France’s credit rating was cut by Standard & Poor’s, which said President Francois Hollande’s policies will fail to spur growth and fix public finances.

The nation’s long-term foreign and local-currency grade was lowered one step to AA from AA+, S&P said in a statement today. France lost the top rating at S&P in January 2012. The outlook on the grade, now the third highest, is stable, according to S&P. French bonds fell, sending the 10-year yield up 2 basis points to 2.39 percent at 8:05 a.m.

The downgrade underlines how Europe’s second-largest economy is struggling to recover in the wake of the financial crisis and recession. Hollande hasn’t managed to reverse a slide in France’s competitiveness with changes to labor laws and payroll taxes, the European Commission said in a Nov. 5 report.

“The downgrade reflects our view that the French government’s current approach to budgetary and structural reforms to taxation, as well as to product, services, and labor markets, is unlikely to substantially raise France’s medium-term growth prospects,” S&P said. “Moreover, we see France’s fiscal flexibility constrained by successive governments’ moves to increase already high tax levels, and what we see as the government’s inability to significantly reduce total government spending.”

In a statement, French Finance Minister Pierre Moscovici criticized the ratings cut as inaccurate and defended Hollande’s policies as a “massive” attempt to restore economic health. In the past year, Hollande has cut payroll taxes, loosened labor laws to makes firings easier and lengthened working lives.

**Investor Reaction**

France dropped from the AAA level at Fitch Ratings in July, after Moody’s Investors Service reduced it to Aa1 from Aaa in November last year. Investors have largely shrugged off those announcements, reflecting a shift from reliance on ratings agencies to a focus on in-house analysis.

Since S&P’s first downgrade on Jan. 13, 2012, French government bonds returned more than 10 percent, according to the Bloomberg France Sovereign Bond Index.

Gross domestic product will expand 0.2 percent this year and 0.9 percent next year, before increasing 1.7 percent in 2015, the Commission said. That’s in line with the Hollande government’s own forecasts. As a percentage of GDP, public debt will climb to 96 percent in 2015 from 90.2
percent in 2012 when Hollande succeeded Nicolas Sarkozy.

To contact the reporter on this story: Shamim Adam in Singapore at sadam2@bloomberg.net

To contact the editor responsible for this story: Stephanie Phang at sphang@bloomberg.net