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Francois Villeroy de Galhau
Governor, Banque de France

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Introduction

Chair John C. Williams

Good afternoon everybody, and welcome to the 755th meeting of The Economic Club of New York. I'm John Williams. I'm Chair of the Club for a few more months, a few more months. Recognized as the premier nonpartisan forum in the nation, The Economic Club of New York stands as the leading platform for discussion on economic, social, and political matters. For more than a century, the Club has hosted over 1,000 preeminent guest speakers contributing to our tradition of excellence.

I'd like to extend a warm welcome to students who are joining us virtually from the Zicklin School of Business, Princeton University, Yeshiva University's Sy Syms School of Business as well as the members of our largest-ever Class of 2024 Fellows – a select group of diverse, rising, next-gen business thought leaders.

Now it's my honor to welcome our special guest today, my friend Francois Villeroy de Galhau. Governor Villeroy has been Governor of the Banque de France since November of 2015. He's a member of the Governing Council of the European Central Bank and Chairman of the ACPR, the Prudential Supervision and Resolution Authority. And in 2022, he was appointed Chair of the Board of Directors of the Bank for International Settlements. So Francois is my boss.

The format today will begin with prepared remarks from Governor Villeroy followed by a conversation in which I'm extremely pleased to be moderating. We'll end promptly at 1:30, and time permitting, and we will make time permitting, we'll take questions from the room. We've got a few questions also, I should mention, before, and I'm going to incorporate those in our discussion. As a reminder, this conversation is on the record as we do have media on the line and in the room. So without further ado, please join me in welcoming Governor Villeroy to the stage.

Opening Remarks by Governor Francois Villeroy de Galhau

Thank you very much, dear John, dear Barbara, ladies and gentlemen, dear friends. It's my great pleasure to be here in this impressive room and at The Economic Club of New York. Can I quote the great American novelist and born New Yorker, Henry James, to start with. He was also a fine connoisseur of Europe in the 19th century. And he once wrote, this was 150 years ago, "It's a complex fate, being an American, and one of the responsibilities it entails is fighting against a superstitious valuation of Europe." Again, this was in the 19th century.

Today, one can almost reverse the quote. It's a complex fate being European today. It takes responsibility to acknowledge our similarities and differences with the U.S. and escape the temptation of relying too much on our cross-Atlantic counterparts for guidance on economic decisions.

Monetary policy, dear John, is not exempt from this temptation. There is often the perception that the ECB cannot or will not act unless the Fed does so. Let me be clear upfront. As Christine Lagarde said last Thursday, and probably if I'm right, repeated this morning, "we are data-dependent, we are not Fed dependent." I quote my president and she's my real boss, by the way. We take our decisions according to our domestic mandate of 2% inflation and based on our best assessment of euro area data and outlook.

That said, we obviously live in the same uncertain – and still more in these days – risky world. Our shared Transatlantic discussions, including in Basel, and trust are our common treasure. And we have seen parallel evolutions, in turn driven by global shocks. But there are also important differences on the drivers of inflation, due more to demand in the U.S. and more to supply constraints in the euro area linked to our greater dependence on imported energy. There are also differences – I will come back to them – on the level of the neutral interest rate, R-star.

Today, we observe disinflation proceeding in both areas, albeit at different speeds. In a recent speech echoing the latest successful French movie, I will say the title in French, Anatomie d'une chute, Anatomy of a Fall. I tried to explain the anatomy of a fall in inflation. But today I would like to expand on three dimensions, three questions that I believe are of common interest. Also, let me be clear, I don't pretend to comment on U.S. monetary policy.

First question: why have central banks succeeded so far in a soft landing? Second, will we succeed in the end? And third, where could we end? And this is a debate about the neutral rate.

First, why have central banks succeeded so far to achieve disinflation and a soft landing in the face of supply shocks? And this is quite unprecedented. Central banks are said to achieve a soft landing if they can bring inflation back down to target at a low cost for employment, a low sacrifice ratio, as economists say. Of course, part of the observed disinflation was due to the reversal of energy prices. And the resilience of employment might be supported by specific labor market factors, including – and this is good news – its significant improvement in Europe and in France. But today, I want to focus on the role of monetary policy in driving disinflation. Let me emphasize one aspect that is at the center of modern monetary policy – I stress the modern – namely, well-anchored inflation expectations.

What changed in the last decades since the last inflationary episode of the 70s? Central bank independence plus the shift to direct inflation targeting – instead of steering monetary aggregates. Added, they are an important legacy of the victory over inflation in the 80s. A credible commitment to return inflation to target ensures that the public sees high inflation as temporary. Ultimately, this leads to price- and wage-setting remaining anchored around our inflation targets, and it avoids wage-price spirals. In other words, a modern central bank with a strong and credible reaction function significantly shortens inflationary episodes and reduces the cost on activity and employment.

This is precisely, let me stress it, the mechanisms that played out during the inflation surge of ‘22. As soon as monetary tightening accelerated – in our case, in mid-‘22 – the initial rise in inflation expectations reversed downward. This solid anchoring of expectations marks a decisive difference with the 70s. The enhanced credibility of central banks, thanks again to their independence and the success of inflation targeting, has been bolstered by their forceful reaction, thus obviating the need to raise real interest rates to levels as high as those seen in the past.

Our Chair and my co-panelist today, dear John, has identified three criteria for assessing well-anchored expectations. I will make it short, John. Reviewing these for the euro area, the first two criteria – a lack of sensitivity of long-run inflation expectations to macroeconomic news and, second, levels consistent with the target are clearly fulfilled. Long-term inflation expectations have remained rather stable – the first criteria – and not too far from the ECB's 2% target. Your third criteria refers to uncertainty or dispersion. And it is still more challenging but mainly because we have data limitations.

That said, about inflation expectations, I think it's important to acknowledge two limitations: we do not yet fully understand how households and business form expectations nor how this maps into their actions. And the second limitation, this expectation channel should not lead to think that monetary policy would work like a magical incantation. Central bank credibility hinges also on concrete actions and their impact on credit and demand. And this is a more traditional challenge beside the expectation channel.

And, by the way, this impact of monetary policy through the credit channel is tangible. Various models developed by the ECB and the Banque de France quantify the contribution of monetary policy to the disinflation, estimating that inflation would have been around 1 to 2 percentage points higher in 2023 in the absence of our policy rate hikes. The impact this year and next year would be even larger, due to the lags of monetary policy transmission.

I now come to my second question. Will we succeed in the end? And this is probably still more interesting. Shall we simply rest on our laurels and celebrate our success?

Certainly not. Success is not ensured until the end, namely durable convergence around 2% inflation. And unexpected and exogenous shocks could arise along the road. Furthermore, a number of observers and policymakers have expressed concerns that the last mile challenge, the last mile of disinflation might be more arduous.

What do they mean? Disinflation now needs to extend to the core and primarily to services. They claim that it will, therefore, be different, harder, and with less tailwind from the base effects of energy disinflation. In economic terms, the Phillips curve would not be linear and would be less favorable now, leading to a higher sacrifice ratio.

But as far as the euro area is concerned, there is no serious evidence to support this fear of the last kilometer. And allow me, as I'm speaking of Europe, to use European metrics. I don't pretend to be a specialist of the last mile. You are the one probably, John. But I have some strong views on the last kilometer. Admittedly, services inflation remains higher at 4%. But it has started to fall in the euro area after peaking at 5.6% last July. Historically, its average has generally exceeded the headline target of 2%, but it's still compatible with it because of slower trend growth below 2% in goods prices, which are now, by the way, at 1.1% inflation. Moreover, we see no signs of a wage-price spiral, which is important as wages are particularly relevant for services. On the contrary, average compensation per employee in Europe is slowing markedly.

True, and to put it in a nutshell, services disinflation can be slower, but not more arduous. The last kilometer could differ in pace, but not in nature. Moreover, accepting that this last kilometer could naturally take longer may also provide protection against the risk of undershooting the inflation target rather than remaining excessively tight to accelerate the process.

This is why the time has come, in the euro area, to ease monetary restriction. Following our Governing Council meeting last week, we should, barring major shocks or surprises, decide on a first rate cut at our next meeting on June 6. Note, this calendar, by the way, it will be the 80th anniversary of D-Day. But this is not why we decided about the rate cut. I would then argue, furthermore, in favor of a policy of pragmatic and agile gradualism. There will have to be further cuts this year and next. Their pace will be guided by the data in a genuine meeting-by-meeting approach. We do not have the same business cycle as the U.S., with activity that is much less buoyant. The gradual easing of our monetary policy is, therefore, more evident, even though it shouldn't be complacent.

That said, we will monitor closely the geopolitical developments in the Middle East and their possible spillovers on energy prices. If ever, if ever these consequences happen to be lasting and propagating, i.e. affecting underlying inflation, we would have ample room after the first rate cut to adjust the pace and the destination if needed – again, I stress “if” – in the incoming monetary path. Indeed, we will anyway still be in restrictive territory for a while.

I come to my third and last question about where we can end and is the neutral rate, R-star, helpful? Here, the economic profession gets divided about the use of another concept dear to you, John, the neutral or equilibrium rate, R-star. It is both an essential structural variable and a key cyclical marker as it is a dividing line between a restrictive and an accommodative monetary policy. But the challenge, as we all know is that R-star is not observable and needs to be estimated. For this reason, some doubt whether the concept is even relevant. I must confess that I am, however, an R-star believer and so are we, the two of us probably. We discussed it in Basel. The ECB and the Banque de France have ventured some estimates using a series of semi-structural models.

These estimates show that the pandemic marks a halt in the two-decade long downward drift in R-star on the back of lower growth and population aging. Our estimate suggests that in the euro area, the real neutral rate is now slightly positive, between 0% and 0.5%. Therefore, the nominal neutral rate, adjusted for 2% inflation, could be between 2% and 2.5%. In the U.S., it could be around one percentage point higher, taking into account the surplus of investment over savings and stronger demographics and productivity gains. This 2% to 2.5% range is a reasonable estimate of the average of ECB policy rates over a future full monetary cycle. This is not necessarily the target for the current rate-cutting phase, but it simply shows that we have significant leeway to lower our rates before exiting restrictive territory.

Let me sum it up and conclude. Echoing Henry James's famous novel, the time for a "turn of the screw" on euro area monetary conditions is over. Now a time is coming in Europe to start to gradually "release the screw" and lower the pressure. Thank you for your attention and let us now turn to our discussion.

Conversation with Governor Francois Villeroy de Galhau

CHAIR JOHN C. WILLIAMS: Well, thank you Francois. Those were terrific comments to start us off, covered a lot of territory. It uncovered a lot of territory about Europe. I think we'll find ways to tie this into what's happening in the U.S. as well. You started with your comments about this last kilometer, and I'll stay in Europe on that, in terms of the terminology. So you mentioned your, kind of the arguments about why you weren't so convinced by this. Why do you think that debate is so lively? Or why do you think these, why are we having this last mile, last kilometer discussion? And how do you think this is a helpful way of thinking about things?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: You should perhaps also give your views on this side of the Atlantic. So I discuss the last kilometer and John will discuss the last mile. But in our case, we have to look at pace. Disinflation was very quick as inflation surge was. And it was, some use the image of a Christmas tree. It was symmetric because we had a strong inflation surge associated to energy and commodity prices, and we had a strong disinflation and fast one.

So the question is not about the pace to come. As I said, it will probably be slower. But is it different in nature? Really, I don't think so. So there could be some confusion about the last kilometer saying if it takes a bit more time, and if you look at our forecast I will repeat what is even our commitment, we are at 2.4. We could have, in the month to come, some plateau, some ups and downs. But we will bring inflation back to 2%, to our target, by next year. And if you look at our forecast for Europe and for France, as I said, it's even a commitment barring major shocks.

So I think this last kilometer debate, again it's linked to this confusion. But we see no reason why disinflation shouldn't happen also in services. It started. And there could be a worry about wages, and a wage-price spiral in services. In our case, we don't see it all. Even the deceleration of wages, the slowing down, is quicker than what we expected.

CHAIR JOHN C. WILLIAMS: So I think from the U.S. perspective, I think your point is spot-on. It's not about, you know, we do know that certain prices, like goods prices move much more quickly than service prices. That's just a fact. We've seen it over many decades. But the question that we really should be asking is the one you said, which is the nature of the disinflation process. So in the United States we've seen inflation rates of goods, services, commodities, food, energy, everything, they've all been coming down. And they're coming down pretty clearly over the past year and a half. And they do come, they went up at different rates and they're coming down at different rates.

But the idea that there's somehow an asymmetry or something particularly stubborn about inflation, I don't think there's really any evidence in the U.S. or, as you mentioned, in the euro area. So I think it's, in a way it's really about, as you said, it's more about kind of just the different inflation rates tend to move at a little bit different rates. Go ahead...

GOVERNOR FRANCOIS VILLEROY DE GALHAU: No, if I may, one sentence, again in our case, if we give too much importance to this last kilometer doubt, we could be at risk of overshooting and paying a too high price, cost in terms of economic activity and perhaps undershooting the inflation target. This is why I am very reluctant to this last kilometer debate. But I accept the fact that it will take more time.

CHAIR JOHN C. WILLIAMS: So you mentioned the Phillips curve a few times. You mentioned the sacrifice ratio, I think, twice in your prepared remarks. I mean, how helpful have those kind of ideas been in thinking about this inflation process and the disinflation process? Is it really the Phillips curve that you think has been helping us understand this? Or is it more about the pandemic and, especially for Europe, the effects of Russia's war in Ukraine on energy prices, commodity prices more generally. How do you combine all of those pieces together?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: Perhaps two quick remarks. First, I am not a born economist. I must apologize to you and probably to others in the audience. And I'm not a great fan of this expression of sacrifice ratio. And if you try to put it in public debate and in political discussion, it will not be very helpful. And in the long run, the fact that we have to fight inflation helps support economic activity, economic confidence, and employment. So there is no tradeoff in the long run. Second, let us be honest, we had a good surprise with the slope of the Phillips curve and with the effectiveness of our monetary policy. And this is why I insisted with the comparison with the 70s. If you look at the level of interest rates, if you look at the economic cost we had to pay in the short run, it was lower than in the 70s. Why so? Probably, this is my main explanation but the jury is still out, due to the credibility of modern monetary policy.

If people believe, and still stronger than in the 70s, much stronger than in the 70s in our case, that the central bank will succeed in its commitment to bring inflation back to 2%, it is a virtuous circle. It is self-fulfilling. And so this would be my explanation. It's too early to tell where exactly the Phillips curve is on both sides of the Atlantic. But for sure, this sacrifice ratio, if we accept this vocabulary, the sacrifice ratio is lower than in the past because the credibility is higher. This would be my main explanation.

CHAIR JOHN C. WILLIAMS: So you talked a lot about your upcoming June meeting, June 6th, and kind of where you're seeing ECB policy. Obviously, there's a lot of discussion about Fed policy as well. How do you see the, kind of, in the U.S. our economy is growing really rapidly. We were over 3% last year. Retail sales say that consumers in the U.S. keep spending. Our inflation data recently have come in higher than expectations. That's not been the story in Europe. You've actually seen inflation come down, I think, a little bit quicker than some people expected. The economies are not growing quite as fast. How do you kind of make sense of the different experiences over the last year or so between Europe and the U.S.?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: So both of us should probably give ____ an explanation because I don't want to comment too much on the U.S. business cycle, but there are probably several explanations to this growth differential. There are cyclical explanations. First, we should never forget that Europe was more hit by the Russian war in Ukraine. It's on our soil and the energy shock was much heavier for

Europe. We are energy importers. Second, the fiscal policy in the U.S. was probably still more supportive – may I say it this way – than in Europe. So these are cyclical explanations.

But, we Europeans shouldn't be complacent. There are also structural explanations, long-term. If I look at the size, and this is interesting, if I look at the weight of our two internal markets, I don't know if you are aware of that, the size is more or less the same. In purchasing power parity, the American single market equals the European single market. But if I look at the weights, we are equal. If I look at the speed, we are not. And if I look at the attractiveness, we are not.

And here, we lag behind in terms of innovation. We lag behind also in terms of integration. And the European single market was a decisive progress 30 years ago thanks to Jacques Delors, but it's not yet fully integrated. I don't know if you are aware that Enrico Letta, the former Italian Prime Minister will present a report this week to the European Council of Head of States about further integration of the single market. And we could win between five and ten points of GDP with further integration.

And we have to be more Schumpeterian. I always stress that Schumpeter was an economist born in Europe, as you are aware, in Austria, Austria-Hungary at the time. But he passed away in the U.S. So, we Europeans should remember that Joseph

Schumpeter was also one of the great sons of Europe. And sometimes I say we should reconcile Keynes, who is clearly a European, and Schumpeter.

And we have several levels for that. A more integrated single market, especially in digital, in telecoms, etc. This will be Enrico Letta's proposal. And second, to use much better our financial savings. We are savers in Europe. We have excessive private saving each year of up to 2% of GDP, and we should use this to fund the digital and the green transition. If we do that and this is a clear political endeavor, I hope it will be the mandate of the next commission and of the next European parliament. We have ways and means to accelerate. But we shouldn't be complacent about the structural part of your question. Sorry to have been a bit long, but I think it's absolutely key.

CHAIR JOHN C. WILLIAMS: If you think about an estimate of potential GDP growth in the euro area versus the U.S., I mean, I'm not trying to be rude, Francois...

GOVERNOR FRANCOIS VILLEROY DE GALHAU: You can be, John.

CHAIR JOHN C. WILLIAMS...but our potential growth is probably around 2% and maybe even higher. In Europe, it's maybe a little bit above half of that. Part of it is the demographics. Part of it is the productivity as well. And these are lasting challenges. And when you think about AI...

GOVERNOR FRANCOIS VILLEROY DE GALHAU: No, you are right, by the way, John, to stress also demography, which I didn't mention. And this is a very difficult debate also about immigration. And we know how sensitive it is in non-economic terms in all of our countries. It's very polarizing politically. But if you look at it from an economic standpoint, it's one of the explanations of the U.S. advantage.

CHAIR JOHN C. WILLIAMS: So, it's The Economic Club of New York, in 2023 and 2024 there's one topic we always mention. That's AI. We're talking about innovation and that Europe needs to re-find its Schumpeterian roots, is the way you put it, Francois. How is AI going to change, is it a game changer, do you think for productivity and innovation in Europe?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: Am I allowed, John, at this stage to reverse a question and to start with you...because I would be very interested in your U.S. analysis about AI and I will follow suit.

CHAIR JOHN C. WILLIAMS: Well, I think what we hear in a lot of our meetings, and a lot of the people in this room have been part of this, is I think everyone is convinced this is a big deal. I think the challenge, and it's a big deal in terms of every company, every organization, including central banks, using this technology. I think it will be productivity enhancing. I think the real big question out there is, is it one of these things that drives fast productivity growth for a decade or two or is it something that is just part of the fabric of an innovative economy that has productivity growth? So we haven't seen that happen. But I have yet to meet someone who doesn't think this is a big deal in terms of investment, in terms of how organizations work. And it's something that, you know, in the U.S. at least, is I think mostly being embraced despite some of the concerns around, you know, some of the risks around it.

GOVERNOR FRANCOIS VILLEROY DE GALHAU: I would tend to agree. And if you look at the European concept, it's more or less the same. All CEOs at present are speaking about AI, are focusing. Also none of them probably precisely know how it will affect its business and increase its productivity, but there is little doubt about the direction of the journey.

So, we all remember that the late Robert Solow said I see productivity of internet everywhere except in the economic statistics. I think this time could be different, but it will take more time probably. We all know this old rule of innovations that we probably, or public debate probably tends to overstate the short-term gains and to understate the long-term gains. I think it's the same for AI. It will be also a significant need for investment. And this is why I advocated capital markets union or what we could call an investment union. We have again significant resources in Europe, which is the excess of private saving. Let us invest more in the European needs including for digital and AI.

CHAIR JOHN C. WILLIAMS: So the next question we had on our list was about a topic, again like the last mile or last kilometer that we hear a lot of, and that's structural inflation. And that's the idea out there, we've heard that even from some of our peers around the world, that the next few decades could be a lot harder than the past few decades have been for you and me and other central bankers. We have the advantage of globalization, bringing costs down, improving efficiency in the global economy. The next decade may be one of more fragmentation. We were experiencing a period of stability where economies did fairly well and inflation was, if anything, a little lower than our targets. And people think, well, there's going to be a lot more volatility in the future, more shocks.

And then finally the idea that, and you mentioned this already, that the investments in a green economy are going to add to demand for investment in the economy and may increase costs. So these are some of the arguments that people have made that over the next few decades we're going to have upward pressure on inflation, maybe upward pressure on R-star – and thank you for mentioning it. But how do you do think about this? Did we have the easy job and the future is going to be even harder?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: The honest answer, at least on my side, is I don't know yet. But let me take perhaps a long view. I would share with you the views that before Covid, in the last two previous decades, we had more disinflationary forces at work. Globalization and digitalization to quote only two of them.

For the future, what could we say? Probably R-star has stopped its decline and could even increase. By the way, this is good news for monetary policy because it means that we would be at the zero lower bound or the effective lower bound of interest rates, whatever it is, less often than in the past. And you know this was a challenge for monetary policy which led us to introduce unconventional tools. But about inflation itself, we could say that fragmentation, perhaps climate change – I would be cautious on that – could have a more inflationary effect.

My analysis at this stage would be more cautious. We will have more supply shocks. And if you look at what happened since 2020, we had two major supply shocks, the pandemic and then the war in Ukraine. The first one was disinflationary or deflationary. The second one was inflationary. This was, by the way, a huge challenge for monetary policy because we had to change course in the sequence of two unprecedented events very quickly. But we will have more supply shocks. And this means probably a greater volatility of inflation in the future. I wouldn't say at this stage yet our target of 2% will be more difficult to achieve as an average, but we should accept probably that inflation will be more volatile in the future around this target than it used to be in the past.

That said, if I look at climate change, for instance, and we will possibly discuss this, this also belongs to the transatlantic debate. But it's not sure today that climate change will be inflationary. The effect on prices and output is still uncertain but it will introduce volatility. And so the role of central banks will be still more important to provide confidence and an anchor.

CHAIR JOHN C. WILLIAMS: And achieving our inflation, long-run inflation goals. One thing we see in our survey, and I've gone about 20 minutes without mentioning the New York Fed research product so I have to do that. But we have our Survey of Consumer Expectations, it's a household survey, and exactly as you mentioned in your prepared remarks, we've seen inflation expectations come back down and be consistent with our goal. But uncertainty, and this is, you know, we ask regular people – not economists, even though economists are regular people too – but we ask regular people, what is your uncertainty about inflation, uncertainty about income? Can you put it in different buckets?

And that was pretty stable and low in the U.S. until the pandemic. It rose dramatically and it stayed pretty high. It's come down a little bit but it's still very high. When I think to myself as just a regular person, that's not surprising. I mean, you mentioned in your remarks, but you think about what everybody's gone through over the past four years here and in Europe and around the world, and then think about this issue of does the future have more variants in it. Not so much the level, but more the variants. I think it's interesting what we're learning from what people say.

GOVERNOR FRANCOIS VILLEROY DE GALHAU: Can I, one point about that, which is perhaps broader than this question of the inflation target. You remember this famous cliche or sentence about monetary policy being the only game in town. This was before Covid. But the idea that central banks were powerful and over-powerful and to settle with all the economic challenges. I think it's wrong. It was wrong already at that time. But if we have many issues on the supply side, this refers also to structural policies and structural changes and public policies by government and international cooperation – think of climate. So I think it's wise to say that in this huge universe we will do our part of the job, but we act mainly on demand. But we cannot settle all these changes on the supply side.

CHAIR JOHN C. WILLIAMS: So the last topic we had was financial stability. And so we have, obviously you're involved on the global front, and in Europe. The global financial system continues to change. We're seeing evolution away from banking-centered finance, even in Europe, to more of what we call the NBFI, non-bank financial institutions. So what are the things that worry you? What are the things that we've got to get right in terms of financial stability? Both in terms of the regulated part of it, the banking part, and the non-bank financial institutions.

GOVERNOR FRANCOIS VILLEROY DE GALHAU: First, may I say with a smile that on financial stability it's my duty, it's our duty, John, to stay awake at night always. If ever I would say one day in this audience, “I have complete trust in financial stability, this problem is over”, you should replace me very soon as it would be complacency. That said, this is clearly an issue where we’ve made progress since the Great Financial Crisis.

I mentioned these two opposite shocks we had – pandemic and then the Russian war and the inflation shock. It could have been, think of the older days, it could have been a trigger for a major financial crisis. And in both cases we avoided it. I think it’s due also to central bank monetary policy, but it’s due to stronger regulations, supervision, and a safer financial system, especially for banks. I will come to NBFI, non-banks, which you mentioned.

And if I look at Europe, you remember ten years ago if we had had this discussion in the Economic Club, you would probably have put a question to me, what about the European banking system? What about such or such country? What about the risk? This question is over, and it’s not by chance. It’s not by chance. Because we succeeded in organizing a single European supervision, banking union. By the way, ten years ago. We will celebrate the ten years in November. We implemented Basel III for all our banks, which is not the case in other jurisdictions. And it helps to prevent the European banking sector to suffer from the banking crisis in March ‘23.

So, our banking sectors, it's true on both sides of the Atlantic but I would wish to have – I don't want to intervene in a U.S. debate, John – but I would wish to have a broader implementation of Basel III also in this country, and I think it would be common interest. But in our case, we have a safer banking system. And we shouldn't be complacent. I sometimes hear calls, including from European banks saying, look, we are now much safer. We should give the priority to the funding of the economy. The funding of the economy is sufficient. You should relax the rules. No. We should implement Basel III as agreed in a time consistent and full manner by early '25 everywhere.

Then comes the issue of non-banks. And here you are right, we made probably less progress. I don't say, and this is very important, I don't say that we should implement the same regulation for non-banks and for banks. The risks are not the same. If I look at the liquidity risk, the __ risk, the risks are not the same. And the risk of a bank is a risk of its balance sheet. The risk of a non-bank is shared with its customers and investors to say the least.

That said, we lack data. We lack transparency. And we are in some segments of the non-banks in a more dangerous situation. So we made progress in the framework of the Financial Stability Board, FSB. We have to implement them everywhere. There are some segments probably of non-banks which are more the focus of attention – commercial real estate, private credit, etc. I don't want to give the list, but we are not yet where we should be.

And let me mention, if you allow me 30 seconds more, John, let me mention one segment of financial stability, which is still rather small, but which is crypto assets. And here we have common principles in the FSB. We should implement these common principles everywhere while it's still time, because it's still a rather limited segment. We know it's very risky. And some around the table of the FSB wanted to prohibit such investment. I don't think it's a good solution. You don't prohibit innovation and you don't prohibit the freedom of investment. But we should be consistent in anti-money laundering, in monitoring, also customers' risk, some liquidity risk for crypto platforms. And we saw them at work. Here we lag behind. This is my call today.

CHAIR JOHN C. WILLIAMS: I mean, one of the big challenges for all of us with NBFIs, again getting back to the broader set of issues, is we don't have the same ability to see what's going on. And the thing for financial stability is often where's the leverage? And where is the hidden leverage? And with the banking system and with the regulated part of the system, we can see what's going on and understand that hopefully well, but other parts of it, it's harder to know. It's often about the data and the ability to see that in addition to regulation and supervision.

Now you said, my last question is what keeps you up at night? It seems like you're up all night, so you must be thinking about a lot of things, worrying about financial stability. But maybe take it home to the economy. If you were to say, okay, a lot of uncertainty about the outlook for Europe, the macroeconomic outlook for Europe, what do you think are the things that could surprise you on the positive? What are some of the tailwinds that might help things get better in the near term? What are some of the downside risks or some of the headwinds that are kind of on your list of concerns?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: This is a question I like, John, because a frequently asked question is what is the bad news you could expect? There are many, and we mentioned some of them, and we are paid to be attentive to bad surprises.

But if I look at the positive assets we have in Europe, first, I think is that disinflation is really underway, and this is a significant good news. And not only for inflation, also for growth. We expect a cyclical recovery in Europe of about 1.5% next year. It's not huge by American standards, but it's rather good by European ones. And due to disinflation, we will have purchasing power, an increase of real wages, and we will have a decrease of rates which is good for investment.

Second, I think that as inflation is receding, it's time to go back to our structural challenges. And if we look at our political agenda, I guess it's true on both sides of the

Atlantic, it has been dominated in the economic debate by this inflationary crisis for the last three years. Now, as inflation is receding, it's time to go back to, as I said, our structural challenges and structural reforms. And I think that in the case of Europe, if we combine a further integration of our single market, Letta Report, plus much strengthened capital markets union, or call it an investment union, then we have decisive asset levels to accelerate.

By the way, we unfortunately had bad news in Europe, which could become good news in the future, and this is Brexit. Let me say one very simple sentence on that. We deeply regretted Brexit, but it's now quite obvious that it had a heavy economic cost for the British economy. If I refer to British estimates, between minus 3 and minus 5 points of GDP already. And so why could this become good news? Because it shows that for us, the power of integration, be it economic single market or financial capital markets union, is very significant in increasing our growth. If you add some Schumpeterian spirit, and please send us the Schumpeterian spirit back across the Atlantic, then I will be quite optimistic about Europe.

CHAIR JOHN C. WILLIAMS: Alright, so now we've covered a lot of issues, and we'll open it up to the room for anybody who has a question. We'll bring a mike to you. We have a question right here.

QUESTION: To what extent are there reforms to the French Security Social and other benefit programs that you might support that are relevant to your role as Governor?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: Interesting question, and a rather political one. I will give you my personal answer, but I would be interested in having the answer of the Chair of the New York Fed too. Because the tradition probably in our two cases is a bit different. We have a core mandate, and this is (a) about price stability, and (b) about financial stability, which we discussed. In this co-mandate, we have the tools and we are independent. We must accept the debate, but we are the players.

And then I could take your onion image. We have a second circle, which is the rest of economic policy, probably a second circle which is fiscal policy and a third circle, which is structural reforms, you just mentioned. Here we are not the players. This belongs to the democratic debate, and this is a good thing. It's not up to the Banque de France to decide about what should be the expenditures or what should be the levels of pensions, for instance.

So in that case, we can bring our expertise and say look at other countries or look at the macroeconomic figures. It would have such or such effects. So it's the opportunity for me, sometimes, to say things about that. In our case, it might be of interest to you. The tradition in France is that each year the governor sends a letter, a public letter, to the

President of the Republic. And in this letter, I give some advice. But I accept that the president and the political forces are free to follow them or not. I accept that I'm criticized in that field. We bring our expertise.

I guess, John, that in your case, the Fed is probably more focused on its co-mandate and speaks a bit less about fiscal policy or structural issues. By the way, there was a significant pensions reform in France last year, as you are aware.

CHAIR JOHN C. WILLIAMS: I think that one thing we do as central banks, and you mentioned that, is that we do have expertise. And so a lot of these public issues, not about what should the elected officials do or not do, but how do we understand what those effects are in the economy? How does that fit in? I feel we do have a role in that. We tend to, even in the region here, we do analysis about the New York City economy. It's not to tell politicians what to do, but to help them have that data and analysis to support that.

Alright, so we'll go, I think we have here...go ahead.

GOVERNOR FRANCOIS VILLEROY DE GALHAU: If you would accept to introduce yourself please.

QUESTION: Of course. Michael Goldfarb with CAB Payments. Just harkening back to your time on the Africa desk at the French Treasury, I'm curious how you perceive the role of the Banque de France in the CFA Franc region going forward particularly as the geopolitical situation has evolved, shall we say, of late?

CHAIR JOHN C. WILLIAMS: That wins the award for the best prepared question.

GOVERNOR FRANCOIS VILLEROY DE GALHAU: Yes. I am very impressed by your precise knowledge of my curriculum. I was in charge as a junior Treasury official of this CFA Franc in Africa 35 years ago. And I guess it's the first time since then that somebody is putting the question to me. (Laughter)

So, that said, I will not elaborate much about this because I think it's not the right format. But this monetary cooperation with have with Western and Central Africa has lasted four decades. It's a choice by African countries themselves and it has brought to them monetary stability. If you look at inflation and growth performance of this country, it's quite favorable compared to their neighbor. That said, I will not elaborate more because it's a question of political choice.

CHAIR JOHN C. WILLIAMS: Looking for hands...okay...

QUESTION: Another non-central bank question, but it is apparent that China is subsidizing manufacturers and we expect them to be dumped into the E.U. and into the United States, just accepting that. And I think Secretary of the Treasury Yellen went over to discuss that and was nicely stiff-armed. What do you expect the impact or the policy response in Europe will be to that?

GOVERNOR FRANCOIS VILLEROY DE GALHAU: Would you start...

CHAIR JOHN C. WILLIAMS: I'll start...

GOVERNOR FRANCOIS VILLEROY DE GALHAU: About the debate in the U.S. It gives me time to reflect.

CHAIR JOHN C. WILLIAMS: The issue is a really, is a relevant one because what we are also hearing from people who study China's economy is that one of the ways they were trying to maintain strong growth is really by pushing manufacturing and basically exporting more goods, especially in the EV area. So this is part of a strategy. I'm not getting into the politics of it. I'm staying on the economics, which is where we started. So I think this is an issue about, you know, seeing a disinflationary force from this around the world, but it also depends on how countries respond. And also for Europe, I think the issue is obviously the auto industry is particularly important for the European economy as it is for the U.S. economy.

GOVERNOR FRANCOIS VILLEROY DE GALHAU: I share what you just said. If I may only add, third, Chinese growth is a question mark at present as we are all aware. Remember where we were at the start of last year. I remember being in Davos January 23. If you remember, it was the end of the Covid restriction in China. And everybody expected bad news on inflation and good news on global growth. And none of them happened, to be frank. None of them happened. And China's growth has been disappointing since then.

So there are probably two reflections I will share briefly. First, there is a domestic issue for Chinese authorities. Will they one day rebalance their growth from the external engine to the internal engine, from exports to consumption, to put it in a nutshell? If you look on paper, it's quite obvious they should go in this direction. But if you look in real terms, and in reality, and in technical terms, it's not that obvious.

Second observation, and Secretary Yellen was quite clear in Beijing, I guess, we all have a challenge, if there is excessive aggressivity, let me express it this way, of Chinese exporters. And this would probably lead to a further rise of protectionist trends in this country here, but also maybe in Europe. And this would be bad for everybody starting with China themselves. So this is, I guess, a political debate our western leaders, starting with Secretary Yellen, must have, and have started to have with Chinese politicians.

If I look at the case of Europe, I am not specialist of trade policy, but we have, for example, two very sensitive domains. First is electric vehicles, and the Commission started an inquiry on that, the European Commission. And then we have wind farms. I don't know if you looked at it, but the Commission also started an inquiry on that. In the two cases, we have a very strong offensive from Chinese exporters. So I think that protectionism would be the common enemy. I stress it in all our economies, including this one. But the Chinese economy would be the first losers. So this would be perhaps my vibrant call still for multilateral solutions. And I'm aware that I'm perhaps a bit old-fashioned making this vibrant call.

But, by the way, John, you and I, and probably several of you are traveling to Washington, D.C. tonight or tomorrow. We will have three days of IMF meetings. We are not a WTO, but we meet very often in the BRS in Basel. I really think that in this uncertain and dangerous world we live in, multilateral and cooperative solutions are still the best ones. I use this opportunity of this prestigious club to repeat this conviction. I am aware that for many of our politicians on both sides of the Atlantic, this is not the most obvious conclusion. But let us give a chance to balanced economic solutions. If not, we will all pay the price starting with China, coming to your question.

CHAIR JOHN C. WILLIAMS: I think this is a perfect point to end our discussion. So thank you so much, Francois, for the very insightful comments and conversation.

So my final task here is just to remind everybody, we've got a lot of great speakers coming up in future meetings. On April 23rd, we have Jamie Dimon of JPMorgan. We still have some, a few seats available. On April 30th, we have Jared Bernstein, the Chair of the Council of Economic Advisers. Now, going all the way to May, we have the Founder and President of the HistoryMakers, Julieanna Richardson, for a webinar on May 2nd. We have Garry Kasporov for a luncheon on May 6th. Dr. Ed Yardeni for a webinar on May 21st. And this time, I'm not surprised to read this, I'll be speaking to the Club in-person on May 30th.

We have many great speakers still to come. Going all the way to June, we've got Glenn Hubbard and Larry Summers once again, a very popular event, speaking to the Club on the 4th of June. And Lisa Cook, my colleague at the Board of Governors is on June 25th. All events are currently listed as always on our website. We'll be updating that as we get new events. So please consult the website and check your calendar for those events.

I'd like to take a moment to recognize those of the 374 members of the Centennial Society who are joining us today as their contributions continue to be the financial backbone of support for the Club. Thanks to everybody for attending. Thanks to you, Francois, for participating. And for those of you who are in the room, please enjoy your lunch. Those watching virtually, we look forward to seeing you at a future meeting.