



*L'Express*

**January 24, 2023**

**Joint interview of the Governor with Joachim Nagel ( Bundesbank )**

**The war in Ukraine has upset all the balances. To what extent has it increased tensions between France and Germany?**

**Joachim Nagel**

I don't see an increase in tensions. As far as monetary policy is concerned, Francois and I completely share the view that we have to fight inflation resolutely. Russia's attack on Ukraine came as a shock and acted as an accelerant on inflation. This called for a strong response, and respond forcefully is what we did on the Governing Council of the European Central Bank (ECB) by raising interest rates strongly. We have acted together. This threat has further strengthened our shared efforts to achieve our mandate: we are monetary policymakers. Our job is to keep prices stable in the euro area. And inflation is far too high across Europe.

**François Villeroy de Galhau**

Let me perhaps take a broader view. Our countries have been put in a common threat with this terrible invasion of Ukraine. This threat takes several forms. The first one is that our Eastern European partners have an increasing defiance towards us. The second one is the acceleration of inflation. And we have partly responded to this together by the normalization of the monetary policy. Now we must have a common response to reduce our dependence on external fossil fuels and accelerate the decarbonisation of our economies. The comparison with Covid is encouraging: at the beginning, Europe gave the impression that it was going it alone. And then we managed to put in place very effective coordinated responses: the joint purchase of vaccines, the major stimulus plan "Next Generation EU". We must do that today too.

**In recent years, France has had a kind of complex about Germany's economic superiority. Do you think that the situation is in the process of being rebalanced between the two countries?**

**François Villeroy de Galhau**

In fact, the complex you are talking about is more a European characteristic: Europe's lack of confidence when it compares itself with the rest of the world. In particular with the United States or China. As far as the relationship between France and Germany is concerned, we, French people, have no complex to have. I deeply admire German success, but France also has its assets: demography, nuclear energy, defense... The only real competition that could be taken into account is that between Europe and the rest of the world.

**Joachim Nagel**

Like François, I don't see any need for a complex. That said, I do think it is normal to strive for improvement, and that goes for the economy as much as it does for sports, say. Our economies grow by nurturing healthy competition between different ideas and solutions. This holds not only for the euro area, but globally, too. In this competition, both our countries and the continent as a whole stand to benefit: Europe's diversity is its great strength, true to its motto – "united in diversity". And this unity is especially evident in Germany's very close and important friendship with France.

**The war in Ukraine has revealed the fragility of the German model with its dual dependence on Russian gas for its energy supplies and on China for its exports. Is the German model in danger?**

**Joachim Nagel**

In finance, it's always a good strategy to diversify your portfolio. And yet, before 24 February 2022, Germany was sourcing about half of its gas from Russia. Today, we are successfully diversifying our sources and reducing dependency risks. With respect to Germany's energy supply, liquefied natural gas is an intermediate step towards a less risky and more future-proof energy model. Regarding German exports, I have no doubt that corporations examine every possibility to increase their resilience.

**François Villeroy de Galhau**

I am always cautious with the notion of a "model". Nothing can ever be taken for granted. What is important is a country's capacity to adapt. And from this point of view, Germany's is remarkable. Think about the quality of the social dialog in Germany, the capacity to reach compromises, the balance between territories, the force of the Mittelstand. So I wouldn't bury too fast the German model: remember that at the end of the 1990s, Germany was referred to as the sick man of Europe.

**The inflationary shock is partly exogenous in nature. Some economists say that the strategy of continuing to raise interest rates is not the right one... Does this annoy you?**

**Joachim Nagel**

The truth is that inflation had already been picking up before the war in Ukraine. The pandemic triggered both supply and demand shocks, as did the subsequent lifting of lockdown restrictions. The war was a major catalyst. Energy prices skyrocketed and over time price pressures have spread across the economy. Just take the core rate of inflation, that means the increase in prices excluding energy and food. In December, it rose to 5.2% year-on-year in the euro area. That's far too high. We have to continue tightening monetary policy to dampen price pressures and keep inflation expectations anchored at our inflation target. High inflation is certainly placing a heavy strain on families, firms and our economies as a whole. The worst hit are the people who have so little in the first place. We need to rein in inflation. Our job is not done yet.

**François Villeroy de Galhau**

The nature of inflation has changed. It is no longer only linked to energy, it now affects all sectors, including services. This is why monetary policy is effective. We will probably have reached the peak in interest rates by next summer, and inflation will come down to the 2% level by the end of 2024 to 2025.

**Given the debt levels in Europe, aren't you afraid of a new debt crisis in Europe, especially if interest rates continue to rise?**

**Joachim Nagel**

Governments were right to act forcefully in response to the fallout from the Russian war against Ukraine. They managed to prevent a sharp slowdown in activity and help the most vulnerable households cope with the surge in energy prices. But now things need to get back on track, with healthy public finances being restored. Governments should not try to stimulate demand with large-scale programmes when inflation is so high. More generally, sound public finances are a precondition for price stability in the long term.

**François Villeroy de Galhau**

Even more than its level, I am worried about the drift of public debt in France. In 1980, the rate of public debt was 20% of GDP, it reached 100% before Covid and it culminates now at 112%. We need to get away from two illusions. The first is the idea that debt would cost nothing. The second is that we would need more and more public spending and debt to generate growth: this is a false; if that were the case, we would be the world champions of growth! We absolutely must have a debate on the quality of our public spending. It costs about 10 points of GDP more than that of our European neighbors. I deeply believe in our common social model, but only if we are more challenging in our French public efficiency.

**What major step forward should Europe take today?****Joachim Nagel**

With regard to financial markets no doubt: the capital markets union. To press ahead with the energy transition, several hundred billion euro will have to be invested in Europe every year. The bulk of this amount will have to come from the private sector. However, financial markets in Europe are highly segmented right now, and not all regulations are harmonised. Investment funds and more generally venture capital in Europe are too small compared to what we see in the United States. We need to create a single market for financing.

**François Villeroy de Galhau**

Yes, Europe has a lot of savings and a lot of green projects to finance. So we need to create a powerful channel between the two. Unfortunately, we feel a very little appetite from political leaders for this subject...

**What can Germany copy from the French model and conversely what should France learn from its neighbor across the Rhine?****Joachim Nagel**

French pragmatism.

**François Villeroy de Galhau**

The German social dialog. And I think interesting the answer of Joachim on France!