



**Interview of François Villeroy de Galhau, Governor of the Banque de France,
with *Corriere della Sera* – 16 September 2016**

“In a world of uncertainty, European monetary policy is a yardstick of stability.”

***Corriere della Sera* - Inflation is at historical lows and the market seems sceptical about it picking up.**

Is monetary policy working?

François Villeroy de Galhau - Yes! But we should put market expectations into perspective; there are other, much higher projections such as the Survey of Professional Forecasters. Our own inflation forecast is for 1.6% in 2018. We are moving significantly closer to our target and within the next few months we should see inflation rise above 1% in the euro area. If we had not taken action, we would, on the contrary, probably be much closer to deflation. According to our estimates, our measures allow gains in inflation and growth of 0.3% to 0.5% each year. Our monetary policy is effective. Its main strength is that it is constant, predictable and clear. We are therefore going to pursue this course.

***CdS* – Does this mean that there is really no need to increase the volume of purchases or that the process can be slowed and spread over a longer period?**

FVG – Our inflation and growth forecasts have been confirmed since last March. It was then that we decided on an overall package of measures that was tailored to the economic conditions of that time. The situation has not evolved since and, as a result, there is no reason for us to change our policy. If the economic situation were

to change, we would be flexible. We have always said that March 2017 is not necessarily a cut-off date; we will also be assessing progress made towards achieving our target for inflation below but close to 2%.

CdS – The markets want to know what is going to happen after March 2017.

FVG – We are doing exactly what we said we would do. In particular, we are fully determined and able to pursue our asset purchases at the rate of EUR 80 billion per month. The markets are sometimes volatile, including in their expectations. But our policy is conducted in light of our analysis of the needs of the European economy and in accordance with our mandate. In a world of uncertainty, European monetary policy is a yardstick of stability.

CdS – Banks are complaining about negative rates. Are they right?

FVG – Negative rates are only one instrument amongst others of the ECB's non-standard monetary policy. It is a useful instrument, but it has its limitations as Mario Draghi recalled. All things considered, the assessment for banks is positive as evidenced by the drop in their financing costs, gains, the greater volumes of credit and the lower risk charge. However, in the long term, we need to pay close attention to the effects of monetary policy on banks' profitability.

CdS – Have the French and Italian governments done as much as they could to take advantage of the ECB's monetary policy?

FVG – Monetary policy is not sufficient in itself. It is vital to deploy the three pillars of economic policy: monetary policy, fiscal policy and structural reforms. In France, and probably in Italy, the priority is to expand structural reforms, beyond those already implemented. The countries which have made structural reforms in the most determined manner have achieved convincing results. I am referring to Germany, Spain, the Nordic countries and the Baltic States. The results speak for themselves: it is the reforms introduced that have made the greatest difference for growth and jobs in the euro area today. And these reforms are compatible with the European social model in which we collectively believe.

CdS – Mr. Draghi says that Germany should use its fiscal space. What do you think?

FVG – Germany is indeed in the position to use its fiscal surpluses. There are needs for public investment. Mr. Schauble has also spoken of tax cuts. There is much less fiscal space in other countries such as France and, possibly, Italy. The idea, often put forward at the moment, that all should use deficits and boost public spending does not make much sense. If that were the key then all the southern European countries would be the growth leaders. This is obviously not the case.

CdS – Do you mean that there is no single solution for supporting economic recovery?

Indeed, there is no one-size-fits-all answer. And a coordinated approach is thus called for in the euro area. More reforms in France and in Italy, more fiscal stimulus in Germany: all countries must move together to foster change in each individual country. This is what I call a collective strategy, a pact of confidence between the countries of the euro area. To achieve this, an institution of confidence is needed. For example, this could be a euro area finance minister. This would probably be easier to put in place towards the end of 2017, after the elections in certain major countries.

CdS - Joseph Stiglitz claims that divergence is increasing in the euro area. He believes that certain countries should leave or he advocates the creation of a northern and southern euro. What is your opinion?

FVG – Admittedly, economic conditions differ across Europe but there are also major areas of convergence, in particular financial: a reduction in interest rate differentials, inflation rates, etc. The euro creates convergence, differences stem from the pace of national reforms. Joseph Stiglitz's analysis of the consequences of a country exiting the euro is much too flimsy. We know what the immediate repercussions would be: speculation against its currency and yields, resulting in a rise in the cost of credit to firms and households, and higher servicing costs for the government. For example, Mr. Stiglitz cites the case of Iceland which introduced capital controls and Argentina which restructured its debt. Naturally, I would not

recommend this model in my country or in any other. Besides, the great majority of euro area citizens (68%) are attached to their currency.

CdS – Might Brexit allow the European financial centres to play a new role, in particular Paris?

FVG - Brexit remains bad news; firstly, for the United Kingdom and its economy, and to a lesser extent for Europe. The real question is what solution the UK will choose regarding its single market access. Will it want full access, in which case it will have to accept all the rules, including the free movement of persons, or will priority be given to controlling immigration? It is nevertheless clear that cherry-picking is not an option; if the UK wants to remain in the single market, notably in the area of finance, it will have to apply all the rules. Paris has a number of advantages: the most robust banking system in the euro area, major players in the insurance sector, financial know-how and highly-skilled workforce, and new initiatives to enhance attractiveness (notably tax measures). And it is also a large international city. So may the best win!

CdS – Does the referendum in Italy worry you?

FVG – Naturally, I have no comment on Italian politics. But I firmly believe that the euro needs a strong Italy. There have been a certain number of encouraging initiatives, both institutional and economic, such as the “Jobs Act”, which is yielding interesting results. As a priority, the problem of non-performing loans affecting some Italian banks must be fully resolved. It is a stumbling block for Italian growth but the Banca d’Italia, with Ignazio Visco at the helm, and the government are addressing this issue.

CdS – We call it the European Banking Union, but since its creation there have not been any unions between banks in Europe...

FVG – There have been some very significant achievements. The Single Supervisory Mechanism based in Frankfurt is credible, and banks take it very seriously. Progress has been made in terms of resolution. Lastly, as regards regulations, Basel III must be completed, ensuring that it is compatible with European economic growth, i.e. without a substantial increase in capital requirements. Italy, France and Germany all agree on this. But I believe that once this framework has been clarified, we should move towards the creation of cross-border institutions in Europe. When you compare the European and the US banking markets, it is obvious that we need more significant cross-border institutions. We could thus enhance cross-border savings flows in Europe to the benefit of firms. That falls within the “Financing and Investment Union” that we could rapidly develop.