New Year address by the Governor of the Banque de France – Paris, 9 January 2024

Speech by François Villeroy de Galhau,

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I would like to start by extending, on behalf of the Banque de France and the ACPR, our warmest wishes to you with whom we work, day-in, day-out: financial centre players, elected representatives and public officials, and journalists. In the turbulent environment of 2024, we will need more than ever to counterbalance the pessimism of intelligence with the optimism of the will, and to remind ourselves that a full life combines both professional commitment and personal ties. So, first and foremost, I wish you much joy with those you love as well as in all your new projects in 2024. This year promises to be an eventful one: Monetary Union was 25 years old on 1 January, we will be celebrating 10 years of the European Banking Union, and France will of course be hosting the Olympic Games. There will also be two elections of key importance for our country beyond our borders: the European elections in June and the US elections in November. Because the year ends "in four", I would like to follow a process of simple addition and share 2+2 wishes with you.

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The first two wishes follow on from those I made before you a year ago. I would like to return to the economic progress achieved in 2023, and invite us to "finish the job".

1.1 Less inflation and more stabilisation

Inflation remains the main concern of our fellow citizens, and our main mission as a central bank. At the beginning of 2023, I stated here before you that French inflation would pass its peak in the first half of the year – it has since declined from 7.3% in February to 4.1% in December[i] – and that we should reach the terminal interest rate "by the summer" – this occurred in early September. I also made a “commitment” that barring any new shocks we would bring inflation down towards 2% by 2025 at the latest. A year ago, many people were expressing polite – or not so polite – scepticism. Today, our forecast is much more widely accepted and believed: average inflation of 2.5% in 2024 and 1.8% in 2025. However, confidence does not preclude vigilance; even if the recent rebound in inflation is technical and temporary – it was actually less than expected in December.

In the face of inflation, monetary policy has proved to be an effective remedy: in France, core inflation (i.e. manufactured goods and services, which account for 70% of household consumption baskets) fell from 4.7% in April, to 2.9% in December. At the same time, we have managed to avoid a recession and maintain positive growth – even though this has undeniably slowed. This soft landing of 0.9% growth in 2024 should precede a gradual recovery from 2025 on. In this context – and barring any surprises – 2024 should be the year of our first interest rate cuts. I am aware that you are waiting for me to say in which season – spring, summer or autumn? – or even in what month. Well, actually no: our decisions will not be guided by a timetable but by data; and we must display neither obstinacy nor haste. Neither obstinacy: I have never believed that worries over the "last mile", where inflation would become harder to bring down and would justify an excessively rigid monetary policy. Nor haste either: If you will allow me to paraphrase La Fontaine: "patience and time do more than a lot of talk". We will cut rates this year when the inflation outlook is firmly anchored at 2% – in actual data – and on a sustainable basis – in forward-looking data.

1.2 Less protection and more adaptation

Last year I stressed that the government could cushion the energy shock temporarily but could not make it disappear. Subsidies have since been partially removed thanks to the favourable movement in wholesale energy prices and government decisions. After costing EUR 37 billion in 2023, the cost could be EUR 10 billion in 2024, the bulk of which would be accounted for by the electricity price shield. Depending on price trends, we could expect to see an even greater reduction before they are removed altogether.

There is a more general lesson here for our economic and fiscal policy: rather than *ex-post* compensatory public expenditure – which has become a French speciality – the real key is everything that beefs up our productive capacity *upstream* through three major supply-side transformations: the energy transformation; the digital transformation; and the transformation of labour, which must be both more abundant and more qualified. Our growth will benefit and our inflation will be more effectively controlled. For the first time in over forty years, France can aim for full employment – meaning unemployment of less than 5% – within the next ten years. Let's not lose track or miss this opportunity.

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I'd now like to turn to my two additional wishes for 2024: sound financing of our economy and the reawakening of Europe.

2.1 Sound financing of the French economy

After the US and Swiss banking crises in March, real fears were expressed about liquidity. These fears are no longer justified: French banks continue to enjoy highly stable total deposits, and liquidity coverage ratios well above 100%. The solvency of the financial sector has improved further. The fact that our financial stability has been preserved is attributable first and foremost to your sound management, which I commend; it is also due to a highly reassuring "European tandem": (i) stringent regulation, in particular Basel 3, which took a further legislative step forward in December with the adoption of CRR3 and CRD6 (ii) a single, efficient supervision mechanism thanks to ten years of SSM and the ACPR. The Paris financial centre has further enhanced its attractiveness, to establish itself as the unquestioned leading continental financial centre post-Brexit: most of the major international banks of American or British origin have now chosen Paris as the location for establishing the majority of their staff dedicated to market activities in the euro area, and three have decided to set up their European headquarters here. Success will continue to beget success.

The resilience of the banking sector must enable it to provide sound financing for the French economy. As far as *businesses* (including SMEs and VSEs) are concerned, access to credit appears to be well preserved overall: outstanding loans rose by 2.7% year-on-year in November, a rate well above the euro area average of 0.1%. We will nevertheless continue to monitor, together with Credit Mediation, the ability of sectors and businesses to obtain financing, with particular attention also being paid to credit insurance. In 2024, we will also develop the Banque de France's new climate indicator, to help businesses and banks in their transition.

As regards *households* and *housing loans*, we all know that there are more questions. New housing loans (excluding renegotiations) remained at a low of EUR 8.7 billion in November, even though the conditions for a gradual recovery now seem to be in place: households' wait-and-see attitude should gradually dissipate as house prices begin to fall. Mortgage rates should stabilise, in line with ECB and Livret A passbook rates, with long-term rates finally falling, and with a return to a quarterly usury rate. The HCSF standards are not the explanation here, since banks have the capacity to lend more by making greater use of flexibilities,[ii] in particular with the three new adjustments decided in December.[iii] To clear up the misunderstanding that still seems to exist about banks' willingness to lend, I would like to reiterate my support, like the Minister, for a market-wide agreement to re-examine creditworthy loan applications: this mechanism can be put in place by the end of January, and it must be simple, accessible and efficient.

I would like to add a wish with regard to household savings: that sufficiently attractive returns on life insurance be accompanied by the use - in a proportionate manner - of available reserves to promote a smooth transition, in particular for the benefit of the euro fund.

2.2 The reawakening of Europe[iv]

Let's face it: neither Europe nor the Franco-German couple are in the best of shape, just a few months before the European elections. In each country, the temptation is to focus on the – very real – domestic problems, but I firmly believe that this would be a mistake: we face more shared challenges than ever before, and the solutions are just as shared. The pioneering success of the European model in the 20th century consisted in reconciling economic growth and social justice. Our promise for the 21st century should be to combine growth and sustainability, prosperity and ecology; to achieve this promise, we can and must harness the potential of three powerful levers.

The ***single market*** is often seen only as a legacy from the past, from Jacques Delors, that great European who first set down roots at the Banque de France. To quote the French President, his memory invites us to "reconcile the French with the economy, France with Europe, and Europe with its future". Precisely, the potential of the single market is far from having been fully tapped. According to the IMF, deeper integration would generate up to seven additional GDP points for the EU. [v] In particular, controls on national subsidies need to be reintroduced to put an end to "state aid shopping". Combined with a genuine industrial policy, this measure will make it possible to achieve an optimal allocation of resources, particularly in terms of decarbonisation. We should also aim for a digital single market that combines regulation, talent development – we need 20 million digital experts, compared to a count of less than 10 million today - and financing.

The second lever is *private financing* and the pooling of capital.[vi] I am calling for a "**Green and Digital Finance Union**", enlarging the call by Christine Lagarde and Bruno Le Maire regarding the Capital Markets Union (CMU).[vii] The “Kantian shift” here means going beyond the technical and somewhat narrow details of the current action plan and daring to set a more ambitious goal, the financing of our ecological and digital transformations: this will ensure much greater political ownership and faster implementation. We could then mobilise the euro area's greatest hidden resource: its savings surplus of EUR 370 billion in 2023. [viii] And then the European Financing Union could be one of the answers to the US IRA.

The third lever is to ***reprioritise our public financing***. Given the high level of public debt, Europe needs a *medium-term fiscal strategy* and a common stability framework to recover room for manoeuvre. I welcome the adoption of the new European rules by the Ecofin Council on 20 December, even if they are unfortunately still complex. What matters now is to apply them, and therefore for France to respect its budgetary commitments by 2027: this would be very new and very welcome. Alongside this new-found national discipline, a common fiscal capacity would then be legitimate to direct resources towards European public goods.

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I would like to conclude with a line from Henri Bergson: "The future is not what is going to happen, but what we are going to do". So, at the risk of being in a minority, I fervently hope that each of us, our country and our Europe can look forward to 2024 with confidence, not fear. Not fear of enduring, but confidence in our strengths, and in our will to act. Happy New Year to you all!

[i] Insee, provisional estimate of inflation for December (year-on-year change and Harmonised Index of Consumer Prices (HICP))

[ii] Utilisation of the flexibility margin remains well below the 20% ceiling, at 14.3% in the third quarter of 2023.

[iii] Haut Conseil de Stabilité financière, *press release*, 4 December 2023

[iv] Villeroy de Galhau, F., The reawakening of Europe and the Franco-German engine, speech, 12 December 2023

[v] Around 7% of GDP according to an IMF study, *Geoeconomic fragmentation: what's at stake for the EU*, 30 November 2023

[vi] According to the European Commission, green transformation and digital transformation will require investments of EUR 620 billion and EUR 125 billion per year respectively until 2030.

[vii] Lagarde (C.), A Kantian shift for the capital markets union, speech, 17 November 2023

[viii] European Commission, Autumn 2023 economic forecast – *Statistics appendix*, November 2023