Christian Noyer: Interview with the Financial Times

Interview of Mr Christian Noyer, Governor of the Bank of France, conducted by Mr Ben Hall, Paris correspondent, and Mr Ralph Atkins, Frankfurt bureau chief on 11 March 2009 in Paris, published on 12 March 2009.

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Financial Times: Is the US appeal for a bigger and more concerted economic stimulus by Europe merited?

Christian Noyer: If one wants really to make sure that all countries are making the appropriate contribution to the stabilisation and further recovery of the world economy, one should take into account everything. It so happens that in some countries the automatic stabilisers play a greater role than in others. Automatic stabilisers mean public expenditure. They may be automatic but they have the same kind of impact on the economy. One could even say a bigger impact because, since they are automatic, they are disbursed immediately and feed into the purchasing power of citizens . Therefore their ability to spend, is quicker than when you go through a budgetary process that takes time to be decided and then implemented and then disbursed. If you take everything into account, my general feeling is that the efforts being made by the major industrial countries are fairly comparable.

FT: Do they need to do more?

CN: What has been designed by various countries – bearing in mind the structure of their economies and the relative importance of the automatic stabilisers – is probably the right balance between what needs to be done to stimulate global demand and the necessity to retain the credibility of the fiscal policy and budgets over time. It is especially important in European countries where we have the feeling that the so-called Ricardian effects can play a role. So if we were to give the impression to citizens that public finances were to deteriorate by too much and for too long consumers might increase their savings ratio to prepare themselves for tax increases in the future that they might regard as inevitable, or the reduction of benefits and pensions. So you have to keep the right balance between long term credibility and immediate stimulation. As far as we can judge, that balance is probably appropriate. That will have to be reviewed according to future economic developments.

A related issue is the fact we all agree that a condition for the revival of the global economy is that financial systems everywhere are stabilised and that stabilisation is convincing the markets. I have the impression that we are a little more advanced in that regard in Europe than in the US. It is clear that the US authorities are making every effort to reach that goal, but that is probably as important as the size of the stimulus itself if we want to stabilise the economy.

FT: What more should they be doing?

CN: They should finish the work they have started and reach the goal of convincing all market players that this is done and the financial system is fully repaired.

FT: But do you think doing too little is riskier than doing too much?

CN: I would say there are two risks. Doing too little is a risk. Doing too much is a risk. If you trigger these Ricardian effects and actually trigger a reduction in the spending propensity of consumers, then of course, the result would be worse.

FT: Would you put the emphasis on putting the regulating framework and only discuss other measures if there is time address other issues, as Axel Weber said yesterday?

CN: The regulatory framework was identified at the summit in November by G20 heads as a very important thing to give back confidence to all market players and citizens in the financial system and the economy. The heads [of government and states] set out a road map on which we have since been working on in various working groups. This holds true. Of course there are things that can only be implemented over the next cycle because I hope there will be things that are designed to be counter-cyclical and to provide for cushions in good times and help the financial system and therefore the health of the economy in the low part of the cycle. But I think that it is important already to agree on the principles even if they will be designed in detail by standard-setters. There are important principles that would create confidence in the financial system, like subjecting all financial actors of systemic importance to appropriate regulation and/or oversight as needed.

FT: Is there a difference between the continentals the UK/UK on counter-cyclical provisioning by banks?

CN: There are two different avenues that could be complementary. They are being studied in a subgroup of the Financial Stability Forum and in the Basel committee on banking supervision. One has to do with the banking book, or classical loans, and is more or less the dynamic provisioning that the Spanish created. That could answer the national pro-cyclical effect of provisions, that is when you increase provisions in the down-turn, and reduce provisions in the upturn, quite normally, because that's what happens when you measure risk at a particular moment. But what the Spanish have done is to take the whole cycle, so that you are obliged to build up certain provisions in the upturn and you can use them in the downturn and that reduces and eventually eliminates the pro-cyclical effects of the credit cycle.

The second concept is that for the trading book. One could oblige banks to build up buffers using part or all of the increase in the value of securities held so that until you have finally sold the security, have booked the profit, you've got a potential profit that you can turn into a cushion. So when you enter a downturn and market values drop, the cushion would be the first defence against that. How it would work exactly still needs to be developed.

These are two different types of activities, two different types of cushion. You could have both.

FT: Could you imagine the ECB embarking on a large-scale programme of quantitative easing, or would you rule it out?

CN: I would not rule out anything and we have not ruled out anything. What I believe we must do – and we keep studying various options – is to look at a few things and see whether we need to go beyond what we have done already. By the way, I consider that we are already implementing a non-standard monetary policy. The fact that we have, first, enlarged the pool of collateral and, second, decided to make the provision of liquidity at all maturities up to 6 months at fixed rates and for unlimited quantities, means we are not in a normal framework.

FT Would you call that quantitative easing?

CN: It is a way of doing quantitative easing, certainly, because, it means that we can provide liquidity to each institution beyond what they actually need. Having given at our last policy meeting the assurance that we would continue this as long as is needed and at least until the beginning of next year, means that we have given the assurance to the banks that the easing policy will continue for quite a long period of time.

Having said that, what we need to look at now is not the theory. We have to be pragmatic, and look at what works and what does not work. The objective of so-called additional measures would be to act where parts of the credit market are not working, the transmission mechanism is not working. A central bank may consider that at a certain point it is appropriate to intervene directly in these markets.

At the moment, we have some signs that the transmission mechanism, in terms of interest rates in almost all segments of the credit market, works relatively well. All money market segments have seen interest rates go down very significantly. It is interesting to note that if you take the 3-month reference rates, there is only 30 basis points difference between the euribor and the dollar libor, and no difference vis-à-vis sterling, so that in practice the transmission is quite efficient in the euro segment.

Finally, the possibility for corporates to issue securities – short term or long term – seems to have revived significantly since December. But we have to see how this continues and develops, and whether there are some market segments that do not improve sufficiently or remain impaired.

FT: But that means it will be weeks or months before you took such steps…

CN: We are working on that. We will see what we feel might be necessary.

FT: But if there were measures taken, they would be "credit easing" targeted a specific problems, not blanket quantitative easing in the way that the Bank of England is doing it?

CN: Well the Bank of England is apparently concerned about the monetary base. But we don't have the same problems for the time being with the monetary base in the euro area. I don't know if it has something to do with the fact that banking intermediation in the euro area as a whole plays a bigger role than in the US or even in the UK.

FT: Some of your colleagues on the governing council want to make a very clear distinction between fiscal policy and monetary policy – whereas in the UK and US they have become blurred. Does that prevent the ECB from doing QE? Would you have to go to governments first?

CN: No, we have the ability to decide on the instruments that we feel we need to use to implement our monetary policy. The only thing is that of course we are attentive to the level of risks that we are taking as a central bank. I would certainly agree that we should not blur the distinction between monetary policy and fiscal policy. That does not mean there is not a good understanding. The fact that governments have taken all the actions that they have taken to support the financial system is extremely important for central banks. It is certainly easier to accept a broad range of collateral when you know that the banking system as a whole is backed by the clear declaration by governments that they will not let a systemic institution fail.

FT: This position of the ECB appears to assume there is no risk of deflation. But do you think that the risks of deflation have increased, given the sharp contraction in economic growth that we have seen?

CN: Of course one should always remain prudent. We know that, given the evolution in prices of energy and non-processed foods, it is likely that we will have a few months toward the middle of the year with slightly negative inflation figures. But that is very different from the persistent decline in prices that characterises deflation.

I do not think personally that the risks of deflation are very high in the euro area for several reasons. One is that we have increased liquidity by a considerable amount. In both the US and the euro area, central banks have increased liquidity in the system in one year by roughly the same amount, proportionately, as the Bank of Japan did in the early 1990s' banking crisis in five years.

Second, we have a number of rigidities in nominal wages. We have a number of rigidities in some prices, so that fuels automatically certain rises in core inflation normally, and for the time being we have not seen that change significantly.

Third, when we look at long-term inflation expectations, until now they have remained well anchored to our definition of price stability.

So these three reasons make me think is that what would normally happen is that after a trough inflation will come back to somewhere close to our definition of price stability. But of course we have to remain cautious and be ready to act, and certainly if we felt there had been a change in these various elements we should ask ourselves if other non-standard monetary policy actions might be necessary.

FT: Classic quantitative easing?

CN: For instance?

FT: Buying government bonds?

CN: Possibly.

FT: Axel Weber has said 1 per cent would be the floor for the ECB main policy rate. Others have said zero could be possible. Where do you stand?

CN: I'm pragmatic. We have certainly not decided in advance that there is a minimum level that would be our floor. But there are a couple of things that we need to take into account. First, it is a general rule that the more you cut rates and you approach zero, the less efficient are the moves in terms of transmission into the real economy. So we may feel that at a certain point we need to do something more, or we do not. But we can expect the effect to be relatively limited.

Second, I think the framework we have set, results in something very different from what we had before. Having decided that we refinance at fixed rates for unlimited quantities, and with a large corridor between the deposit facility and lending rate means, the lending rate has become the ceiling and the deposit facility rate is the floor and markets tend to move the money market rates in between, with overnight rates at a very low level and the three month rate at a level which can be below the refinancing rate. As a consequence, the rates effectively paid by borrowers are much closer to the situation in the US or the UK than most people would imagine.

FT: What does that mean in practice? That the main policy rate need not go any lower, or can't go any lower?

CN: I didn't say that.

FT: Or that the deposit facility rate can't go any lower?

CN: I didn't say that either. But it is clear that the room for manoeuvre on the deposit facility is limited. What I mean is that if we keep the present framework, we cannot move much. That's obvious. If we want to move more, we have to change the framework, which could cause inconvenience.

FT: So there is not much room for manoeuvre and very soon you are going to have to think about other non-standard measures?

CN: If we feel we need more… We are in a process where three month rates lose a few basis points every day. Market and lending rates are continuing to move nicely downwards. The process has been fuelled by the 275 basis points cut that the ECB has decided. The process is not finished. We need some time for all that to feed through into the economy.

FT: So no rate cut in April?

CN: We will see. We have proved that we were always ready to act when we felt it was necessary. But we act on the basis of facts and figures, not only macro-economic facts and forecasts, but also on the actual developments in the financial markets.

FT: Do this week's French industrial production figures means things in France are going to get a lot worse than expected by the Banque de France and the government?

CN: The figures were bad and I must say that they probably makes our own forecast of a decline of growth of 0.6 per cent during the first quarter maybe a little bit optimistic. But this being said it is difficult to judge what it means without all the analysis. For instance, when I look at the negative growth of the last quarter – minus 1.2 per cent in France – one comforting aspect was that three-quarters of the decline was due to a reduction in inventories. So that was of course much better for the future because it means that once the inventories are back to the required level, to the level that corporates want to have, production starts up. So it is difficult to comment without seeing all the explanations.

For the time being I have the feeling that our situation will be relatively, slightly better than that of some of our neighbour countries. What was one of our weaknesses in the past – that is a strong reliance on domestic demand and domestic consumption for growth, and certain weakness in net exports – has become a strength in the downturn. Exports have fallen, like in Germany, but their weight in GDP is much lower, so that it has hit the economy less. The consumer spending trend has remained positive. Compared to countries like Spain or the UK the average indebtedness of households was lower, so that the effect of the turmoil on consumer spending has been also relatively lower than in other countries. For all these reasons we felt that we had some slightly better resilience, but we must remain prudent.

FT: Should Germany do more in terms of fiscal stimulus?

CN: I think that they have decided on a second package that is sizable. I recognise the importance of the efforts that Germany has made.

FT: Your plans for a central clearing house for derivatives have provoked controversy in London, where this is seen as a continental grab for business to pass though LCH.Clearnet and people are unconvinced that you need to have this lender-of-last-resort, central bank function.

CN: For me, the argument is very simple. If you really want to have a safe system you really need these clearing houses to have the possibility of extensive access to central bank liquidity. I think that is the only way to ensure that in times of stress, when you have eventually defaults of counterparties, you can manage the liquidity in a smooth fashion. Having said that, no central bank would accept large-scale access to central bank liquidity without having the oversight.

FT: But market participants say that even after the Lehman collapse, they still managed to unlock a lot of these trades without having to resort to central bank liquidity.

CN: Well, the fact that it went well doesn't mean that it will always go well. It may depend also on the type of instruments that you are clearing. We have the feeling that it may be different for, on the one hand, fixed-income instruments and, on the other hand, derivative instruments. But this is a long-standing position, it is not taken especially vis-à-vis London.

FT: What sort of model of European capitalism will emerge after this economic crisis?

CN: We will probably return to a more organised, ruled, economic system. We are discussing regulation of the financial system but it doesn't mean that we need an over regulated system – certainly not. We have to strike a balance, but it is clear in Europe, that we hope we will have a system that will be more regulated, or at least better regulated, without holes in the system. But we are living in a global world and we need to have consistent rules around the world.

FT: But Europe also needs to have its own internal dynamism, to encourage innovation. That was part of the problem of the economic model before the crisis. If you create more regulation, doesn't that make the problem worse?

CN: I think it does not prevent innovation if the rules are well designed. The lesson that we should take from the crisis is that if we let something an innovation – like hedge funds, or securitisation – develop freely and continue not to regulate it or exert any surveillance even if it grows to such an important level that it is systemic, then the risk is enormous. We should be able to detect when a systemic risk is becoming too big in the system and then act.