Le grand rendez-vous de l'investissement productif

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Speech at the National Assembly by

François Villeroy de Galhau

Governor of Banque de France

"Corporate equity financing in France and the euro area": what needs? what tools? what role for the Banque de France? "

Press contact: Clémence Choutet (01 42 97 74 51; clemence.choutet@banque-france.fr).

Honourable Members of Parliament, ladies and gentlemen,

I am delighted to participate in today's assembly on productive investment, which centres around a paradox. France is a nation of savers with very abundant household savings. At 30 September 2017, household financial wealth stood at EUR 4.924 trillion, or more than twice annual GDP. However, our companies still have a lack of equity financing and they often have to resort to debt financing. We must therefore consider: (A) the exact nature of the French situation and how it compares to that of other countries; (B) how to better mobilise savings for the benefit of growth and employment.

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A. What is the French situation?

1) In France and the euro area, firms have a lack of equity financing, and household savings are insufficiently channelled into it. [slide 2] This is in sharp contrast with the United States, where equity financing represents 123% of GDP, against just 74% in France. From this point of view, France is similar to the euro area as a whole (73%). [Slide 3] While an American household invests more than half its financial savings in equities, 57% to be precise, a French household invests 69% in fixed income products, because among other things there is a long-standing incentive to do so, notably tax exemptions.

2) This situation, which is fairly widespread in Europe, is more worrying in France since French businesses have a greater need for equity financing than those of our neighbours. Why is this the case? Because they do not appear to have the same ability to self-finance investment as their German peers, or as their southern European counterparts. [Slide 4] Let us look at the "financing capacity" of firms, i.e. the difference between their cash flow and investments. It is clear that the balance is zero, whereas our neighbours display a significantly positive balance: 4% of the value added in Germany, and 3.6% in Italy. [Slide 5] The situation of our neighbours is – it must be said – abnormal and may reflect a lack of investment. The difference in France currently stems from a positive factor – higher investment – and from a negative factor – a relatively weak cash flow position, even though government measures have gone some way to increasing profit margins since 2014. [Slide 6] Consequently, French corporate debt has grown much faster than in neighbouring

countries: year-on-year, non-financial corporations' debt rose by 2.6 percentage points of GDP in France, whereas it was stable in Germany and it fell by 2.1 percentage points in Italy. We are now significantly above the euro area average.

3) We therefore have **two challenges**: debt that is rising a little too quickly, and not enough equity to finance innovation.

Given this situation, it is above all essential that we avoid an infinite debt spiral. The High Council for Financial stability (HCSF), chaired by the Minister of the Economy, Bruno Le Maire, decided in December 2017 on a macroprudential measure to limit the sharp rise in the debt of certain large companies, including bond debt. This measure – which is unprecedented in Europe – will apply as of 1 July after approval by the European authorities.

But, at the same time, we need a better allocation of our abundant financial savings: 5% of gross disposable income in France. Our problem is not quantity, but quality. Overall, the French economy has no shortage of bank loans but it lacks equity financing. An economy that is catching up, like post-war Europe or emerging countries today, finances itself with debt because it is a relatively established method. But equity financing is the key to innovation for companies, and therefore to growth in economies close to the “technological frontier”, like in the United States and we hope is the case for France: as it is riskier to finance innovation, it should offer higher returns.

B. What solutions?

It is not just a matter of financing: companies themselves, including family ISEs and SMEs, must be willing to open up their capital and their boards in order to develop. This is never an easy decision, and this "bonsai effect" on the size of French companies is well known.

1) But as regards financing, the priority today is to create **new savings products, which are more productive for our economy.**

Here, **insurers have a key role to play**: indeed, the insurance sector is the main institutional investor of the euro area, and life insurance is by far the most popular investment of French citizens (EUR 1.920 trillion at end-September 2017). Admittedly there are unit-linked life insurance policies, whose gross inflows have recently risen, up EUR 36 billion at end-2017, but which are not without limitations: flows can be procyclical – this is what happened in practice during the last crisis, with rapid withdrawals that exacerbated the CAC 40's fall. Moreover, these products have no capital protection and, in this respect, I wish to stress the obligation of professionals to advise policyholders on the actual risks they are taking, especially at the top of the stock market cycle. Conversely, Euro-croissance was a good idea but it got off to a poor start, collecting just a little over EUR 2 billion in outstandings at present.

We should try to consider the issue of savings products from a broader perspective, starting with the **expectations of French citizens**. French savers are admittedly very attached to safe investments, but the debate would benefit from distinguishing more clearly between the two components of this search for safety: they are more attached to the protection of capital than to liquidity, because they have an increasingly long-term horizon associated in particular with the need to prepare for their retirement. We therefore welcome the fact that professionals are starting to devise long-term life insurance products which are less liquid but feature a form of capital protection, and which are largely invested in equities. The Minister of the Economy made very constructive proposals regarding the PACTE law on growing and transforming companies, which will be discussed in parliament later this year. This will also be beneficial for savers who will enjoy higher returns on equities over the long term. [Slide 7] As an illustration, over 40 years in France, cumulative returns on equities have been more than three times greater than those on Livret A passbooks, and have also been higher than government bond yields.

2) It is down to financial industry professionals to design appropriate products, but **the public authorities and the regulators also have a role to play** in encouraging their development.

The Banque de France and the ACPR ensure that the **regulatory framework** is stable and conducive to the smooth financing of our economy. As regards bank financing, the "rules of the game" were stabilised thanks to the final agreement we reached in December 2017 on Basel III. I wish to stress that all the key sectors of the French economy will remain fully financed with Basel III, from the real estate sector to SMEs, right through to large scale investment projects. Currently, regulations in no way limit the supply of credit in France.

As concerns the insurance sector, we are closely monitoring the European review of the Solvency II. In many respects, this new regulatory framework constitutes a major step forward, but we must, with the active participation of professionals, closely analyse its impact, in particular on investment behaviour (notably in equities) and the financing of the economy, in order to propose adjustments if necessary in the two reviews in 2018 and 2020.

For these new savings products to be successful, we must also **avoid tax distortions** favouring risk-free savings, and gradually plug the numerous tax loopholes. The flat tax is contributing to tax neutrality for the different forms of savings, which is long overdue. I see that banks are considering offering a new long-term savings product: why not, provided that the aim isn't to create a new tax loophole for savings; we have made enough use of this interesting French speciality. This tax neutrality should ideally also apply to the companies that are financed in order not to penalise equity financing compared with debt financing: this is naturally a greater undertaking, and this bias is unfortunately present in almost all countries.

Lastly, this financing challenge calls for a response at the European level: I advocate a "**Financing Union for Investment and Innovation**", which would better channel the euro area's EUR 350 billion savings surplus into equity financing and innovation, be it the digital or energy transformation. It would bring together and expand the Banking Union, the Capital Markets Union and the Juncker Investment Plan.

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I would like to finish with a more general observation. Beyond the technical measures that I have discussed, we cannot achieve this better financing of our economy without **an improvement in French citizens' financial knowledge and the information available to them**. For as long as we continue to sell fantasies about bitcoin and other crypto-assets, we will make no progress on financing productive investment. It is the role of financial professionals to inform their customers about the type of investments they are making and about the risks involved: the ACPR and the AMF ensure that this is the case. But French citizens need to be better trained and informed in order to make enlightened decisions about their financial investments, and be able to, if they so wish, take greater risks. I am very pleased that the Prime Minister insisted on this earlier. The Banque de France, as a provider of economic and financial education to the public at the request of the Ministry of the Economy and Finance and the Ministry of Education, is fully committed to this initiative, with the support of all its partners – associations, and institutional and professional players. This will be one of our priorities in 2018. Thank you for your attention.