



## **Interview with François Villeroy de Galhau, Governor of the Banque de France**

**«The real threat is inflation, not deflation»**

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**Monsieur Villeroy, through your family – the owners of the company Villeroy & Boch in the Saar area – you have a close connection to Germany.**

**François Villeroy de Galhau :** Yes, I was raised in Paris, but my parents now live in Saarland, not far from the French border. I go there nearly every month. We are probably the only French family that has been living in Germany for two centuries. I speak German and love Germany. Germany had two hyperinflation episodes, we did not have the same in France and our memory of deflation is probably stronger. So I have full respect for German history and we should take it into account. But if we look at Europe at the moment, the danger we face is without any doubt deflation not inflation.

**You fear deflation? If you take the falling oil price out of inflation, inflation is at 1 per cent, far from negative.**

You are right: Oil price and raw material price are the driving factors for low inflation. But inflation without energy and raw material prices is still at 1 per cent far below our common target of close to two per cent. Furthermore, after a while the low oil price also affects other prices. It makes some goods cheaper and there could be slower wage increases. If that happens, you cannot simply forget about the oil price.

**What will the ECB do?**

As you know we are forecasting inflation and growth each quarter. We will see the next figures at the beginning of March – and then we will see whether to act. Temporary falling oil price alone are not a sufficient reason. But if the low energy prices have sustainable long-term effects, we have to act. That seems to be the case, but we will see in March.

**Will the ECB buy even more government bonds than the 60 billion a month it is buying now?**

It is one possibility, among others; we are ready to act, but we will have to see the economic data first.

**Germans are worried about the billions that central banks spend on government debt.**

We have to explain why the central banks are buying government bonds in large amounts – economists call that quantitative easing (QE) – to increase liquidity and reduce financing costs for the whole economy. We do it because that is useful and not dangerous, as we look closely at financial stability. You should look at other central banks worldwide. All of them – Japan, US, UK – they all bought government bonds before the ECB. This is important because some people in Germany view QE as some European French-Italian phantasy. It is not.

**The Chinese central bank did not start such a programme.**

They are obviously in a different situation. But all advanced economies bought large amounts of government bonds. They did it because we are facing low growth, low inflation, low interest rates. In such a situation it is appropriate to do such a programme. Some even criticise the ECB that it acted too late.

**You think so too?**

No, I do not share that criticism. The ECB started to act against the crisis with credit easing. We made it easier for banks to lend money to the private sector. This was different from the other central banks that bought government bonds right from the start. But it can be explained by the structure of the financial system. In Europe the private sector is financed mainly through banks, which is different from the United States for example, where companies often finance themselves through the market. So the Eurosystem went first through the banks – and only second through the market with QE.

**It is dangerous for a central bank, if it indirectly finances the state. The state could become addicted to the money.**

We are only buying on the secondary market, not directly from the treasury. And Governors – beginning with myself – strongly advocate sound public finance. So, QE is fully consistent with the Treaty – all governors agree on that – and with our mandate. We have a mandate of price stability. It has been defined as an inflation rate of close to but below 2 per cent, as the Bundesbank did it before. If we are in a situation where inflation is significantly too low and there are efficient tools to change that, it is our duty to use them.

**You could change the target. A lot of people would say: 1 per cent inflation is enough.**

No, we cannot do that. If you miss your target and then change it instead – you would lose your credibility completely.

**Are you not afraid that you cannot get out of that programme – like the Bank of Japan?**

The US Federal Reserve managed successfully to stop its net purchases of government bonds since 2014.

**There is one thing that Germans and French both do not like about the ECB policy. It pushes down the interest rate and savers do not know where to put their money anymore.**

For French savers too the yield on life insurance and the interest rates on the famous Livret A decreases. That is never considered as good news. In this respect all savers worldwide are the same. But let me stress one point. Inflation is also very low. That means that your nominal yield does not have to be as high as during high inflation. Most savers are still earning in real terms fortunately.

**The QE programme started one year ago. Today inflation is still low. Has the ECB failed?**

That is clearly not the case. Take the three years 2015 to 2017. Our common estimates show an increase of 1 per cent of inflation during this period, due to QE. If we had not acted, inflation would have been 1 per cent lower. We have been efficient within our mandate, according to our duty.

*Interview by Lisa Nienhaus.*