Executive summary

Since the publication of the last annual report of the Haut Conseil de stabilité financière (HCSF – High Council for Financial Stability) in September 2020, the French economy has continued to suffer the consequences of the covid-19 pandemic, but the financial system has shown resilience and financial stability has been preserved. This 2021 annual report first examines the impact of the crisis on the financial situation of households and companies, and on the main players in the financial sector (banks, insurance companies, asset managers, financial markets, etc.). It then reviews the HCSF’s work over the past year and provides an analysis of the main measures it has taken. Lastly, three theme-based chapters explore in greater depth the subjects that the HCSF has focused on: money market funds, commercial real estate and climate risk.

The shock from the crisis was followed by a rapid rebound in the economy and financial markets

France’s GDP fell in 2020 in connection with the covid-19 pandemic and the health restrictions introduced to contain it. The progress in the vaccination campaign and the gradual easing of restrictions should pave the way for a marked rebound in activity in 2021.

Equity and corporate bond markets had also fallen sharply in March 2020, but valuations have since rebounded significantly. In the summer of 2021, equity markets rose to above their pre-crisis level and bond yields returned to historically low levels. Average valuations are consistent with fundamentals, given the very low level of interest rates. However, certain developments may spark fears of the emergence of localised bubbles in a context of abundant liquidity.

Households accumulated significant excess savings and firms were able to borrow massively

The crisis forced households to reduce consumption significantly, while income was preserved by government support measures. As a result, household savings rose sharply in 2020. These excess savings were primarily channelled into bank deposits, which are liquid and guaranteed, but also riskier and more profitable investments, such as shares held directly or via unit-linked life insurance products. After a trough in spring 2020, housing lending rebounded, with new lending now above its pre-crisis level and interest rates at historic lows.

Thanks to government support measures and the resilience of the financial sector, companies were able to borrow substantially from banks and financial markets to meet their cash flow needs. They did so on very advantageous terms, with interest rates on cash loans reaching historic lows. The gross debt of companies rose sharply in 2020, but this increase was accompanied by an almost equivalent increase in their cash position, with little change in net debt. However, the financial situation of companies remains heterogeneous: a small proportion of them both increased their debt and decreased their cash position, which warrants specific support.

Banks and insurers showed resilience to the crisis

Despite the crisis, banks’ capital ratios remained almost stable and they continued to lend in 2020, in particular to meet the particularly high financing needs of companies. While banks’ profitability plunged in 2020 due to higher loan portfolio provisions, it remained positive and rebounded sharply in the first half of 2021 to exceed its pre-crisis level.

The impact of the crisis on insurance companies’ financial position remained moderate, with a solvency ratio still well above supervisory requirements. Life insurance recorded a net outflow, but this affected only euro-denominated funds, whereas unit-linked funds performed well. Although insurers were not
generally directly affected by the losses caused by the pandemic, they still have to contend with a low interest rate environment that, in the medium term, will constrain their asset-liability management.

The easing of credit standards was interrupted by the recommendation adopted by the HCSF at the end of 2019 and revised at the end of 2020

In December 2019, the HCSF issued a recommendation requiring credit institutions to respect best practices in the granting of housing loans, in particular in terms of debt-service-to-income (DSTI) ratios and the maturity of loans. This recommendation aimed to halt the continuous decline in credit standards since 2016, which threatened to erode the soundness of the French housing finance model. Based on the lessons drawn from the implementation of this measure, the HCSF decided in December 2020 to adjust some of the terms of the recommendation and announced that it would make the measure legally binding in the summer of 2021.

Housing loan developments since the end of 2019 confirm the appropriateness of this measure. The share of loans with high DSTI ratios or long maturities started to fall, without affecting the production of new housing loans or the access to credit, for all income ranges. At its September 2021 meeting, the HCSF adopted a decision on credit standards, which incorporates the terms of the recommendation. It will enter into force on 1 January 2022.

The HCSF maintained a high level of vigilance regarding the risks to financial stability posed by the crisis

The high level of debt in the non-financial private sector increased further during the crisis and remained a key area of concern for the HCSF. In addition to its activities related to household debt, it also decided to extend until 2023 its large exposures measure, which limits the bilateral exposure of French systemically important banks to large, highly indebted companies.

It also closely monitored developments in certain market segments that were more affected by the crisis. This is the case for money market funds, which are discussed in a topical chapter of this annual report. These funds saw substantial redemptions in March 2020 before confidence in the market was restored by various support schemes. International and European work was conducted on the regulatory framework for money market funds to make this ecosystem more resilient to systemic shocks such as that of 2020. The HCSF analysed the developments in France and is closely monitoring the current international discussions and the regulatory initiatives that should ensue.

The crisis is also affecting commercial real estate in two ways: cyclically, as the drop in activity is depressing demand for offices and commercial premises, and structurally, with the development of teleworking and e-commerce. Thus, as of 2020, the volume of transactions and market prices fell, albeit moderately, and the prices of real estate companies’ shares tumbled. A topical chapter in this annual report is dedicated to this topic and presents simulations of the medium-term impact of these developments on financial institutions, based on the economic outlook and changing work habits. They suggest that the impact on the position of French banks and insurance companies, taken in isolation, remains moderate overall.

The HCSF also analysed the emergence of new risk factors for financial stability, in particular climate change

The HCSF also examined the risks to financial stability posed by climate change, which are presented in a topical chapter of this annual report. The physical and transitional risks of climate change can affect the economy as a whole, and hence the financial system. In particular, the HCSF examined the results of the ACPR's pilot exercise, which provided an initial assessment of the impact of these risks for French banks and insurers up to 2050. The results show that while the exposure of banks and insurance
companies to climate risk is moderate overall, the impact of the scenarios analysed may be very significant for certain sectors or regions. Beyond this initial assessment, institutions must become more aware of this risk and better take it into account.