

François Villeroy de Galhau: Challenges for France's economy and financial sector in 2016

New Year Address by Mr François Villeroy de Galhau, Governor of the Bank of France, Paris, 18 January 2016.

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Ladies and gentlemen,

Thank you for coming here today to this magnificently restored Golden Gallery. This is the first time that I am giving this address as Governor of the Banque de France, but it is an auspicious tradition that brings us together. I would like to start by extending my warmest wishes to you, your colleagues and your institutions.

2016 has already been marked by volatility: weak financial markets and commodity prices, from China and the Middle East; political uncertainty in Europe, in Southern Europe, in Eastern Europe, North-Western Europe with the British referendum, and even in Central Europe with the refugee crisis. It is our duty to be vigilant, but we must also, on the one hand, distinguish real information from background noise and real challenges – and there are no shortages of them – from the sensational and sometimes excessive statements at this start of this year; on the other hand, in the face of current volatility, we must stick to our medium-term objectives. This evening I will not discuss the Eurosystem's monetary policy as we are in the "silent period" leading up to the Governing Council meeting this Thursday. Such long-term strategies also apply to the reforms in Europe and in France.

I would like to broaden my personal wishes to three collective wishes: for our country and its economy first; for its smooth financing second; and for financial stability and the soundness of your institutions lastly.

1) Today a **confirmed recovery** is underway, with growth of over 1% in France in 2015, and 1.5% in the euro area. In 2016, despite the uncertainties, all indicators point to higher growth. France must now transform this modest but real recovery into strong, lasting, job-creating growth. To do this, two conditions must be met in 2016: public reforms must be pursued, and corporate investment must be stepped up.

As regards the reforms, France is currently being penalised by excessive debt levels in its public sector (differential of 25% of GDP vis-à-vis Germany, whereas both countries displayed the same level in 2010) and the deterioration in its trade balance and competitiveness. The fight for growth and against unemployment can only be won over time, with the great virtue of steadfastness. We must therefore keep up all efforts with regard to containing government expenditure and hold firm on that which is starting to work: the Responsibility and Solidarity Pact and the Tax Credit for encouraging Competitiveness and Jobs (CICE) should enable us to catch up, between 2014 and 2017, one-third of our competitiveness lag with Germany which built up over the first years of the euro (1999–2007). Transforming the CICE into a permanent reduction in social contributions for corporations would be a very welcome development. But more is required; the unemployed and youth cannot afford to wait. In addition to emergency plans, at least four reforms appear obvious since they have worked for our European neighbours: apprenticeships on a widespread level; simplifications, including in the area of labour law; the development of entrepreneurship; and lastly the decentralisation of social dialogue to the company level, i.e. as close as possible to the economic and human reality.

Corporate investment depends first and foremost on the willingness and the confidence of thousands of entrepreneurs, but it must naturally be promoted by financing... and therefore by you.

2) This brings me to my wish concerning the smooth financing of the economy, against the backdrop of persistently low interest rates. **Monetary policy** is proving to be effective: in 18 months, since June 2014 and the announcement of non-standard policies, bank lending rates to business have fallen by around 80 basis points in the euro area, and outstanding bank loans have risen from a negative growth of 2.5% in June 2014 to positive growth of 0.9% in November 2015. According to estimates, including the decisions of 3 December 2014, non-standard policies improve the growth outlook for the euro area by 1% between 2015 and 2017, and that of inflation by 0.5 percentage point in 2016 and 0.3 percentage point in 2017.

Bank lending must therefore remain accessible. In this respect, French banks have achieved good results. Bank lending to business has risen more sharply in France than anywhere else in Europe: up 4.5% in annual terms at end-November 2015, compared with a rise of 1% in Germany, and 0% in Italy. Moreover, interest rates in France are among the lowest in Europe. Interest rates on new bank lending are currently below 2% on average, compared to 5% in 2007. However, I would like to stress the fact that access to cash loans is more difficult for very small enterprises. Their fragile financial position may be one reason; but there is an ongoing misunderstanding with the banks that the latter must seriously address.

French households' savings must also adjust to the low interest rate environment. This is an opportunity to encourage more "risky" and more long-term investments, both in the interest of investors themselves and of our economy. Today only 31% of French households' financial investments are made up of risky assets, against 45% in the euro area. This requires taking action in two directions. First, the decrease in interest rates should be gradually passed on to risk-free investment returns – this is why I proposed lowering the rate on the PEL, the French housing savings plan, this is also why we must resolutely continue to lower the returns on life insurance invested in euro funds. Second, new products should be developed: probably less liquid, with or without a capital protection over the long term, and possibly offering the best equity performance over time. A crucial point is to avoid any tax distortions to the detriment of these products compared to liquid and risk-free investments. It remains all the more essential to fully inform investors about the risks involved when they invest their savings; two examples come to mind today, unit-linked contracts, and managers offering disintermediated financing.

3) My third and last collective wish for 2016 is that of **financial stability** and **sound financial institutions**.

Since the financial crisis, the regulatory framework and the supervisory and oversight architecture have been considerably strengthened. This was necessary, I believe no one here doubts it. In the banking sector, this involved implementing Basel III / CRD4-CRR, finalising the TLAC, the new anti-shock weapon, and setting up the European banking union, which now includes two effective mechanisms: the single supervisory mechanism, and -since 1 January- the single resolution mechanism. Today, French banks are sounder: their core Tier 1 solvency ratio stood on average at 12% in September 2015, against 6% at end-2007. And contrary to the fears that have often been expressed, including by some of you, the current situation shows that these rules have not impacted lending and growth, in particular thanks to the positive effects of monetary policy. In 2016, the projects still underway should be completed. In particular in order to improve the comparability of internal models – and thus improve their credibility –, not to substantially increase overall capital requirements. To finalise and stabilise Basel III, not to open a new Basel IV.

The **insurance sector** has not been left out. The entry into force of the European regulatory reform Solvency 2, also on 1 January, marks a profound break. We all know that "Solva 2" may still be improved; but it is a significant step forward. In this respect, it is important that all institutions continue their efforts to improve governance and enhance the quality of estimates and data submitted to supervisors, in order to ensure an adequate monitoring of risks, in

particular those linked to the persistence of very low interest rates. At the international level, other challenges lie ahead, notably the definition of systemic groups – it must be similar on both sides of the Atlantic, like you I am sensitive to this–, harmonised capital requirements and resolution strategies.

However, the soundness of the financial system does not depend solely on prudential regulations. It also depends on the **confidence** that economic players and the public, households and businesses, have in their financial system. In this respect, the efforts of financial institutions **to protect their clients** are essential. In 2016, what is needed is a firm implementation of the Eckert law on dormant bank accounts and unclaimed life insurance policies, and greater freedom of choice of loan insurance on real estate loans. And, of course, more than ever, we need **to step up the fight against money laundering and terrorist financing**. New measures have already been taken, some are being strengthened. I expect from financial institutions – both insurers and banks – an exemplary participation in this fight. I know that they fully agree to the principle, but they must now carry it through in their daily management; it is in your interest as compliance risk has become as vital, as strategic, as credit risk.

May your institutions be strong on both fronts; may our country be as involved in the economic battle as in the fight against terrorism, with the contribution of all of us; and may each one of you remain vigilant and active, yet as serene as possible in 2016. Thank you for your attention.