



Interview of François Villeroy de Galhau – Governor of the Banque de France

Le Figaro – 16 October 2017

Ten years after the financial crisis of 2007-2008 the global economy is finally back on track. Can it grow faster?

With a growth rate of 3.6% in 2017 and a little more next year according to the IMF, the global economy is faring better, without having regained its pre-crisis growth rate. More can indeed be done - and this was one of the issues brought up at the Washington meetings - by better coordinating economic policies and by stepping up the structural reforms as France is currently doing.

The euro area is no longer lagging behind. But why does the IMF expect lower growth in 2018?

It is rather the growth rate of over 2% in 2017 that is very high. We will reach cruising speed back next year at around 1.8%. There is no cause for concern, especially as there should be greater convergence between euro area countries. Overall, the euro area will have created 7 million jobs over five years since 2013. Obviously, efforts must continue to reduce the unemployment rate, which is still too high at 9%.

The British economy is starting to slow due to Brexit. Could continental Europe also be impacted?

No. It must be clear: the Brexit is bad news but its economic consequences are now only being felt in the United Kingdom, where both domestic and foreign investment has receded. Conversely, the euro area has not ceased to revise upward its own growth forecasts. There might even be opportunities for our country. In the wake of other players, the large American bank JP Morgan recently announced, during the meeting of its CEO with Bruno Le Maire, that it will increase its staff in Paris due to Brexit.

Why are inflation and wages not rising faster in Europe, Japan and the United States despite extraordinarily generous monetary policies?

There is no doubt that monetary policy has been effective, in particular in Europe, in combating the risks of deflation in the aftermath of the great financial crisis of 2009-2011. At the beginning of 2016, inflation was still negative in the euro area, whereas now we have returned to 1.5%. It is true, however, that wages are rising less rapidly than economic

growth, for two major reasons. In countries where unemployment is still high, the employment situation is weighing on wages. And in economies that have returned to full employment, the causes are more structural, such as the sharp slowdown in productivity, and globalisation which slows the growth of imported prices. However, we are convinced that the usual sequence of growth, wages and inflation is at work, even though it will take longer than before.

Among the risks that it has identified, the IMF is concerned about the normalisation of monetary policies. Can central banks control it?

Each central bank acts according to its economic situation. The United States is more advanced in the economic cycle. For the euro area, the Eurosystem has started to cut back the amount of its monthly net purchases of assets since last April. As long as we are moving towards our inflation target - which is below but close to 2% - but we have not yet reached it, this normalisation must continue in a very gradual way. Nobody should fear a further reduction in the pace of our monthly net purchases of assets, and their possible end thereafter, as we will maintain a very accommodative monetary policy – which should be gauged on all of its instruments.

How do you plan to adjust your policy?

Monetary policy is not just a solo instrument, quantitative easing (QE) – consisting of assets purchases - but a quartet. As far as QE is concerned, I would like to stress that we will remain extremely present with a very large stock of assets held by the ECB, and for a long time. But there are also three other instruments. First, low and even negative interest rates; once we have set the limits, at -0.4%, they prove very useful in supporting lending activities. Then there is forward guidance, i.e. the visibility that we give markets on the outlook for policy rates; it is clear that we should not go raise them until we are on a path of sustainable inflation adjustment. The fourth instrument that should not be overlooked is the TLTRO, in other words the provision of liquidity to banks in the medium term; their outstanding now account for 7% of the euro area's GDP.

Will the ECB Governing Council meeting of 26 October set the new terms for 2018?

We said that announcements would be made in the autumn, which does not end in October! But it is probable that most decisions will be taken on the 26th. Of course, we cannot say what their exact content will be. But the gist could be, given the progress that has been achieved, an appropriate reduction in the monthly net purchases of assets, while maintaining a high stock of assets held by the ECB, and a very accommodative monetary policy with the whole range of instruments at our disposal.

Is the heterogeneity of national performances in the euro area a problem for the ECB?

The Eurosystem's policy has helped to reduce what is known as fragmentation, i.e. an excessive gap in financing conditions across countries. With economic convergence in Europe, we are heading in the right direction. But it is necessary to amplify this convergence: this requires conducting reforms in the countries that need them most - France but also Italy – but also strengthening Economic Union. What is required is greater co-ordination of

national policies, a mobilisation of European savings which are very abundant - what I call a Financing Union for Investment and Innovation - and a common budget for the euro area. Today, Europeans have an unprecedented window of economic and political opportunity: for growth and jobs in Europe, it is now or never. And to use an expression of JF Kennedy which has often been quoted at Washington meetings: "The time to repair the roof is when the sun is shining."

The IMF refers to a second risk, the high valuation of financial assets, shares and bonds...

Ensuring financial stability is one of the IMF's tasks, like for central banks in each country. It is true that many asset prices are at high levels, not always justified by economic fundamentals. The return to growth does not mean that we should drop our guard.

How to defuse the risk of over-indebtedness of households and firms, which is also a source of concern for the IMF?

There is a strong warning in China about corporate indebtedness and the Chinese authorities have started to tackle it. In Europe, government debt must be reined in further, especially in France. Nevertheless, we also need to take a look at the rapid growth in the debt of households and especially of large companies, which has risen by almost 8%. The High Council for Financial Stability, chaired by the Minister of Finance with the active participation of the Banque de France, will after discussing with banking and market professionals issue a detailed assessment by the end of the year.

If necessary, we will take macro-prudential measures. Lending is robust in France, and this is good news, but it must not be lastingly out of line with the economic situation. The revival of investment is very encouraging. But there is also a strong rebound in debt-financed acquisitions by large companies: this is an aspect on which we need to keep a close eye.

At what stage are the Basel 3 negotiations on banking regulation?

France, which has always worked towards establishing international rules, has a strategic interest in concluding a final agreement on the strengthening of banks. Much progress has been made, but this agreement is yet to be concluded. This must imperatively be fair: the rules must be respected by all, including the Americans, on market activities; they must simultaneously preserve the capacity to finance each national economy.

Were the fears of protectionism exaggerated given that world trade is picking up? The trade recovery, at a pace that is once again above global economic growth, is one of the pieces of good news for 2017. It is due in particular to a revival in business investment. Similarly, the geo-political risks - very real - have not yet affected economic activity. There has been less talk of protectionism in our autumn meetings.