



La Repubblica: “ ECB will quite probably cut rates in October”

Interview of François Villeroy de Galhau, Governor of the Banque de France, in La Repubblica

Europe’s growth is weakening, some countries are in recession. Should we expect a rate cut already in the October ECB meeting?

François Villeroy de Galhau: “Yes, quite probably, as President Lagarde hinted in the European Parliament last Monday. But not exactly for the reason you mention: our compass for monetary policy and rate cuts is first and foremost inflation, which again surprised on the downside and fell below 2% in September, at 1.8%. True, core inflation is still at 2.7%, with services inflation stickier at 4%; but core should recede gradually close to 2% next year. Market expectations for inflation in 2025 are even lower than our forecast, below 1.8%. All this means that the balance of risks is shifting. In the last two years our main risk was to overshoot our 2% target. Now we must also pay attention to the opposite risk, of undershooting our objective due to a weak growth and a restrictive monetary policy for too long. Another measure of this risk is to look at the options market: the probability of being above 2.5 % inflation in the next five years is now only at 17% while the probability to be below 1.5 % is 38%, so more than double”.

Are you satisfied by the inflation trajectory or do you see still the risk of a surge in price dynamics, due also to the price of oil?

“The victory against inflation is in sight, but it’s not a reason to become complacent and relax on a preset course. I argued strongly in our last Governing Council to keep full optionality for October, and rightly so. I will not today change my mind and abandon a pragmatic approach, meeting by meeting, which by the way never meant for me quarter by quarter. On oil price and the Middle East, we should monitor carefully this very volatile situation. But as long as it would be temporary and not spilling over to core inflation, an increase in oil price shouldn’t necessarily change our monetary policy. Still more if this increase were to dampen growth in Europe.”

Could you get more aggressive in cutting rates? The Fed has recently cut half a point.

“We are obviously independent from the Fed. We started to cut rates earlier, in June, and lowered them at 3.5% now versus up to 5% in the US. But the trend on both sides of the Atlantic is clearly to further rate cuts. We’ll see till which terminal rate: if you look at market expectations, rates in the euro area could be as low as 2% at the end of next year, or even below. I would rather express it this way: if we are next year sustainably at 2% inflation, and with still a sluggish growth outlook in Europe, there won’t be any reason for our monetary policy to remain restrictive, and our rates to be above the neutral rate of interest.”

Germany, the biggest economy in the euro area, doesn’t seem able to get over the stagnation and recession phase that started in 2020. Do you think that one of its problems might be its debt brake?

“We shouldn’t focus on one country in particular: subdued growth is a paneuropean problem. It is quite striking: if we look at the weight, the European and the American GDPs are equivalent. But on speed (growth), Europe is much weaker. Of course Germany has suffered particularly from the Russian war against Ukraine and the consequent gas crisis, and from the Chinese slowdown. On the debt brake, I won’t comment on a specific fiscal policy. In France, for instance, we have clearly the opposite problem, of an excessive deficit. Let me only say that: we have now a common fiscal framework in Europe: the revised Stability Pact. Each country should stick to this common framework, it is better than having specific national rules”.

The president of the ECB, Christine Lagarde, said “we have faced the worst pandemic since the 1920s, the worst conflict in Europe since the 1940s and the worst energy shock since the 1970s”. Do you think that this has contributed to the rise of the far right in your country, France, in Italy or in Germany? And what can central banks do to address these multiple crisis?

“The Banque de France is independent: we serve all French and European citizens and make no political comments. But I would say that in this difficult environment, there is among European citizens a common issue of trust, or fear. Where Central banks can help is in restoring trust in the economic and monetary field. Inflation was a very real fear, very damaging for our fellow citizens, especially the most modest ones. When we are successful against inflation, we bring a very important contribution to restore trust and standards of living”.

Mario Draghi’s report was much discussed on one point: he suggested Europe should invest 800 billion euros a year to avoid an “agony”. Do you agree?

“There was a bit of a misunderstanding. Mario Draghi mentioned this figure of 800 billions’ investment gap to succeed in the transition, but he didn’t mention a precise share of public or private funding. Nevertheless, everybody jumped in favour or against an hypothesis that wasn’t

there: that it should be mainly financed with Eurobonds. And let us remind that this is only one part of the crucial Draghi report, as he himself stressed recently”.

But European countries have tight fiscal margins - France has high deficit, Italy an enormous public debt and Germany the debt brake. Where could the money come from, if not from Eurobonds?

“The solution is not easy but lies in two dimensions. First, let’s look at the quality of public expenditure. We should prioritize it more: money put in investments is more promising for growth than in current expenses. This is never debated. We should look at the best performing countries in each domain - health, education, security... - and try very pragmatically to transpose their efficient policies. Second, there is also private savings to fund the needed investments. Enrico Letta in another important recent report advocates a ‘Savings and Investment Union’: how can we mobilize the very significant amount of excessive private savings - 2% of the European GDP - to fund our investment needs which are up to 5% of GDP? We are talking of a possibly significant part of it. Europeans should listen to these two great Italians, Draghi and Letta”.

So what would you pick as the most important passages of Draghi’s report?

“Mario Draghi strongly advocates three much needed changes: energy (and hence climate), innovation, simplification. And for each of them, he gives proposals that are very often structural, not financial. For example: in competition policy, authorities should systematically take the European view and not anymore the national view. There is unfortunately a serious risk that short termist governments bury these structural reforms. Hence we should, as central banks, become more vocal to support them, as my colleague and friend Governor Panetta does in Italy. What is at stake is so important, we should go beyond some bureaucratic resistance we see too often”.

What do you mean?

“Think of more integrated capital markets: Christine Lagarde suggested a unified market supervision like in the US, for example with Esma. What is at stake is our collective economic success, it’s not a question of bureaucratic power for national authorities”.

Don’t you think that the heart of Draghi’s and Letta’s report, so the need for a further integration, is jeopardized by the surge of far right movements in all Europe?

“Our fellow citizens expect real, practical progress. They want to see result. For most of them, it’s less about ideology than about action: on simplification, energy transition or defence. And if you look at the political environment: Brexit had no spill over in Europe, on the contrary. Now less and less Europeans want to leave Europe”.

The Banking Union was decided in 2010, but we are still far away from completing it. What should be prioritized?

“I am slightly more optimistic about the Banking Union. We have built a strong Supervision union, of which we just celebrated the 10th anniversary. Nine years ago, when I became governor of the French central bank, we really had the problem of the fragility of European banks and the risk of a European banking crisis. This risk has now disappeared, despite the fact that we had to raise interest rates and that there was a banking crisis last year in the US and Switzerland - Silicon Valley Bank and Credit Suisse. But we are not yet there in building paneuropean banks and having larger banks with a cross border dimension”.

Apropos paneuropean banks: Unicredit is moving to takeover Commerzbank. But the German unions, politicians, even the chancellor have rebelled against this “hostile takeover”, as Olaf Scholz called it. What do you think about it?

“I don’t comment on specific cases. But let me make two general remarks. First: it shouldn’t be a political or nationalistic question, in any country. Luckily, thanks to Banking Union, the decision making process is in the hand of a European institution with an independent and technical evaluation, namely the ECB. Second, what the ECB will have to judge is not only the proposed deal itself, with its financial skills and tricks, but also, and mainly, the solidity, the sustainability, and the governance of a possible new group”.

ECB and Antitrust are big European successes - those where countries gave up sovereignty and where Europe is a global power. Shouldn’t this be stressed more?

“You are right: Europe is respected worldwide in these two fields of money and competition. It’s not by chance: having there European independent authorities, resulting from a clear democratic process, can help to achieve the common political goals. The independence of course must be based on a precise democratic mandate, and we have to deliver on results. To go further on shared sovereignty, the answer belongs to politicians.”