Risks for the French Banking sector

French banks roundtable

Paris, 3 June 2019

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Risks for the French Banking sector

1. Risk outlook on corporate and property lending
2. Risks for the French Banking sector
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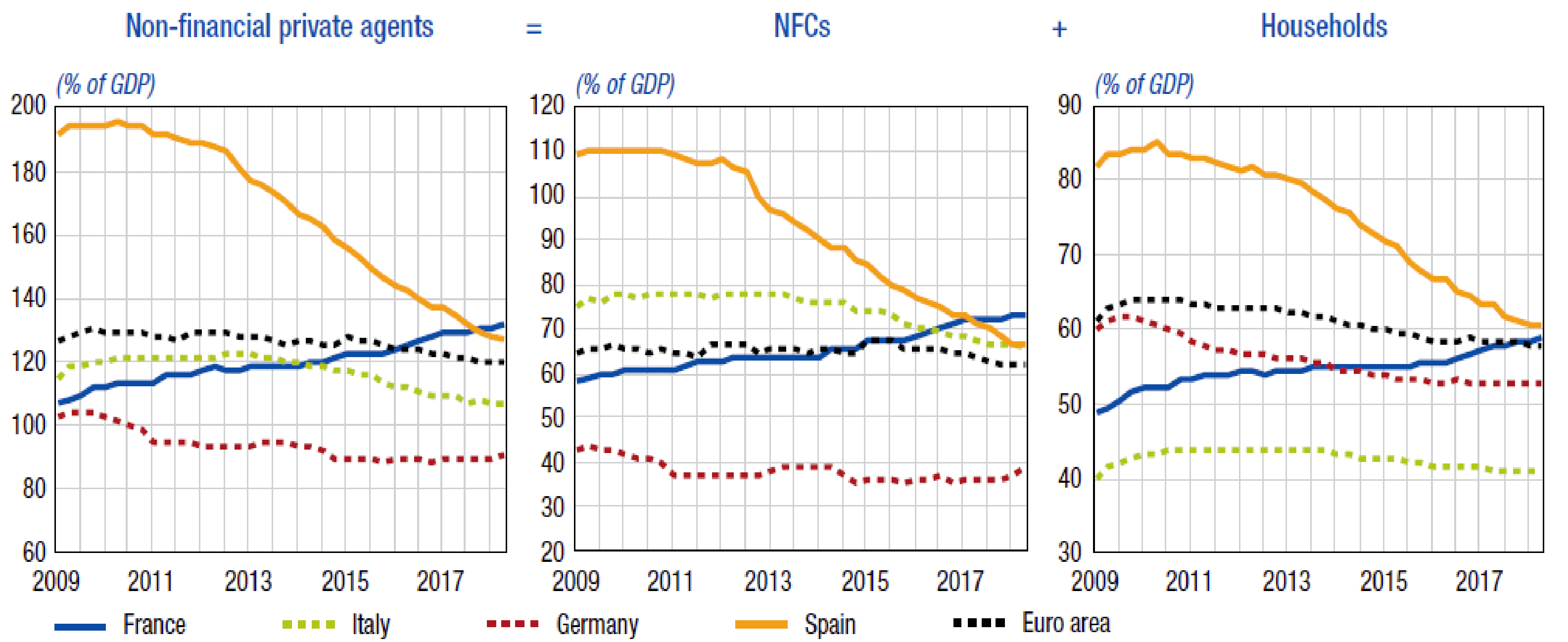
1. Risk outlook on corporate and property lending (1/3)

Private debt is reaching elevated levels

Debt ratio of non-financial private agents in European countries



Source: Banque de France.

Debt ratio of French non-financial private agents:

- ➢ lower than in the United Kingdom (155%), the United States (149%) and Japan (147%),
- ➢ but 12.3 pp above the euro area average (120%)
- ➢ mainly owing to the debt ratio of non-financial corporations, 11.2 pp higher than the euro area average.

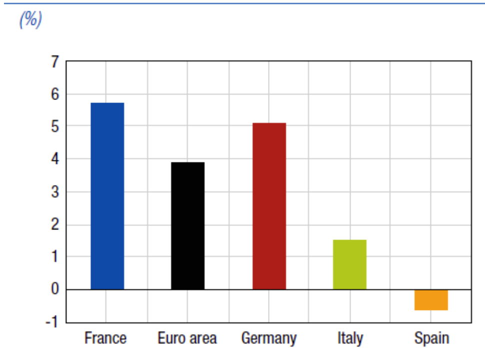
Risk outlook on corporate and property lending (2/3)

Non-financial companies debt continued to increase

Total debt of non-financial companies:
1 658 billion euros

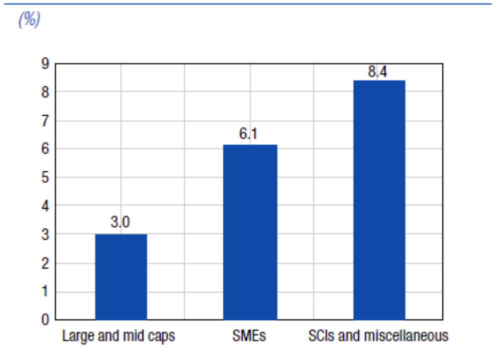
- 653 billion euros in debt securities
- 1 004 billion euros in loans from French banks

Annual growth rate of bank credit, European comparison (October 2018)



Sources: Banque de France, European Central Bank.

Annual growth rate of bank credit by company size, France (October 2018)



Source: Banque de France.
Note: SCIs = real estate companies.

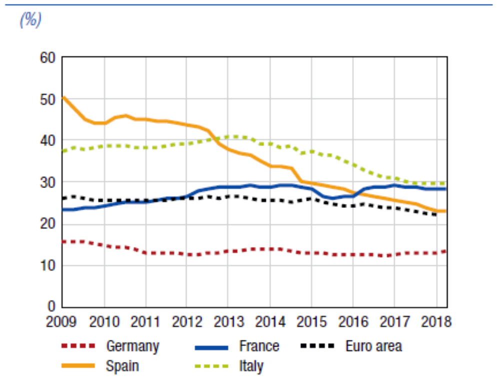
Financing costs still very low

Debt service ratio has stabilized

NFC financing costs

Source: Banque de France.

Debt service (share of repayments in NFC earnings)



Sources: Banque de France, European Central Bank.

1. Risk outlook on corporate and property lending (3/3)

Household debt is increasing

Outstanding loans to resident individuals: 1 213 billion euros, including 999 billion in property loans and 178 billion in consumer credit.

1 - But **three structural factors** specific to the French market need to be underlined which help to mitigate the risk in the vent of difficulties:

- since virtually all property loans are at fixed rates, an increase in interest rates would not have a direct impact on borrower solvency;
- virtually all property loans are protected in some way, either by a "cautionnement" guarantee (60% of loans), a mortgage (30%) or another type of guarantee (5%);
- borrower solvency remains the main criterion of analysis, rather than the value of assets financed.

2 - The non-performing loan ratio for property loans to households is historically **very low (around 1.5%)** and has risen little since the 2008 financial crisis.

2. Risks for the French Banking sector (1/2)

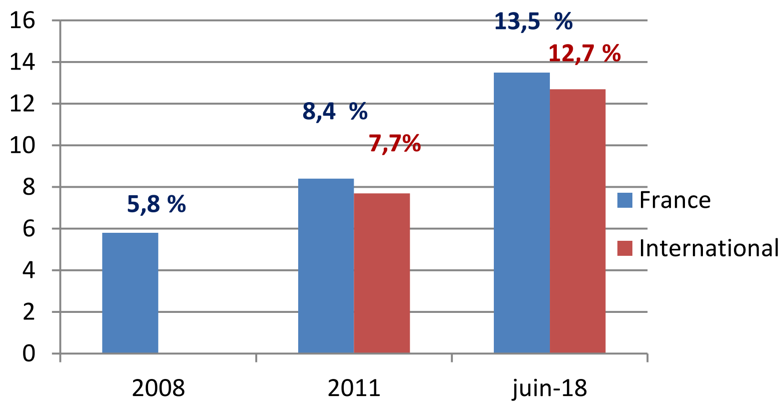
Main risks to the French financial system in December 2018	Level and outlook
1. Market risk The risk of a sudden repricing of financial assets remains despite recent equity market corrections. Portfolio turnover phenomena have been observed. Valuations are still high on financial markets, for both equity and bonds, which reflects investors' appetite for risk. Nonetheless, investor confidence could be undermined by a combination of several factors of uncertainty originating from the United States (protectionism and economic policy), Europe (the political situation in Italy, Brexit) and emerging countries (financial vulnerabilities).	⬆ (High risk)
2. Risks linked to private sector debt Non-financial corporation (NFC) and household indebtedness continues to rise in France, in contrast to trends observed in other European countries. NFC debt dynamics are notably a source of liquidity and default risks, which could intensify in the coming months. Growth in household lending remains sustained and calls for careful monitoring in the face of signs of an easing of lending conditions.	⬆ (High risk)
3. Interest rate risks linked to fragmentation The political situation in certain euro area countries has led to widening bond yield spreads and a risk of fragmentation in euro-denominated debt markets. This raises the fear of a resurgence of the contagion loop between sovereign risk and bank risk and higher interest rates for the private sector, particularly in Italy.	➡ (High risk)
4. Risks linked to structural changes in the financial sector The financial system continues to face structural challenges (digitalisation, cutting costs, the search for new profit sources). Rising operating costs remain an area to watch, as banking institutions continue their efforts to adapt and transform their business models. However, in general the resulting risks are controlled and institutions remain resilient.	➡ (Moderate risk)

Systemic risk High risk Moderate risk

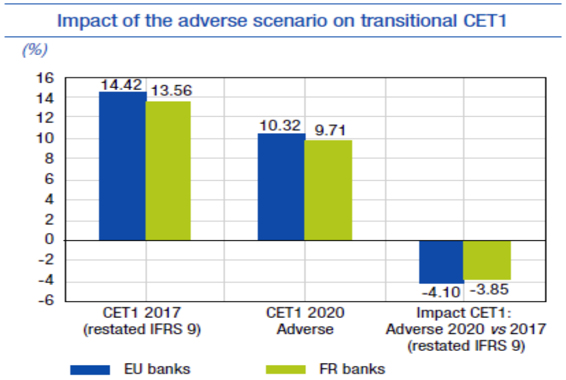
The current level (shown by the colour code) is based on an expert assessment that reflects the probability that the risk will materialise and its potential systemic impact over the medium term. The outlook (shown by the direction of the arrow) indicates the likely change over the next six months.

2. Risks for the French Banking sector (2/2)

1. A good capital base (CET1)

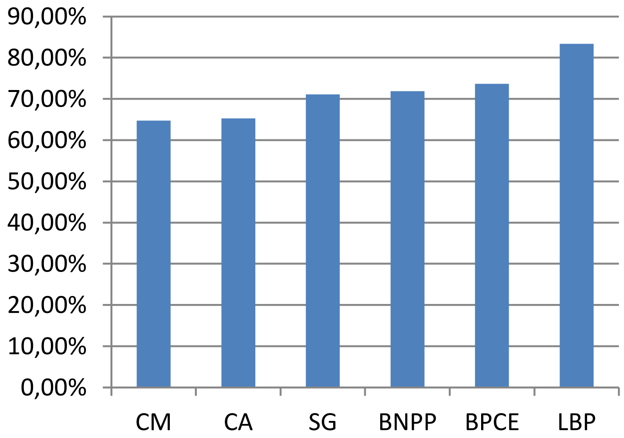


2. Good resilience in the EBA/ECB stress test

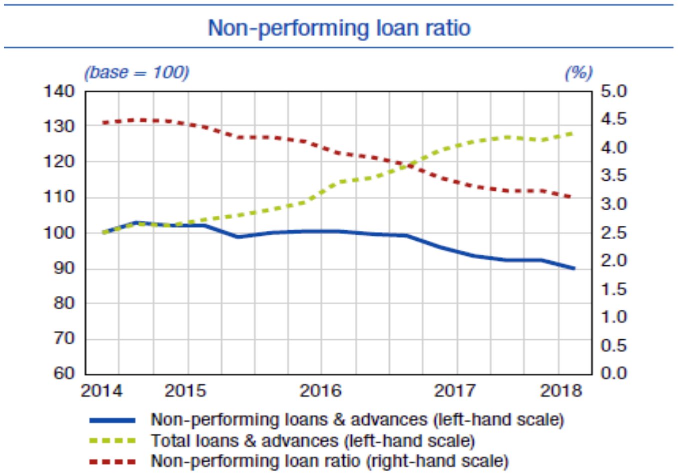


Sources: EBA, Banque de France calculations.

3. Cost to income still high (end 2018)



4. Low level of non performing loans



Source: ACPR.

ACPR BANQUE DE FRANCE

The macro prudential measures taken (1/2)

First measure: limit to highly indebted French corporates

The measure consists in requiring from systemically important French credit institutions a tightening of the large exposure limit on **highly indebted large NFCs, down to 5%** of banks' own funds (came into effect in July 2018).

1. Motivation for this measure

- Resilience: it protects systemic banks in case of defaults in the large French NFC sector.
- Prevention: it sends a strong warning signal and intensifies vigilance of institutions and investors ; aims at limiting intertwined risks between systemic NFCs & systemic banks

2. Selection and calibration of the measure:

- In contrast to other potential measures, this measure
  - ✓ Targets where the risk lies i.e. in highly indebted Large NFCs (systemic motive)
  - ✓ Focuses on systematically important banks (95 % of NFC loans in France)
- The 5% limit is designed as a trade-off between
  - ✓ Resilience : i.e. sufficiently tight to protect financial institutions
  - ✓ Prevention : i.e. not too restrictive to avoid emergency deleveraging on specific NFCs, while preventing the build up of risks in the sector of large NFCs.

3. Short-term implications of the measure:

- With a 5 % threshold: no direct impact, implementation of a backstop as intended

3. The macro prudential measures taken (2/2)

Second measure: a countercyclical capital buffer

- A general backdrop of a **supportive financial cycle:**
  - The deviation from its long-term trend in the ratio of credit to gross domestic product for France is maintained at a high level, and was in the 4th quarter of 2017 by 3.8 percentage points (compared with 4.1 percentage points in the previous quarter). The buffer rate that would mechanically result from the application of this benchmark would be 0,5 percentage point.
  - The deviation from its long-term trend in the bank lending ratio to gross domestic product is 0.7 percentage point (4th quarter 2017)
  - The dynamics of the leverage of non-financial agents, house prices or the evolution of financial, macroeconomic and monetary indicators confirm the acceleration in the financial cycle that has restored or exceeded its long - term average, and the persistence of cyclical risks at significant levels

- It was decided in June 2018 to raise the rate of the countercyclical capital buffer (CCyB), a capital surcharge for European Union (EU) banks in relation to their exposures in France, to **0.25%**, and in March 2019 to raise the buffer to **0,50 %.**

- The measures, which will enter **into effect in July 2019 and April 2020**, are intended to make the banking system more resilient. This will ensure that this latter is able to support credit supply in the event of a cyclical reversal, especially for SMEs, which are structurally reliant on it.