Rating Action: Moody's upgrades long-term ratings of Credit Agricole S.A. and CACIB to A1; stable outlook

Global Credit Research - 19 Jul 2016

Credit Agricole S.A.'s baseline credit assessment (BCA) and adjusted BCA are upgraded to baa3 and baa1, respectively

London, 19 July 2016 -- Moody's Investors Service has today upgraded the long-term debt and deposit ratings of Credit Agricole S.A. (CASA) and Credit Agricole Corporate and Investment Bank (CACIB) to A1 from A2, and revised their outlooks to stable from positive. Moody's also affirmed CASA's and CACIB's short-term ratings at Prime-1.

Moody's upgraded CASA's baseline credit assessment (BCA) to baa3 from ba1 and its adjusted BCA, which reflects Groupe Credit Agricole's (GCA; unrated) credit strength, to baa1 from baa2. These upgrades reflect improvements at both GCA and CASA itself, particularly in asset risk and profitability. Concurrently, CACIB's BCA was affirmed at ba2.

Moody's has also upgraded the ratings of all subordinated and hybrid debt instruments issued by CASA and its backed subsidiaries by one notch. Lastly, the long-term Counterparty Risk (CR) Assessments of CASA and CACIB were upgraded to Aa3(cr) from A1(cr), while its short-term CR Assessments were affirmed at Prime-1(cr).

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_191183 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

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- Methodology Used

UPGRADES REFLECT THE GROUP'S IMPROVED FUNDAMENTALS

The upgrade of CASA's BCA and adjusted BCA was driven by material improvements in the financial strength of both GCA and CASA itself, as well as expectations of further improvements in capitalisation, despite Moody's view that the bank will operate in a difficult and uncertain economic and regulatory environment.

As a result of the internal support mechanisms prevailing with the Credit Agricole cooperative group, CASA's adjusted BCA is driven by the analysis of the group on a consolidated basis, whereas its BCA reflects its weaker overall credit fundamentals relative to those of the group, in particular solvency, and its less retail-oriented business focus. CACIB's adjusted BCA of baa1, equivalent to CASA's adjusted BCA, is also driven by GCA's credit strength.

CASA's asset quality has strengthened, largely thanks to the reduction of credit issues in Italy, and its cost of risk fell to 39 basis points (bps) of outstanding loans in the twelve months ending March 2016 from 51 bps a year earlier, while GCA's cost of risk was only 28 bps in the same period versus 34 bps a year earlier. This compares favourably to the average cost of risk of the French banking system, which was 40 bps in 2015.

In addition, GCA reported a common equity tier one (CET1) ratio of 13.9% on a fully-loaded basis as of end-March 2016, an improvement of 1.0 percentage points, placing GCA's capitalisation at the high end of peers in France. Moody's expects GCA to retain more than three-quarters of its earnings and increase its CET1 ratio by close to one percentage point every year. In Moody's opinion, high capital accretion at GCA level makes the group's objective of a 16% CET1 ratio by 2019 achievable, unless regulatory changes are more stringent than currently contemplated. Although capitalisation is not a strength at this level of the group, CASA's CET1 ratio also improved to 11% as of end-March 2016, pro forma for the transfer of CASA's 25% stake in the Caisses
Regionales de Credit Agricole Mutuel (the "CRCAMs" or "regional banks"). CASA will effectively transfer its participation to a new vehicle entirely owned by the CRCAMs themselves in the third quarter of 2016.

CASA and GCA’s profitability has rebounded sharply on the back of lower credit losses since year-end 2014, bringing reported profits closer to underlying earnings power and in line with its peers. Moody’s expects the group’s retail-focused activities in France to generate stable and sustainable returns, despite protracted low interest rates eroding net interest margins. International operations ceased to weigh on profitability, in particular in Italy, thanks to the provisioning of credit issues and improved risk management practices. Cassa Di Risparmio Di Parma E Piacenza S.P.A. (Cariparma, deposits and senior debt A3/A3 stable, BCA ba1; ratings unaffected), CASA’s retail bank in Italy, saw its cost of risk fall to 113 bps in the twelve months ending March 2016 from 140 bps in full year 2014. In the meantime, the consumer finance division also reported a declining cost of risk, at 140 bps in the twelve months ending March 2016 compared to 264 bps in full year 2014, due to the sharp decrease of loan losses at Agos, CASA’s consumer finance unit in Italy. Overall, the group should exhibit lower earnings volatility than in the past, despite possible credit costs linked to exposures to troubled industries, for instance in the energy and shipping sectors.

Despite significant wholesale funding needs, Moody’s considers GCA’s funding structure as satisfactory in view of (1) the EUR 114 billion of long-term stable surplus reported by the group (long-term stable resources less long-term assets) at end-March 2016, illustrating the long term maturity of the majority of wholesale funding; (2) the very strong geographic and product diversification of its funding sources; and (3) its proven capacity to make private placements via the retail networks and the structured notes market via CACIB. In addition, GCA’s liquidity is good in Moody’s opinion, as illustrated by the ratio of liquidity reserves to short-term debt of 261% at end-March 2016.

The upgrade of the long-term deposit and senior unsecured ratings to A1 from A2 was prompted by the upgrade of CASA’s adjusted BCA. These ratings are underpinned by (1) CASA’s adjusted BCA; (2) the application of Moody’s Advanced Loss Given Failure (LGF) analysis, resulting in a two-notch uplift from the adjusted BCA of baa1, given the significant volumes of senior debt and junior deposits and resulting in very low loss-given-failure for these instruments; and (3) government support uplift of one notch, reflecting a moderate probability of support.

The upgrade of the long-term CR Assessments follows the upgrade of CASA’s adjusted BCA to baa1. The CR Assessments of Aa3(cr) are four notches above the Adjusted BCA, reflecting the substantial volume of bail-in-able liabilities protecting operating obligations as well as a moderate probability of government support.

RATIONALE FOR THE STABLE OUTLOOK

Moody’s has assigned a stable outlook to CASA’s A1 long-term debt and deposit ratings in reflection of the group’s diversified and stable sources of retail-oriented earnings and its capacity to retain the vast majority of its earnings to build capital buffers. These factors counterbalance the profitability headwinds stemming from the low interest rate environment and provide an effective “shock absorber” against unexpectedly rising credit costs.

WHAT COULD CHANGE THE RATING -- UP/DOWN

An upgrade of CASA’s adjusted BCA could occur if (1) the bank achieves a longer track record of stable and sustainable profits, in line with a low risk profile; and (2) GCA’s capital metrics were to improve significantly above the objectives currently set by the bank. This would likely result in an upgrade of CASA’s long-term ratings.

CASA’s BCA and adjusted BCA could be downgraded because of (1) a significant deterioration in asset quality, driven for instance by the energy or shipping sectors; (2) stronger-than-expected erosion of revenues linked to declining net interest margins; or (3) negative developments in the bank’s capital or liquidity.

A downgrade in CASA’s BCA and adjusted BCA would likely result in a downgrade of the bank’s long-term ratings. The bank’s long-term ratings could also be downgraded as a result of an increase in loss-given-failure, should senior debt and deposits account for a significantly smaller share of the bank’s overall liability structure, or benefit from lower subordination than is currently the case.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.
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