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The HCSF publishes an analysis of the French financial system's interconnections, simulating the propagation of shocks

As the propensity of the financial system to mitigate, amplify or propagate shocks appears as an important matter, the study published by the High Council for Financial Stability (HCSF) sheds light on interconnections between the different components of the French financial sector, with an unprecedented degree of granularity.

Building on a previous study by the HCSF (K. Benhami, C. Le Moign, D. Salakhova, A. Vinel (2018)) focused on asset management, the HCSF offers an analysis of the interconnections between banks, insurance, and asset management, the three industry sectors that make up the French financial system.

A scope of 8,308 French financial institutions

Jointly carried out by economists from the AMF, the ACPR, the Banque de France and the French Treasury, this study sheds light on the vulnerabilities associated with the structure of interconnections between financial sectors. It is based on individual data from 8,308 French financial institutions from the Banque de France, the Prudential Control and Resolution Authority and the Autorité des Marchés Financiers. For each institution, this data describes the exposures associated with its holding of bonds, shares and investment fund shares issued by other network institutions, as well as the holding of assets external to the network.

On this basis, the study examines the propensity of the French financial system to propagate and to attenuate or amplify market shocks.

Two contagion channels are tested

The model analyses the transmission by the network of an exogenous valuation shock to their assets, namely those not issued within the French financial system. It considers two main channels of contagion: the prices of securities in the market and cascades of potential defaults. The securities market channel accounts for common exposures to the same set of securities and for the impact of an institution's losses on the price of its own securities (equities, bonds and fund shares) issued by the entity and held by other financial institutions in the network. The second channel reflects institutions' losses due to the defaults by their financial counterparties.

The main conclusions

The spread of small exogenous shocks across the network underscores the importance of the market channel compared to traditional default cascades. The simulations tested induce very low losses for the three types of network entities as a proportion of their total assets. A reverse stress test confirms the general robustness of the network: it takes a sizeable shock to trigger a default. Beyond these overall results, the method enables to identify the components of the network playing an important role in these diffusion phenomena.


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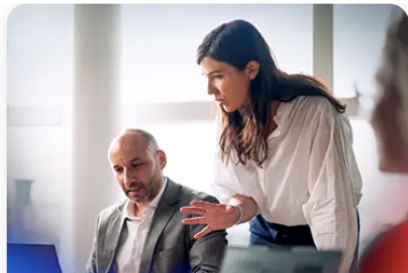
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