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"Europe, France and the United Kingdom: facing our common economic challenges"

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Ladies and Gentlemen,

It is a pleasure to be in London today and I wish to thank you for inviting me to speak at your Annual Financial Lunch. The destiny of France and the United Kingdom has indeed been linked for a very long time; the existence of the French Chamber of Commerce in Great Britain, which was established 143 years ago, is a good illustration of these firm and lasting ties. In this regard, I would like to express our full solidarity for the series of terrorist attacks that hit London recently. King Georges VI declared in 1940, and his words still apply to this day, that: “It is not the walls that make the city, but the people who live within them. The walls of London may be battered, but the spirit of the Londoner stands resolute and undismayed.” I believe that the spirit of resilience that is so characteristic of Londoners is what we need the most in times of crisis. We are and will always remain close friends and partners, even if we will no longer – unfortunately – be in the same European Club when Brexit is completed. Today, I will first elaborate on two challenges that will continue uniting us: the need for good national economic policies, pro-business and long-term oriented; and the need for active multilateralism to face our global challenges. Then, I will dwell on a challenge that we will have to address together: our future relationship and Brexit.

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I. The need for pro-business and long-term national economic policies

Let me start with the challenge of national economic policies. In the euro area, the economic recovery is now robust and broadly-based across countries and sectors. GDP growth should stand at at least 2.2% in 2017 according to our ECB forecast. The ECB’s accommodative monetary policy has contributed to this acceleration of growth in the euro area. Yet monetary policy cannot be the only game in town. Structural reforms in each country, along with stronger European coordination, are of the essence to boost potential growth in the medium term and to treat the fatal disease of mass unemployment. In recent years, several European countries, including in Southern Europe, have successfully carried out in-depth reforms that are yielding positive results in terms of growth and employment. Germany, the Netherlands and Nordic countries, as well as Spain and Portugal, are proof that economic success, a solid single currency, and the European social model are compatible. We should run pro-business, long-term oriented, fiscally sound economic policies, while keeping the core elements of a common social model, which can be the DNA and pride of Europe in this highly divided world. The social model that we share in the Eurozone combines a high level of public service, relatively low levels of inequality – much lower than in the United States – and a good intensity of social dialogue. Call it “social market economy” if you want, without prejudice to the intense and legitimate debate within the UK today.

In France, growth has started to pick up, reaching 0.6% and 0.5% in the second and third quarters of 2017 respectively. However, despite strong job creation, the unemployment rate is still high, at 9.4% in the third quarter of 2017. Therefore, stepping up reforms is now a priority in France too, with a focus on two main areas: sustainably consolidating our public finances, and aiming to achieve a structural economic transformation, with a major simplification effort in the labour market, and large-scale investment in education, vocational training and apprenticeships.

The new government, under Mr. Macron's Presidency, has made decisive steps in that direction. I stress this as an independent central banker. As regards public finances, France still has one of the highest public spending levels among OECD countries, at 56% of GDP in 2016. The French government is committed to reducing this ratio by 3 GDP points within the next 5 years. Besides, measures have been taken to keep public deficits below the threshold of 3% of GDP. For the first time in 10 years, the government deficit should be below this threshold in 2017 (2.9%). Needless to say, these efforts have to be pursued in the future, as the European Commission stressed yesterday while acknowledging the progress France had already made.

As regards the structural transformation, the government has decided to act rapidly by passing legislation by decree in the first months of its mandate. A substantial **labour market reform** was approved last summer and has already been implemented. It provides more flexibility to firms by giving social partners more room for negotiation and reducing uncertainties regarding contract terminations. Moreover, measures were announced to promote employment by reducing labour costs: the transformation of the CICE – credit tax for competitiveness and employment – into a permanent reduction of social contributions, and the transfer of social contributions financing health and unemployment insurance to a flat income tax with a larger base (CSG). In addition, measures have been taken to **reduce the tax burden on investment**; the abolition of wealth tax on all financial investments, the reduction of the corporate income tax towards the EU average or the flat tax at 30% on capital income. By supporting equity financing, these measures should hopefully enhance the creation and development of firms, especially innovative SMEs. Funds will be devoted to vocational training. A forthcoming reform of vocational training and apprenticeship is expected next year, which is badly needed as the French economy is still experiencing labour shortages despite high unemployment. These reforms should have **a significant impact on growth and employment** in the long term.

II. The need for active multilateralism to face our global challenges.

Let me now turn to my second point: the need for active multilateralism to face our global challenges. In the current context, international cooperation between countries is maybe more important than ever. Beyond the EU's borders, and with all our partners, we have to strive to maintain the collective rules of the game in order to preserve the improvement in the global economic environment.

The global recovery has indeed been gathering pace since 2016: according to the latest IMF forecast, global growth should stand at 3.6% in 2017, after 3.2% in 2016. However, there are two major risks threatening growth: first, financial instability, with the continued rise in global public and private debt since the start of the 2000s – from 190% of global GDP in 2001 to 230% in 2016. The 2008 crisis stemmed from this, but this trend has unfortunately not slowed down since; the private debt in emerging countries (namely corporate debt) has risen particularly rapidly. Any temptation to dilute the financial regulations implemented in the wake of the 2008 crisis would be all the more worrying.

Since the G20 summits of London and Pittsburgh in 2009, the regulatory effort that has been undertaken is unprecedented, in particular in the banking sector: by increasing both the quantity and quality of banking sector own funds, the Basel III reform has considerably enhanced the robustness of banks; in addition, it ensures better account is now taken of the diverse risks to which banks are exposed, thanks to the introduction of two new liquidity ratios for bank cash levels. But beyond Basel III, we should finalise measures that target non-banks. We must ensure a balance between financing channels. The priority has now shifted **from the solvency of banks**, which has improved substantially, **to the liquidity of the shadow banking sector**, particularly funds and asset management companies that are exposed to the risks of sudden panic-driven runs.

We have to make sure that this internationally agreed regulatory framework is implemented everywhere with consistency. Unilateral deregulation would be nothing less than a lose-lose scenario with serious consequences for the stability of the global financial system – we would be paving the way for the next financial crisis – as well as the competitive landscape for US, British and European banks. As Bank of England Governor and Financial Stability Board Chair Mark Carney advocated in Washington in April, what we need is: "the combination of robust international standards and greater trust as a consequence of transparent implementation and intensive supervisory cooperation".

The second risk is related to the protectionist tendencies in the United States, after the election of the president. We, Europeans, shoulder-to-shoulder with Canada, Japan and others elsewhere, must resolutely defend international economic relations based on commonly respected rules and multilateral institutions: their deterioration would dampen world trade and economic activity.

III. <u>Our future relationship and Brexit</u>.

There is one obvious challenge nevertheless that we will have to face together: our future relationship and Brexit. A year and a half ago, the British people chose to leave the EU and, even if we regret it, we respect this democratic decision. Now we have to work towards reducing uncertainty and the negative impact it may have for the United Kingdom and, albeit to a lesser extent, for the European Union. The Banque de France is not directly involved in the Brexit negotiations; this falls within the remit of governments and the European Commission, and more specifically Michel Barnier, who is conducting this mission with impressive commitment. I sincerely wish that we can achieve a constructive agreement. Let me say it loud and clear: no one is seeking to punish the UK in any way and we truly hope to keep the UK as a close partner.

But preserving the interests of the EU, its citizens, its businesses, its Member States, means that the agreement with the UK should not undermine what we have managed to achieve in Europe in the economic field: one of our strongest assets is our single market; it removes all internal borders and regulatory obstacles to the free movement of goods, capital, services, and persons in the European Union. For the sake of consistency, there is one principle in particular to which we have to stick in preparing the agreement between the EU and the UK: in the single market, you cannot separate access and rules. For the financial services industry, this means that you can hardly expect to obtain a European passport if you do not accept the single market's rules.

London is and will remain in the future a global financial centre, but the architecture of the European financial system may have to evolve in this regard. We cannot foresee the outcome of the negotiations – which I hope will be in the interest of both parties – but all actors should as of now undertake all the necessary preparations to avoid any potential "cliff-edge" risk. London will and should probably continue to attract and transform savings from all over the world. In this respect, on a more personal note, allow me to comment on what I read with surprise in some British newspapers last July: I personally never met with the City's Special Representative to the EU, Mr Browne, and the Banque de France has never wished for Brexit to be detrimental to the City of London, and we have friendly and frequent contact with the City of London Corporation.

But, besides savings from the rest of the world, the savings of the EU-27 Member States will be increasingly handled within the single market, given its significant size and the safety of its rules. This means that we will move towards some degree of "Europeanisation" for wholesale banks, insurers and asset managers.

It is symmetrically the duty of Europe and its member countries to be business-friendly and attractive to the financial industry. We should not achieve this by lowering the bar for our common regulations: the SSM, EIOPA and ESMA are duly mobilised to prevent certain entities that keep their resources outside the EU from setting up empty shell corporations in the EU, mere company name plates, to benefit from passporting rights. We should rather be attractive by offering a stable and favourable framework for investors, including infrastructures, labour skills and labour laws, and taxes. There is some fair but positive emulation in this regard. In this new environment, the Paris financial centre has obvious advantages, building on the very welcome measures announced in July by our Prime Minister to strengthen Paris' attractiveness. To name a few, France has the biggest investment banks in continental Europe, the largest asset management industry and is the leading private equity investor; and French universities are renowned worldwide for the excellence of their finance teaching. And, last but not least, Paris will have the privilege of welcoming the EBA.

Furthermore, the euro area has to keep control of the risks regarding its currency, the euro, and euro-based transactions. Some financial market infrastructures located in London, which are key for the EU, will soon become off-shore to the EU as a consequence of Brexit. This is particularly problematic when these infrastructures could put the EU's financial stability at risk, as they represent 70% of the daily euro clearing business, equivalent to around EUR 930 billion (GBP 792 billion) in trades per day[i]. This is the reason why the Commission proposed – and we support – a location policy for CCPs. Clearing activities in euro, for all those of "super-systemic" importance, must be located where the supervision of the Eurosystem can be exercised effectively. It is a matter of consistency for monetary policy and financial stability.

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To conclude, let me quote a sentence attributed to one of the great British statesmen, Benjamin Disraeli: "circumstances are beyond human control, but our conduct is in our own power." We are indeed going through a difficult period, which puts the friendship between our countries to the test. But we have to face it together. Our objective should be to reach a lasting and consistent agreement allowing our countries to remain closely linked to each other in the future. I believe that it is our common desire and interest. Thank you for your attention.

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[i] House of Lords, report 2016 ; https://publications.parliament.uk/pa/ld201617/ldselect/ldeucom/81/81.pdf