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MONETARY UNION

French central bank governor sets out eurozone risks, principles in 2019

Villeroy takes stock of euro achievements, explains monetary, economic policies for future, emphasises European monetary sovereignty in a difficult global context

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[\(/yannick-lambert\)](#) 11.01.2019



Photo: Steve Eastwood

On Thursday, the governor of the Bank of France, (https://de.wikipedia.org/wiki/Fran%C3%A7ois_Villeroy_de_Galhau) François Villeroy de Galhau, took stock of the situation of the euro since its introduction 20 years ago at a speech delivered at the European Convention Centre in Kirchberg.

Villeroy, who addressed the audience in French, pointed out how he has roots in the Greater Region of Luxembourg, and he furthermore praised the Grand Duchy as a bridge between France and Europe. He was introduced by Gaston Reinesch, the governor of Luxembourg Central Bank, who co-organised the event alongside the 'Bridge Forum Dialogue' non-profit organisation.

Alongside his role as governor of the Bank of France, Villeroy is a policymaker at the European Central Bank (ECB) Governing Council.

The currency's three pillars

In the face of uncertainties, he outlined three pillars of the success of the eurosystème.

The first major role of the euro is "price stability", according to Villeroy. Periods of excessive inflation should be avoided and purchasing power of households preserved.

One example of stability is how inflation has been kept in check. Before the adoption of the euro, average inflation within eurozone countries was around 4.9% whereas now it hovers around 1,7%. Furthermore, the 'spread', meaning the dispersion of inflation between eurozone members "has significantly decreased".

He cautioned against a double-mandate, such as that of the US federal reserve, which both tries to keep prices stable whilst fuelling economic growth.

He pointed out how that the ECB's attempt to keep inflation below 2% was followed by the Federal Reserve and Japan's central bank, a phenomenon he welcomed as a "conceptual convergence".



Banque de France in Paris

Photo: Shutterstock

The second aspect is the independence of central banks, following the example of the Bundesbank. In an age where independence of central banks is contested more and more, such as in the US currently, it is important to defend and keep it. Independence is important on three levels. First, independence from governments is necessary. Beyond that, independence from the economic area is vital, as much as independence from short-termism.

The third pillar is the political one. "The guiding spirit of the euro is the European interest". "The euro was first and foremost a political project", by politicians such as François Mitterrand and Helmut Kohl in parallel.

"The euro is supported by 75%, thus by a majority of the citizens of the eurozone, the highest level since 2013", referring to a Eurobarometer study, with support for the euro being the highest in Luxembourg.

"The EU becomes popular once it becomes concrete", he explained.

Challenges by populists, Brexit, protectionism

However, the euro has of course also undergone several crises, such as the Greek crisis, which saw the establishment of the Euro Stability Mechanism (ESM) in 2012, equally based in Luxembourg.

Furthermore, Ireland and Spain benefited from the establishment of the European banking union, according to Villeroy.

Given the rise of euroscepticism, "the European interest is in the process of weakening", he explained to the audience in Luxembourg.

According to Villeroy, the euro will be facing major challenges in 2019.

The economic circumstances are particularly challenging. Growth and activities are slowing down, but there is not an "economic downturn" yet.

Despite this, the "scenario remains relatively positive" but is marked by three major challenges, Villeroy identified as the three "Is", namely Uncertainty ('incertitude' in French), impatience and isolationism.

Brexit is one of the main uncertainty factors the eurozone and the EU are facing. "Caution is necessary", he said, but he also added that the "consequences are more severe for the UK than the EU."

Concerning impatience, Villeroy mentions the high volatility and political pressure due to "populist impatience" against the budgetary adjustment ('redressement budgétaire'). He cautions against favouring short-term solutions over more sustainable long-term plans.

Thirdly, isolationism, expressed through economically protectionist measures such as Trump's trade war, affects growth.

Solutions

He emphasised that monetary policy should shift towards normalisation, but he urged patience, and a "gradual, pragmatic" approach based on the three aforementioned pillars.

"We need to keep our options open," he added. "We are predicable but not pre-committed," he added in English.

"The European Central Bank (ECB) should wait until the spring before changing its policy."

"We don't need to give new indications on the timetable or the scope between today and the spring, when we will fine tune the sequence depending on economic data."



Photo: Steve Eastwood

As potential solutions, he said that inflation needs to be kept in check even more in order to guarantee price stability, especially with regards to core inflation (inflation sous-jacente) and that salary inflation needs to follow overall inflation.

However, "monetary policy cannot be the only game in town", the central bank governor said

(<https://www.consilium.europa.eu/en/policies/capital-markets-union/>)Villeroy thus also supports the creation of the proposed 'capital markets union'. The EU commission foresees the following targets for the union: (<https://www.consilium.europa.eu/en/policies/capital-markets-union/>)

- provide new sources of funding for businesses, especially for small and medium-sized enterprises
- reduce the cost of raising capital increase options for savers across the EU
- facilitate cross-border investing and attract more foreign investment into the EU
- support long-term projects
- make the EU financial system more stable, resilient and competitive

The project supports and complements the investment plan for Europe , which is designed to boost investment in the EU.

Villeroy is in favour of a 'Union for investment and innovation'. Villeroy applauded the EU's investment plan, also known as the Juncker-plan, calling it a "beginning, but just a beginning".

The 'Juncker-plan', aims at freeing public and private investments in the "real economy" of at least € 315 billion over a three years fiscal period.

According to Villeroy, the European Securities and Markets Authority (ESMA) needs to be strengthened. He regrets that some necessary reforms are currently being blocked at the level of the EU council.

On top of that, the European Stability Mechanism's (ESM) needs to reinforce its precaution instruments.

European sovereignty

Beyond the technical but necessary reforms, he stressed the importance of the euro as a means of securing European sovereignty and independence from the US and China. "The euro is the world's second global currency, but remains significantly below the dollar".

"There might be a future where the Chinese yuan becomes more important, but that will depend on China opening up".

However, the euro is important to the international monetary system and it will be especially vital in preserving independence and sovereignty in areas such as energy, commerce and artificial intelligence and should therefore be maintained and reinforced in that role.

He also added that the "euro club needs to stay open". "We have already gone from 12 initial members to 19" and that "new members should be accepted if they meet the stability criteria".

When quizzed by the audience on cryptocurrencies such as bitcoin, he cautioned against calling them a 'currency' due to their volatility, instability, their lack of transparency as a guarantor of value, and the high level of speculation that goes with them.

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