Financial Stability Report

JUNE 2025

BANQUE DE FRANCE

EUROSYSTÈME

SOMMAIRE

Overview

The French financial system is facing an unprecedented international macroeconomic environment characterised by very high uncertainty, fueled by the unpredictability of US policies. The announcement by the United States on 2 April of widespread and large-scale tariffs, which were subsequently partially suspended, and the implementation of bilateral retaliatory measures by the affected jurisdictions, notably China, have added to an already severely strained geopolitical environment In addition to the ongoing wars in Ukraine and Gaza, an open conflict between Israel and Iran started on 13 June.

Since the outbreak of the trade war, markets have been resilient, but are still at risk of disorderly adjustments in the event of further adverse shocks.

The exceptionalism of financial assets issued by the US government and US corporates, which prevailed at the time of the December 2024 Financial Stability Report, is now being called into question. At the end of 2024, US equities were still appreciating significantly faster than those in other advanced economies, driven by expectations of faster growth and their concentration in the digital technology sector. These expectations were also reflected in an appreciation of the dollar and a decoupling of interest rates between the United States and the euro area. However, in January 2025, fears over a potential artificial intelligence bubble triggered a correction, with a gradual deterioration in US equity market valuations. This reversal accelerated in February and March with the deterioration in US growth expectations that accompanied the new administration's first economic policy announcements, while Germany's budget announcements supported bond yields and European stock market valuations.

Financial markets then reacted sharply to the announcement of tariffs on 2 April. The significant movement of risk aversion also impacted US Treasuries, which failed to play their traditional role as a safe haven. The Treasuries market experienced increased volatility in early April, with a sharp rise in long-term rates. At the same time, the US dollar depreciated sharply against other currencies. Contrary to the usual historical correlations, the rise in long-term Treasury yields was not accompanied by an appreciation of the US dollar. Conversely, gold benefited fully from its status as a safe haven asset, reaching an all-time high.

However, the steepening of the US yield curve is part of a broader trend of rising long-term sovereign bond yields worldwide since 2022. This trend is partly attributable to a deterioration in fiscal positions in many jurisdictions, characterised by high government deficits and large public debts in a context of moderate global growth. At the same time, the bond market normalised with the end of ultra-accommodative monetary policies.

Hedge funds are increasingly prominent in G10 sovereign debt markets, including in Europe. In 2023, they accounted for more than half of the volumes traded in euro area sovereign securities, as well as half of the aggregate demand recorded by the main banks during auctions. Due to the high leverage embedded in certain strategies, a significant price movement could force funds to unwind positions simultaneously, increasing volatility and weighing further on prices, particularly if other financial intermediaries are unable to absorb these sales.

The announcement of tariffs also led to significantly higher volatility on international equity and bond markets, with US indices underperforming markedly. However, in Europe and France, the adverse movements on equity and bond markets following the announcements on 2 April remained contained. Equity indices recovered most of their losses in June 2025. Equity market valuations remain high, particularly in the United States, in view of the climate of uncertainty and the long-term historical average. Risk premia on corporate bonds deteriorated temporarily in the United States and Europe, in particular for lower-quality issues, before returning to levels close to those prevailing prior to 2 April.

The materialisation of geopolitical risks may disrupt supply chains and result in higher risk premia in markets. The proliferation of international armed conflicts, in particular the deteriorating situation in the Middle East, may disrupt strategic trade routes, such as the Strait of Hormuz, and lead to higher prices for energy commodities.

While the cut-off date for the market data in this report was 17 June 2025, the outbreak of the Israel-Iran war on 13 June and US military involvement on 22 June have added to the uncertainty. Under these circumstances, oil prices initially rebounded strongly. A sustained rise in commodity prices could fuel inflationary pressures and an escalation of the conflict could possibly lead to increased risk aversion in markets and investor flight to safe assets.

The trade war and widespread uncertainty could weaken non-financial players

The unpredictability surrounding new international trade rules is encouraging companies and investors to adopt a wait-and-see approach, which is likely to hold back global growth. However, it is still difficult at this stage to quantify the macroeconomic impact of tariffs on economic activity and inflation in France, given the many possible scenarios. Studies conducted by the Banque de France suggest that the new US trade policy would in principle result in limited losses for French GDP. Furthermore, although tariffs are likely to lead to imported inflation from the United States, their overall effect should in principle be rather disinflationary due to a decline in global demand and to lower import prices from other regions of the world.

The relative resilience of the French economy in the first few months of 2025 is contributing to the stability of the financial system, despite moderate growth prospects in the short term. After reaching 2.3% in 2024, headline inflation is expected to bottom out at 1.0% in 2025 due to a sharp decline in energy prices,[1] while inflation excluding energy and food is expected to fall to 1.9%. From 2026 onwards, the normalisation of energy prices would bring headline inflation back to 1.4% in 2026 and then to 1.8% in 2027, still below the 2% threshold. This return of inflation to its target would occur without a recession, while growth is expected to remain moderate but nevertheless positive, at 0.6% for 2025 and 1.0% for 2026. However, the risks to these growth forecasts are on the downside, given the unpredictability of US trade policy.

French firms are overall less exposed to the US market than their German or Italian counterparts, with disparities across sectors. Within the manufacturing sector, aerospace, beverages and, to a lesser extent, pharmaceuticals are the most exposed. However, these sectors are currently in very good financial health and the low level of corporate debt contributes to their resilience. In 2023, the share of at-risk debt held by companies in these three sectors was less than 1% of total debt. Conversely, the real estate sector, which accounts for the bulk of at-risk debt in France, is not expected to suffer directly from the increase in US tariffs. However, this sector remains vulnerable as it is particularly sensitive to fluctuations in long-term interest rates and economic activity.

Beyond the potential impact of trade barriers and the high uncertainty environment, French corporates continue to suffer from high interest expenses. The cost of new loans is continuing to adjust downward as monetary easing is passed on, but borrowing costs remain high in France due to the French financing system, with a predominance of fixed-rate loans. However, French companies, as elsewhere in Europe, have adjusted to the period of higher interest rates by reducing their leverage. In addition, the level of corporate failures appears to have stabilised across all sectors and for all company sizes in the first few months of 2025. This improvement comes after a sharp rise in failures in 2024, which was partly due to a catch-up effect following the low point observed during the pandemic.

With public debt at 113.2% of GDP in 2024, France ranks third among euro area countries in terms of debt-to-GDP ratio, behind Italy and Greece. Such a high level of debt is very worrying in the current context of rising average interest rates on French public debt. Moreover, the fiscal space needed to mitigate an adverse shock appears very limited and could complicate the implementation of any countercyclical fiscal measures, beyond the role of automatic stabilisers.

The persistence of high government deficits and the failure to correct the debt trajectory are having a negative impact on market conditions. As a result, the yield spread between French and German government bonds was still higher in June 2025 than it was before the announcement of the snap election in June 2024, with a higher

[1] Assumption underlying the macroeconomic forecast published on 12 June 2025.

spread than for some lower-rated countries. However, liquidity conditions remain good, on both the primary and secondary markets.

Although household confidence has deteriorated due to the high level of uncertainty, the risks associated with housing credit appear to be contained. Households' financial assets as a whole are underpinned by a high saving ratio.[2] Furthermore, with historically low unemployment and continued growth in the purchasing power of gross disposable income, the risks stemming from households' financial position appear limited, although aggregate indicators could mask some heterogeneity across income levels. According to the June 2025 macroeconomic projections of the Banque de France, the rise in the unemployment rate is expected to be limited.

The residential real estate market is starting to recover, while the commercial real estate market is stabilising. After an orderly decline in prices and transaction volumes starting in 2022, the gradual reduction in borrowing costs has paved the way for a recovery in residential real estate, resulting in an acceleration in new housing loans, an increase in transaction volumes, and a slight rise in prices for existing homes. While the commercial real estate market is showing signs of stabilisation, it remains vulnerable to a potential deterioration in the macroeconomic environment.

Financial intermediaries have limited direct exposure to US assets but remain exposed to a deterioration in the macroeconomic environment

Banks remain exposed to a deterioration in the macroeconomic environment and to the situation in the non-financial sector. The cost of risk for banks continued to increase in the first quarter. While in 2024 the rise in the cost of risk was mainly attributable to the loan portfolio of non-financial corporations (NFC), the situation changed in the first quarter of 2025. The cost of risk rose on the portfolio of households, confirming the heterogeneity of situations within this sector despite a broadly robust financial situation, but remained stable on NFC portfolio outstanding amounts. However, in terms of asset quality, the portfolio of bank loans to SMEs deteriorated, accounting for just under half of total outstanding loans to NFCs.

French banks can rely on a sound and diversified business model and are benefiting from improved financing conditions, which enable them to post historically high income. After declining in 2023, the net banking income (NBI) of the six leading French groups had already grown significantly in 2024 (+8%), supported in particular by income from fees and commissions and from market activities. The figures for the first quarter of 2025 show that this growth has continued. This is mainly underpinned by growth in net interest margins and, to a lesser extent, a volume effect confirming the recovery in lending in response to stronger demand.

The insurance sector remains sound, with solvency well above regulatory requirements. French insurers hold own funds well in excess of their capital requirements, with the solvency capital requirement coverage ratio reaching 238% at the end of 2024. Investment portfolio yields are improving, thanks to past interest rate increases, and insurers' exposure to commercial real estate remains very limited (7% of investments at the end of 2024). However, non-life insurance technical profitability remains under pressure, due to past inflation and the multiplication of climatic events.

A deterioration in the macro-financial environment could also test the resilience of unlisted asset funds, which generally target highly indebted companies. Private equity and private debt funds have experienced rapid growth over the past decade, although growth has been less strong since 2022. This growth has been accompanied by increasing interconnections with the rest of the financial system, which remain difficult for authorities to measure accurately. Greater transparency in this market appears essential in order to better understand the risks and ensure effective supervision.

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[2] In Q4 2024, the household financial saving ratio stood at 9.7% of gross disposable income, while the saving ratio (including investments in new housing and major renovations) reached 18%.

In the sector of crypto assets, the development of stablecoins poses risks of contagion to the financial sector. Dollar-backed stablecoins account for 99% of these instruments, which are highly concentrated around two main issuers. In the event of a loss of confidence, a sudden run by investors could force stablecoin issuers to rapidly liquidate their reserve assets, at the risk of generating stress in the underlying markets. To date, the reserves of the two main stablecoins consistmostly of short-term US Treasury securities. Rapid growth of stablecoins would therefore enhance their potential footprint on the short term sovereign debt market. Moreover, the rapid development of dollar stablecoins, encouraged by the new US administration, should not come at the expense of European monetary sovereignty.

Geopolitical tensions and the weakening of multilateral initiatives are increasing cyber and climate risks

According to data from the University of Maryland, the number of cyber attacks worldwide stabilised in 2024, but threats persist. Increasing digitalisation, the use of external services providers, and the deterioration of the geopolitical environment could lead to a resurgence of cyber attacks. The European Agency for Cybersecurity (ENISA) has highlighted that banking institutions are prime targets and were affected by close to half of all cyber attacks targeting the European financial sector between 2023 and 2024. However, the entry into force in January 2025 of the European Digital Operational Resilience Act (DORA), which will complement other coordination mechanisms at national, European and international level, should enhance the resilience of the European financial system to cyber threats.

The assessment of the consequences of climate change confirms that, in both the short and long term, transition is significantly less costly than inaction. While in France, a no policy change scenario with regard to climate change would lead to a loss of 11.4 percentage points of GDP by 2050, the return on mitigation policies appears to be significant. Conversely, less coordination of transition policies and delays in their implementation raise the costs and risks associated with the transition. In this context, the fact that the United States is scaling back its ambitions in this area and withdrawing from the Paris Agreement could increase the climate risks weighing on the financial system.

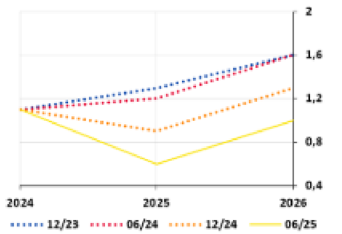
A thematic chapter of this report introduces a new forward-looking transition risk indicator for French financial sector market portfolios. This indicator is based on a model of sectoral income trends in response to climate transition, derived from scenarios developed by the Network for Greening the Financial System.[3] By projecting changes in corporate income according to the sectoral breakdown of their turnover, this approach makes it possible to identify climate vulnerabilities at the microeconomic level in a forward-looking manner.

[3] For a presentation of these scenarios, see the cross-sectoral chapter of the Financial Stability Report, Part 1.4, June 2025. Banque de France.

ASSESSMENT OF RISKS OF THE FRENCH FINANCIAL SYSTEM | June 2025

CYCLICAL RISKS

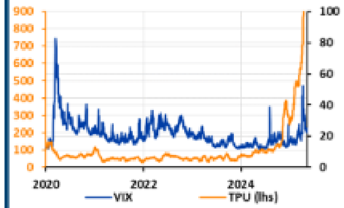
Risk of deterioration in the global economic environment



Changes in growth forecasts for France (Banque de France)

- Unpredictability of the US trade policy
- Downward revision of growth forecasts
- High debt levels of certain NFCs
- Developments in the Middle East
- Limited direct trade exposure to the United States

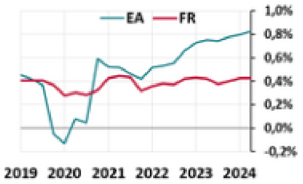
Risks of disorderly market correction



Market volatility and trade policy uncertainty (Caldara and Iacoviello ; Bloomberg)

- More frequent spikes in volatility
- Widespread uncertainty
- Equity valuations remain high
- Highly leveraged positions in certain funds
- Resilient market infrastructures
- Diversified investors

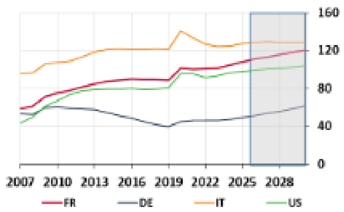
Risks to French banks and insurers



Quaterly returns on assets of major French banks and of the euro area (Bloomberg)

- Uncertain macroeconomic environment
- Increased cost of risk for banks
- Financial deregulation
- Strong solvency of banks and insurers
- Low level of non performing loans
- Limited exposure to US assets and dollar-denominated assets

Risks on sovereign debt



Changes in public debt/GDP ratios (IMF)

- High French public debt
- Tensions on the US Treasuries market
- Rise in long term interest rates internationally
- Liquidity of the French primary and secondary markets

STRUCTURAL RISKS

Cyberrisks

- Dependence on third party services
- Exploitation of vulnerabilities facilitated by AI
- Implementation of DORA
- Investments in cybersecurity

Risks related to tokenization

- Rise of cryptoassets, particularly stablecoins
- Development of DeFi
- Preparations for central bank digital currencies (CBDC)

Climate risk

- Exposure to physical and transition risks
- Transition policy implementation delays
- Climate stress tests

Risk outlook

Very high risk | High risk | Moderate risk

Vulnerabilities in blue
Resilience factors in green

Measures taken by authorities

Against a backdrop of gradual disinflation, the Governing Council of the European Central Bank (ECB) continued its policy of lowering key interest rates initiated in the second half of 2024, with four additional cuts of 25 basis points in January, March, April and June 2025. Since 11 June 2025, the interest rates on the deposit facility, the main refinancing operations and the marginal lending facility have been 2.00%, 2.15% and 2.40% respectively. At its June meeting, the Governing Council noted that inflation is currently around the 2% target for the medium term and that concerns over a tightening of financial conditions, in response to the uncertainty and market volatility that prevailed in April following trade tensions, have since eased. It reaffirmed its commitment to a meeting-by-meeting and data-dependent approach, particularly given the current context of exceptional uncertainty.

Furthermore, the Governing Council maintained its strategy of gradually reducing its asset purchase programmes. Asset purchase programme (APP) portfolios are continuing to decline, with no reinvestment of the principal payments from maturing securities. The pandemic emergency purchase programme (PEPP) portfolio is also declining at a measured and predictable pace, as the Eurosystem has no longer been reinvesting the principal payments from maturing securities since December 2024.

The French macroprudential framework has been simplified while continuing to ensure the resilience of the French financial system. The rate of the countercyclical capital buffer (CCyB)[4] remained stable at 1%. In June, the HCSF decided to scrap the sectoral systemic risk buffer (sSyRB). Introduced in 2023 to replace the "large exposures" measure, this buffer was designed to mitigate the risk of the concentration of French systemic banks' exposures to heavily indebted large companies. The specific risks that led to the introduction of this measure have significantly decreased, as reflected in the current very low prudential requirements for this buffer. Its deactivation therefore has no effect on the resilience of the French financial system and was considered useful for the purposes of simplification. Furthermore, the *Haut Conseil de stabilité financière* (HCSF – High Council for Financial Stability) adopted reciprocal measures for the Belgian[5] and Norwegian[6] systemic risk buffers. The legally binding standard[7] for granting residential housing loans remains in force. This standard imposes a maximum debt-service-to-income ratio of 35% (including borrower's insurance) and a maximum repayment period of twenty-five years (or twenty-seven years in certain specific cases[8]), with a flexibility margin of 20% of the banks' quarterly new lending.[9] It has helped to limit excessive debt repayment periods and debt service-income ratios since its introduction, without significantly impact on new housing loans or residential real-estate prices since interest rates began to rise. Banks' use of the flexibility margin for granting housing loans increased slightly, but remained well below the 20% ceiling.[10]

[4] *Haut Conseil de stabilité financière* (HCSF) (2023), "Publication on the countercyclical buffer", December
[5] Decision HCSF-2025-1
[6] Decision HCSF-2025-2
[7] Decision HCSF-2021-7
[8] This flexibility applies to loans where there is a lag between the disbursement of the loan and the date when the borrower(s) can move into the property. This applies in particular to the purchase or construction of a new dwelling and those related to purchases of existing dwellings giving rise to a work programme for which the amount represents at least 10% of the total cost of the transaction.
[9] 70% of this flexibility margin must be reserved for buyers of primary residences, of which 30% must be reserved for first-time buyers.
Flexibility is applied in the event that one of the two allocation limits or the total flexibility margin is exceeded in a single quarter, with compliance with these limits on overall new lending for that quarter and the following two quarters constituting appropriate and sufficient corrective action.
[10] Press release and HCSF of 04 March 2025

The new European Commission, which took office in December 2024 for a five-year term, presented its first major initiative in January 2025, a roadmap entitled "Competitiveness Compass for the EU".[11] It provides a clear strategic framework to guide the Commission's work during its term of office and translates the recommendations of the Draghi report[12] into an operational roadmap structured around three main lines of action: innovation, decarbonisation and security. These priorities, considered essential for boosting European competitiveness, are complemented by five horizontal catalysts designed to strengthen all economic sectors. These catalysts include financing competitiveness (through the Savings and Investments Union) and simplifying regulations.

As regards the financing of the economy, on 19 March 2025 the Commission published a document on the Savings and Investments Union.[13] The measures announced primarily aim to strengthen financial integration in order to enable the European Union to finance the additional investment needed to meet current challenges (in particular climate change and technological developments) estimated at an extra EUR 750 billion per year by 2030 in the Draghi report. This strategy also aims to enhance the prosperity of citizens and the economic competitiveness of the Union by mobilising more private savings for the real economy. It is structured around four complementary strands of work: facilitating citizens' access to financial markets to offer them products with better returns (Citizens and Savings); encouraging business investment, particularly by small and medium-sized enterprises (SMEs) and start-ups, through better access to capital markets (Investment and Financing); removing barriers to integration in order to build a genuine single capital market in Europe (Integration and Scale); and strengthening the convergence and effectiveness of financial supervision within the internal market (Efficient Supervision in the Single Market). These priorities correspond to those identified by the Banque de France and the *Autorité de contrôle prudentiel et de résolution* (ACPR), as set out in their response to a consultation launched by the Commission in the first quarter of 2025.[14].

The European Commission also wants to shore up the competitiveness of European businesses by developing a roadmap for regulatory and administrative simplification. It has therefore committed to reducing the administrative burdens on European businesses by more than 25%. For example, this commitment was demonstrated with the publication in February 2025 of the "omnibus package", which aims to reduce the administrative and regulatory burdens on SMEs and intermediate-sized entities with regard to environmental, social and governance (ESG) reporting. The proposal also provided for postponing certain ESG disclosure requirements, and was fast-tracked and adopted on 14 April 2025.[15]

Given the temptation to ease financial sector regulations in the United States, French and European authorities have clearly stressed that the European simplification agenda will not mean deregulation. In other words, the aim is to simplify the regulatory framework to make it more effective, reducing its complexity without lowering its standards. While the new US administration has not yet announced its timetable for finalising the implementation of the Basel III agreements, certain statements suggest that it may propose a reduction in capital requirements for US banks. In light of these uncertainties, the Bank of England announced that it would delay the implementation of these agreements by one year (to 2027).[16] The Governor of the Banque de France reiterated that he was "a strong advocate" of implementing the Basel III agreements, with one exception: given the uncertainty at the international level, it seems appropriate to postpone the implementation of the market risk framework reform by one year, to 2027. Beyond prudential regulation in the banking sector, financial deregulation in certain jurisdictions could also occur in the area of cryptoassets (including stablecoins), but also as a result of

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[11] Press release of the European Commission of 29 January 2025.
[12] European Commission (2024), "*The Draghi report on EU competitiveness*", September.
[13] European Commission (2025), "Savings and Investments Union », March.
[14] European Commission (2025), "Feedback from: Banque de France / ACPR" March.
[15] Directive (EU) 2025/794 of the European Parliament and of the Council of 14 April 2025 amending Directives (EU) 2022/2464 and (EU) 2024/1760 as regards the dates from which Member States are to apply certain corporate sustainability reporting and due diligence requirements (Text with EEA relevance)
[16] Bank of England (2025) "*The PRA announces a delay to the implementation of Basel 3.1*", January.

less ambitious measures to address climate-related challenges or the non-bank financial intermediary (NBFI) sector. Such a development would entail new financial risks and systemic vulnerabilities; it would also increase the risk of regulatory arbitrage.

Box: The pilot systemic stress test exercise conducted by the Banque de France, the *Autorité de contrôle prudentiel et de résolution* (ACPR) and the *Autorité des marchés financiers* (AMF)

The growing interconnections between banks and non-bank financial intermediaries, such as investment funds and insurance companies, are making the financial system more complex and increasing the risks of contagion, which are not currently taken into account in individual stress tests. System-wide stress tests therefore appear to be promising tools for identifying and quantifying these interconnections, better assessing contagion risks and improving their management.

The Banque de France and the ACPR are currently working with the AMF to finalise the terms of a pilot systemic stress test exercise involving banks, insurers and investment funds. This exploratory and voluntary exercise, which will be conducted in the second half of 2025, will not translate into regulatory requirement. It is primarily a mutual learning exercise for the authorities, participants and the Paris financial centre as a whole. The methodology, which is currently being finalised, is being developed jointly with the participants in the exercise.

The US retreat from its climate ambitions was evident in the Trump administration's (renewed) withdrawal from the Paris Agreement in January 2025 and in its new prospects for fossil fuel projects. The US administration's actions are also weakening international climate finance mechanisms: it has withdrawn its support for the Loss and Damage Fund and, in February 2025, cancelled a USD 4 billion commitment to the Green Climate Fund (GCF). Moreover, heightened trade tensions could exacerbate climate risks: increased customs duties and retaliatory measures are disrupting the low-carbon energy value chain, as illustrated by China's April 2025 export controls on a range of critical minerals, rare earth elements and permanent magnets to the United States. More generally, trade tensions increase regulatory uncertainty for businesses – including uncertainty surrounding environmental regulations – and can have adverse macroeconomic effects on the green transition, such as slowing the diffusion of technological progress.