François Villeroy de Galhau: Addressing Brexit, and unlocking Europe's investment potential

Welcome address by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Paris Europlace International Financial Forum, Paris, 6 July 2016.

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Welcome to Paris! It is a pleasure for me to be here today, and to share with you our responses to the new disruptive challenges facing Europe. Brexit is certainly a new one: the decision has serious consequences, especially for the United Kingdom. And obviously, Europe is at a crossroads. But let me just stress that this is nothing new. I've said it before, notably in a joint article with Jens Weidmann last February. Brexit is not a game-changer, but it does highlight the need to give renewed impetus to the European project. It also reminds us what finance is for: achieving the best balance between savings and investment. ***How*** this is done is still more important than ***where*** it is done; but there is clearly a link between the two. Before I share my views on the way forward for unlocking Europe's investment potential, let me add a few more words on Brexit.

1) Addressing the consequences of Brexit

Obviously, Brexit is bad news, first and foremost for the United Kingdom. The priority right now is to deal with the fallout as smoothly as possible. For economic and monetary authorities, this means reducing uncertainty and fostering confidence, in at least three ways:

- First, by managing the financial shock. Financial markets experienced sharp corrections, with a significant drop of the Pound, but they did not freeze. Cooperation between central banks to cope with the Brexit vote has been effective. We, on the ECB Governing Council, remain fully mobilised and determined.
- Second, by maintaining the proper functioning of the euro area – a collective asset belonging to 340 million people. More than two-thirds of euro area citizens support the single currency, according to the Eurobarometer survey. Of course, Brexit will have an impact on the euro area economy, but this impact will be more modest than in the UK. Brexit does not change our economic projections for this year in France: we still expect growth of at least 1.4%. But it is important to reduce the uncertainty over Britain: the quicker, the better.
- Third, by preparing the new trade deal between the UK and the EU in a swift, orderly and consistent manner. We can't make any assumptions at this stage as to the outcome of the negotiations. What is clear, however, is that there can be no cherry-picking and no free-riding. For the UK to maintain access to the single financial market, all the usual EU rules should be strictly respected.

2) Building on our strengths to raise investment and growth

Despite the gradual economic upturn seen in 2015–2016, our main European challenge is still how to increase growth. To achieve this, the priority is to boost business investment – in France it is currently forecast at +3.4% for 2016. This depends on economic levers, to be strengthened through structural reforms. But it also depends on financial levers – the core challenge being equity financing, which is key for innovation. In this respect, Europe is lagging far behind the US: the equity share of corporate financing in the euro area is 52% of GDP compared with 121% in the US.

France and Europe do ***have substantial strengths*** to meet this investment challenge. Let me focus on two of them today:

– First, ***savings are abundant***. In France, the household saving rate is high: 14.1% of gross disposable income in 2015, second only to Germany (17.4%) among the main European economies. In the euro area, the current account surplus is substantial: more than 3% of GDP in April 2016 – meaning that savings exceed investment by nearly EUR 330 billion. This gap needs to be closed by fostering investment rather than by reducing savings.

– Second, our ***financial system is solid.*** The regulatory and supervisory frameworks have been considerably strengthened since the crisis, both at the international and European levels. Today, the French banking system is one of the soundest in Europe and in advanced economies: between 2008 and 2015, the CET1 solvency ratio of France's major banking groups more than doubled, from 5.8% to 12.6%, which is EUR +143 billion of core capital. Moreover, their liquidity ratio has exceeded 100%, three years ahead of the Basel III deadline. The French insurance sector too is robust, and has swiftly adapted to Solvency II. New assessments are under way, but using the previous standards, France's major insurance groups cover their own funds requirement by around 230%. Clearly, financial stability is a priority for us; and by the way that is why financial regulators – including Banque de France and ACPR – pay close attention to the proposed merger between the London Stock Exchange and Deutsche Börse.

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Let me draw a parallel to illustrate the situation. In France and in Europe, we have the raw materials – savings. We have the processing industry – the financial sector. But we are missing two links in the economic chain: downstream, we need to open up new opportunities in productive investments via a broader range of processed savings products; and upstream, we need stable and legible rules to allow the industry to conduct its business. Therefore, I see ***two ways forward***.

First, ***better channel our abundant savings towards productive investment***. As I said, the core challenge for increasing innovative investment is to boost equity financing, both in France and in Europe:

– In France, this means new savings products and an appropriate trade-off between risk and return. Indeed, the share of households wealth invested in risky assets is more than three times lower in France than in the US: 77% of GDP versus 241% of GDP. But French and European savers are more attached to security – or capital protection – than to liquidity. Therefore professionals should offer them savings products that are less liquid, with some long-term capital guarantee, and that offer the best equity performance over time. A crucial point is to avoid any tax distortions that might penalise these products more than liquid and risk-free investments. Low interest rates are not the disease, but the symptom of an imbalance between savings and investment; and low interest rates are probably an opportunity to speed up the cure towards productive investment.

– At the European level, we need to build an ambitious "Financing and Investment Union" (FIU) bringing together existing initiatives – namely the Juncker plan, the Capital Markets Union and the banking union – which currently work in isolation and therefore do not bring sufficient results. We definitely need to put the pieces of the puzzle together to create a multiplier effect towards private risk-sharing in Europe: with more equity financing and more cross-border flows.

The second way forward for raising investment and growth in Europe is to ***rapidly stabilise the regulatory environment*** for banks, eight years after the financial crisis. However, in finalising the Basel III reforms we need to avoid two pitfalls. First, as has been stressed by the GHOS and the G20, the completion of reforms should not result in a “significant increase in overall capital requirements”. As they stand, the current technical proposals put forward for consultation by the Basel Committee do not respect this commitment: they must therefore be revisited. Second, we should be careful not to oversimplify the regulatory framework and loose the risk sensitivity. Adjustments to the internal models approach should not amount to imposing the standard approach on all, either explicitly, or implicitly by applying poorly calibrated “output floors”.

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Let me conclude with some words on the strengths of the ***Paris financial centre itself***: robust banks and insurance companies, a dynamic asset management industry, strong financial market infrastructures, a highly skilled labour force. And you can be assured of three points:

1. First, French authorities, including the Banque de France, attach utmost importance to making sure Paris is one of Europe’s strongest financial centres. This is crucial for employment, for investment, as well as for the strength of the euro area economy as a whole.
2. In addition, we are already making every effort to build an innovation ecosystem: through the recent and efficient ACPR-AMF cooperation on FinTechs; through our support for the development of new tools – such as ESNI on securitization and Euro GC+ on repos, or our upcoming project to test interbanking information sharing processes based on blockchain technology; and also through our partnerships with many French universities renowned for their excellence and their Masters in Finance.
3. And lastly, we will do more in the future to enhance the attractiveness of the Paris financial centre: the Government will do its part – the Prime Minister will talk about this later –; the Ile-de-France region and the Paris City too; and the ACPR will examine in a prompt way all applications in its remit coming from financial institutions that are already licensed in another EU member state. Of course, Paris is not the only financial centre in the euro area, but it has everything it needs to be one of the best. It depends on us, on all of us. Therefore, now more than ever, the time has come for Paris Europlace to take center stage.