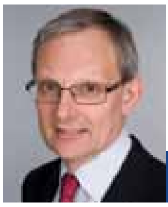
OMFIF BULLETIN

Global Insight on Official Monetary and Financial Institutions

April 2011



ECB throws down the gauntlet

Rate tightening confirms two-speed Europe

Peter Warburton, Director, Economic Perspectives

The European Central Bank's increase in interest rates on 7 April is likely to trigger another twist in the European financial crisis as investors shun government debt markets. Thursday's symbolic expressions of central bank Angst creates a real danger. The bail-outs for Greece and Ireland – now joined by Portugal – are precariously balanced. Monetary tightening could send these countries over the edge.

Europe's political leaders would like a crisis resolution mechanism from mid-2013. Yet the ECB's throwing down of the gauntlet, confirming how Europe is split between creditors and debtors, may produce a worsening crisis long before then.

Since the eruption of the global credit and financial crisis, the rapid expansion of central bank balance sheets has played an important role in private sector risk mitigation. Through the provision of additional liquidity, the relaxation of collateral quality requirements and the absorption of primary issues of government debt, central banks have nursed the global economic and financial system back to life, if not health. Central banks, not least the ECB, are eager to unwind these extraordinary provisions, yet the wholesale funds markets have not recovered sufficiently for them to fulfil their former role.

On the face of it, there could hardly be a greater contrast between the operations of the US Federal Reserve and the ECB over the past two years. The Fed embraced credit easing, as it preferred to call it, with enthusiasm in spring 2009, while the ECB offered temporary concessions on term liquidity and the broadening of collateral.

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EUROPE PONDERS JEAN-CLAUDE TRICHET SUCCESSOR. SEE P. 8-10 FOR OMFIF GUIDE TO CANDIDATES

OMFIF launches International Academy of Central Banking with programmes for all levels

OMFIF is launching an important education initiative aimed exclusively at central banks. The International Academy of Central Banking draws on the expertise of experienced central bankers and academics in offering programmes that cater for all levels of seniority. Programmes will be offered on both a regional open-enrolment basis and on-site at facilities with central banks. Proprietary course materials, including the Academy's own subject-specific readers, case studies, problem sets and presentations, will underpin learning and allow for extensive self-study. For further details, please contact malan.rietveld@omfif.org **FOR ARTICLE ON OMFIF ACADEMY SEE P.18**

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Card wars

Pursuing payments

Michael Lafferty, Co-chairman

A world-wide battle for domination among payment card networks is building momentum, underlining Asian and European regulators' and governments' belief that cards-based payment systems are strategic national infrastructure.

India and China are both trying to create global alternatives to Visa and MasterCard, the dominant global players. As US companies quoted on the New York stock exchange, they are seen by rivals in fast-growing developing economies as predominantly serving American interests – and therefore ripe for competition from powerful new entrants.

Profits from world-wide card credit cards sector (the most attractive part of the global payments cards business) are estimated at around $40bn. The latest player to enter the network game is Rupay of India, an initiative of National Payments Corporation of India (NPCI).

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Letter from the chairman

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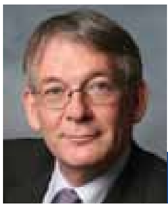


Make of it what you will

Shades of grey in world economy

David Marsh, Co-chairman

This month's OMFIF Bulletin combines the practical with the visionary. Practical, because we include an up-to-date account of the trials facing economic and monetary union in Europe. Visionary, because we assemble a selection of articles that map out a course of action for behaviour by official and private institutions to reinforce the safety and reliability of financial markets.

Without a doubt, the politicians behind EMU have recently made strides towards what our distinguished Advisory Board member Niels Thygesen calls a 'proper set of fiscal and macro rules, which could well work – with support from the likely degree of market discipline.' However, governments also have to confront their track record of having continually dashed hopes for improvement, summed up in Frits Bolkestein's bitter description of EMU as a 'boulevard of broken promises.' Peter Warburton reminds us that previous efforts by the European Central Bank to take away the punch bowl at which market buffs are quaffing have triggered EMU crises. He fears Thursday's ECB rate tightening could precipitate a similar reaction. The 23-25 March OMFIF meeting at the Nederlandsche Bank in Amsterdam was the occasion for sobering outpourings on the single currency, as our brief review of the gathering shows.

A more uplifting pointer to the future is provided by David Pitt-Watson, who calls for a new framework for responsible shareholder behaviour in which official institutions could play an important part. This would have positive structural effects that go well beyond the repercussions on individual companies and market sectors, he suggests. Ruud Lubbers and Paul van Seters, two new Board Members whom we welcome this month, applaud President Nicolas Sarkozy's proposals for international monetary reform, even though they indicate it's an uphill struggle. John Kornblum opens up a vista of a new world where western (and US) values will remain strong and governance of networks will take over from intergovernmental treaties as the main forces for stabilisation. Malan Rietveld outlines the new OMFIF education academy for central banks. This is an attempt to meet the rising demand for central bank education with a series of tailor-made services. We believe that central banking should be viewed as a profession, similar to law or accountancy, that requires a specific approach to education and personnel development.

In other spheres, Michael Lafferty examines the battles brewing between large international players in the payments cards business. Darrell Delamaide surveys the fresh tone of openness in US monetary policy decision-making. Jean-Claude Trichet's pronunciations have become a less accurate guide to policy, but Ben Bernanke is emulating European practice by holding quarterly press conferences. No doubt, it seems, to describe a retreat from quantitative easing in coming months as the US economy (despite everything) improves. Stefan Bielmeier surveys the repercussions of the Japanese shocks and finds them manageable. Steve Hanke questions whether the fad for higher capital-asset ratios makes sense since they would depress broad money and reduce growth. William Keegan tries to penetrate the riddle of why the UK government announced last month a prospective sharp rise in Britain's foreign exchange reserves in the next four years.

The world picture is adorned not by clear-cut hues but shades of grey. A UK official giving guidance on the currency reserves opines elliptically: 'Make of it what you will'. Let that be our Leitmotif, at least for the coming month.

David Marsh

End of the world as we knew it

Europe will increasingly seek US cover

John Kornblum, Advisory Board

The Atlantic world as we have known it is coming to an end. Two decades after the fall of the Berlin Wall, it is time finally to bid farewell to our tidy post-war community.

Our economic and political lives are being turned on end, not by emerging powers, but by the products of our own ingenuity. No part of the globe can avoid the revolutionary effects of high-speed information and logistics networks, which are being created by western values and technology. Economic life is now based on a globally integrated 24 hour cycle, which has redefined traditional concepts of time and space. Workers and managers live within a seamless web of influences which function without reference to geography or to central authority.

We should not assume that either the Atlantic world or emerging societies will escape the effects of today's dramatic technological change. Human society will be altered as fundamentally in the next 50 years as it was during the industrial revolution in the 19th century. To find the right answers to the challenges we must learn to ask the right questions.

It is unlikely that new and old powers will confront each other directly in conflicts over markets or resources, as so many now seem to fear. Instead both are already enmeshed in global networks where cooperation is often the best foundation for successful competition. The new benchmark of global political and commercial influence will be success in managing these complex network relationships. The NATO action in Libya is an early example.

Our future will be determined less by outdated concepts of geopolitics, than by our ability to apply intellectual leadership to the design and direction of this new type of global integration. By intellectual leadership I do not mean scholarship, invention or even ideas as such, but rather the ability to demonstrate initiative in finding ways to meet the changing needs of society and to make them a reality.

America will continue as the world's most influential nation, even though US interest in active management is steadily declining. The US is not well suited to maintaining a multipolar political world, but it has an uncanny ability to project its values across time and space. Its rapidly growing population will do the rest. Europeans seem slow to understand that their economies can flourish only if their community is redefined on a global plane. As a result, they lack strategic vision and are short of tools for influence. Although its companies are rapidly spreading globally, the EU's only roadmap for the global future is a 20-page treaty which outlines its internal bureaucracy. In coming years, European nations are likely to abandon hopes of an independent global role and increasingly to seek cover from the US. There is no other option.

Most intellectual leadership today comes from technological innovators. We are dangerously behind when it comes to building a new synthesis of values across the spectrum. Closing this gap is likely require a form of self-regulation – already applied in global corporations – in which underlying values serve not as rules, but as the basic operating system for increasingly autonomous integrated political and economic networks.

The most important remaining task will be to ensure that network processes do not develop into value-free zones. This would be a recipe for disarray and conflict. The good news is that for all the talk about state capitalism, one thing is certain: open societies can best meet the challenges of the radically new era ahead.

Our liberal values are the most pragmatic foundation for such self-regulation. Innovation works best in open societies which encourage dialogue and risk-taking. Helping establish these skills in societies around the world will be a service to the cause of sustaining justice, prosperity and peace in the turbulent years which lie before us.

Our future will be determined less by outdated concepts of geopolitics, than by our ability to apply intellectual leadership to the design and direction of this new type of global integration.

Card wars *(continued from page 1 ...)*

NPCI is owned by the major Indian banks and has the support of Reserve Bank of India. Rupay will initially focus on clearing and settlement of debit card transactions before moving on to credit cards. Before long, it will be operating internationally alongside another relative newcomer to the cards networks business, China UnionPay.

China UnionPay (CUP) is the Chinese equivalent of Rupay but it is several years ahead of the Indian initiative and is already well-advanced on plans to build a global network of its own that will compete with Visa and MasterCard. Its immediate priority is building acceptance of CUP cards to service the tens of millions of Chinese consumers who are now travelling worldwide. Adding to the potential headache for Visa and MasterCard, CUP has a monopoly on domestic transactions in China, which prevents Visa and MasterCard from entering this lucrative payment cards arena.

Meanwhile, in Europe, the European Commission and the European Central Bank have been actively promoting the development of Europe-based cards networks. Three possibilities have emerged:

- Monet – a project with ancestry stemming from Deutsche Bank-inspired initiatives of the 1980s and 1990s such as eurocheque, Eurocard and the euro Travellers Cheque – all now defunct. (The German bank does not seem particularly committed to Monet, hardly boding well for the project.)
- EAPS, a system that plans to grow by linking up national ATM networks across Europe.
- PayFair, a retailer-inspired initiative, which achieved some notoriety by labelling SEPA (the Single European Payment Area) as 'sending European payments to America'.

Judging from industry reactions to recent presentations by the three European networks , none has much chance of success. 2011 will be the decisive year. The possibility of two or three of them merging cannot be discounted.

Other smaller networks are also competing – notably US-based American Express (Amex) and Diners Club and Japan-based JCB. Amex is possibly the classiest global brand in consumer financial services and cards payments worldwide. Today it is an issuer of T & E (travel and entertainment) and revolving credit cards to well-heeled consumers in the US and worldwide – and the operator of a payments network which is an up-market alternative to Visa and MasterCard.

Despite being the first 'credit card' to be issued in the late 1950s, Diners Club is a US-based cards network that has never lived up to its potential. Its recent acquisition by Discover, the giant US credit cards company, may change all that. Its immediate priority is to build global acceptance of the Diners and Discover brands.

The other entity ready for expansion is JCB , a Japanese payment cards company with global ambitions but which for now is primarily focused on Asia.

The chances are that Rupay, CUP and the prospective European projects will not be the only new payment networks to emerge around the world. Similar initiatives are brewing in Russia, Brazil and South East Asia. Despite that, the days of global American dominance in cards-based payments seem destined to continue for the foreseeable future.

ECB throws down the gauntlet *(continued from page 1 ...)*

The Fed hoped that one burst of asset purchase, focused on asset-backed securities (ABS) would suffice. It reversed course last autumn when the patient seemed to be sickening for more.

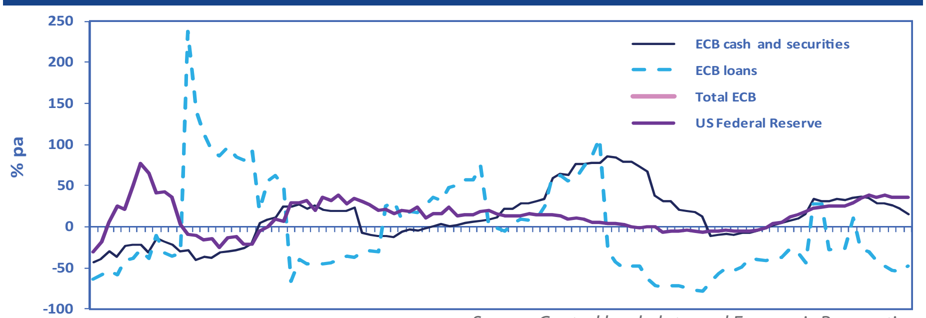
The ECB reacted to the crisis of peripheral country sovereign debt in March 2010 by effectively creating a new fund, supporting embattled sovereigns by honouring their bonds at repo and buying up covered bonds. In the calmer days of late summer, as the crisis subsided, the ECB shrank its lending abruptly (see chart).

Its eagerness to discipline the growth of the ECB balance sheet may well have contributed to the tighter liquidity conditions that set the scene for the collapse of the Irish banking system. This soon required another ad hoc response that triggered the first use of the European Financial Stability Facility (EFSF). The Fed's brazen pragmatism has delivered a smoother profile of 3-monthly changes than the ECB's dog-eared dogmatism; yet their differing approaches have led them down the same path.

However, in recent weeks, the ECB's securities purchases have stalled and its loan book has continued to shrink.

Since ECB president Jean-Claude Trichet warned that 'an increase in interest rates at the next meeting is possible' at a press conference on 3 March, Euribor 3-month rates fully priced in a 0.25 percentage point repo rate increase on 7 April – an outcome that was duly confirmed. The ECB's progressive monetary tightening could have unintended consequences.

Growth rates of ECB and US Federal Reserve balance sheets



Source: Central bank data and Economic Perspectives

New framework for governance

Official investors can work to make boards accountable

David Pitt-Watson, Hermes Asset Management

The action taken by international regulators in 2008 to 'save' the banks avoided what could have been a catastrophic meltdown. They are to be congratulated. However many observers, including participants at OMFIF's Amsterdam meeting, believe that the risk of a future systemic collapse has not disappeared. Many think that the bankers themselves don't believe the world has changed in any fundamental way.

That is not because we have failed to regulate the financial sector. From Basel III to the appointment of bank directors, the authorities have passed regulations which say 'Do this, Do that'. But they have spent less time thinking about how to create a system of checks and balances which stops the system from becoming unstable in the first place.

The language of financial regulation is bimodal; either the market delivers the intended result, or it is regulated to prevent a bad outcome. Regulation is necessary, but should be the last resort. The institutions in our financial markets should be designed to produce overall good behaviour. Those who manage our money, working in a framework including their own self-interest, should generate efficient, stable savings and investment products. And the system should contain checks and balances to prevent it going out of control.

The characteristics of such a system are known. It should be one where each entity in the system is responsible for its actions. It can only be expected to be responsible if it is accountable. Those who call the entity to account will need relevant information, which is independently prepared. And just as a healthy political system hinges on effective scrutiny, so a successful financial system will need the oversight of vigilant market participants, whether they be journalists, pressure groups, other institutions or individuals.

The seeds of our current crisis can be seen in the lack of these characteristics. Who was responsible for the security offered by toxic CDOs? To whom were they accountable? Were bank balance sheets showing the relevant information when they made no provision for future losses that were known at the balance sheet date, and so recognised profit before it was earned? Were the credit rating agencies independent? Similar problems are apparent today. Is it responsible to buy and sell naked Credit Default Swaps? Why, after centuries of creating open financial markets, are we now allowing the creation of 'dark pools'?

Here is the broad point. We know what outcomes we want from our capitalist system. We need to design systems and institutions that will produce them. Let me suggest one specific initiative. Many countries, either through their sovereign wealth funds, their public pensions systems or their central banks are large holders of shares in banks and other large companies. In a stable system, the board of directors of a bank would be accountable to the shareholders. The shareholders, or their representatives, would in turn act as good owners; scrutinising performance, and ensuring prudent management.

Prior to the crisis they singularly failed in that responsibility. Any bank CEO will tell you that the shareowners' representatives were trading shares, they were short-term, they encouraged the bank to borrow and lend more, to trade to the limits regulation would allow. This was not in the shareholders' best interests. The system was dysfunctional. And most bank executives will tell you that, since then, this behaviour has not fundamentaly changed.

But we would change that system if our sovereign funds and public pension entitites collectively demanded that their money be managed in a different fashion, so that shareholders and their agents worked actively, constructively and in concert to make boards accountable. This wouldn't need new regulation, just an effective assertion of existing shareholder rights. Indeed OMFIF, across its broad series of operations linking private and public sector institutions in many countries, might form the framework where we can begin to build this initiative and make it work on a global scale.

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Why Basel III lowers growth

Higher capital-asset ratios destroy money

Steve Hanke, Advisory Board

Since the collapse of Lehman Brothers in September 2008, the Delphic Oracles, politicos and chattering classes of all stripes have been working overtime to make the world safe from banks and, yes, bankers. From many quarters we hear the same refrains: 'shrink the banks,' 'put the bankers in straitjackets' and so forth.

The official mantra is less colourful than what's heard on the streets. It boils down to a simple refrain: higher capital-asset ratios. Yes, onward and mainly upward. Not surprisingly, and in the interest of making banks safer, Basel III was finalised in September 2010. This will require banks in member countries to push up the ratio of capital to risk weighted assets to 7%. And if that's not bad enough, Prof. David Miles of the Bank of England's monetary policy committee tells us that the ratio of capital to risk weighted assets should be set at 16-20%. Is Miles mad?

Prof. Tim Congdon – the authority on broad money – convincingly argues that even Basel III's 7% mandate qualifies as 'overregulation.' We can only imagine what Prof. Congdon thinks of Prof. Miles' proposal. Prof. Congdon demonstrates that a paradox accompanies excessive bank regulation. While the higher capital-asset ratios that are required by Basel III are intended to strengthen banks (and economies), these higher ratios destroy money. In consequence, higher bank capital-asset ratios contain an impulse – one of weakness, not strength; hence, the paradox of excessive bank regulation.

To demonstrate why the paradox exists, we only have to rely on a tried and true accounting identity: assets must equal liabilities. For a bank, its assets (cash, loans and securities) must equal its liabilities (capital, bonds and liabilities which the bank owes to its shareholders and customers). In most countries, the bulk of a bank's liabilities (roughly 90%) are deposits. Since deposits can be used to make payments, they are 'money.' Accordingly, most bank liabilities are money.

Under the Basel III regime, banks will have to increase their capital-asset ratios. They can do this by either boosting capital or shrinking assets. If banks shrink their assets, their deposit liabilities will decline.

In consequence, money balances will be destroyed. So, paradoxically, the drive to deleverage banks and to shrink their balance sheets, in the name of making banks safer, destroys money balances. This, in turn, dents company liquidity and asset prices. It also reduces spending relative to where it would have been without higher capital-asset ratios.

The other way to increase a bank's capital-asset ratio is by raising new capital. This, too, destroys money. When an investor purchases newly-issued bank equity, the investor exchanges funds from a bank deposit for new shares. This reduces deposit liabilities in the banking system and wipes out money.

As banks ramp up in the anticipation of the introduction of Basel III in January 2013, we observe stagnation in the growth of broad money measures in the US, the UK, the rest of Europe and Japan. Given the paradox of excessive bank regulation, this is no surprise. Since the quantity of money and nominal national income are closely related, overzealous bank regulations, such as Basel III, constitute bad economic news because they drag down broad money growth and ultimately economic activity.

Government failure plunged the world into the greatest slump since the Great Depression, and over-zealous bank regulation – yes, another government failure – has put a damper on broad money growth. In consequence, we can expect a period of modest trend-rate growth, at best.

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Sarkozy's bid for reform

Struggle to bring SDR on to agenda

Ruud Lubbers & Paul van Seters, Advisory Board

President Nicolas Sarkozy of France is keeping up the momentum for a major reform of the international monetary system by the end of the year. If Sarkozy succeeds in this endeavour, he can claim to have made a serious contribution to resolving the global financial crisis.

The recent meeting of the finance ministers and central bankers of the G20 countries, on February 18–19 in Paris, represented no more than an intermediate stage in Sarkozy's campaign. In the media, the reactions to the Paris summit were mixed, especially regarding the decision to start working on a list of indicators that will allow the International Monetary Fund (IMF) to identify 'those persistently large imbalances which require policy actions.' In addition, Sarkozy's bid to enlarge the IMF's Special Drawing Right (SDR) appeared to receive a distinctly unenthusiastic response at the G20 meeting in Nanjing in late March.

Some commentators thought the Paris outcome was too non-committal, others claimed it as a modest but concrete step forward after the supposed failure of the previous G20 summit last November in Seoul. However, it is clear that Sarkozy's agenda for the overhaul of the global monetary system was systematically left out of the discussion. Sarkozy has not been shy about the agenda. When he assumed the G20 presidency in November in Seoul, he said he would make reform of the monetary system his first priority, announcing, 'We have to update the international monetary system for the 21st century.'

Since Seoul, Sarkozy has articulated his resolve on several occasions. On 21 January in Paris, when he accepted an advisory report of a commission of financial and monetary experts he had appointed – the Palais Royale Initiative. The report – A Cooperative Approach for the Twenty First Century – emphasises the lack of a unified global governance structure. The IMF was originally intended to provide this structure, but has become ineffective. The Fund has been suffering from a 'legitimacy deficit'. Emerging markets and developing countries are under-represented and the largest members habitually go their own way.

The final version of this report dated 8 February contains 18 proposals. Especially noteworthy are the suggestions of a new role for the G20 in the intended upgrading of the IMF and making the SDR the new global reserve currency. Most of the other proposals – developing globally consistent exchange rate norms and recognising the role of regional organisations – buttress the aim of building a new monetary system for a multipolar world.

At the World Economic Forum in Davos on 27 January, Sarkozy linked reform with irresponsible behaviour by bankers, arguing for stricter rules and stating, 'There's no market economy without a minimum amount of morality.' He backed turning the IMF into the central global authority for economic, financial and monetary policy, which would develop indicators for global imbalances, formulate rules to prevent or redress these imbalances, and make sure the rules are enforced.

Meanwhile the Financial Stability Board (FSB) on 15 February issued a progress report expressedly intended for the G20 Paris gathering of finance ministers and central bankers. This FSB report shows the broad spectrum of work for strengthening global financial stability. This ranges from improving organisation of markets for financial derivatives and supervising credit rating agencies to stepping up regulation and oversight of the shadow banking system and converging strengthened accounting standards. Much more is happening in practical steps than might be deduced from media reports.

Sarkozy's G20 presidency draws to a close in November in Cannes, when government leaders gather to discuss his plans. Will he succeed? It is too early to say. The opposition is formidable, especially in the financial sector where many people are ready to return to 'business as usual.' If Sarkozy succeeds, he will have earned his place in the history books.

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Ten candidates for make-or-break job

Germany may have interest in interim leader

The landmark defeat of Chancellor Angela Merkel's Christian Democrat party in the Baden-Württemberg state election on 27 March has clear implications for deliberations over the successor to Jean-Claude Trichet as president of the European Central Bank.

Trichet's eight-year term of office expires on 31 October. Merkel's growing unpopularity with voters may increase her desire for a 'stability-first' successor to Trichet from one of Europe's northern creditor states. This lowers the chances that Mario Draghi, governor of Banca d'Italia, will get the job – and leaves the race as wide open as ever. A decision on the succession is scheduled for June. Don't be surprised if this is postponed. And watch out for more wrangling.

One factor making for a potential accord is that Merkel could throw her weight behind a strong interim candidate from Germany or the Netherlands, Jürgen Stark or Nout Wellink, who could serve until after the German parliamentary elections are out of the way in 2013. This would provide voters with assurance that the German approach will be adopted in the three crucial years that will be make-or-break for the Euro. It could also be seen as limiting risks on Germany's indefinite exposure to the Euro's problems. But at the same time it would assuage fears in countries like France that Germany will take unduly over-bearing influence.

Last year it was widely anticipated that Bundesbank president Axel Weber would be the first German to fill the ECB's top position. But in February Weber announced that did not want to take over, not least because he had lost the confidence of his colleagues following his hard-line stance on ECB support for troubled euro area sovereign borrowers. Weber has also been involved in tussles – both in public and behind-the-scenes – with Merkel over political demands for 'solidarity' with hard-up European states.

Weber will retire from the Bundesbank on 30 April, a year ahead of the expiry of his eight-year term. He will be replaced by Jens Weidmann, who has been Chancellor Merkel's economic adviser since 2006 and was previously at the Bundesbank for three years (in a relatively junior position). Weidmann is notable for three reasons. He is the first German government official to make a direct transition to the No. 1 Bundesbank post – underlining a new interdependence between government and central bank. Aged 42, he is the youngest-ever Bundesbank chief. And he is the first one to speak French. Given permanent Franco-German monetary differences, this may come in useful.

Weber's poor relations with Merkel came out into the open at the end of March when the German Chancellor made a veiled attack on the Bundesbank president at a high-profile banking conference in Berlin. In an otherwise unremarkable address at the conference, organised by the Federation of German Banks and attended by Weber and many key figures from German politics and economics, Merkel veered off-piste by indirectly accusing the Bundesbank chief of a lack of support for other European states over the future of monetary union. The dispute between the government and the Bundesbank over the government bond programme to support hard-up euro members, decided in May last year, was a major reason for Weber's decision not to stand for the post of ECB president. Merkel said that the Bundesbank during its history had earlier shown solidarity with other European countries by buying currencies such as the French franc and Italian lira.

Now that Weber is no longer a candidate, 10 contenders for the ECB succession can be regarded as in the running, some quietly, others with government support, others apparently with none. Any over-eager bid could doom them. It is by no means clear that Germany has given up its claim on the title, even though Weber's self-removal has widened the odds on a German president. Here is a list of prospects encompassing the favourites and not-so-favourites. The star rating indicates the likelihood that they will be given the job. All are male, four are German, two are from Luxembourg and one each is from France, Finland, the Netherlands and Italy. Their average age is 58.

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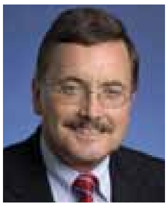
Nout Wellink (67) ★★★★ Netherlands central bank governor, due to retire on 1 July. Highly credible candidate if Draghi is ruled out. Would be only an interim incumbent, which could suit many governments. Studied law before obtaining a doctorate in economics at the prestigious Rotterdam Erasmus University and joining the Dutch Finance Ministry 1970. Since then, at centre of Dutch, European and international financial and economic debates, becoming an executive director of De Nederlandsche Bank in 1982 and taking over as president when his predecessor Wim Duisenberg moved to the European Monetary Institute in 1997 and became ECB president in 1998.

An unusual combination: tough-minded hard money man popular with his peers. He was chosen by other governors to chair the Bank for International Settlements (2002-06). Chaired the Basel Committee on Banking Supervision since 2006. Given his age he would be a candidate for no more than half the eight-year term.

For: Could be regarded as using the Netherlands's entitlement to a further three years in the job after Duisenberg left (as pre-arranged) in 2003 before expiry of eight-year term.
Against: Lack of firm support from Dutch minority government which announced his departure last year, partly as a result of public criticism of the Nederlandsche Bank over shortcomings in Dutch bank supervision arrangements, and has been embarrassingly slow in making a decision on his successor.



Jürgen Stark (62) ★★★★ ECB Board member for economics since 2006, when he took over from Otmar Issing. He was Germay's first choice to take the first ECB board member post in 1998, but Issing was regarded as a more neutral candidate. Immensely experienced former deputy president of the Bundesbank (1998-2006) and state secretary in German finance ministry (1995-98). Well-known as a monetary hawk but has gained diplomatic skills over the years. Close politically to Merkel's Christian Democrats, having previously served under Chancellor Kohl including as sherpa in international summits. With three years of his non-renewable eight-year term on the ECB board still to run, he would be a 'safe pair of hands' for Merkel, tiding her over beyond the 2013 parliamentary elections. Used to taking on difficult jobs – was Bundesbank interim president after Weber's predecessor Ernst Welteke resigned over an intrigue-ridden scandal regarding irregular hotel payments in 2004.

For: Would suit German voters' penchant for toughness, without constraining a German to more than three-year term.
Against: Sardonic sense of humour not always appreciated by interlocutors. Monetary tensions with France and peripheral states might increase under a Stark presidency.

Mario Draghi (63) ★★★ Governor of Banca d'Italia, vastly experienced official, head of the Basel-based Financial Stability Board. Long seen as an alternative to Weber. Privately favoured even by some German officials at the ECB. Merkel's defeat in Baden-Württemberg, ending her CDU party's 58 years of government there, may have tipped balance against him. Even before the election defeat, some analysts argued that backing the Italian for the ECB job would be politically dangerous. Profligate countries which have not followed the rules of the Maastricht treaty, including Draghi's home country of Italy, are not popular with German voters. A politically weakened Merkel may not be able to risk backing Draghi even if she wanted to, and there has always been some doubt about that.

For: Bild Zeitung, Germany's top popular newspaper, endorsed him in late March.
Against: Draghi's previous employer, Goldman Sachs, earned Merkel's ire by organising derivative transitions in early 2000s to hide Greek government debt.

Yves Mersch (61) ★★★ Governor of Banque centrale du Luxembourg since its foundation in 1998. Experienced central banker, with 13 years of practice at ECB meetings (like Wellink), having been a governing council member since it started in June 1998. A former senior official in the Luxembourg finance ministry from 1975, he has been intimately involved in all the main decisions leading to EMU. Not afraid to stand up to Belgium, traditional senior partner in Belgo-Luxembourg arrangements. However, he and his country may lack the clout to play front-line role in international monetary affairs. All his significant appointments have been made by the government of Luxembourg, not by his peers in the international financial and economic community.

For: Well-versed monetary diplomat, fluent in English, French and German, wry sense of humour.
Against: A lawyer, not a trained monetary economist.

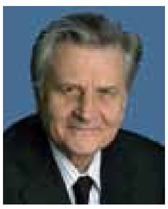
Klaus Regling (60) ★★ Experienced international economic policy official with European Commission, IMF and German finance ministry to his credit. No central banking experience. He ticks some of the basic ECB qualification boxes but not, it seems, the one that matters most, the backing of Angela Merkel. Moreover, he is, as head of the European Financial Stability Facility, already at the heart of efforts to contain Europe's sovereign debt crisis.
For: Pro-European credentials appeal to France.
Against: Previously worked for hedge fund Moore Capital (together with Philipp Hildebrand, now president of Swiss National Bank). May not be regarded as a plus point by Angela Merkel.

Jörg Asmussen (44) ★★ State secretary for international monetary affairs in German finance ministry. Often substitutes for minister Wolfgang Schäuble in intergovernmental meetings. Wide national and international experience in government. Headed the ministry's directorate responsible for European affairs and general financial issues . No central banking experience. Coupled with Weidmann's move to Bundesbank and Merkel's wish to keep an experienced civil servant close to her side in troubled financial times, this makes him a rank outsider.
For: Karl Otto Pöhl and Hans Tietmeyer, two former Bundesbank presidents, once held Asmussen's job.
Against: Asmussen sat on supervisory board of IKB bank, the first major German bank to need support in the 2007 credit crisis.

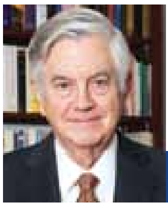
Erkki Liikanen (60) ★★ When Europe is looking for compromise candidates for international jobs, it is never long before a Finn's name pops up. Governor of the Bank of Finland since 2004, following 10 years as the Finnish member of the European Commission in Brussels. Lacks academic qualifications as an economist which, while not essential, would give candidacy more credibility. Some say that he has long had his eye on the job of President of the Finnish state.
For: Credentials as monetary hawk. Shows caring side through chairmanship of Finnish Red Cross.
Against: May appears to some as just another ambitious outsider.

Jens Weidmann (42) ★ Cannot be ruled out in an emergency. Merkel could push through her protégé, but – with just two months of experience in his new Bundesbank job when the European summit takes place at end-June – this might appear opportunistic. Weidmann speaks French and is well liked by the French establishment. But others on the ECB board would feel ill-treated by by being passed over. Jürgen Stark would quit the ECB board and return to Bundesbank as president.
For: Merkel would have her own man at the ECB.
Against: Might look like German take-over.

Jean-Claude Juncker (56) ★ Polished prime minister and finance minister of Luxembourg. Europe's most experienced government leader, took office in 1995. He would have been a more serious contender until a few years ago but he has blotted his copy book. After having previously been a key Franco-German power broker under former German chancellor Helmut Kohl, he has fallen out with Merkel. Regarded as a friend by Gerhard Schröder, the former German chancellor – this will not help his candidature. High-profile but somewhat ineffectual head of the Eurogroup of EMU finance ministers since the trans-Atlantic financial crisis broke in 2007. Connected with general shortcomings in European governance.
For: Well-known on international stage.
Against: Transition of a seasoned government leader would indicate the ECB has lost its independence and become fully politicised.



Jean-Claude Trichet (68) Given the shortage of clear-cut candidates and the notable leadership he has provided, some have wondered if governments might tinker with the EU Treaty in order to remove Trichet's constitutional ineligibility to serve even part of a further term. This is not going to happen. Trichet probably does not want the job. Selecting the incumbent even for a short period would demonstrate that Europe cannot solve its crisis. It would set a very poor precedent for encouraging longevity in office. The failed leadership of Alan Greenspan – aging, tiring, tiresome and overestimated – in his final seven years as chairman of the US Federal Reserve Board is a warning that this would be a thoroughly bad idea.
For: Familiar face.
Against: Familiar face.



A boulevard of broken promises

Franco-German discord heralds more EMU crises

Frits Bolkestein, former European commissioner

Economic and monetary union (EMU) suffers from a congenital defect. France and Germany have different views on the nature of monetary union. France wants important economic decisions to be made by politicians. Imbalances would be redistributed over surplus and deficit countries, in a system facilitated by the European Central Bank.

Germany (and the Netherlands) want fundamental economic decisions to be laid down in the guiding European treaty: an independent ECB, priority for price stability, government budgets in equilibrium and no bail-out, with the practical implication that deficit countries should fend for themselves. These different views have been papered over but not reconciled. Probably they never will be.

European leaders have now proposed that a country which fails to close the gap by 5% each year between its debt level and the EU limit of 60% of GDP would face fines. Is this credible? Will we see Italy or Belgium doing that? We mustn't forget the solemn undertakings given under the Stability and Growth Pact. It was trashed after a few years. Fines will continue to be subject to political bargaining. EMU is a boulevard of broken promises. The new 'Euro-plus' pact is supposed to improve Europe's competitiveness. If that is the aim, why not deepen the internal market, for example, by restoring the directive on services to what was originally proposed by the European Commission? But that is most unlikely to happen. Too much competition.

We have to consider EMU members and non-members – the ins and the outs. The ins total 17, the outs are the rest. The pact is addressed at the ins. But half of the proposed measures affect the internal market, thus also the outs. Is this a two-speed-Europe in the making? If the ins were to hold separate summits, that would be a big step towards the two speeds. So that should not happen.

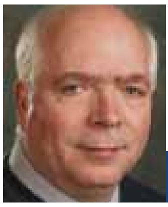
The European Parliament wants to strengthen the pact to produce more competitiveness. Perhaps it will. It lives in a federal fantasy. It wants 'more Europe' in everything, even if EU citizens do not. It is no longer representative of these citizens. There is a real democratic deficit. Unelected officials wield a great deal of power. The European parliament does not provide a check in accordance with the citizens of Europe.

The latest idea from the European Parliament is to launch Eurobonds, which would take the place of the sovereign debt of the most heavily indebted countries. The interest rate would be a European average. That would make these instruments unattractive for Germany and the Netherlands. They would form a monetary veil which would shield the debtor countries from the market. But since promises are not kept, the only thing that can discipline profligate countries is the market.

What is needed is strong sustained economic growth. Forcing the Irish to increase their corporation tax rate would be counter-productive. According to the OECD, a 1 percentage point increase in corporate tax may lead to a 3.7% fall in foreign direct investment, which the Irish badly need. The French government is always afraid of fiscal competition, to protect its high-spend high-tax economy. But Europe is taxed too much as it is. A little fiscal competition would do it good.

Herman Van Rompuy, the European council president, has said the EU must double its economic growth. Agreed. But then he adds: in order to safeguard 'the European way of life'. I take this to mean the welfare state. But this gets us into the realm of Catch-22. If we want more economic growth, we must reform the welfare state. If we don't, we won't grow. Former UK prime minister Harold Macmillan once said: 'You've never had it so good'. Let me say: 'We've had it far too good.'

Former UK prime minister Harold Macmillan once said: 'You've never had it so good'. Let me say: 'We've had it far too good.'

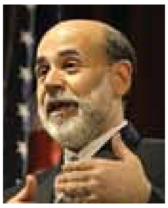


Fed opens up as exit debate begins

A retreat from Greenspanesque opacity

Darrell Delamaide, Board of Contributing Editors

All members of the Federal Reserve Board of Governors (currently five with two unfilled positions) and all 12 heads of the regional Fed banks take part in the regular monetary policy meetings of the Federal Open Market Committee, but the only ones who vote are the governors, the NY Fed chief and four other regional bank heads in a three-year rotation.



Ben Bernanke

Bernanke to meet the press

The announcement that Federal Reserve chairman **Ben Bernanke (voter)** will start giving regular press briefings got a mixed reception among Fed watchers in the US. Analysing and interpreting Fed statements is a cottage industry that keeps hundreds of pundits of different levels of seriousness gainfully employed and fills hours on TV business networks.

It will simply give people more opportunities to misinterpret and overreact, was the comment from one analyst. It will certainly require an adjustment to the usual practice of discussing every changed comma in the statement from the Federal Open Market Committee meetings and listening instead to an explanation straight, as the saying goes, from the horse's mouth.

Some commentators noted that the Fed is the last of the G7 countries to adopt the practice of briefing the press. Fed officials have no doubt felt that, as in everything else, the US position in the world economy and role of the US dollar in world trade and finance make it a special case. After all, remarks by the Fed chairman do attract more notice than comments by, say, Bank of Canada governor Mark Carney, and it behoves a US central bank chief to be careful about what he says.

Jean-Claude Trichet, the European Central Bank president, who gives a press conference every month after the ECB's main monetary policy meetings, will probably feel vindicated by the move. Trichet's statements have in fact become a less good guide to the ECB's decision-making. The bank has become more erratic in departing several times from pre-announced norms in reaction to the deepening European debt crisis. Somewhat high-handedly, Trichet frequently says that this bank was the first in the world to give 'real time' press briefings – ignoring the fact that his own remarks have become increasingly misleading and that the Bundesbank used to comment to journalists immediately after its interest rate-setting moves in the years before the ECB was set up.

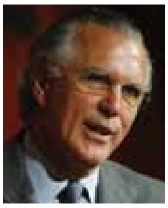
Bernanke has clearly been on this path since the financial crisis broke. He gave a lengthy and very personal interview to CBS 60 Minutes when the crisis was at its height and the Fed was taking unprecedented emergency measures to shore up the financial system. He hired a former Enron lobbyist, Linda Robertson, as PR consultant to improve messaging and stymie congressional efforts to curb the Fed's mandate. In February, Bernanke gave the press briefing a trial run with an appearance before journalists at the National Press Club.

The plan is to have the chairman brief journalists after four of the eight FOMC meetings held during the year. There will be three briefings in the remainder of 2011, following the meetings in April, June, and November. The committee statement, which normally comes out punctually at 2.15pm, will be released at 12.30, ahead of the briefing at 2.15.

Bernanke's predecessor, Alan Greenspan, became an overblown cult figure among financial analysts for his Delphic comments. In his semiannual appearances before House and Senate committees to testify on monetary policy, Greenspan cultivated a vague and convoluted style in his answers to questions from lawmakers, who in any case were not too aggressive in grilling the official they generally revered as the maestro.

All that has changed in the wake of the crisis, and Bernanke now faces open hostility in his congressional appearances. In coming months, he will also have to navigate a difficult period of balancing the needs of a sluggish US economic recovery for monetary stimulus with the concerns at home and abroad about price spikes in food and energy.

Some FOMC members (see opposite page) have pledged to vote against any further stimulative measures. Of course, while the panel usually seeks consensus, a chairman can push his agenda ahead despite dissenters on the committee. And now, Bernanke will have the last word on the decisions in the court of public opinion.

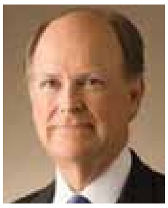


Richard Fisher

Regional Fed chiefs ready to tighten

A globetrotting **Richard Fisher (voter)**, president of the Dallas Fed, is telling anyone who'll listen that he's had it with quantitative easing. With some people suggesting the Fed should consider a QE3 to counter the impact of higher oil prices from the Mideast conflicts and the hit to the Japanese economy from earthquake and tsunami, Fisher said there would be at least one dissenting voice.

'I have made it very clear I won't support any more, barring something that I cannot foresee, some awful development,' Fisher told Wall Street Journal reporters after a speech in Frankfurt. Trotting on to Hong Kong, he said on Fox Business News, 'I cannot foresee a circumstance where I can support any further liquidity in the economy.' Fisher acknowledged that he voted in favour keeping up the Fed's purchases of longer-term Treasuries through the second quarter as planned, despite his opposition to the programme, because it's important for a central bank to follow through on what it says it will do. The QE2 measures were decided last year, when Fisher did not have a vote.



Charles Plosser

Fisher likes to say he is the 'least academic' FOMC member and that it is his conversations with businessmen that make him wary of inflation. 'We have to skate ahead of the puck,' Fisher told the Wall Street Journal, quoting hockey player Wayne Gretzky.

Philadelphia Fed chief **Charles Plosser (voter)** echoed these remarks. 'I worry about us getting behind the curve,' he told reporters after a meeting of the Shadow Open Market Committee in New York.

Thomas Hoenig

Plosser acknowledged there would be pressure to keep monetary policy easy because many commentators are concerned about the depressive effect of the spike in energy prices. He worries that such a response will lead to inflation and the Fed should 'lean against that.'

Last year's dissenter-in-chief, **Thomas Hoenig (non-voter)** of the Kansas City Fed, also joined in this chorus as he continued to urge a tighter monetary stance. 'If current policy remains in place, we almost certainly will stimulate the growth of asset values and inflation,' Hoenig said in a speech at the London School of Economics.

James Bullard

Time, tide and the Fed wait for no man

Another peripatetic FOMC member, St. Louis Fed chief **James Bullard (non-voter)**, stressed in several stops in Europe (including an OMFIF event in Amsterdam) that US monetary policy can't stay on hold until all world crises are resolved. The committee will certainly begin debating its exit strategy this year, even if uncertainty about oil prices and the Japanese economy remain, Bullard said at events in Prague and London.

'The process of normalising policy, even once it begins, will still leave unprecedented policy accommodation on the table,' he said, in a summary of his London talk provided by the Fed. Bullard said that normalisation is the most difficult part of the business cycle for a central bank and will take time. While traditionally the market looks to the policy rate – the overnight Fed funds rate – for indications of monetary policy, in this case, because of quantitative easing, the very act of reducing the Fed balance sheet to more normal levels may marks the start of the process.

Note on contributors to April Bulletin

Frits Bolkestein, Secretary for Economic Affairs and Minister of Defence under Prime Minister Ruud Lubbers, was European Commissioner for Internal Market and Services from 1999 to 2004.

Steve H. Hanke is Professor of Applied Economics at The Johns Hopkins University in Baltimore.

Ruud Lubbers is former Prime Minister of the Netherlands and Honorary Co-Chair of Earth Charter International.

David Pitt-Watson is Founder and Chair, Hermes Focus Asset Management.

Peter Warburton is Director, Economic Perspectives and Managing Director, Halkin Services, an international risk analysis service.

Paul van Seters is professor of Globalisation and Sustainable Development, TiasNimbas Business School, Tilburg University.

OMFIF Advisory Board

Ruud Lubbers and Paul van Seters join Advisory Board

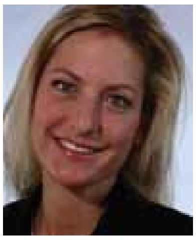
We are pleased to welcome to the Advisory Board Ruud Lubbers (*left*), Prime Minister of the Netherlands between 1982 and 1994. He is chair of the Energy Research Centre and the Rotterdam Climate Initiative and honorary co-chair of Earth Charter International. Joining him is Paul van Seters (*far right*) is professor of Globalisation and Sustainable Development, TiasNimbas Business School, Tilburg University.


Meghnad Desai*


Songzuo Xiang**


John Nugée**


Frank Scheidig**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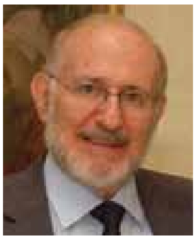
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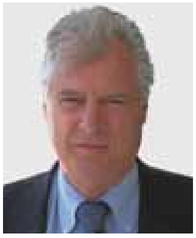
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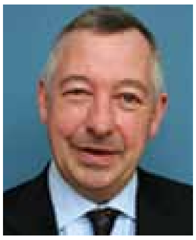
Albert Bressand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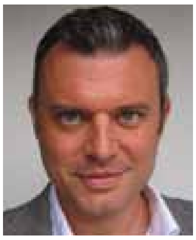
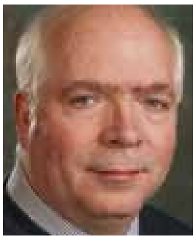
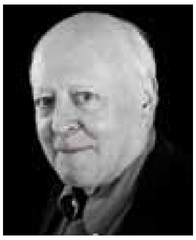
Hon Cheung


YY Chin


John Cummins


Jon Davis


Darrell Delamaide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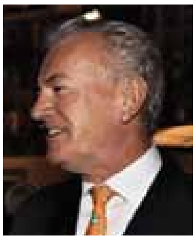
Steve Hanke


Dick Harryvan


Carl Holsters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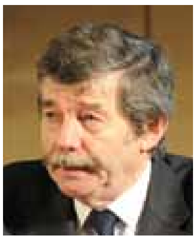
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Mumtaz Khan


Joel Kibazo


David Kihangire


John Kornblum


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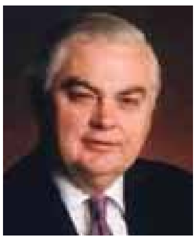
Philippe Lagayette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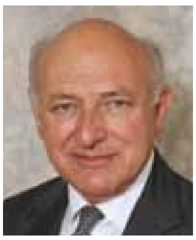
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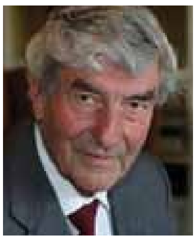
Ruud Lubbers


Mariela Mendez

The Advisory Board under the chairmanship of Prof. Lord Desai has grown considerably from OMFIF's inception in January 2010. The Board is divided into sub-groups for Public Policy, Research & Economics, Education, Editorial & Commentary, Banking, Capital Markets. The three deputy chairmen are Songzuo Xiang (Renmin University), John Nugée (State Street Global Advisors) and Frank Scheidig (DZ Bank). OMFIF is building up the Advisory Board particularly in fast-growing emerging markets. The Advisory Board includes a number of ex officio members whose names are not publicised.


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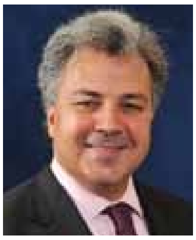
Rakesh Mohan


Paul Newton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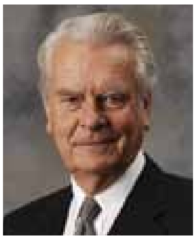
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Bruce Packard


Ila Patnaik


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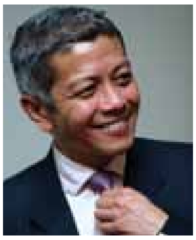
Robin Poynder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Poul Nyrup Rasmussen

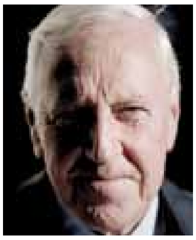

Paul van Seters


Marina Shargorodska


Michael Stürmer


Paola Subacchi


Jens Thomsen


Niels Thygesen


Makoto Utsumi


John West


Ernst Welteke


Derek Wong

Advisory Board members perform a variety of tasks including participation in seminars and speaking engagements for OMFIF's clients and members. For details contact omfif.secretariat@omfif.org

** Chairman* *** Deputy Chairman*

Looking ahead – 2011 diary dates

OMFIF Debate with
Dr Hans Tietmeyer
Lord Norman Lamont
20 April 2011, London
The Future of EMU

OMFIF Lecture with
Dr Jürgen Stark
European Central Bank
11 May 2011, London

OMFIF Seminar with
Dr Lorenzo Bini Smaghi
European Central Bank
26 May 2011, London

OMFIF Lecture with
Miroslav Singer
Czech National Bank
28 June 2011, London

OMFIF/Lafferty Conference
The World Banking Summit
29-30 June, London
New Models for Growth

OMFIF Seminar with
Philipp Hildebrand
Swiss National Bank
4 July 2011, Edinburgh
Swiss Franc's Role in World Money

OMFIF Meeting with
South African Reserve Bank
22-23 August 2011, Pretoria

OMFIF Meeting
Luxembourg Monetary & Finance Week
12-16 September 2011, Luxembourg
Europe and the World Economy

OMFIF Meeting
Asian Central Bank Watchers' Conference
1 November 2011, Kuala Lumpur
Asian Perspectives on World Money

Risks multiply for world economy

Crises in Japan and Libya add extra strains

DZ Bank Economic Forecasts			
GDP growth			
	2009	2010	2011
US	-2.6	2.9	2.7
Japan	-6.3	4.0	-1.7
China	9.2	10.3	9.2
Euro area	-4.0	1.7	1.4
Germany	-4.7	3.6	2.5
France	-2.5	1.5	1.4
Italy	-5.2	1.2	0.8
Spain	-3.7	-0.1	0.5
UK	-4.9	1.3	0.9
Addendum			
Asia excl. Japan	6.1	9.2	7.8
World	-0.7	4.7	3.8
Consumer prices (% y/y)			
US	-0.3	1.6	2.2
Japan	-1.4	-0.7	-0.1
China	-0.7	3.3	5.0
Euro area	0.3	1.6	2.0
Germany	0.2	1.2	1.9
France	0.1	1.7	2.0
Italy	0.8	1.6	2.0
Spain	-0.2	2.0	2.0
UK	2.2	3.3	3.8
Current account balance (% of GDP)			
US	-2.7	-3.2	-3.1
Japan	2.8	3.6	2.1
China	6.0	5.2	4.8
Euro area	-0.6	-0.6	-0.2
Germany	5.0	5.2	5.2
France	-2.0	-2.2	-2.4
Italy	-3.2	-3.0	-2.9
Spain	-5.1	-4.7	-4.6
UK	-1.7	-2.3	-1.8

This table and commentary appear by courtesy of DZ Bank, a partner and supporter of OMFIF

The Japanese disaster and the Libyan escalation have greatly increased the risks facing the international economy. In Japan, a recession in 2011 has become probable. It is still too early to gauge the economic impact on the Asian region and key trading partners. In the short term, concerns over the global economy are being fanned by the Libya crisis and fears this will spill over into other countries. The focus is less the direct effect on international trade, more the latent dangers in a rising oil price.

An enduring rise in the oil price will damage both industrialised countries and emerging markets. In the industrialised countries it threatens the still fragile recovery. The loss of purchasing power by private households could considerably dampen consumer demand. Many emerging markets are already having to contend with high inflation rates. This could be exacerbated by further energy price rises, forcing central banks to opt for a more restrictive course.

In the euro area debt crisis, crucial decisions were taken at the end of March on the future of economic and monetary union. EU leaders agreed the European Stability Mechanism (ESM) that will replace the provisional European crisis fund in 2013 and is set to have a total volume of €700bn. Moreover, the Stability and Growth Pact established in 1997 is being tightened and European monitoring of national economic policies introduced under the terms of a so-called Euro-Plus pact.

All this is necessary because the debt crisis showed that alongside overly high budget deficits, other macroeconomic imbalances can become a danger. A current example is Portugal, whose government has largely forfeited any confidence on either the domestic front or in the international financial markets. Yet its key financial policy indicators had not, prior to the financial crisis, triggered a reaction by the EU stability watchdogs. In Portugal, the public sector budget deficit in 2007 was 2.8% of GDP and therefore within the tolerance zone of under 3%, while debt levels of 62.7% only mildly infringed the regulations.

Yet Portugal has now admitted that it cannot handle its problems without outside assistance, and has lodged a request for funding under the 'temporary' EMU rescue facility set up in May 2010. Given the resignation of the Portuguese prime minister, economic uncertainties are compounded by deep-seated political worries.

The Brussels agreement on a European crisis mechanism can be treated as positive news, even if some issues remain open. Independent of this, as regards the economic outlook, the consolidation programmes necessary in the individual countries in the current year and next year are a major factor dampening economic performance and are included in the forecasts. By contrast, an expansion of the Japanese and Libyan crises has not been factored into the figures.

Chain reaction from Japan

Modest direct effect from triple shock

Stefan Bielmeier, Head of Research and Chief Economist, DZ Bank

The triple shock of earthquakes, tsunami and the nuclear disaster ranks as the worst blow to a rich and highly developed country since the Second World War. The loss of lives and the amount of human suffering cannot be counted in terms of GDP. Assessing the effects on economic growth might thus appear somewhat heartless. Despite this caveat, it is worth looking at the economic effect in Japan and various regions of the world.

For Japan itself, the disaster is much more severe than the Kobe earthquake 15 years ago. The affected region is economically less important than the area around Kobe, but the widespread effects of resulting energy shortages and the lasting damage to agricultural resources give recent events a different quality. Production disruptions at the region's numerous component suppliers will affect many industries in Japan and to some degree also in other industrialised countries, thereby harming Japanese exports.

GDP had already fallen in Q4, and will now probably continue to fall for at least another two quarters. Consumption and capital spending will remain subdued until the supply of energy and food has normalised. The government is likely to support reconstruction with substantial extra spending, possibly helped by tax increases in the form of a 'reconstruction surcharge'. Our GDP forecast now stands at -1½ % (previously +1½) for 2011 and a strong 2½ % for 2012, owing to catch-up effects and reconstruction programmes. The effect on inflation should be close to zero, as price pressures from supply shortages are partly offset by a yen appreciation.

East Asia and the Pacific region have close trade links with Japan and may experience some negative effect, but there is certainly no danger of a recession, as the economy in parts of the region is bordering on overheating. Neighbouring China receives 13% of its imports from Japan, especially electronic components that are built into products for Chinese exports. Temporary disruptions in production and exports are unavoidable, but the effect on Chinese GDP will largely be compensated by lower imports of raw materials and other commodities. Chinese exports to Japan (8% of total Chinese exports) might even benefit from the distress in Japan. The negative effect on Chinese growth should therefore remain negligible at 0.1 – 0.2% of GDP.

For the US, the most noticeable effect will probably be some disruption in production owing to problems in the supply chain of Japanese component parts, particularly in the automotive industry and the US plants of Japanese carmakers. That should be short-lived, because even if deliveries from Japan would fail to resume soon, they could easily be substituted with supplies from Korea, China or Europe or even from domestic producers. Only 3% of US exports go to Japan. As a major exporter of food and agricultural products, the US might even benefit from the situation in Japan and moreover from the yen appreciation. We have therefore not made any changes to our US growth forecast.

The direct effect on the euro area is only limited. Japan accounts for 2.3 % of exports and 2.8 % of imports. With the exception of possible short-lived disruption in the supply of electronic components, Europe should feel no direct negative effects. For Germany, the importance of Japan as a trading partner has dwindled in recent years. Japan makes up less than 3% of Ger-man imports and only 1.4 % of exports.

Overall, Japan, though still the third largest economy in the world, contributes only 3% to world trade. The global financial system is much less dependent on Japan than on the US. The most important consequence for the world as a whole may therefore be a deeper understanding of the concepts of risk and probability. Even events with close to zero probability may nevertheless happen. The financial world already digested that lesson during the financial crisis. Now it has become manifest in the 'real' sphere as well.

Japan, though still the third largest economy in the world, contributes only 3% to world trade. The global financial system is much less dependent on Japan than on the US.

Building human capital
Central banks must develop their staff

Malan Rietveld, Chief economist

Around the world, central banks are looking for ways to develop the skills and expertise of their staff. The global financial crisis and its aftermath have resulted in central banks performing an evermore complex and contentious set of tasks. As The Economist put it in April 2009, 'The simple rules by which central banks lived have crumbled.' More than ever, central banks face a strategic need to build their human capital by investing in staff education and management development.

While demand for central bank education is apparent and rising, the supply side of the education equation has been slow to adjust. Universities continue to offer programmes that, that provide a sound theoretical basis for policy analysis, but remain largely silent on policy implementation, central bank management and leadership, and the institutional foundation of central bank law and governance. Seminars that do cover such topics are largely ad hoc, exclusive and somewhat expensive (often requiring extensive travel).

OMFIF believes that the time has come for an educational platform that treats central banking as a distinct professional discipline – much like accounting or law. To achieve this, we are launching the International Academy of Central Banking. The Academy will offer three distinct programmes, aimed at central bankers with varying degrees of experience:

- The Foundation Programme: for new recruits, entry-level employees and staff with less than five years' experience. The objective of this programme is to help participants to transition from a theoretical academic education to a more practitioner-orientated education in the profession of central banking.

- The Advanced Management Programme: for mid-career central bankers, looking to upgrade their skill set, and gain a comprehensive 'birds eye view' of all the critical policy, operational and managerial practices in modern central banking.

- The Leadership in Central Banking Programme: for deputy/assistant governor, department/division heads, and non-executive board members who need to be aware of current legislation, societal and political challenges and environmental shifts that affect their institutions. The programme promotes creative and forward-looking leadership that extends beyond the day-to-day management of central banks.

Working with experienced central bank practitioners and academics we have developed a curriculum built around a number of core modules. Each module has a set of proprietary learning materials, consisting of the Academy's own core readers, problem sets, case studies, presentations, tutorials, test and essay assignments. Each programme addresses the nature and challenges of the central banking profession from the following dimensions:

- Core policy functions: such as monetary policy, financial supervision and payments systems oversight.

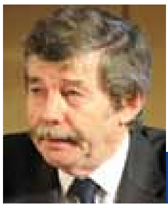
- Central bank operations: such as accounting, communications and research.

- Challenges in central bank leadership and management: such as motivating and retaining staff, political relations, strategic planning and modernisation.

To address another major shortcoming of current education services for central banks, we will also offer the Academy's programmes on a country/regional basis – including on-site programmes hosted within a central bank. In addition to this in-person teaching segment of each programme, there is also a comprehensive self-study component during which participants are guided through critical concepts and topics in central banking using structured course materials.

The International Academy of Central Banking is the first of its kind – combining a global orientation with a model of localised delivery in educational services dedicated exclusively to the central banking profession. The Academy is OMFIF's contribution to assisting central banks in building their most important asset: human capital.

The International Academy of Central Banking will start operations in the second quarter of 2011. Please contact Malan Rietveld, Head of Education at OMFIF, to receive further information and a detailed Prospectus. Email: malan.rietveld@omfif.org



Britain's riddle over rising reserves

Speculation rife on targeted boost to official holdings

William Keegan, Chairman, Board of Contributing Editors

Drawing my attention to an announcement about the official UK reserves in one of Chancellor George Osborne's Budget documents on 23 March, a Whitehall official told me, elliptically: 'Make what you will of it.'

The announcement was contained in Debt and Reserves Management Report 2011-12, not the kind of document towards which one normally rushes on such occasions. The relevant paragraphs were wrapped in classic, old-style Whitehall-ese – unlike the hearty way in which the Budget Report, under New Labour and now the Conservative/Liberal coalition, cannot resist proclaiming, at the beginning of each section, jolly value judgements such as 'Making People Feel Better'. (I exaggerate only slightly.) What the announcement boiled down to was that the official reserves were to be boosted by £6bn in the 2011-12 financial year, and this was to continue until 2015.

The last time the reserves became news was when, early in his Chancellorship, Gordon Brown sold a large proportion of the UK's gold at what turned out to be a knock-down price.

The official gold and foreign exchange reserves! My first reaction was to think 'Wow, they have been out of the news for a long time'. When I worked as Economics Correspondent of the Financial Times in 1967-76, the reserves were seldom off the front pages. There was continuing interest in the travails of sterling, and the monthly reserves announcement was awaited with bated breath. Now I cannot even find a reference to the state of the reserves in HM Treasury's Pocket Databank. What memories come to mind! Among other things, there was always a guessing game, because between them the Treasury and the Bank of England continually 'cooked the books' in bad times.

The last time the reserves became news was when, early in his Chancellorship, Gordon Brown sold a large proportion of the gold at what turned out to be a knock-down price. Before that we have to go back to September 1992, when the Major government spectacularly lost all the reserves – and more – in that doomed attempt to prop up the pound on Black Wednesday, to the delight of George Soros and Co. After that there was a long period of 'floating', interrupted only twice when the Group of Seven intervened collectively in the markets in 2000, around the time of the Prague meeting of the International Monetary Fund and World Bank, and very recently, after the earthquake in Japan.

The announcement about the reserves states that the move '*partly* arises from commitments to the IMF made over the last few year', including the expansion of the New Arrangements to Borrow (NAB), and the G20 agreement on the future doubling of IMF quotas.

I have italicised the word 'partly' because this has captured the imagination of certain City analysts. As the Times commentator Sam Fleming put it, 'The decision to lift the reserves by an admittedly modest £6bn this year was also taken by some City economists as a signal from the Treasury that it is taking an active interest in the value of the pound and that it might be willing to put some muscle behind the goal of keeping it steady.'

Now, in those bad old days when they would routinely 'cook the books' the story was usually one of spending reserves in order to prop up the pound. But the pound, as we all know, has experienced a very large devaluation in recent years, and with the domestic prospects so bleak, the Cameron government is relying heavily on an improvement in the balance of foreign trade.

Although they could not possibly comment to this effect in public, I suspect that the last thing the British government's economic strategists want is for the markets to take the pound back up – after the manner of the mid-1990s, when the post-Black Wednesday competitiveness gain was gradually eroded. But the markets are already speculating about higher interest rates (in due course) leading to a stronger pound (in due course).

Make of it what you will...

Review of OMFIF Meeting at De Nederlandsche Bank in Amsterdam

Mapping a route back to normality

Challenges growing as Europe, G20 search for sustainability

The Second OMFIF Meeting in Europe, hosted by Nederlandsche Bank in Amserdam on 23-25 March, followed the first three meetings in 2010, at Deutsche Bundesbank in Frankfurt on 2-3 March, Bank Negara Malaysia in Kuala Lumpur on 15-17 May and U.A.E. Central Bank on 31 October-2 November. The symposium brought together 123 delegates from 72 institutions in 31 countries including Africa, Asia-Pacific, Europe, the Middle East and North America.

1. **Stability and governance in the euro area.** There was a generally gloomy tone to deliberations of the euro area's problems, amid frequent references to the accompanying European Union summit in Brussels pondering measures to tighten economic governance. The resignation of the Portuguese prime minister reminded delegates of the acute political pressures caused by austerity in heavily-indebted states. The overall conclusion was that efforts to improve cohesion and coordination did not go far enough to guarantee sustainability. The integrated nature of banking and finance within the euro area had been one of the successes of monetary union but now presented a source of threat in view of the overhang of debt bearing down on creditor banks and countries

2. **Challenges for central banking and for national and international policy coordination.** Speakers voiced an unusual amount of self-criticism about failures to spot the dangers building up through excess leverage in the financial system. With both the Federal Reserve and the European Central Bank considering an exit in coming months from extraordinary credit and liquidity measures, a principal issue was the speed with which central banks could return to 'business as usual'. There was some optimism that, at least in the US, this might be the case. Linked to this was a discussion of the role of the G20 in global policy coordination as well as in steps to achieve international monetary reform – widely regarded as unlikely to achieve any significant breakthrough.

3. **Financial sector regulation.** The meeting discussed the re-regulation of the financial sector and, in particular, whether the Basel III reforms advocated by the G20 are addressing the right objectives and will be implemented in a way that will meet them. There was considerable discussion on the possible negative impact on growth of increases in capital and liquidity ratios, and whether this and other potential repercussions represented a worthwhile trade-off. Partly on the basis of official assessments, a number of participants pointed out that – although longer-term risks from banking reform are potentially troublesome – their impact is being exaggerated by banking lobbyists.

4. **An ethical approach to banking and asset management.** The economic strains of the past four years and the devastating effects on economies and employment of shortcomings in the financial sector and in regulation have heightened calls for a more ethical approach to banking and asset management. There was considerable interest in an initiative for greater shareholder responsibility, which was seen as creating beneficial economic outcomes for asset managers by shielding them from exposure to practices that endangered stability. In the banking sector, there was animated discussion on an initiative designed to tighten up standards for boards of banking directors and to make their members compliant with new national and international regulations.

5. **Revolutionary effect of e-money.** The mobile device is revolutionising financial services. Momentum in the wider world of mobile payments will accelerate growth of e-money although this is just one product line in a suite contained in the mobile device. The growth in mobile payments was attributed to massive shipments in mobile devices with smartphones representing an increasing proportion. Meanwhile customer preferences for carrying out financial transactions via mobile devices are leading to ever more sophisticated and seductive applications. The mobile device is likely increasingly to displace the plastic card as the medium for credit and debit card transactions. All this has clear implications for regulation.