Christian Noyer: Interview in *Le Point*

Interview with Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, in *Le Point*, 9 August 2012.

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Markets were hoping that Mario Draghi and the ECB Governing Council would take strong action to give Spain and Italy a little breathing space ... The ECB has chosen to do nothing! Why? Are you saving your ammunition for later?

We haven't heard the same thing! The Governing Council recently announced its intention to intervene on the bond market to allow a smooth transmission of monetary policy. The objective is to counter the emergence of excessive risk premiums on certain sovereign debts. Naturally, this only makes sense if governments themselves decide to act and to activate the solidarity and support mechanisms of fiscal consolidation they have established. Our operations will be on a sufficient scale to have a strong impact on the markets. We should be prepared to respond very rapidly, by focusing on short-term bonds. Have no doubts about the Governing Council's determination and its ability to act within its mandate.

One gets the impression in this crisis that everyone is watching the boat sink without doing anything. To start with the ECB ...

That is incorrect! And unfair! It is the markets that are reacting in this way. European authorities have been responding to countless issues since the start of the crisis. They have launched a number of major, extremely technical projects which, ultimately, will reinforce monetary integration and governance within the European Union. Much progress has been made over the past five years to strengthen Europe and clarify the rules on which no one really wanted to make headway. Markets would like to have everything settled within five minutes. But there are 17 democracies in the euro area and 27 democracies in the European Union. The time perspective of the markets is not that of democracies. Like Jean Monnet, I believe that Europe will be forged in crises.

The only question that markets are asking is straightforward: are euro area countries prepared to support each other financially? They want a yes or a no ...

It's more complex than that. Markets lend money to governments and want to know whether they will be reimbursed. They want to be able to count, if necessary, on the intervention of the European Stability Mechanism (ESM) [programme intended to provide financial assistance to governments in difficulty, editor's note]. As creditors, they especially want to ascertain the credibility of the entity to which they are lending money. Hence the need for consolidation efforts in most countries. Besides, solidarity itself implies that everyone make as much effort as possible, because should this aid not be reimbursed, additional taxes would have to be raised in all countries.

After all, the credibility of the ECB is intact ... Why not use the instruments at your disposal to appease the markets' doubts? Is Germany imposing its conditions on the rest of Europe?

The ECB has a range of tools to ensure price stability and the proper functioning of the market. It can remedy market disruptions. It has done so several times in recent years to avoid a "credit crunch" by greatly increasing its provision of liquidity to the banking system and by lengthening the maturity of refinancing operations. Still within our mandate, we are able to take quite significant non-standard measures and we have done this on several occasions. The mandate of the ECB is also to ensure the solidity of the euro. But the ECB cannot replace governments, nor spare them from making the necessary efforts to control their debt and restore the competitiveness of their economy. The credibility of governments cannot rest on the central bank. And yet, the former must demonstrate their determination to improve their fiscal position.

But under Germany's pressure, the ECB is not using all the instruments at its disposal. How is this justifiable when huge efforts are required of Spain and Italy?

The ECB is being unfairly accused. No central bank in the world – neither the Fed nor the Bank of England – directly funds governments or purchases sovereign debt on the primary market to finance their deficits. However, it is possible on the secondary market. We have done so in the past. There are no differences of opinion between the French, the Germans and the European Commission. All say the same thing: we are not against ECB intervention to correct market anomalies. But it only makes sense if the economic and fiscal policies pursued aim at correcting imbalances and restoring balanced public finances.

Some people are now expecting Greece and Spain to leave the euro. Are you preparing for such a scenario?

We are not contemplating a Greek departure from the euro area. Moreover, such a scenario is not provided for by the Treaty. There is therefore no plan to prepare a country's exit from the euro. Besides, comparing Spain to Greece makes little sense. The two situations are completely dissimilar. Spain is competitive. Paradoxically, with the crisis, it is even more competitive than a year ago as the growth of its exports shows. It has serious problems to manage such as the situation of its banks, of its property developers and the indebtedness of its autonomous regions. But Spain is taking the necessary measures: it is pushing through impressive reforms and reinventing its growth model.

In your opinion, how did the euro area get into this situation?

The euro area is not simply confronted with a financial crisis. It is facing a challenge: it must complete its construction. During the setting up of the euro area and subsequently during its first years of existence, governments acted with an inadequate sense of responsibility. Its construction was incomplete. Fiscal rules were not sufficiently strict and, moreover, they were often ignored. There was a form of cowardliness. Governments preferred to close their eyes rather than to consolidate the edifice. None of the Member States listened to the warning bells that were regularly sounded, notably by the ECB. At the same time, the markets also closed their eyes to the widening gaps within the euro area. Once the single currency was in place, everyone found it convenient to disregard the area's economic divergences and differences in competitiveness. The result is that today we have a monetary union zone, but the heterogeneity of its different economies has increased.

What a mea culpa !

It is not a *mea culpa*. The ECB and the Governing Council, of which I am a member, have never contributed to this indifference. On the contrary, over the last ten years we have signalled and highlighted these risks. However, neither markets nor governments took any notice. Everyone benefited from what I would describe as an "incredible" decade, with interest rates decreasing for everyone across the board and certain countries posting exceptionally dynamic growth rates in an essentially inflation free environment. In that context, everyone got access to cheap debt financing relatively easily. The wake-up call is all the more painful today as a result. The financial crisis obliges us to completely rethink the European social model that is substantially state-financed.

Was Europe ready for the single currency?

The founding fathers of the euro, and particularly François Mitterrand and Helmut Kohl, imagined the euro as a major stimulus for greater European integration. They knew that it would require stronger European governance and the implementation of euro-area fiscal discipline … But governments chose to side-step their responsibilities in this respect.

In 2003, France and Germany, the two most powerful States in the euro area, breached the famous Maastricht criteria… Are they not partly responsible for the subsequent crisis?

Each Member States carries a share of the blame. The ECB however is not to blame. There were strict fiscal rules. If governments had respected these rules we would not have had this chain reaction leading to the current crisis. In 2007, 2008 and 2009, we had to prevent the financial crisis from deepening and limit the consequences for the real economy. The ECB and States did what was expected of them by supporting the banking systems. However, after 2009, the markets started looking at the accounting situations of each Member State and started doubting the capacity of certain States to honour their financial liabilities. The markets also remembered that behind the governments' bank rescue plans there were States and with no single or common signature and that the banking system was not sufficiently uniform at the European level. Each State therefore found itself with its own financial credibility and its own specific debt financing conditions, depending on its individual fiscal situation.

And in this respect, what is your opinion of the policy orientations adopted by François Hollande, his government and the new majority?

I am pleased to see that the objective of a return to fiscal equilibrium within five years is one of the new government's priorities. The President of the Republic has undertaken to achieve balanced public accounts by the end of his mandate. This is a necessary target. So far, the tax increases have allowed the financing of additional spending and the reduction of the deficit. I am waiting to see the 2013 budget proposal to measure exactly by how much the State's spending will be reduced.

In concrete terms, what exactly would you like to see?

The *Cour des comptes* (court of auditors) has compiled a list of the different potential savings that the government should examine. I agree with its analysis. It is indeed a colossal and ambitious project. Alongside the reduction of public expenditure, we must also encourage investment, entrepreneurship and restore confidence for those who wish to start a business. We therefore need structural reforms and a reform of our labour laws to allow greater flexibility with the objective of restoring and improving the competitiveness of our economy. We must change our social model because it is no longer coherent with global competition.