



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

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After the financial crisis of 2008, almost ten years ago, major central banks including ECB conducted massive monetary stimulus. But wages and prices are still weak compared to historical standards. Are there limits of effectiveness of monetary policy? How do you evaluate the situation?

The very active monetary policy conducted by the major central banks including the ECB and the Bank of Japan was necessary after the crisis in order to avoid deflation, which would have been dangerous for the world economy. It was necessary, and it has been efficient, too. If you look at the ECB, Eurozone inflation was still negative 18 months ago, at -0.2% in April 2016. Now it's closer to our target at 1.5% in November 2017. We estimate that monetary policy contributes approximately 0.4% per year to euro area inflation. This is very significant.

Nevertheless, prices and wages remain subdued. This is especially true in Japan but it's also true in Europe. This is the debate on the so-called "Phillips curve". Our conviction is that the Phillips curve is still at work: there is still a positive relationship between economic activity and employment on the one hand, and wages and inflation on the other. But it is taking longer than in the past.

So, the Governing Council of the ECB has no doubt about the general direction. We think it's more a question of time, due to several causes. First, there is the effect of past low inflation. Governor Kuroda calls it adaptive expectations. Second, there is still, in Europe, a rather high level of unemployment. These factors will vanish or diminish. Furthermore, there could be more structural factors like technological change or globalisation, etc.

We are ready to be patient regarding our monetary policy, as it is a question of time, and to maintain an ample degree of monetary policy accommodation for as long as necessary.

How do you see the effectiveness of monetary policy? Asset purchases, negative interest rates, forward guidance, you try a lot of things. Which one is more effective?

It's very difficult to disentangle the effect of each tool taken separately. There is a consistency between what I sometimes call the quartet of our monetary policy instruments. It's not a solo: it's not only about QE. It's QE plus low interest rates with negative interest rates, plus forward guidance, plus possibly liquidity provision (we have in Europe the "TLTRO", which is a long-term favourable financing of financial institutions). We use all these tools in order to implement the right combination.

The Bank of Japan also uses negative interest rates as a tool. But in Japan there is a lot of criticism from banking sectors, long-term investors like pension funds or insurance companies. How do you see the negative interest policy in the Eurozone? Is it working?

Negative interest rates have their limitations. We clearly said in the Governing Council that we would not go lower than the present level: -0.4%. That said, they are effective, at least in two ways. First, there is a transmission of negative short-term interest rates to long-term interest rates, which is key for the financing of the economy. Second, negative interest rates have helped to maintain the positive slope of the yield curve, which is also important for bank profitability.

Next I want to talk about the normalisation process. Recently, the ECB decided on the normalisation process. Some tapering or reducing of bond purchases, and the extension of purchases until September 2018. Would you elaborate on the normalisation strategy of ECB?

What we are pursuing is a path of gradual normalisation, which corresponds to the economic situation we are in. We are progressing towards our inflation target, but we are not yet there. We must maintain an ample degree of monetary stimulus. What we decided on 26 October was a decisive step towards a possible end to net asset purchases. We halved the volume of monthly net asset purchases from EUR 60 to EUR 30 billion. But we must keep in mind, as I stressed, that monetary policy is not a solo game. It is not only net asset purchases: if you look at QE, you also have the stocks, not only the flows.

Next year September, do you expect an extension of those purchases?

Central bankers have to be both pragmatic and credible. We gave visibility for the nine months to come. You need to be a bit patient: we still have seven monetary meetings, from now to next September! We will have many opportunities to decide, depending on economic data and forecasts.

What's the procedure of normalisation? Timing of interest rate hikes?

We are very clear about the sequencing. First, the end of net asset purchases, while keeping a high level of stock. Second, rate hikes. We reiterated that the second step would come well past the first one. We will see precisely how we implement this combination, depending on our progress towards our inflation target. We have a very clear mandate i.e. price stability, and we have a very clear definition of price stability i.e. medium-term inflation of close to or below 2%.

Governor Kuroda stressed the overshoot commitment. Will the ECB continue monetary easing until inflation reaches 2%?

First, it's a medium-term goal. We reached 2% at the beginning of this year, but it was transitory. Second, we need an inflation target. It's the anchor of monetary policy and its credibility. It's not often noticed, but it's very impressive if you look at the four major central banks in advanced economies, including Japan, the US and UK: they all have the same medium-term inflation target of 2%. You could call it a great monetary convergence, which is new. This was not the case 10 years ago.

How do you view the current Eurozone economic outlook?

We have, in the Eurozone, a very robust recovery which has been gaining momentum. In 2017, we will probably achieve growth of at least 2.2%, which is much more than expected a year ago, and equivalent to US growth for the second consecutive year. It's an impressive performance. The euro area economy has created 7 million jobs since 2013.

It's important in this situation that monetary policy should not be the only game in town. Countries should also be very committed to structural reforms; this is currently the case in France, where the new government -I stress this as a fully independent central banker- is implementing quite impressive structural reforms in order to foster growth and employment.

Could you elaborate more on the future of the Eurozone integration?

It's the same idea: monetary policy shouldn't be the only game in town. There is the domestic part -national reforms- but there is a European part of the story. When we, Europeans, signed the Maastricht treaty 25 years ago, we decided to build an "economic and monetary union" (EMU). Our monetary union is a success. The euro is an internationally acknowledged currency. Inflation has been lower, financing costs have fallen. There is very strong confidence in the euro on the part of European citizens. But if you look at economic union, it still hasn't been completed. This is the window of opportunity we have at the moment. We have this economic recovery. We have stronger reforms in France. We will hopefully have new governments in Germany and in Italy, in the coming months. We also have a degree of external stimulus from events in Britain, with Brexit, and in the United States. We Europeans have to take our destiny more into our own hands. Let us strengthen the economic union, through four necessary accelerators. First, the better coordination of national economic policy. Second, a "Financing Union" for Investment and Innovation, including Banking Union and Capital Markets Union, to better use our abundant private savings. We have a EUR 350 billion annual savings surplus that we can channel towards the very significant investment needs in the Eurozone. Third, President Macron has proposed a budget for the euro zone. 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.

The world has different disintegration problems, but you are optimistic about the Eurozone. How is that so?

It's not a matter of being optimistic. It's a matter of being realistic. What do we need in order to deliver higher growth and employment to our citizens? Many of the reactions you mentioned are due to the problem of too high levels of unemployment and inequalities.

Europe and Japan agree that protectionism is not the answer. It's not the answer to the rising inequalities, or to the high unemployment rate in some countries. Quite the contrary:

protectionism would make things worse. Second, looking at Europe, there is some euro scepticism in France, Germany, and other countries, although it is receding because of Brexit, i.e. Britain's unfortunate departure from Europe. What we need is for Europe to deliver concrete progress for its citizens: more growth and more jobs.

How do you evaluate Mr. Draghi's presidency at the ECB?

Mario Draghi played a decisive role in 2012 in overcoming the Eurozone crisis. We are very lucky to have such an excellent president, and to have him still for the coming 2 years.

How do you view the Japanese economy?

It's not my role to comment on the domestic policies of other countries. You can see the progress of the Japanese economy. Obviously there are still some structural challenges as illustrated by the current debate about the labour market. Can I mention something else we have in common? We have different societies, but we have a strong social model and we think that economic progress and social cohesion are necessary.

How do you view digital currencies like bitcoin and the digitalisation of national currencies?

These are two very different issues. There are some technological innovations like the blockchain, which we are experimenting at the Banque de France like elsewhere. But let me be very clear about bitcoin. Bitcoin is no way a currency or a crypto currency. It's a speculative asset, full stop. Those who invest in bitcoin should do so at their own risk and peril.

Turning to the other issue about digital currencies, we see a general trend in all our advanced economies towards the development of digital payment means with bank cards or mobile phones. Does it mean that one day central banks could issue a digital central bank currency? We should remain cautious about this. One priority is to improve digital payments.

What do you think are the largest sources of risks at the moment?

At the global level, I would mention three economic risks. First would be protectionism, which we must definitely fight against. Second is the global debt dynamics, because debt levels have not been reduced as a proportion of GDP since the financial crisis. There has been some private deleveraging in advanced economies; on the contrary, if you look at emerging economies, debt has increased significantly, especially corporate debt. The third risk is the issue of inequalities. Inequalities matter not only for social or political reasons, but also for economic reasons. If you do not have inclusive growth, then you will have a smaller labour force, less skilled labour, and less well prepared for technological innovation.

How should central banks deal with inequalities?

Our mandate is price stability. Delivering price stability is part of social inclusion. Hyper or too strong inflation would create huge distributional problems; deflation would cause recession and unemployment. The rest is obviously up to governments and fair economic and social policies.