



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

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The European Commission has just downgraded the economic outlook. How dangerous is the situation?

It is a significant slowdown, it's not a U-turn or a recession. Spain is resisting, with 2.1 percent growth expected this year. And our forecast for France remains is 1.5 at this stage. But there is a slowdown in Germany and stagnation in Italy. The key question is to know whether this deceleration is temporary, especially in Germany, or if it is a permanent change.

The ECB will probably revise the key figures in March. What is your insight?

There is less uncertainty for France and Spain because the main driver for growth is internal demand, due also to short-term fiscal stimulus in both countries, there is also rather resilient internal demand and our main uncertainty is. Exports play less of a role than in Germany. The main trigger for the slowdown across the globe is uncertainty. It's less economic policy than geopolitical risks: protectionism worldwide, Brexit in Europe. If political leaders are able in the months to come to diminish this uncertainty, it would significantly improve the economic picture.

You said we're not yet in recession. But is this scenario becoming more likely?

I don't think so. In three of Europe's major economies – Germany, France and Spain – internal demand is resilient. There is an increase in wages, there is significant purchasing power and so this is a basis for private consumption and growth. Italy is a specific case.

The forecast cut in France is explained by the social tensions. Is it due to the direct economic impact of the Gilets Jaunes movement or because it shows that President Macron is no longer able to put forward his reform agenda?

There was a negative effect in Q4; the fiscal stimulus announced by President Macron should nevertheless have a positive effect on growth this year. The key question for the future is the ability to maintain the structural reforms which have been accelerated in France in the last three years. The President and the Government have been clear: they don't want to go backwards. Spain provides a positive lesson: reforms following the crisis have been very impressive and efficient which explains why Spanish growth is today the strongest amongst major European economies

In Spain, the risks come from the political tensions.

It's not my place role to make political comments, especially in the present Spanish situation. The main political risk is presently at the geopolitical global level: trade tensions.

Is Italy the biggest threat to the euro zone?

Everyone have has an interest in seeing faster Italian growth. But the best recipe is not the budget and increased deficits: it would be structural reforms on education, lifelong training, labour skills, which have worked in other European countries.

How destabilizing for the financial stability would be a no deal Brexit?

A no-deal Brexit would be bad news for everyone, even if it would be much worse for the British economy. Our role as supervisors is to safeguard financial stability in any scenario. There are issues, but if we manage them, as we clearly intend to, there will be no financial stability consequences.

Is France and the Eurozone prepared for this scenario?

We don't desire it, but we are prepared. We had a common working group between the ECB and the BOE and we converged broadly on the analysis and the measures to be taken.

Mario Draghi is about to leave office. What will be his legacy?

The euro has been lucky enough to have with Mario Draghi, and before him with Jean-Claude Trichet and with Wim DuisenburgDuisenberg, a dedicated European and a great president. The After 20 years, the euro is a collective success we can all be proud of.

What qualities will his successor need?

Fortunately, this will be a democratic decision by political leaders. We can only look at the past to see how wise our leaders have been, choosing Presidents dedicated to price stability, independence and European spirit.

Draghi had to face the criticism from Germany and other northern countries. Was it a threat to the independence of the ECB ?

On the contrary, it's a justification for independence. There have been beliefs critics on both sides. At present, our duty in these uncertain times we live in is to combine clarity -- with our chained guidance and sequencing of our normalization – and flexibility –about the timing. At this juncture I see a quite strong homogeneity within the governing Governing council Council about this combination.

Does the recent data make it less likely that there is a hike after the summer?

We will look at that data. The key question will be if the slowdown is temporary –with a bounce-back during this year- or more durable.

After the last Governing Council meeting, the ECB said it still has other tools available. Was Draghi thinking about the long term bank loans ?

We can be extremely efficient with what I call “the trio” of instruments: the stock of assets, about 2600 billion euros; the interest rates; and tools for liquidity provision. We will be pragmatic in using this trio. The liquidity tools need to be placed based on monetary specification justification and cannot be designed for specific needs of some banks or some jurisdictions.

Where are the biggest weakness of the European financial entities?

European and Spanish banks are now much more robust and resilient compared with six seven years ago. They have increased significantly the capital and liquidity ratios. But there is still a profitability challenge. Bank profitability is not satisfying. It should not to be compared with the level before the crisis, but with other countries outside of the eurozone.

The measures the ECB can take will have an impact on this profitability shortfalls.

Yes but it's not the only factor. On revenues, and costs, digitalization is a huge challenge. and banks must prepare themselves. Diversification is probably the most significant uncertainty. On the cost side, banks Banks have to adapt gradually to the new environment regarding the number of bank branches and the number of staff. It has to be gradual. And on the risks side the clear priority is to diminish the NPLs.

The ECB asked BBVA to clarify certain relationships. How important is it for the banks to clarify public image?

As a general rule, we supervisors look at what we call Pillar I (legal requirements) . But there is also Pillar II about specific risks. They can be reputational risk or technological. This Pillar II is not very well known but it is a significant part of our role as supervisors.

Is it the case of BBVA?

I don't comment specific cases.

What else needs to be done to complete the architecture of the Eurozone?

The monetary union is a success but we have yet to achieve the economic union. Let us push it as far as possible to avoid overburdening monetary policy, which is a German worry I can understand and share. On private risk sharing, Banking Union has to be completed through an efficient resolution process. A "common backstop" was agreed upon but it must be delivered quickly. A real Capital Markets Union is also a basic element needed. On public mechanisms, the principle of a common fiscal capacity could have an impact for the euro zone as a whole but it now has to be translated into a concrete mechanism, and the ESM should have an effective role in preventing the crises, not only in managing them ex post.

Do you fear a political paralysis?

European progress has never been easy, but ministers and governors have a collective responsibility. 75 percent of European citizens –the highest figure ever- support the euro. This trust from European citizens creates an obligation for us.