adjusted for SRF contributions. Source: banks, Scope Ratings.

Figure 4: Net interest income, EUR m



Source: SNL, Scope Ratings

Figure 5: Profitability indicators (ROA, ROE)



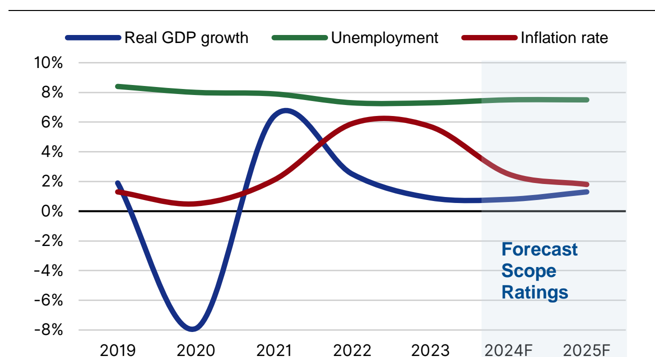
Source: SNL, Scope Ratings

Lending dynamics: muted loan demand reflects stagnating economic growth

According to INSEE, France's national statistics bureau, real GDP grew moderately by +0.2% (quarter-on-quarter) in Q2 2024, after +0.3% in the first quarter. For the full year, GDP growth is likely to end close to its 2023 level, at around +1%. The policy direction of any future government, for instance around supply side reforms, is a key unknown for short-term business prospects. Still, on a positive note inflation trending down towards 2% could support broader economic stability.

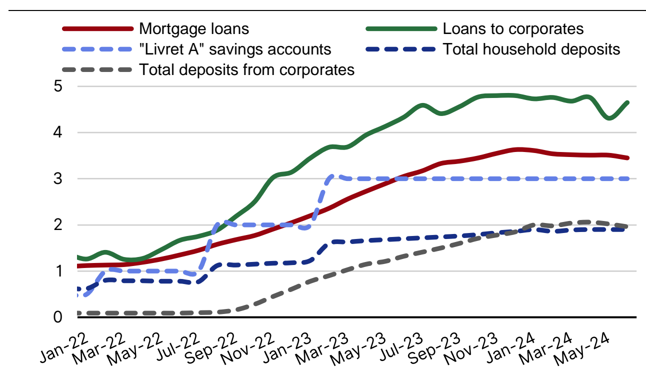
Even though mortgage rates have come down, this trend has not yet revitalised new loan production. The recovery, if maintained, will be visible towards the end of the third quarter, given some seasonality effects and expectations that rates will continue to fall. Annual growth in consumer loans has been declining in recent months (+2.5% in April, +1.7% in June) and cannot compensate for the slowdown in mortgage lending, given its relatively small share of total outstandings (less than 15% of loans to households). Lending to corporates is more dynamic, growing by 1.8% in the year to July, according to Banque de France data. However, sector dynamics were mixed in June, with outstandings contracting in some large sectors of the economy such as manufacturing, trading and hospitality. Aggregated data reflects this muted or very moderate portfolio growth. It also shows the limited effect of geographical diversification on portfolio growth.

Figure 6: Macroeconomic projections



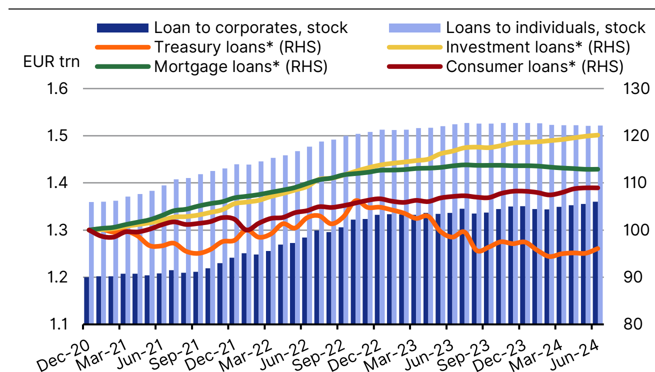
Shaded area represents forecasted values. Inflation rate: annual average Harmonised Index of Consumer Prices. Source: IMF, Scope Ratings

Figure 7: Interest rates on loans and deposits, %



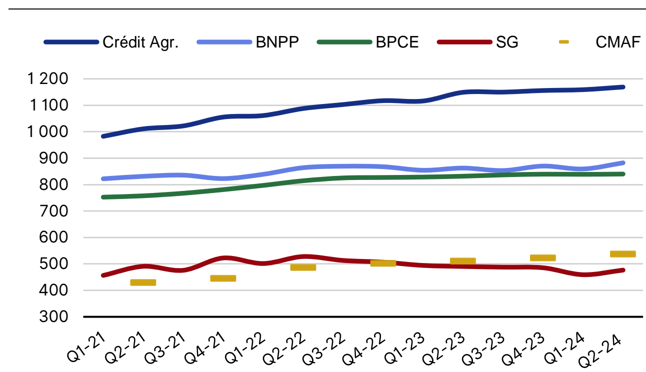
Interest rates on loans: new business, all maturities, annualised agreed rate. Source: Banque de France, Scope Ratings

Figure 8: Domestic lending dynamics



*Change of stock, Dec 2020 = 100. Source: Banque de France, Scope Ratings

Figure 9: Customer loans, nominal amounts in EUR bn



At amortised cost. Source: banks, Scope Ratings

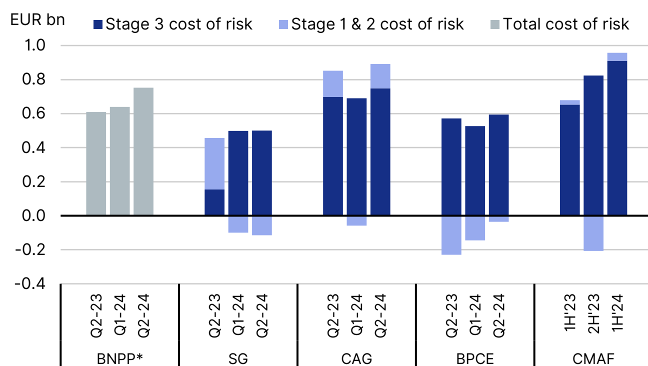
Asset quality: no broad-based deterioration, but cost of risk rising

The normalisation of asset quality is becoming more evident, after years of limited need for stage 3 provisions. While cost of risk has previously shown signs of volatility due to collective provisions or model adjustments, stage 3 cost of risk is on the rise and is the main driver of impairment charges. The figures now are aligning with historical averages or with the banks' medium-term objectives. However, the banks do not generally see asset quality deteriorating. Rising stage 3 loans reflect sector-specific or single-name issues.

Despite the negative effects of higher interest rates on loan demand and on the solvency of borrowers, resilient real GDP growth and employment support this view. We note that the macroeconomic scenarios used to calibrate expected losses were not significantly revised at end-June 2024.

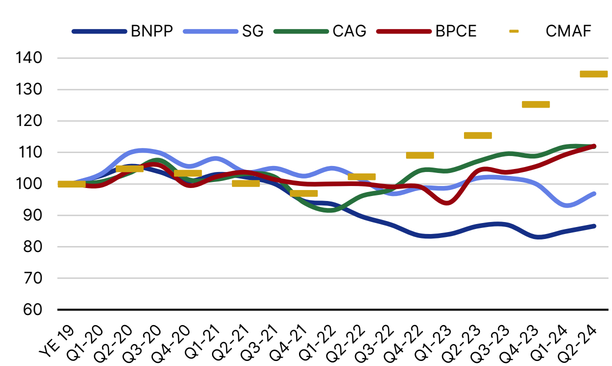
However, the positive outlook around the resilience of customer loan portfolios contrasts with the rise in corporate bankruptcies in France, which are at their highest level for years partly owing to the withdrawal of Covid and energy related support measures. We expect the rising trend to continue. This deserves attention because the most exposed sectors – trade and construction – play an important role in the French economy and we may see bankruptcies shift from very small enterprises to larger companies, especially in the construction sector.

Figure 10: Cost of risk



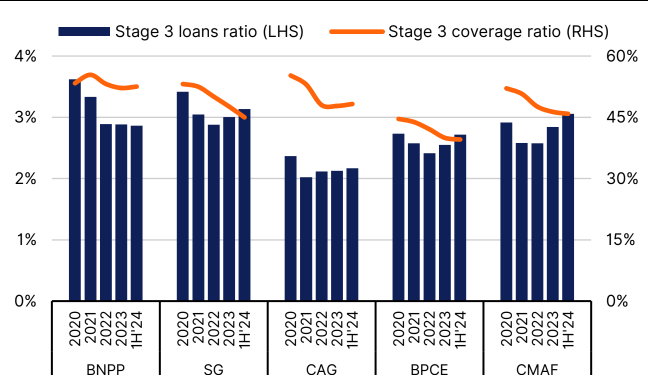
* BNPP: Quarterly breakdown not available. Source: banks, Scope Ratings

Figure 11: Impaired loans (stock, Q4 2019 = 100)



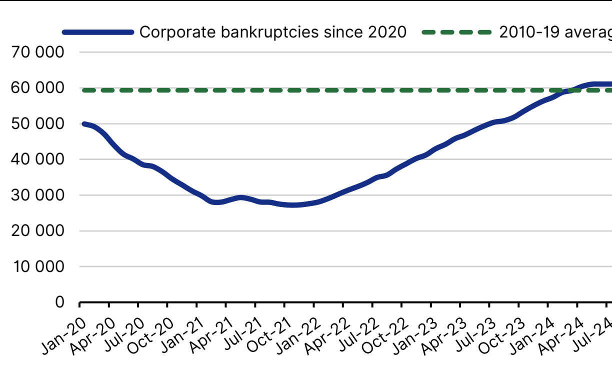
Source: banks, Scope Ratings

Figure 12: Stage 3 ratios



Source: banks, SNL, Scope Ratings

Figure 13: Corporate bankruptcies



Note: Number of bankruptcies registered. Source: Banque de France, Scope Ratings

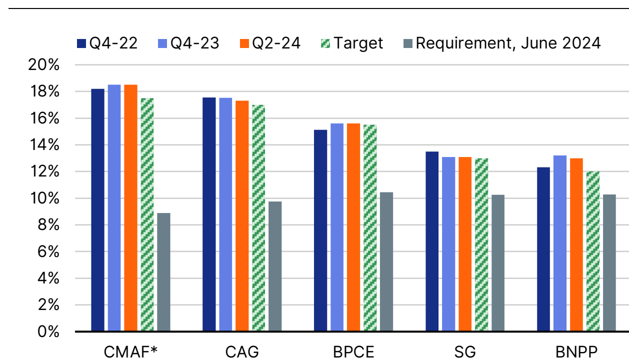
Distance to regulatory requirements: preserving large buffers is essential

Preserving substantial buffers above minimum regulatory requirements is essential to preserve investor confidence. French banks have maintained a constant focus on Common Equity Tier 1 ratios, Liquidity Coverage Ratios and resolution buffers (vs. TLAC or MREL requirements). These ratios are well managed and maintained within a managed corridor. The lowest ratios, albeit still fully compliant, are Société Générale's and BNP Paribas' leverage ratios, and the net stable funding ratio of BPCE, all of which are more tightly managed than those of peers (domestic and international).

For a variety of reasons, including pressure on earnings, organic and non-organic growth ambitions or already tightly managed capital positions, French banks' share buyback programmes have been more limited than those of their more profitable European peers, which provides good visibility on capital trajectory and remains a positive element for their risk profiles.

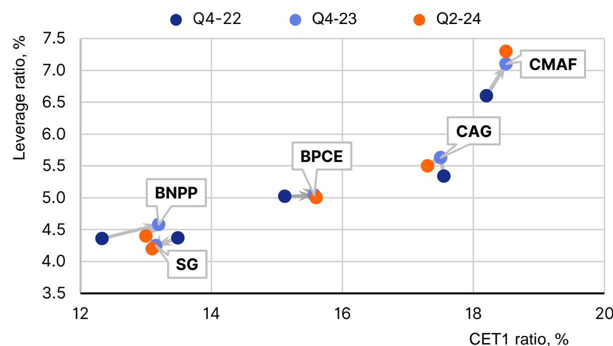
French banks also maintain good market access. Annual debt issuance programmes are already well advanced thanks to a very active debt issuance in the first half of the year. Issuance for the rest of the year, while still marginal, will be more opportunistic and likely dependent on a stable political outlook.

Figure 14: CET1 (ranking by CET1 ratio at end-June 2024)



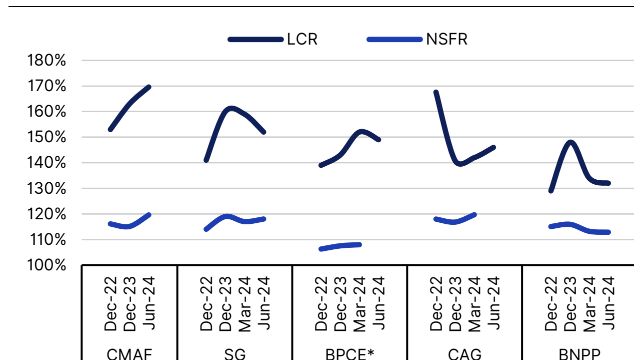
*CMAF's CET1 target between 17% and 18%. Source: banks, Scope Ratings

Figure 15: CET1 and leverage



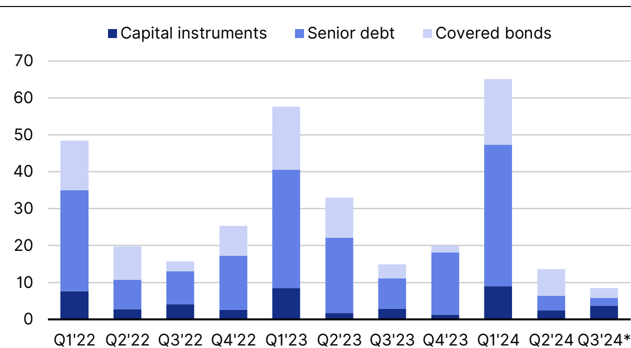
Source: banks, Scope Ratings

Figure 16: Funding and liquidity ratios (ranking by LCR)



LCR: end-of period Liquidity Coverage Ratio; NSFR: Net Stable Funding Ratio.
*BPCE: LCR based on average end-of month ratios during the quarter. NSFR not yet available for BPCE and CAG.
Source: banks, Scope Ratings

Figure 17: Quarterly debt issuance, historical (USD bn)



*From July to Sept 5. Issuance activity of French banking groups in our sample. Only large public international bond issues predominantly in EUR, USD and GBP. Excludes private placements, retained issuance, debt documented and sold privately.
Source: Bond Radar, Scope Ratings

Related research

Selected research available on **scoperatings.com**:

France: political uncertainty weighs on public finances and funding conditions, September 2024
Full depositor preference a step towards EDIS?, August 2024
Italian bank quarterly: Higher-for-longer rates support performance, credit fundamentals improve, Aug 2024
Supervisory changes to assess bank risk and calculate capital add-ons a positive step, August 2024
European banks in Russia: exceptional factors drive profits amid pressure to exit, August 2024
European Bank Capital Quarterly: refinements to supervision and regulations are credit supportive, July 2024
EU banks: NPLs look set to continue rising, July 2024
France: electoral outcome set to slow growth reforms, fiscal consolidation, and EU policy agenda, July 2024
French banks: uncertain policy agenda casts shadow over drive to improve profitability, June 2024
Spanish banks quarterly: profitability better than expected; competitive dynamics shifting, May 2024
Italian Bank Quarterly: benign operating conditions support performance, May 2024
Bank Capital Quarterly: dealing with the TBTF dilemma, May 2024
Strategic case for Western European banks in CEE remains intact, April 2024
Norwegian Savings Banks: strong profitability set to continue, April 2024
EU banks NPL Heatmaps: modest increases to continue, April 2024

Issuer rating reports available to ScopeOne subscribers:

Banque Fédérative du Crédit Mutuel

BNP Paribas S.A.

BPCE S.A.

Crédit Agricole S.A.

Société Générale S.A.

Scope Ratings GmbH

Lennéstraße 5
D-10785 Berlin
scoperatings.com

Phone: +49 30 27891-0
Fax: +49 30 27891-100
info@scoperatings.com

in
Bloomberg: RESP SCOP
Scope contacts

Disclaimer

© 2024 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Ratings UK Limited, Scope Fund Analysis GmbH, and Scope ESG Analysis GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope's ratings, rating reports, rating opinions and related research and credit opinions 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. Scope's ratings, rating reports, rating opinions, or related research and credit opinions are provided 'as is' without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct, indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope's ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope's credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5, D-10785 Berlin.