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The current soundness of banks and insurers, for the smooth financing of the French economy

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Ladies and Gentlemen,

I am delighted to welcome you to the annual ACPR Conference. The theme of this year's conference was an obvious choice: "The financial sector and the new inflation environment and rising interest rates". Without wishing to kill the suspense before we even start, I can already say at the outset that this rise in interest rates is generally beneficial for both banks and insurers. More broadly, in 2023, which has been overshadowed by great uncertainty, the French financial sector has confirmed its considerable resilience (I). It should be able to draw upon this strength to contribute to the sound financing of the French economy during the current slowdown (II).

I. In a year of great uncertainty, the French financial sector has confirmed its considerable resilience

2023 was once again marked by exceptional levels of uncertainty: the concerning geopolitical situation – from Ukraine to Israel alas – which is a source of instability and economic and financial volatility; banking turmoil in the United States and Switzerland at the start of the year; and inflation that remains too high.

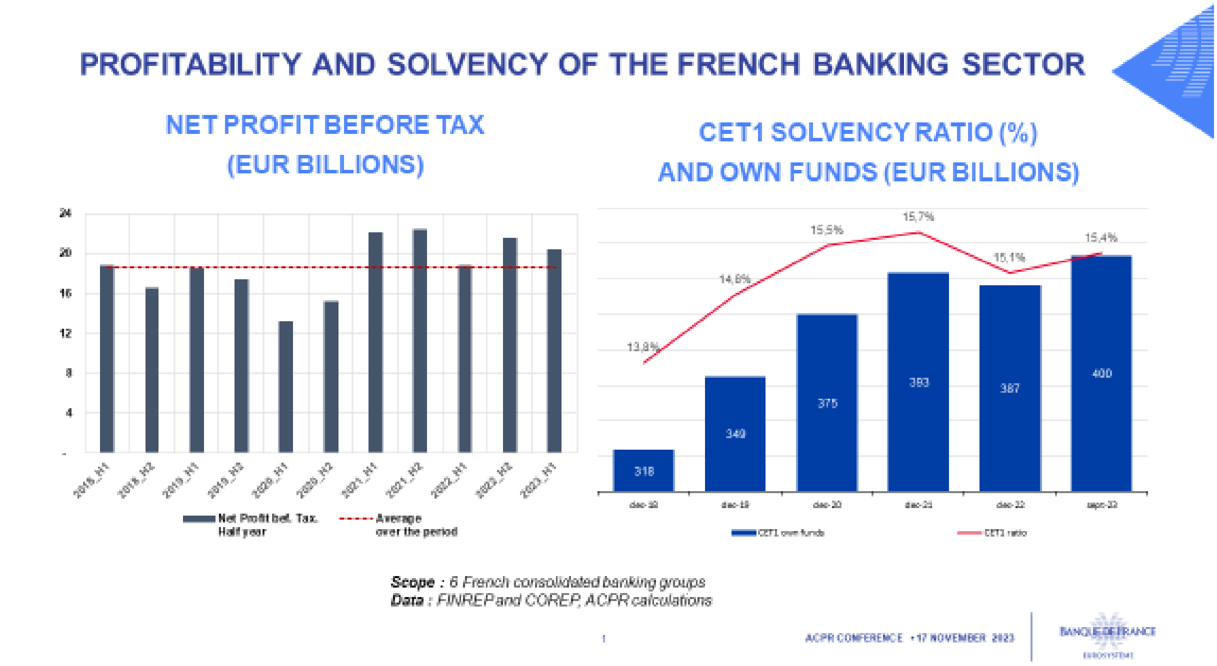
Eurosystem's key interest rates have risen by 450 basis points since July 2022, lifting the deposit facility rate to 4% in September in response to inflation that peaked at 10.6% in the euro area in October 2022. Standing at 2.9% last month,[i] inflation has come down considerably. Energy prices are certainly contributing to this, but core inflation (i.e. excluding energy and food) is also continuing to fall: it now stands at 4.2% in the euro area and is even lower in France (3.5%), and has clearly come down from its spring peak. This proves the effectiveness of monetary policy and fully justifies the decision taken by the Governing Council on 26 October to put an end to the series of interest rate hikes. Our monetary policy must now be guided by *confidence* and *patience*: confidence that we are making steady progress in bringing inflation down towards 2% by 2025; and patience that interest rates will remain stable at their current level for the time still needed to pass them on in full.

1.1 Enhanced profitability and solvency

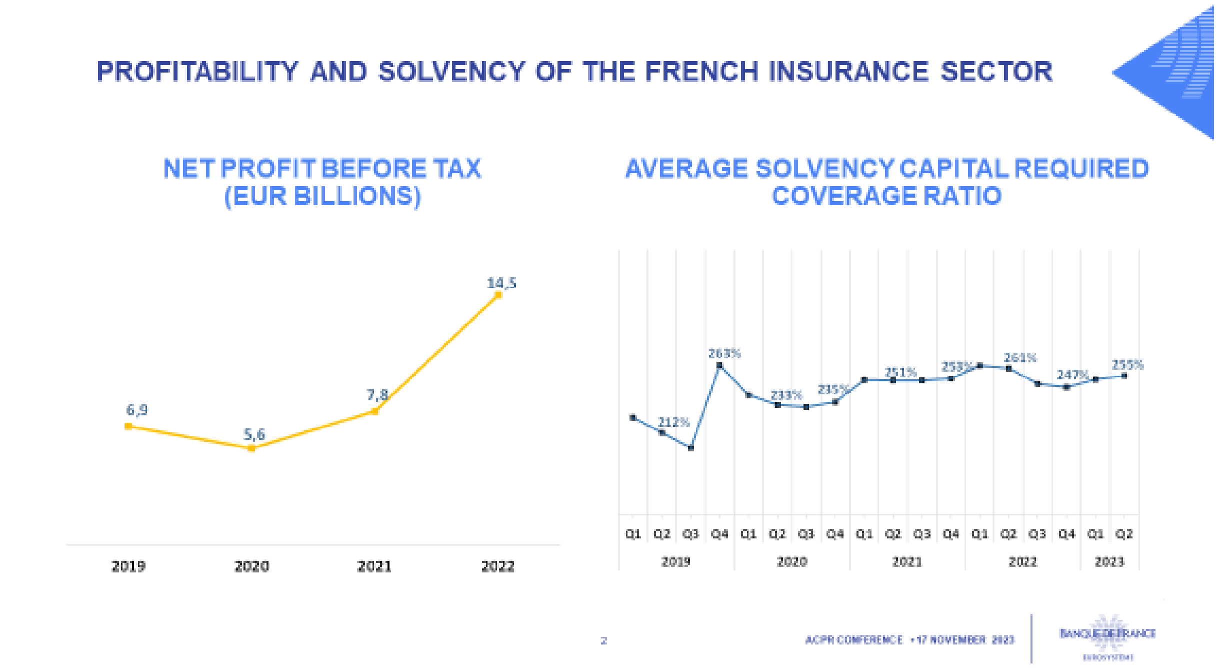
There can be no doubt that European banks are generally benefiting from higher key interest rates, although there is a certain time lag for French banks due to their business model. The predominantly fixed interest rates on their assets (97% of outstanding housing loans are granted at fixed rates), and on regulated savings on the liabilities side, mean that financial conditions take longer to adapt in France. An automatic catch-up is expected over the next few quarters, as French banks continue to renew their assets and liabilities.

This time lag has been attenuated by the decision to stabilise the interest rate on Livret A passbook accounts, which was kept at 3% on 1 August and should remain stable at this level until at least 1 February 2025. This is a very favourable decision for bank interest rate margins; the counterparty, I should recall, is the accelerated growth in popular savings passbook accounts (LEPs), which were held by as many as 10.3 million savers in September 2023, a number which should climb to over 12.5 million next summer. This stabilisation of interest rates on the Livret A passbook account is also intended to ensure the sound financing for the French economy – I'll come back to this point later.

The financial results of the French banking sector have remained very robust: the 2023 half-year on half-year pre-tax earnings of the six largest banking groups grew by 2.5% to stand at EUR 21.7 billion and net banking income (NBI) has been trending upwards since early 2022. Consequently, French banks' solvency ratio has improved once again, rising to 15.6% at 30 June 2023, compared with 15.1% at the end of 2022, well above minimum regulatory requirements. The results published by the four main French banking groups in the third quarter of 2023[ii] point to a more mixed performance, with French retail banking revenues sometimes impaired by interest rate hedging strategies that can prove costly in the current interest rate environment.[iii]

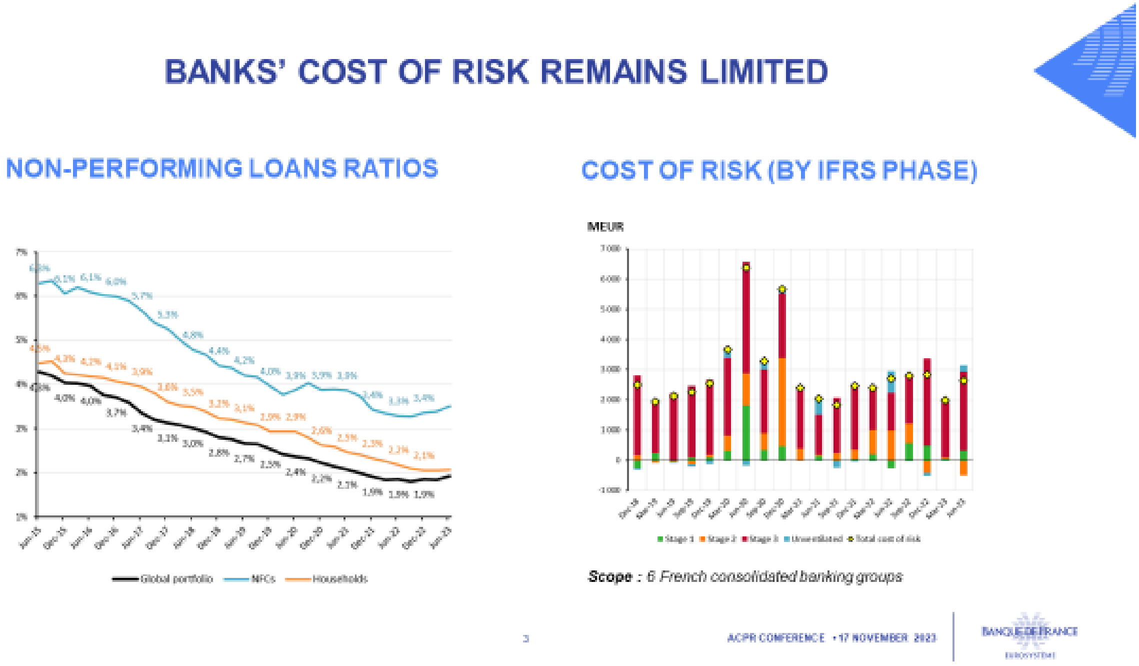


The rise in interest rates is also improving profitability in the insurance sector: as the duration of liabilities is longer than that of assets, this has a positive impact on the balance sheet and therefore on the solvency of insurers. As a result, the solvency capital requirement (SCR) coverage ratio for insurance companies has risen from 247% in Q4 2022 to 255% in Q2 2023.



Looking further ahead, the rise in interest rates makes it possible to refocus portfolios on higher-yielding assets. This is also resulting in portfolio shifts by customers, with redemptions of life insurance policies totalling EUR 62 billion over the first nine months of 2023 (including EUR 47 billion in non unit-linked contracts). However, the ratio to premiums was relatively contained at 73% in Q3 2023, well below its record high of 100% observed at the end of 2011. We are closely monitoring the slowdown in life insurance net inflows and reallocations to other savings products, insofar as these involve greater risk of capital loss and higher liquidity risk.

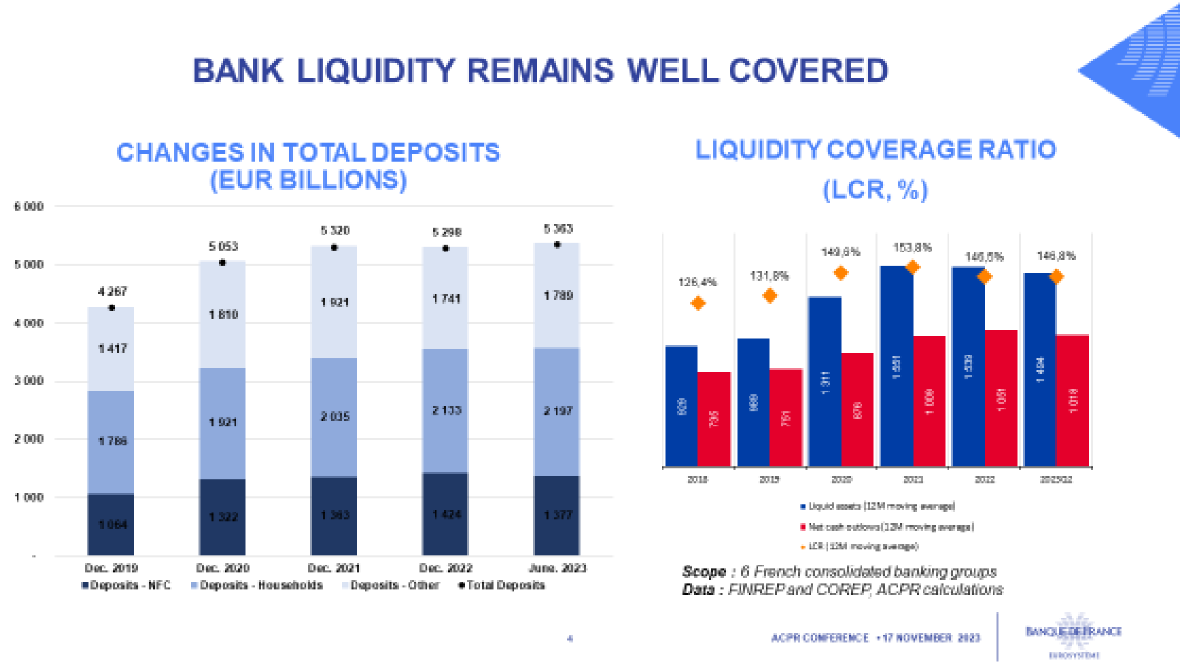
Another key point is that, despite the economic slowdown, banks' cost of risk has not increased significantly, and has even remained at a moderate level.



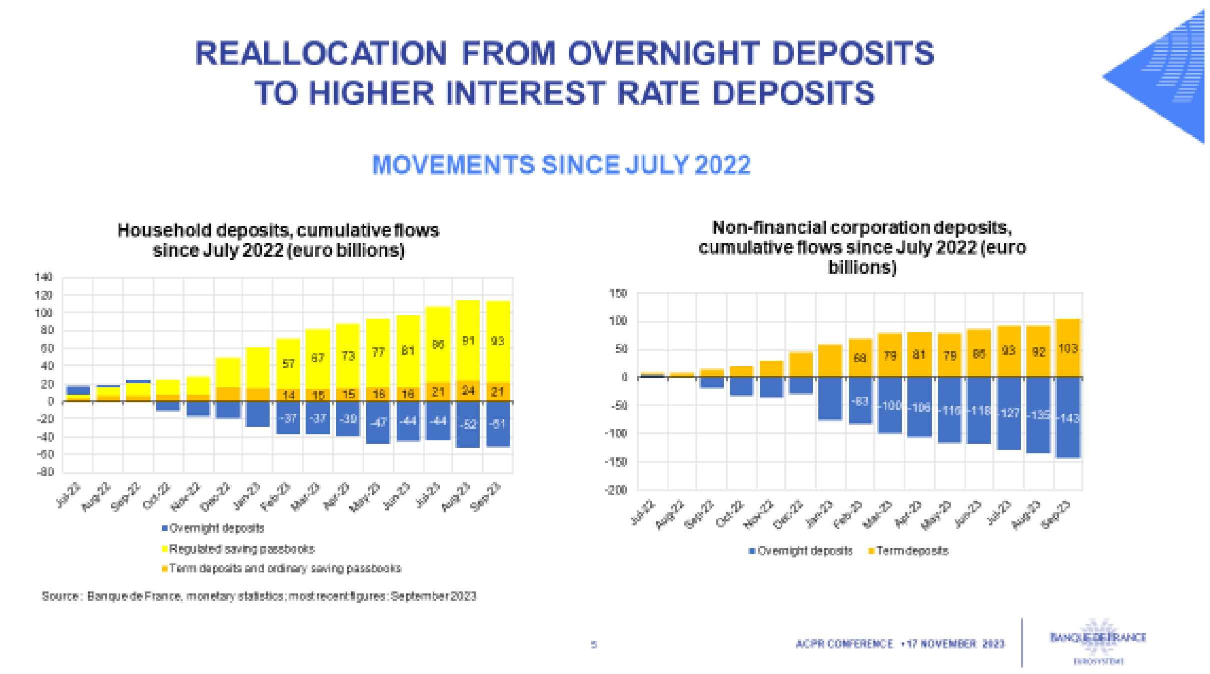
The quality of assets remains high: the ratio of non-performing household loans has remained stable, while the ratio of non-performing business loans has increased slightly to close to 4% at the end of June 2023. This stability is attributable *inter alia* to the high proportion of fixed rate loans in business loan books. The soundness of French banks in this area has been confirmed by the results of European stress tests published in late July. While we do not expect a widespread deterioration in the cost of risk in the short or medium term, we are carefully tracking borrower solvency. In particular, certain commercial real estate players have already been weakened by structural changes affecting their business segment and by their high level of debt, making them more vulnerable to higher financing costs.

1.2 Liquidity has generally been preserved

Major concerns had been voiced regarding liquidity, especially in the wake of the failures of Silicon Valley Bank in the United States and Credit Suisse. Eight months on, however, French banks are enjoying very stable levels of total deposits and liquidity coverage ratios that remain well above 100%.



So what we are seeing with the rise in interest rates is not a widespread 'deposit flight', but rather a process of portfolio shifts from overnight deposits into interest-bearing deposits, not only on the part of households but by businesses as well, which have increased their holdings of fixed-term deposits and savings passbook accounts since mid-2022. Since July 2022, households have generally increased their deposits (by EUR 63 billion) by more than businesses have reduced theirs (by EUR 40 billion) in favour of money market funds. This follows a period of historic growth in deposits between 2011 and 2022, during which non-financial customer deposits rose by an average of 6.4% per year.



On the whole, these aggregate figures reflect intra-group reallocations of savings products, as illustrated by the stability of each banking group's share of total deposits from households and businesses over the same period. Frankly, there is no reason for there to be a “war” over deposits or for banks to individually seek to achieve "excess liquidity". Indeed, monetary policy will continue to result in a large bank liquidity surplus for a long time. It currently stands at around EUR 3,600 billion and market analysts for instance expect it to diminish only gradually – and only to halve by the end of 2026.

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The good results of the French financial sector are not down to chance: they are attributable to sound management of the institutions themselves, and to the highly reassuring 'European tandem' of stringent **regulation** (transposition of Basel III - we are awaiting equivalent regulations in the United States for most banks) and a single, efficient **supervision** mechanism under the SSM, based on the recognised ACPR model.

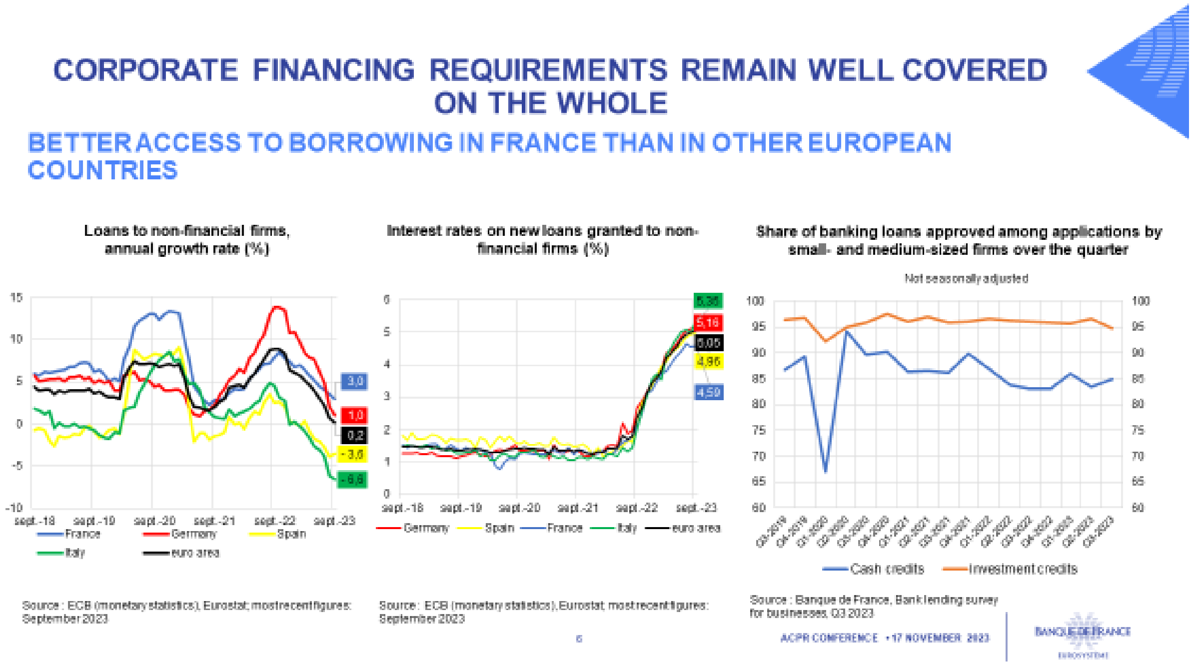
However, one area is still incomplete in Europe: **resolution**. The existing framework for large groups needs to be rounded out to enable this mechanism to be used more extensively. Europe is better at preventing banking crises from occurring *ex ante* than the United States, but it is by no means certain that it would be as good at dealing with them *ex post*. Recent events have shown that the availability of potentially significant amounts of liquidity in times of crisis is a key issue. While the framework enabling the ECB to provide "Eurosystem resolution liquidity" has yet to be built, we also need to think carefully about how to ensure that existing sources of funding are actually available, including deposit insurance funds.

II. These strengths should enable the financial sector to ensure the sound financing of the French economy during a slowdown

In other countries, banking sector profitability and profits are even higher than those currently being observed in France. Indeed, these record profits are attracting criticism and windfall taxes elsewhere: I believe it is fortunate that this is not the case in France. **However, the soundness of the banking system must be accompanied by the effective financing of our economy.**

2.1 Businesses are still well financed

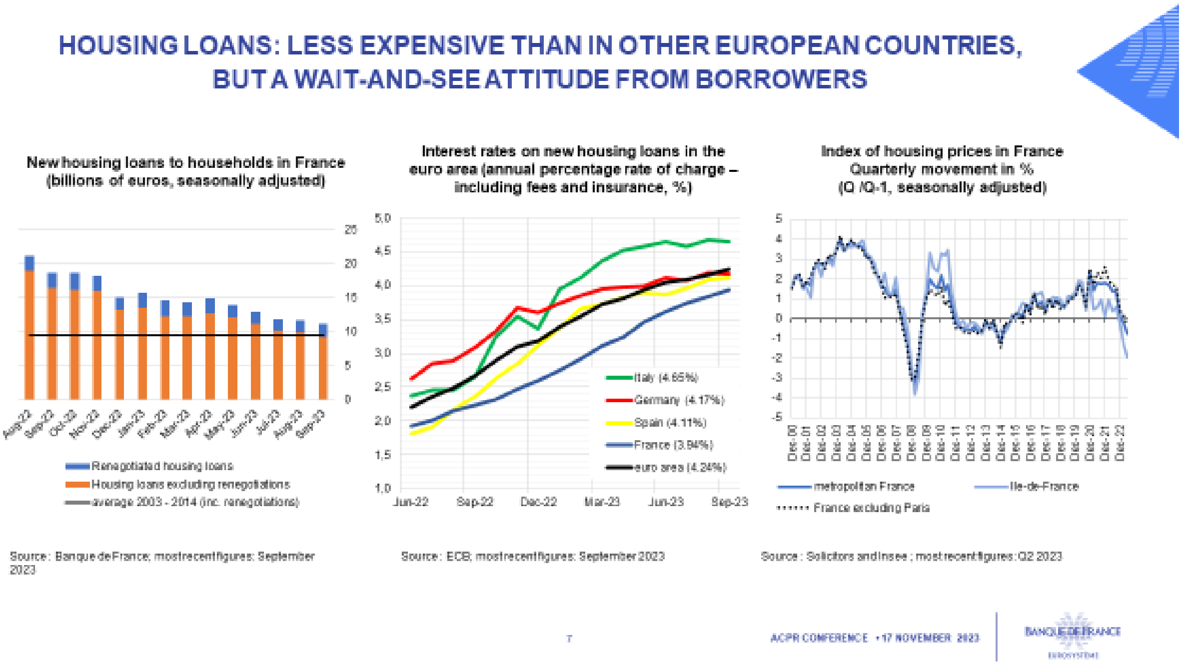
As far as *businesses* (including SMEs and VSEs) are concerned, access to credit appears to be relatively well preserved. Driven by investment loans, outstanding loans are continuing to grow for all sizes of business at a rate that is gradually slowing down (3.0% year-on-year to the end of September), reflecting lower demand for credit from non-financial corporations. Compared with our European neighbours, access to bank loans also continues to be more favourable in France where interest rates on new loans are lower on average (4.6% in France in September, compared with 5.05% in the euro area); the share of approved loans has remained stable – both for financing investment and cash flow – according to our quarterly business survey published yesterday evening.



Credit Mediation, which is available in all of the Banque de France's departmental branches, is still not very widely used, with an average of around a hundred requests per month over the past year. Nevertheless, the steady slowdown in outstanding business loans means that we must remain vigilant.

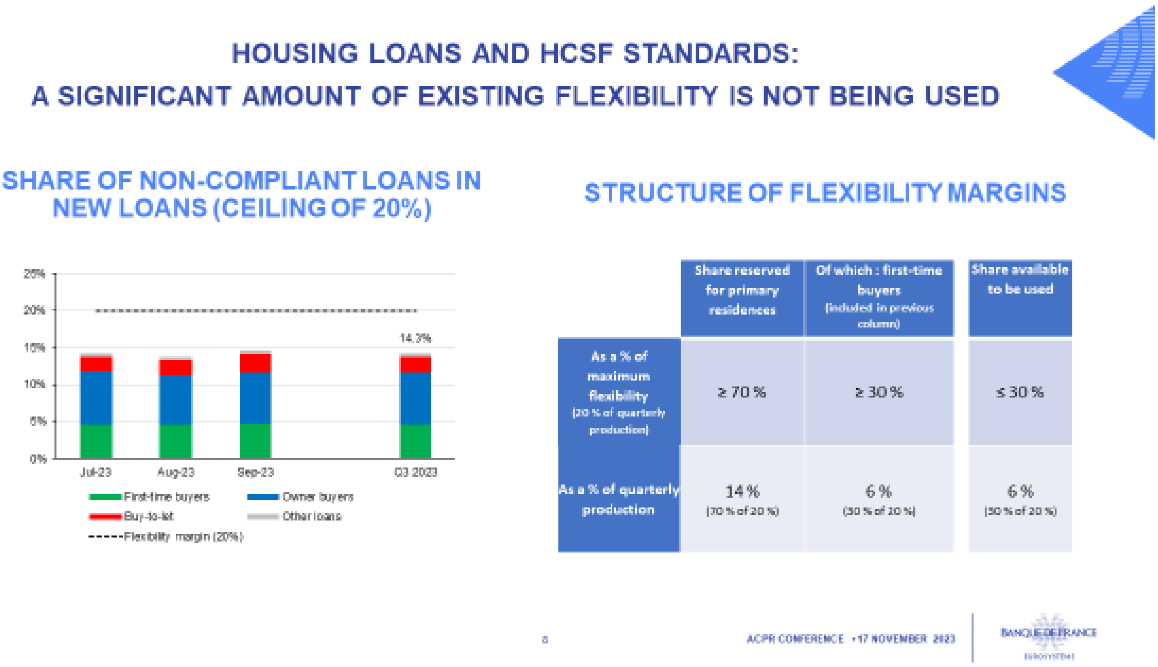
2.2 Housing loans are a more sensitive area

Housing loans are a more sensitive area. New housing loans (excluding renegotiations) fell to a low of EUR 9.2 billion in September, a level almost identical to the monthly average recorded prior to 2015 and the introduction of ultra-accommodative monetary policies. This slowdown in new housing loans is only natural given our position in the interest rate cycle. After making massive use of housing loans up to mid-2022, French households are now adopting a wait-and-see attitude in the face of higher interest rates - even though they remain lower than in neighbouring European countries - and, correlatively, of house prices that have only just begun to come down since the start of the year at national level.



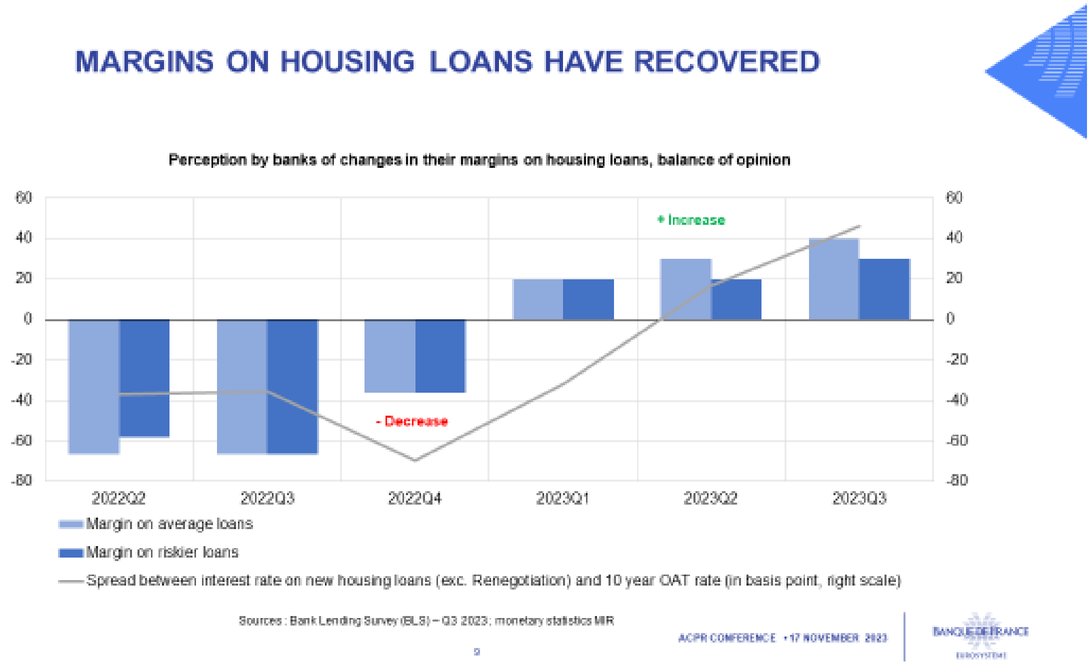
However, aside from a wait-and-see approach, there is a big question mark over supply, and the fact that "banks appear to have stopped lending". Even if it is exaggerated, this impression is not good for anyone: not for the banks or their image; not for the housing sector, as it can discourage borrowers; and not for the overall economic assessment. The excessive “halo” around housing loans no doubt prevents us from focusing on other necessary levers for action in the sector: the supply of land; the proliferation of regulatory standards; and overlapping tax incentives and subsidies of a complexity unrivalled elsewhere in Europe. Progress is being made around these different issues but I would like to examine two questions with you here this morning:

- HCSF (*Haut Conseil de Stabilité financière* - High Council for Financial Stability) standards are an easy and recurring target for criticism, but - do we need to say it again? - the HCSF was created not by the Banque de France but by French national law, namely the 2013 Banking Law. Over the last few years, it has unanimously achieved its mission of mitigating risk amid the continuing and exceptional increase in household indebtedness, and the marked deterioration in loan maturities and debt servicing costs. Moreover, its standards are not restrictive these days as banks have the capacity to lend more thanks to *all* of the flexibilities provided by the HCSF's decision within the 20% flexibility margin. The total flexibility of 20% for the main criteria – debt service to income ratio and loan maturities (currently set at 35% and 25 years maximum, respectively) – was only used up to 14.3% on average over Q3 2023. More specifically, the 6% flexibility on buy-to-let investments is only being used up to 2.6%. Making greater use of these flexibility margins rather than challenging them is the best way for banks to lend more... provided of course that they maintain the volume of compliant loans: we will take care to ensure that longer, riskier loans do not replace safer loans.



That said, as stated in its press release of 26 September 2023[iv], the HCSF will examine possible new technical adjustments provided they do not lead to an increased risk of overindebtedness.

- The bank rejection rate should not increase for similar levels of risk. This rate is not measured in a precise manner, however there is a widespread impression that it has risen. But if we go back to the assessment I made in the first part of my speech, there would be no justification for this: neither in terms of profitability - margins have recovered, thanks in particular to the accelerated increase in the exceptional usury rate in 2023; nor in terms of liquidity, where an "over-adjustment" by the national branch networks would be counter-productive by seeking, for example, a significant increase in the coverage of loans by deposits.



In any case, it seems both necessary and in the collective interest to monitor these rejection rates more closely. Among our initial internal discussions, I would like to mention two non-mutually exclusive avenues for moving forward:

- Collating data from different sources, including the Eurosystem's upcoming quarterly bank lending surveys (BLS). We are keeping a careful eye on these after the increase in Q3 of rejection rates and the balance sheet constraints being highlighted by French banks.
- I believe it would be in the general interest for both the banking industry and the public authorities to initiate a mutual agreement process for the current phase of the cycle: this would target apparently creditworthy housing loans that have been rejected – just like the process that already exists for business loans.

We will pursue the reinforced individual exchanges between banks and the ACPR on credit standards for housing loans, which naturally form part of the broader exchanges conducted within the Single Supervisory Mechanism.

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Let me conclude with an even broader outlook. Major structural challenges lie ahead, including the digitalisation of payments. French and European banks are strong enough to meet these challenges in a proactive and innovative manner.

Alongside the EPI project and tokenisation of bank deposits, the central bank digital currency (CBDC) project, both retail and wholesale, is one such example of this. In this sphere, as in so many others, including the climate transition, the public authorities and the ACPR will always work in hand in hand to prepare for the future and not miss decisive turning points for the European financial system. Thank you for your attention.

[i] Eurostat, provisional estimate, published on 31 October 2023

[ii] Four of the six main banking groups publish quarterly results (i.e. BNPP, SG, GCA and GBPCE).

[iii] Impact of EUR 500 million in Q3 2023, and estimated impact of EUR 1.6 billion for the year as a whole.

[iv] Haut conseil de stabilité financière (HCSF – High Council for Financial Stability), Press Release, 26 September 2023