William White contributed in a variety of ways to the recent Eurofi High Level Seminar in Amsterdam. First, he had an exchange of views with Philippe Bordenave (BNP Paribas) on the impact of ultra low interest rates on European financial institutions and on their customers. Second, he chaired a panel on the challenges posed by the aging EU population for the financial sector. Third, he summarized the main findings of the sessions that took place on the first day (April 20) of the conference, including those noted above. His summary can be found **here**.

The Eurofi High Level Seminar, April 20-22

Summary of the Main Points from Day 1

"Economic and Monetary Challenges"

Introduction

Today's seven sessions can be conveniently repackaged into three broad sets of topics. The first four sessions all had to do with the various longer term challenges facing the **EU economy**, and how they might be managed. The next two sessions focussed more specifically on the challenges faced by the **financial sector in the EU**, not least due to the unintended side effects of the wave of recent financial regulation. Finally, the last session stepped beyond the EU to focus on **global monetary developments** and their impact on the global economy.

In most of the panels there were a number of representatives of the official sector and an equal number representing the private sector. This was intended to facilitate a dialogue, hopefully leading to better public policy going forward. Not surprisingly, the perspectives of the public and private sector representatives commonly differed about policy issues. The former more commonly saw the glass as "half full" (objectives were being achieved), while the latter commonly saw the glass as "half empty" (undesirable side effects). There was general agreement, however, that with respect to virtually every policy issue there was no single right answer. Rather, a balance had to be struck between competing objectives.

Longer term challenges facing the EU economy

In a first session ("Reinforcing investment and growth prospects"), the speaker suggested that the EU "convergence machine" had fallen into deep crisis. Instead of slower- growing economies speeding up to converge to faster ones, the faster ones (post crisis) were slowing. This reflected the impact of the crisis itself, but also a number of factors slowing potential growth. The speaker stressed that easy money could not deal with this problem. It could only “buy time” for Governments to do what was within their range of competence – not least, structural reforms. He then went on to suggest that, even when Governments were aware of what they had to do, implementation remained a serious challenge. Only 5 percent of the post crisis suggestions for action had been fully implemented.

In the second session, another speaker went beyond the suggestion that monetary policy would not work to restore strong, sustainable growth to assert that it would actively reduce spending. He focussed on the fact that the market for bank loans has both a supply side and a demand side. Since the ultra-easy stance of monetary policy reduces bank profits, it was also likely to reduce the supply of credit. Moreover, this was going on at a time when the tightening of regulatory standards was working in the same broad direction. Concerning this latter development, I noted that the intention of regulation was to increase financial stability. However, if the reduction in loan supply was severe enough, this could in turn aggravate recessionary tendencies, raise NPLs, and actually increase financial instability. Such a process has been well documented historically by Reinhart and Rogoff, and can currently be seen at work in Italy.

The following panel, on the demographic changes challenging the EU, highlighted the magnitude of the problem. Rising dependency ratios associated with aging will slow GDP growth. This will cause problems for both governments (higher spending on pensions and health and reduced debt service capacity) and for those offering private sector pensions (lower roll up rates for investments). In sum, all three Retirement Pillars will face difficulties. Within the second Pillar, defined benefit pensions will become increasingly underfunded, while defined contribution pensions will become increasingly inadequate to support an “adequate” life style in retirement.

The panel felt that this problem was generally understood by governments, but not yet by ordinary citizens. Indeed, a number of panellists noted that people consistently underestimated how long they were likely to live (and their retirement needs) as well as the actuarial probability of a household member dying or having to seek invalid benefits. The dire state of government finances, threatening Pillar 1, was not commonly appreciated. This led a number of panellists to suggest that Pillar two pensions might have to be made mandatory by legislation, or imposed automatically subject to an opt out clause.

What to do? Attention needed to be paid to all three Pillars and presumably in a cooperative way between the public and private sectors. To raise GDP growth going forward, attention should be paid to a variety of structural reforms to raise the availability of labour (later retirement, more working women, more skilled and better educated youth etc.), of capital (more saving) and of total factor productivity (more innovation).

One panellist noted that more personal saving was a two edged sword in that it might lead (Keynes' paradox of thrift) to lower saving in aggregate. This provided an appropriate lead in to the next sessions and how this problem might be avoided through encouraging more investment.

As for more saving, there was general agreement on the need for more longer term saving, and for seeking the relatively higher rates of return offered on such investments. Most panellists supported the introduction of Pan European Personal Pension Products in parallel with existing products. These should be "Simple, Transparent and Standardized". Some suggested that, given the existing degree of popular mistrust of financial institutions, the government might have to back up these new products with some form of a government guarantee. There was general agreement that all forms of pension funds should rely more on digitalisation to reduce management costs to the benefit of pensioners.

As for more investment, written submissions indicated cautious optimism about the possible impact of the Juncker Plan. Given an EC guarantee, the European Investment Bank now has greater risk taking capacity. Accordingly, the European Fund for Strategic Investments (EFSI) will buy more equity and longer term investments than other investors. In effect it will "derisk" investments by private investors, thus increasing their willingness to participate. Private participants welcomed this, though noting that public sector subordination was crucial if cherry picking was to be avoided. There was similar cautious optimism about the European Investment Advisory Hub's role in providing a "project pipeline" for potential investors to consider.

Challenges facing the financial sector in the EU

A small panel first exchanged views on the resilience, efficiency and competitiveness of the EU banking system. As in an earlier panel, the conclusion reached was the EU banking system was now more stable than a few years ago, but this advance had been purchased at the cost of reduced willingness to lend. It was hoped that this might only be a transitional phase as higher levels of capital were being built up.

It was generally accepted that maintaining the diversity of the EU's banking system meant ensuring "proportionality", especially between systemic and non systemic institutions. However, one panellist worried that there might be too much diversity (including non-viable banks) and that words like "proportionality" and "equivalence" often seemed to mean different things to different people. Most agreed that insurance companies and banks are in different businesses and their regulatory regimes should recognize this.

An underlying sentiment was that further regulatory tightening was very likely but could well be counterproductive. As one panellist put it, "the best is often the enemy of the good". Further tinkering could undermine confidence on the part of lenders. In any event, uncertainty about this should be removed as quickly as possible.

A second session was focussed on the responses to the "Call for Evidence" on the effects of post crisis regulatory changes on the EU financial sector. Everyone agreed that such a study was warranted in **principle**, even if the proper balance had been struck between financial stability and the availability of loans. All policy changes can have unexpected consequences and/or lead to problems of oversight and/or overlap. In **practice**, however, the exercise raises uncertainty about future regulatory changes which sharply contrasts with the call for more certainty raised in the preceding panel. One panellist went further, saying it was simply too early (Solvency ll especially) to evaluate the full effects of regulatory changes to date.

The tendency of regulators to see "the glass is half full" and for industry representatives to see it as "half empty" was most evident in this exchange of views. The former emphasized the achievement of more and better capital, the single rule book, and a promising start to the Capital Markets Union. The latter focussed on existing constraints to loans to SMEs, and the threat of "severe" disruption in response to rumoured changes. The costs of compliance were seriously cutting profits, and regulations were becoming "complex, inconsistent and unstable".

The views of a global observer on recent monetary developments and their impacts on the economy

The speaker noted that post crisis monetary policy had averted a potential financial markets disaster, but had not yet established “strong stable and balanced” growth at the global level. Moreover, it was increasingly unlikely to do so. The undesired side effects of these policies were growing in influence over time, not least the headwinds of a constant increase in the ratio of debt (government, household and corporate) to GDP. Moreover, many of the problems that were found only in the advanced economies in the pre crisis period had now spread to the emerging market economies as well.

Monetary policy had “bought time” for governments to do what only they can do. First structural reforms to increase supply potential must be vigorously pursued. Second, there is a need for both more public and more private investment. Third, as proposed by another participant, countries with room for fiscal manoeuver should use it. Fourth, in many countries the labour share of factor income could be raised to encourage household spending. And finally, more attention should be paid to the orderly reduction of debts that cannot be serviced and weigh on future “green field” investments. All of these proposed changes should be acted on as quickly as possible. Governments across the globe, including those in the EU, have relied on central banks for far too long.