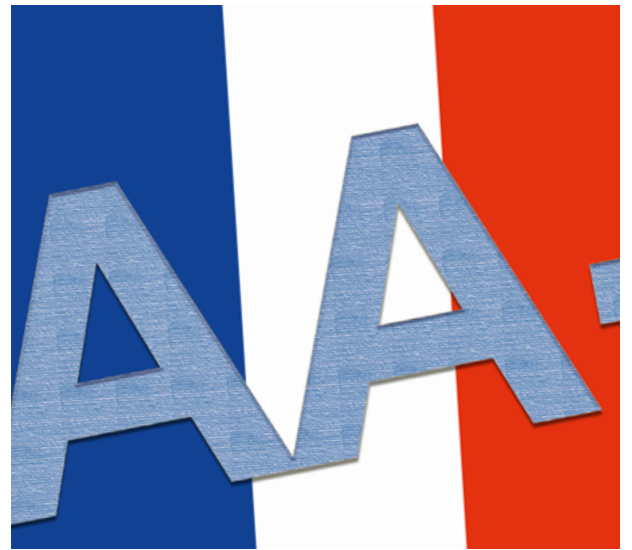


► FEATURE

Credit and Credibility

France still enjoys privileged access to financial markets, retaining a strong credit rating and the ability to obtain financing. But a widening budget deficit and mounting government debt could threaten its position.



► EDITORIAL Stéphane Giordano and Stéphanie Hubert | AMAFI

An air of expectancy has settled over France and Europe in the wake of the recent elections.

In France, the key issue is whether the budget deficit will be reduced by cutting expenditure, as called for by the national employers' confederation, Medef, or by hiking taxes on capital, which our companies so desperately need if they are to meet the challenges of technological and energy transition while remaining competitive. Although the markets continue to finance France's debt (see *Feature*, p. 2), the country – the second-largest economy in the eurozone – must return to more sustainable deficit levels, particularly since it is now under the EU's excessive deficit procedure. The question therefore is what choices France will make in terms of channelling savings into the capital markets and providing long-term financing for its businesses? The 2025 Finance Act should provide some initial answers.

At EU level, a number of reports recommending far-reaching reforms to the Single Market and closer integration of capital markets have been published since the spring. Aside from the superficial approval they have garnered, their analyses have sparked debate among member states. With the newly-appointed Commissioners due to be sworn in by the Parliament in November, there is still uncertainty about the reforms that will actually be launched and the political support they will receive. While the European Parliament is more fragmented than before the elections, it can undoubtedly secure a majority on many issues. Nonetheless, a strong political consensus is needed to drive forward the structural reforms that are vital if the European Union is not to decouple permanently from the USA and China. It was against this backdrop that AMAFI held discussions with European decision-makers at the latest Eurofi forum in Budapest (see *News* p. 5), where the mood was cautious.

Credit and Credibility

 Sandra Sebag

Is France heading to the bottom of the class in Europe because of its budget deficit and government debt? When the euro was introduced in 1999, the continent's economies agreed to meet convergence criteria covering inflation, public finances, exchange rate stability and long-term interest rates to maintain price stability across the euro area. Those requirements remain in place even when new countries adopt the single currency. Under the public-finance criteria, a member state's annual fiscal deficit cannot be more than 3% of gross domestic product, and overall government debt is not allowed to exceed 60% of GDP. However, France's central government budget has not been in surplus – or even in balance – since 1974. In fact, save for the brief period from 2017-2019, it has consistently breached the convergence criteria since 2002, and the deficit has increased steadily in the post-2020 era. After hitting 5.5% in 2023, the budget deficit is forecast to widen to 5.6% in 2024, according to the latest numbers from the French finance ministry, which has warned that things could get worse unless corrective steps are taken, projecting deficits of 6.2% in 2025, 6.7% in 2026 and 6.5% in 2027. The situation is placing an ever-increasing drag on government debt, which amounted to 112% of GDP in the second quarter of 2024 – a long way off the Maastricht requirements.

Not alone

France is not the only laggard, however. According to the European Commission's spring economic forecast, while the aggregate EU government deficit is projected to shrink in 2024 (to 3.0%) and 2025 (to 2.9%), 11 out of 27 member states will record deficits of more than 3% of GDP in 2024, dropping to nine in 2025. Meanwhile, Britain's government posted a deficit of £120 billion in FY 2023/24, equivalent to 4.4% of GDP. The UK has recorded just five budget surpluses since 1970/71, with the last one dating back to 2000/01. At present, the national debt

is around £2.7 trillion, or just under 100% of GDP. The story is remarkably similar in the United States, where the federal government budget has run a surplus just four times in the last half-century, most recently in 2001. In its Budget and Economic Outlook Update for 2024 to 2034, the Congressional Budget Office said that the adjusted federal budget deficit would reach \$2 trillion in FY2024, or 7% of GDP, and rise to \$2.8 trillion by 2034. Debt held by the public, meanwhile, which was \$26.2 trillion at the end of 2023, is projected to climb from 99% of GDP in 2024 to 109% in 2028 – higher than at any point in the nation's history – before soaring to 122% of GDP by the end of the projection period in 2034.

In recent years, much of the debt increase can be put down to the Covid-19 crisis, as governments around the world stepped up their borrowing to cope with the pandemic. Unforeseen and unbudgeted expenses have added to the burden, which has been further compounded by a major impact from higher interest rates. Catherine Lubochinsky of the Cercle des Économistes, a French think tank, says that a 100-basis point increase in interest rates costs the country's central government an additional €2.6 billion from year one, rising to €17 billion by year five.

A series of wake-up calls

Taking stock of these data, several of the major credit rating agencies have downgraded French debt. Fitch Ratings lowered its rating from AA to AA- in April 2023 and Standard & Poor's did likewise in May 2024. Moody's looks set to follow suit when it conducts its next review in October 2025. Hannah Dimpker, head of sovereign ratings at Fitch Ratings, points out however that the agency affirmed France's AA- rating with a stable outlook this April and left both rating and outlook unchanged after President Emmanuel Macron dissolved parliament in June. In fact, Fitch's rating already factors in a one-notch qualitative adjustment to reflect the high government



►► debt-to-GDP ratio as well as a political environment that is un conducive to consolidation. Since the subsequent general election resulted in a more fragmented parliament and increased the risk of legislative gridlock or new expansionary fiscal measures, the agency will keep a watchful eye. Key challenges for the new government include passing the 2025 budget and presenting a medium-term fiscal adjustment plan to the European Commission under the EU's new fiscal rules. At this stage, says Dimpker, a significant and persistent increase in the debt-to-GDP ratio could lead to a downgrade.

Meanwhile, the European Commission has opened an excessive deficit procedure against France, which was joined on the naughty step by Italy, Belgium, Hungary, Poland, Slovakia and Malta. Each of those five was given until September to present a fiscal and structural plan to rein in the excesses, while France was allowed extra time because the new prime minister, Michel Barnier, was not appointed until early September.

France now has to put forward a budget that is deemed credible not only by Brussels but also by investors, reflecting the fact that French debt is primarily held by non-residents and traded on financial markets. In the first quarter of 2024, French banks held just 8% of the country's sovereign debt, while French insurers held 9% in the form of non-unit linked funds. Although these investors collectively form an inherently stable base

as a result of regulatory incentives to hold this type of asset, they make up only a marginal share of French-debt holders. Non-residents hold the bulk of the debt – about

54% – and adopt a portfolio management approach, allocating a portion of their investments to European debt. Paradoxically, German and French government securities are often viewed on a par, even though the two countries have strikingly different macroeconomic equilibriums, with Germany's debt amounting to just 64% of GDP. According to observers, France therefore gets a free ride in Europe's financial system, benefiting from excessively favourable value increases for its debt on fixed income markets and enjoying a credit spread over Germany that does not reflect its management of the public finances and hence the real risk.

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International investors are bullish on France's governance and view the local financial sector's fundamentals as rock-solid

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Even so, France is still attractive

Be that as it may, markets are reassured by France's tax-raising capabilities, while structural and non-financial factors also make it attractive. International investors are bullish on its governance and view the local financial sector's rock-solid fundamentals as a bulwark during times of crisis. For example, the country's credit spread has widened by a mere 20 basis points since parliament was dissolved, despite the financial markets' aversion to uncertainty. This forgiving attitude stems in part from the specific characteristics of France's debt. In particular, ►►

►► it is one of a handful of euro area countries, alongside Germany, to boast a strong rating coupled with extremely liquid debt.

France also benefits from an implicit guarantee from the European institutions, which introduced tools to support struggling economies through securities purchases by the European Central Bank, in the wake of the 2011 debt crisis that rocked Greece, Spain, Portugal, Italy and Ireland. More recently, the Next Generation EU stimulus plans were actually funded by European debt, a first step towards pooling euro area debt to provide support for weaker economies.

Admittedly, some investors recently switched into Spain, which has a 10-basis point spread over France and sounder public finances. Japanese investors likewise have pulled out lately and were net sellers of French government bonds to the tune of €8.1 billion in July. These switches were not only a response to the elections; they were also designed to take advantage of expected rate cuts for US debt. While cautionary, however, these movements remain on a small scale overall. France's most recent debt issues have been heavily oversubscribed, with excellent bid-to-cover ratios, especially on 2036 and 2040 maturities and even on 2055, although the rate fell slightly compared with the June 2024 issue. In another positive move, the ECB began lowering interest rates on July 5, and policy rates have already been cut by 50 basis points, making French debt more appealing to yield-hunting investors because of the pickup relative to Germany. When quizzed about whether French debt is still attractive, Hannah Dimpker points out that France, alongside Germany, is still one of the euro area's main benchmark issuers, with significant financing capacity

and sound access to national and international funding sources. Right now, she says, Fitch has no concerns about France's ability to finance itself.

Working hard to make the grade

Nevertheless, a French sovereign debt crisis cannot be ruled out. Consider what happened in the UK. In September 2022 the then-prime minister, Liz Truss, and her finance minister, Kwasi Kwarteng, unveiled a proposed mini-budget including unfunded tax cuts that would have swelled the budget deficit by £45 billion a year by 2026/27. The ensuing outcry and turmoil on financial markets forced Truss and Kwarteng to step down. Lubochinsky argues that these events illustrate the regulating force exerted by investors. "When financial firms begin to doubt the ability of an economic participant – especially a government – to repay its debt, a financial crisis can erupt and then be amplified by investors' herd behaviour." To avoid this, economists of all stripes emphasise the need to bring down government spending. Furthermore, to continue investing for the future, France will have to lean on Europe. In his report on EU competitiveness released in early September, former ECB boss and Italian Prime Minister Mario Draghi pointed to the need for massive investment plans funded by European debt, especially to decarbonise the continent's economy and foster innovation. But to win the backing of northern countries, which tend to be more frugal than those in the south, spendthrift nations must do more domestic belt-tightening. France, for one, needs to find savings of €100 billion by 2028. So while it still has credit and credibility, it has its work cut out to get back the top of the public-finance class.

EUROFI

Eurofi Financial Forum, Budapest



Eurofi held its Financial Forum in Budapest from 11 to 13 September. The event took place at a crucial time, with the European Union in the midst of institutional renewal, and Mario Draghi's recent report on European competitiveness fuelling discussions about the impacts on the roadmap of the new Commission.

AMAFI's meetings focused on its proposals ([AMAFI / 23-88](#)) for the Capital Markets Union, which the Letta Report has suggested rebranding as a Savings and Investment Union, and drew attention to the challenges involved in switching to T+1 settlement.

AMAFI Chairman Stéphane Giordano, Director of European and International Affairs Arnaud Eard, and several members of the European Action Committee met with institutional representatives, including Stéphanie Yon-Courtin, member of the European Parliament's Committee on Economic and

Arnaud Eard

EFSA

Copenhagen meeting



Finance Denmark welcomed its European colleagues from the European Forum of Securities Associations (EFSA) for a meeting in mid-September. The Danish association takes over the Forum's secretariat from AMAFI for the coming year.

Arnaud Eard

Monetary Affairs, Martin Merlin, Financial Markets Director at DG FISMA, as well as finance ministry representatives from ten member states.

AMAFI's proposals for the Savings and Investment Union ([AMAFI / 24-56](#)) were broadly welcomed, especially those aimed at nurturing less developed local markets. There was also general agreement about reviving Europe's securitisation market and channelling household savings to finance the European economy through tax incentives and a European label. By contrast, proposals on reforming the governance of ESMA and shifting towards more centralised supervision for cross-border activities received more muted support. Those reactions raised questions about the political will needed to carry out structural reforms in order to build deep and competitive capital markets.

On shortening the settlement cycle ([AMAFI / 24-57](#)), it is now apparent that Europe is set to follow the lead of the United States and several other countries that recently moved to T+1. AMAFI's talking partners seemed receptive to the argument that the work areas needed to support a successful move should be identified before setting a date for the switchover. The unique infrastructure and liquidity features of Europe's markets must be accommodated to ensure that these markets stay efficient and competitive. These issues should likewise be foremost when organising the vital coordination with UK and Swiss authorities (*see News p.7*).

The meeting was an opportunity to hold discussions and mull joint positions on topical issues such as EU institutional renewal and the relaunch of CMU in the light of the Draghi report and other recently released publications. Participants also discussed the Retail Investment Strategy, the switch to T+1 settlement, and ongoing MiFIDII/MiFIR consultations.

AMAFI is gratified by the outstanding collaboration between EFSA members and the joint initiatives conducted over the past year to represent European sell-side interests in Brussels.

The next meeting will be held in Warsaw in April, on the sidelines of the Eurofi Financial Forum.

MiFID

MiFID Review

As part of the MiFID II and MiFIR review, ESMA has drawn up Level 2 measures on which it is holding consultations. Key areas of focus include equity market transparency (still underway), non-equity market transparency (AMAFI / 24-51), the consolidated tape (AMAFI / 24-50), commodities (AMAFI / 24-49), a reasonable commercial basis for the cost of market data (AMAFI / 24-51) and reference data (RTS 23) (AMAFI / 24-53).

Given the Commission President's keenness to simplify the regulatory framework and promote a competitive European economy, AMAFI stressed three major points in its consultation feedback:

- ▶ The goal must always be to make European regulations simpler, not more complicated.
- ▶ Changes mean investments – sometimes substantial – for firms but also for regulators, making it important to assess whether they are appropriate.
- ▶ New standards, even at Level 2, must factor in EU competitiveness, especially relative to the United Kingdom, which has embarked on a broad-based review of its market rules.

Emmanuel de Fournoux, Diana Safaryan

PRUDENTIAL REGIME FOR INVESTMENT FIRMS

IFR-IFD

Following publication in June of an EBA/ESMA consultation paper on revising the prudential regime for investment firms, AMAFI underlined (AMAFI / 24-61) the need to maintain a regime that is tailored to the business and risks of investment firms. It noted that the regime in place for the last three years has proven satisfactory, as supervisors themselves have admitted.

Given this, AMAFI stressed the importance of avoiding increased complexity while maintaining regulatory stability. It urged that attention be paid to EU competitiveness, particularly with regard to remuneration policies, and highlighted the need to improve the rules on intragroup consolidation.

Emmanuel de Fournoux, Diana Safaryan

EFSA CONFERENCE > AGENDA

Competitiveness of European markets, Brussels 12 November

EFSA is organising a conference on 12 November in Brussels on the competitiveness of European markets in the light of recent initiatives on the topic, including four reports – ESMA, Noyer, Letta and Draghi – as well as the conclusions of the Eurogroup and Council.

The conference will open with an address by Christian Noyer, Honorary Governor of the Banque de France, followed by a panel discussion moderated by Urban Funered, CEO of Sweden's SSMA, and featuring representatives from European institutions and the private sector, including AMAFI Chairman Stéphane Giordano.

For information and enrolment, contact:

📧 secretariat@amafi.fr

Arnaud Eard

SETTLEMENT

Switch to T+1

In view of the clear determination to shorten the securities settlement cycle to one day, AMAFI considers that it is now critical to concentrate on the prerequisites needed to support a smooth transition within the European Union, which include:

- ▶ Ensuring that the settlement process is tailored to a T+1 cycle from end to end.
- ▶ Adopting an asset class-based approach, paying particular attention to corporate and sovereign bonds and exchange-traded funds.
- ▶ Temporarily suspending and adjusting the CSDR penalties regime (see below).

AMAFI stressed (AMAFI / 24-57) that an implementation date should not be chosen until these prerequisites have been properly identified. It also emphasised the need to pay heed to the UK's timing.

AMAFI has set up a T+1 working group to look at these questions in greater depth, in partnership with France Post Marché and AFG.

CSDR - Penalties

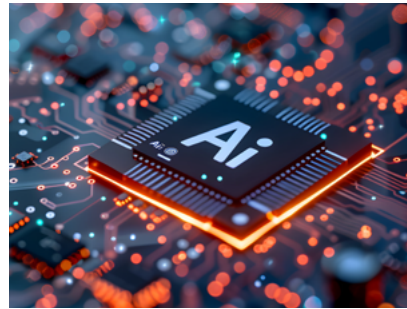
Given the implications of transitioning from T+2 to T+1, AMAFI put forward several recommendations in the joint response it submitted with France Post Marché to ESMA's CSDR consultation (AMAFI / 24-58). Among other things, it emphasised the need to adjust settlement discipline rules to avoid excessive penalties, particularly for bonds and ETFs. It also recommended temporarily suspending the CSDR penalties regime for at least three months after T+1 has been implemented and then assessing the need for a further extension.

AMAFI called for a penalty regime that takes account of the specific characteristics of different asset classes and argued that penalties and mandatory buy-ins should be treated separately.

Emmanuel de Fournoux, Diana Safaryan

ARTIFICIAL INTELLIGENCE

Applying the AI Act to the financial sector



The European Commission recently consulted financial sector participants about the use of artificial intelligence in their activities, with a view to providing guidance on implementing the AI Act. In its feedback (AMAFI / 24-62), AMAFI stressed:

- ▶ The need to avoid additional specific requirements for AI in the financial sector, given that an extensive and robust framework already exists.
- ▶ The lack of clarity in the definition given for "AI system", which makes it hard for firms to determine whether the AI Act applies to their systems.

Thiebald Cremers, Yann Besseau

INVESTOR PROTECTION

Retail Investment Strategy (RIS)

The Council and Parliament have now established their respective positions on the RIS. While significant advances have been made relative to the Commission's initial proposal, particularly on inducements, a number of worrying points remain:

- ▶ The introduction of unnecessary barriers that would complicate the client journey and potentially dissuade retail savers from investing in capital markets.
- ▶ The advantage given to products deemed to be simple and affordable, a situation that could diminish and significantly standardise the range of financial products on offer.

AMAFI continues to voice these concerns with its institutional talking partners, particularly the French Treasury (AMAFI / 24-44). The RIS is a major issue for making European markets attractive to retail investors, and could actually conflict with the goals of simplifying and promoting retail investment in EU companies put forward by Enrico Letta and Mario Draghi in their recent reports.

Trilogue discussions on the RIS are set to start in October, once the new Commission is in place.

Catherine Balençon

LIQUIDITY CONTRACT

AMAFI Charter

AMAFI published a new version of its liquidity contract charter in early September (*AMAFI / 24-48a*). The document provides clarifications on operation of the liquidity account, position limits, disclosure of contracts to the AMF and the role of the compliance function.

AMAFI also released new versions of the liquidity contract template (*AMAFI / 24-48b*) and its accompanying explanatory note (*AMAFI / 24-48c*).

This work was an opportunity to update legislative and regulatory references, to clarify the classification of various securities (illiquid, liquid and highly liquid) and the ban on trading beyond limits set by the AMF, and to add stipulations on initial public offerings and block trades. Clarification was also provided on procedures for takeover of securities.

Thiebald Cremers

STRUCTURED PRODUCTS

Actively Managed Certificates

The AMF consulted AMAFI (*AMAFI / 24-46*) on the regulator's draft recommendation for the distribution of Actively Managed Certificates. AMCs are structured products whose specific feature is an underlier that can be "rebalanced" (i.e. adjusted) during their lifecycle.

In its feedback, AMAFI pointed out that the draft recommendation would amount to goldplating European rules and proposed at the very least that some AMCs should be treated – subject to strict requirements – as simple products authorised for broad distribution to customers. It further advocated that the ability to decide on the composition of the underlying interest could be extended beyond investment services providers authorised for collective or portfolio management, under the responsibility of the manufacturer.

Working groups set up by authorities

At the initiative of its Retail Investors Consultative Commission, the AMF Board set up in July a working group on structured products. The group, comprising members from three AMF consultative commissions (Retail Investors, Asset Management and Markets), is looking, among others, at the clarity of product documentation provided to investors.

While not part of this group, AMAFI nevertheless plans to provide it with input by preparing product briefing memos (*AMAFI / 24-46*) and conducting collective discussions. These talks will parallel the work of the group, which is expected to wrap up by the end of the year.

Catherine Balençon

TEAM

Following a work-study placement, **Yann Besseau** has joined AMAFI's Legal Division, where he is providing support to Legal Affairs Director Thiebald Cremers. Yann holds a master's degree in banking and financial law from the University of Montpellier.

NEW MEMBERS

► **Banque Pictet & Cie (Europe) AG**, Paris branch, a credit institution whose activities include portfolio management and investment advice. Its senior managers are Jean-Baptiste Douin (CEO) and Guillaume Compain (COO).

► **Macquarie Asset Management Europe SARL** has joined AMAFI as a correspondent member (social status). A portfolio management company, its legal representative is Stéphane Brimont. The correspondent member (social status) membership category is open to companies voluntarily applying the national collective bargaining agreement for financial market activities (CCNM).

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www.amafi.fr

Most of them, notably AMAFI's responses to public consultations, are freely available, but some are restricted to members only.



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