



Interview of François Villeroy de Galhau, Governor of Banque de France

Les Echos– December 11, 2016

Les Echos: What message was the ECB trying to send out last Thursday?

François VILLEROY de GALHAU

The ECB was said to be constrained, but we have demonstrated both our freedom to act and our pragmatism. First, the recovery in Europe is proving resilient, supported by our monetary policy. Our growth forecast for 2016 and 2017 has been raised to 1.7%, despite Brexit and Mr Trump's election victory. As the threat of deflation also seems to have been definitively averted, this has enabled us to scale back our financial asset purchase programme from EUR 80 billion to EUR 60 billion per month. By also extending the programme to December 2017, we are giving markets and economic agents visibility. In a world of uncertainty, at least European monetary policy is clear.

Did the Italian referendum and the rise of populism weigh on the decision?

François VILLEROY de GALHAU

No. We should only take into account the impact of political events on the real economy. The effects of the Italian referendum should be limited.

What about Brexit?

François VILLEROY de GALHAU

We are only expecting a slight negative impact on Europe excluding the United Kingdom. In contrast, the pace of growth in the UK, which has been higher up to now, should fall below that of the euro area in 2017.

And the Trump effect?

François VILLEROY de GALHAU

For now, markets are factoring in a probable widening of the US deficit and an acceleration in growth, which is leading to rises in equity prices and interest rates and, to a lesser extent, in the dollar. Europe has in part resisted this rise in rates. But the trade agenda is still a big unknown.

The majority of international institutions are saying that fiscal policies should complement monetary policies. Is that also the ECB's stance?

François VILLEROY de GALHAU

That recommendation needs to be made more specific. The Commission is right in saying that certain European countries such as Germany and the Netherlands have the fiscal leeway to support economic activity. But only on the condition that other countries respect the shared rules.

Does that mean France?

François VILLEROY de GALHAU

France can only legitimately ask Germany to provide stimulus if it is itself credible on the acceleration of its reforms and on its fiscal commitments. In any case, reforms are the key to boosting France's rate of growth, which we expect to remain too low, at 1.3% in 2016 and 2017. France has carried out more reforms than people give it credit for, but far fewer than our neighbours, who are showing us how to successfully combat unemployment while remaining within the bounds of our European social model. With regard to the public accounts, France will only be listened to in Europe if it is believed. We need to stick to our commitment of cutting the deficit to below 3% of GDP in 2017.

Is that a message for the candidates in the upcoming election campaign?

François VILLEROY de GALHAU

For them and for the current government. I've been stressing this issue, which is in our collective national interest, since the publication of the 2017 draft budget at the end of September. According to Banque de France projections, the deficit should actually be around 3.1%, which is more than the 2.7% set out in the budget. Getting down to below 3% implies EUR 4 billion of savings, or 0.3% of public spending: that's perfectly feasible. But nobody should try to create any illusions in the electoral debate: the acceleration of French growth cannot come from fiscal stimulus.

Why not, given that interest rates are so low?

Firstly, interest rates will not always be at these levels, and, second, all this accumulated debt will need to be repaid. As a share of GDP, France's debt has increased fivefold since 1980. When my generation were 20 years old, debt was just 20% of GDP. Today, now that our children have reached the age of 20, we're approaching 100%. But at the same time, as far as I'm aware, France, like Italy, has hardly turned out to be a European champion when it comes to growth. Our public spending accounts for 56% of GDP, whereas the same social model only costs 51% of GDP in Sweden, or an average of 47% in the euro area. That means we spend between EUR 100 billion and EUR 200 billion more than our European neighbours. I'm a true believer in public services, but we need to pick up the slack in terms of efficiency.

For the time being, we only have the right's election manifesto. François Fillon is planning to cut public spending and help businesses. Does the Banque de France like that?

François VILLEROY de GALHAU

The Banque de France sets great store by its independence. It is certainly not our role to take sides in politics.

One party, the Front National, has pledged to hold a referendum on whether France should remain in the euro. Do you feel it's your role to defend the euro?

François VILLEROY de GALHAU

The French have already voted in favour of their currency in a referendum, in 1992, and around 70% currently back the euro. A democratic discussion is always possible; the role entrusted to us under the laws of the Republic is to safeguard the solidity of the euro, with all its benefits.

Have low interest rates encouraged households to invest and take more risks?

François VILLEROY de GALHAU

Not yet. But it's an important issue for Europe because, in order to have an innovative economy, businesses need to have greater recourse to equity financing. The United States has a twofold lead over Europe in this respect. It is imperative, therefore, that we channel Europe's savings surpluses more effectively towards firms. Financial professionals - insurers, asset managers, etc. - need to come up with new products that are less liquid, but in exchange offer a capital guarantee along with the higher returns from equities. Making these products a success will also require some form of tax neutrality. In parallel, for the past year, we have been reforming regulated savings products to remove any excessive incentives and adapt them to the low interest rate environment: cut in the interest rate on PEL housing savings accounts, end of the higher indexation rate for the *Livret A*, calls for lower rates of return on life insurance products.

Do you agree with the Council of Economic Analysis's assessment that the main victims of low interest rates in France are the banks?

The main beneficiaries of low rates are actually borrowers, which means companies, households in the case of real estate, and governments. However, according to our studies, the impact of monetary policy on banks has so far been broadly balanced. French banks have significantly improved their solvency ratios since the crisis, by doubling their capital while at the same time continuing to lend. But it is high time that we finally stabilised the banking regulations. This uncertainty is weighing not only on banks' valuations, but also on their strategies and thus on the proper financing of the economy. Discussions are underway to try to finalise the so-called Basel III framework: I am more confident now that we will soon have reached an agreement. Once the collective regulation has been properly defined, we need to make sure we do not undermine the supervision of individual banks. I am firmly against the current proposal in the 2017 draft budget law to cut the French supervisor's budget by EUR 3 million. The measure is inopportune and unjustified.

Why is the ECB refusing to give the Italian bank Monte dei Paschi more time to raise capital, as we found out on Friday?

François VILLEROY de GALHAU

The Italian banks' problems can be resolved. But what we need is a rapid solution, with no further delays. The Italian authorities hold all the cards.

Are you worried that the future Trump administration will unpick all the financial regulation put in place since the crisis?

François VILLEROY de GALHAU

They haven't said anything yet about financial regulation. We shouldn't forget, however - even though attention is now focused on the ongoing Basel Committee discussions - that a huge amount has been achieved since 2008. We must strive to preserve it.

Interviewed by Dominique Seux, Isabelle Couet and Edouard Lederer.