



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

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Macron was elected with an ambitious reform agenda. Why would he succeed, where his predecessors failed?

As an independent central banker, don't expect political comments from me. But the new government has clearly committed itself to reforms. The reform of the labour market was adopted very rapidly, and has already been implemented. The budget for next year is ready; the deficit is below 3% for the first time in 10 years. France is today a reliable economic partner for the Netherlands and Europe.

The budget deficit is 2.9% this year and next year, growth is below the average for the euro zone. That is not something to celebrate, is it?

Next year, the decrease in the budget deficit will be limited due to a large tax reduction for companies and investors. This measure was necessary to foster business confidence and investment. But there are also significant expenditure cuts which need to be increased in the following years.

Within a normal economic cycle, it is not surprising to think that there will be a recession in the coming years. How is France going to deal with that, with such a large budget deficit and a public debt of 100% of GDP?

We have to repair the roof when the sun is shining. That applies not only to France, but to Europe as a whole. That is why we must now strengthen the economic union. 25 years ago it was decided in Maastricht to establish an economic and monetary union. The latter is a success. Monetary policy has been powerful; the euro is supported by European citizens and is an internationally recognised currency. But there is no economic union yet. If a recession hits us Europeans again and the economic pillar of the Union hasn't been strengthened, we would have to rely too heavily on the monetary pillar.

Do you think that in the current situation we leaned too heavily on monetary policy?

In the past crisis, we relied greatly on monetary policy. But I would not say too much, because it was our duty to ensure price stability, and there was no other option. But in the future we also need to have other instruments in the toolbox.

France wants far-reaching political integration in the euro zone. Is there support for this among European citizens?

Fortunately, we all live in democracies. So it is up to the democratically elected governments to decide on this. But I believe we have now an historic opportunity with the European economy recovering, and a political momentum in key euro area countries, including France and the Netherlands where we have a stable political situation for the next four years. Furthermore, after the election of Mr. Trump and the Brexit referendum, Chancellor Merkel rightly stressed that it is time for us Europeans to take our destiny into our own hands.

You said that France is a reliable economic partner. The Netherlands only wants to take steps if France is really reforming. Do you understand that position?

I understand that. But reforming is precisely what France is doing now. This was not the case in the past. It would be a dangerous bet to wait another 2 to 3 years to see all the results. Then the present opportunity and momentum would have vanished, and we would run the risk of facing a next recession without having strengthened the euro area. With all the economic and political damage that this would entail.

But do you understand that Dutch suspicion?

Suspicion is certainly not the best word to use between fellow Europeans, but rather our attitude should be one of reasonable mutual trust. We don't have to choose between national reforms and European coordination. We clearly need to pursue both avenues ; now is the time.

What is the most important thing that needs to be changed in the Economic and Monetary Union in order to be ready for the future?

In my view there are four necessary economic accelerators: first - and I share this view with Governor Klaas Knot -, a "Financing Union" for Investment and Innovation, to better use our abundant private savings; this includes completing the Banking Union. Second, a better coordination of our national economic policies. As a third step, President Macron has proposed a budget for the euro zone. This is a sensitive debate, because - among others - Germany fears that the euro zone could then become a transfer union, where the money always comes from the same countries. I don't want that either. With all members contributing, a euro area budget should finance common goods such as defense, refugees or climate change. The last accelerator would be to have a euro area Finance Minister and Parliament. But let us not focus our discussion on institutions, before having made progress on the substance.

In case of emergency support to euro countries, the Dutch government explicitly wants private investors to participate. In that way, the so called –no bail-out’-clause will be strengthened. What is your opinion on that?

The no bailout-clause is and should obviously remain in the Treaty. For the past 15 years, we have had endless discussions about the balance between rules and solidarity. But it is not “one or the other”. Rules are a prerequisite for solidarity.

To get it straight: for banks it has already been stipulated that private investors have to participate in case the event of a rescue. Should this also apply to support to countries?

Private investors have significantly contributed in the case of Greece. We must strive for balance, while remaining careful about the status of government debt, because these markets are very sensitive.

The ECB has decided to extend the purchase programme by nine months. Did you agree with this?

I never comment on my personal position within the Governing Council, but on our collective decisions. We have halved our purchases to €30 billion per month. This is a decisive step towards the end of our purchases. Moreover, we stressed that monetary policy is not just about these purchases. It is a combination of four instruments: assets purchases and stockholding - the "QE" -, low interest rates, forward guidance and liquidity provisions. We have made progress on economic recovery and inflation, so we have to reduce the intensity of the package. But we are not yet in line with our target of 2% inflation, so the policy is still accommodative.

This is the first step towards the end of the programme?

It is the second step, and a decisive one: we had already reduced our asset purchases from €80 billion to €60 billion per month last April. The end of the net purchases will come, for sure. But we will then keep a high level of stock for the necessary period.

What if inflation is not close to 2% after nine months?

Be patient, we still have seven monetary meetings till then! And we do not focus on this one instrument, but on a combination that best fits the situation.

When the ECB bought €80 billion a month, inflation hardly changed. So how can that €30 billion achieve this?

You cannot say that it did not work. On the contrary. May I remind you where we were 18 months ago? Inflation was -0.2% then. Now we are at 1.4%. We are therefore much closer to our goal. This is not only but largely due to our monetary policy, which has contributed about 0.4% to inflation per year. Almost all economists agree that, after the crisis of 2009-2011, there was a danger of deflation. The biggest difference with the financial crisis of 1929 was that deflation was not prevented then.

Why do savers and pension funds have to suffer from your monetary policy?

Interest rates will rise, but only based on solid economic fundamentals. Savers would not benefit from a wrecked economy. And the Dutch, like other Europeans, are not only savers but also consumers, borrowers, job takers; and as such they clearly benefit from an accommodative monetary policy.

We are coming from a debt crisis and the ECB is now encouraging us to make more debts.

For economic growth we still need investments and therefore credit. But the Governing Council and each national central bank remain very vigilant about financial stability. Let me reassure you: private debt as a percentage of GDP in the euro area has not increased since 2011. On the contrary, it is lower today.