



Paris, 17 December 2018

Publication of the report on the Assessment of Risks to the French Financial System

On Monday 17 December 2018, the Banque de France published its [Assessment of Risks to the French Financial System](#) for the second half of 2018.

In an environment marked by the rise in protectionism and ongoing political uncertainty both at the European and international levels, **the Banque de France has identified four main risks:**

- **Market risk**

First, there is continued uncertainty in economies and global markets. The risk of a repricing of financial assets remains despite recent corrections, with the possibility of price rises in the coming six months. Portfolio turnover phenomena have already been observed.

Financial asset valuations remain high, in both equity and bond markets, mainly due to the low interest rate environment and investors' risk appetite. Nonetheless, investor confidence could be undermined by a combination of uncertainty factors originating from the United States (protectionism and economic policy), Europe (the political situation in Italy and Brexit) and emerging countries (financial vulnerabilities).

- **The risk linked to private sector debt**

Second, the risk associated with non-financial private sector debt is perceived to be high and is likely to rise further in the next half year. The debt of the non-financial corporation (NFC) and household sectors is continuing to rise in France, in contrast to trends observed in other European countries. The combined debt of these two sectors reached 132.2% of GDP in the second quarter of 2018.

NFC debt dynamics are notably a source of liquidity and default risks, which could intensify in the coming months. Thanks to the decline in financing costs, NFCs' debt burden has stabilised, but did not shrink. NFCs are particularly vulnerable to a sudden macroeconomic downturn or a sharp hike in interest rates, as a large proportion of their outstanding debt (44%) is made up of floating rate loans. The growth observed in leveraged, covenant-lite financing also requires vigilance.

The rise in lending to households is being driven by the sharp increase in consumer credit (up 6.6% year-on-year in October 2018) and by the ongoing growth in mortgage lending (up 5.9% year-on-year in October 2018). This has been accompanied by an easing of lending standards which calls for careful monitoring by the authorities. That said, most home loans are fixed rate and guaranteed, which limits credit risk.

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- **The Interest rate risk linked to fragmentation**

Third, the interest rate risk associated with euro sovereign debt market fragmentation is high and is expected to remain stable at a six-month horizon.

The political situation in certain euro area countries, in particular Italy, has led to widening of bond yield spreads and a risk of euro sovereign debt market fragmentation. This raises the fear of a resurgence of the negative feedback loop between sovereign and bank risk and of higher interest rates for the private sector.

- **The risk linked to structural changes in the financial sector**

Lastly, the risk associated with structural changes in the financial sector is deemed moderate and is expected to remain stable. Indeed, the structural challenges facing the financial sector persist (digitalisation, cost cutting, profit seeking, low interest rate environment, etc.). Against this backdrop, rising operating costs remain an area to watch. However, financial institutions are continuing their efforts to adapt and transform and the related risks are generally under control.

About the Banque de France. The Banque de France is an independent institution with three core tasks: monetary strategy, financial stability, and the provision of services to the economy. It contributes to the definition of euro area monetary policy and ensures its implementation in France. It supervises banks and insurance companies, and works to mitigate risks. It also offers a range of economic services to businesses and private individuals.

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