July-August 2016
Vol. 7 Ed. 7

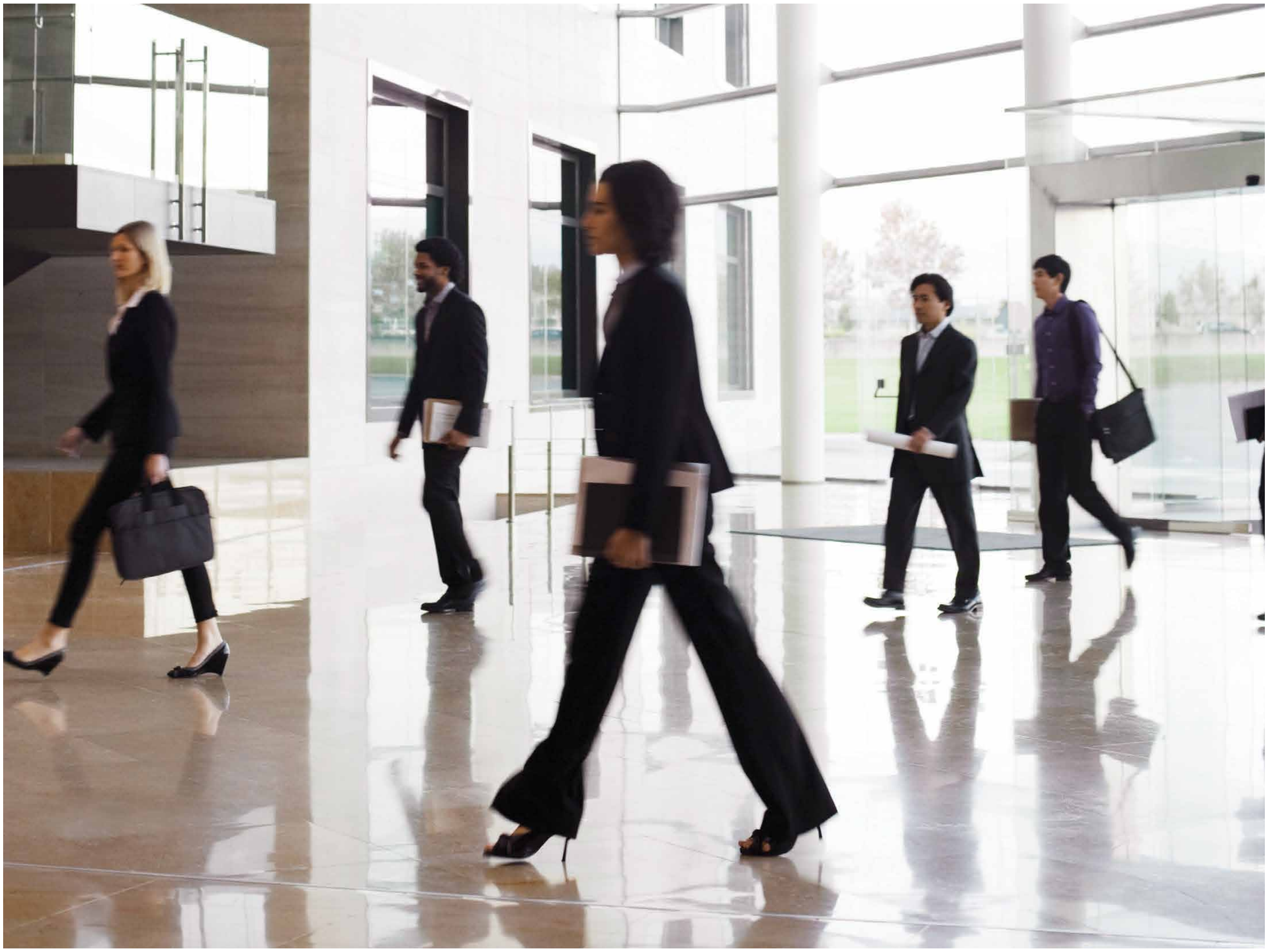
The Bulletin

Official monetary and financial institutions ▪ Asset management ▪ Global money and credit

March of female power
A referendum and its consequences

Caroline Butler on Big Data and markets
Kevin L. Kliesen on the slow US economy
Patrick J. Schena on Saudi sovereign fund
Boris Vujčić on central bank independence
Harald Walkate on impact investment

OMFIF



Contents - Vol. 7 Ed. 7

July-August 2016

COVER STORY: March of female power


6


7

22

Official Monetary and Financial Institutions Forum

30 Crown Place
London
EC2A 4EB
United Kingdom

T: +44 (0)20 3008 5262
F: +44 (0)20 7965 4489

www.omfif.org
@OMFIF

Company Number: 7032533
ISSN: 2398-4236

OMFIF

Promoting dialogue for world finance

The Official Monetary and Financial Institutions Forum is an independent platform for dialogue and research. It serves as a non-lobbying network for worldwide public-private sector interaction in finance and economics. Members are private and public sector institutions globally. The aim is to promote exchanges of information and best practice in an atmosphere of mutual trust. OMFIF focuses on global policy and investment themes – particularly in asset management, capital markets and financial supervision/regulation – relating to central banks, sovereign funds, pension funds, regulators and treasuries.

Analysis

OMFIF Analysis includes research and commentary. Contributors include in-house experts, Advisory Board members, and representatives of member institutions and academic and official bodies. To submit an article for consideration contact the editorial team at editorial@omfif.org

Meetings

OMFIF Meetings take place within central banks and other official institutions and are held under the OMFIF Rules, where the source of information shared is not reported. A full list of past and forthcoming meetings is available on www.omfif.org/meetings. For more information contact meetings@omfif.org

Membership

OMFIF membership is comprised of public and private institutions, ranging from central banks, sovereign funds, multilateral institutions and pension plans, to asset managers, banks and professional services firms. Members play a prominent role in shaping the thematic agenda and participate in OMFIF Analysis and Meetings. For more information about OMFIF membership, advertising or subscriptions contact membership@omfif.org

Advisory Board

The OMFIF 165-strong Advisory Board, chaired by Meghnad Desai, is made up of experts from around the world representing a range of sectors, including banking, capital markets, public policy and economics and research. They support the work of OMFIF in a variety of ways, including contributions to the monthly Bulletin, regular Commentaries, seminars and other OMFIF activities. Membership can change owing to rotation.

EDITORIAL

Comedy of errors and the march of female power

In the execution and aftermath of the European referendum, the British political class has commemorated Shakespeare's quadricentennial by serving up a 21st anniversary version of *The Comedy of Errors*. The ripples of the 23 June vote to leave the EU are spreading. Sterling, the third most important reserve currency, has fallen by 13% against the dollar, interest rate rises everywhere are on hold, and one more source of risk is stalking the global economy. All these issues are high on the agenda at OMFIF's Main Meeting in St. Louis on 14-15 July.

One important side effect: Theresa May, the quietly confident UK home secretary, bottom right in our cover picture, has replaced David Cameron as prime minister – joining Angela Merkel, Christine Lagarde and Janet Yellen in a march of female economic power.

As Meghnad Desai wrote, now that the decision has been made, 'We can ignore the miracles promised by the Brexiteers or the dire predictions of the Remainers.' But the litany of political, psychological and purely human miscalculations by protagonists on both sides of the struggle casts considerable doubt on the judgement of those in, or aspiring to, high office.

A referendum Cameron never truly expected to hold and his opponents didn't think they could win was, at bottom, a stratagem to heal Conservative party divisions and help Europe regain a sense of purpose. It has ended up deepening Tory splits, inflaming anti-integrationist spirits around Europe (despite early Franco-German protestations of unity) and, in a dash of Bard-like knife-twisting, drenching many of the dramatis personae in their own and their rivals' blood. George Osborne, the UK chancellor of the exchequer, who has gone from hero to hapless in a few short weeks, has cast aside his ill-thought out threat of emergency budget cuts in the event of an 'out' vote.

Niels Thygesen in Copenhagen, Philippe Lagayette in Paris, Stuart Mackintosh in Washington and Jacques Lafitte in Brussels analyse the ramifications of the biggest setback to the EU since the European Economic Community was set up in 1958. In central and eastern Europe's sensitive circumstances, the technical issue of the European Central Bank's controls on non-monetary assets on the balance sheets of national central banks takes on additional significance, as a special correspondent reports from Warsaw. Challenges abound elsewhere. With the Swiss franc once again a safe haven, Peter Warburton and Federico Corrado investigate the post-referendum challenge for Swiss monetary policy. At a time of rising constraints on central banks' independence, Boris Vujčić, the Croatian central bank governor, outlines the finely calibrated navigational instruments they must deploy to steer between competing exigencies.

Patrick Schena explains the changes under way in Saudi Arabia's sovereign fund. Ben Robinson describes how emerging market central banks – in particular the People's Bank of China – are reacting to upheavals in the UK and European economies. Low or negative interest rates are inciting fund managers to open their portfolios in novel ways. Harald Walkate from Aegon Asset Management extols the effect of impact investment on institutional holdings.

The US Federal Reserve has understandably decided once again to put interest rates on hold, as Darrell Delamaide relates. However, better jobs data for June, released on 8 July, may change the picture. Kevin Kliesen of the St. Louis Fed writes on the mixed signals facing US policy-makers. Peter Petri, visiting fellow at the Peterson Institute of International Economics, focuses on the US elections and trade policy.

In a section on new technology, Caroline Butler outlines the potential ramifications of 'Big Data' on global risk management, while Steven Bardy from the Australian Securities and Investments Commission explores how regulators can better understand the opportunities and meet the challenges of blockchain as it permeates financial transactions. William Keegan provides an epitaph for the referendum struggle with a mournful book review of former UK Prime Minister Gordon Brown's plea for a maintained British place in Europe. The OMFIF advisory board reminds us of battles to come: Greece's fundamental problems are set to re-emerge in 2017.

After British referendum, European austerity heads for the exit

UK-EUROPE REFERENDUM AFTERMATH

An all-out pan-European effort to 'stop populism', especially to tackle social and economic ills by lifting fiscal constraints and relaxing German-style austerity, is likely after the UK vote, according to an Amsterdam meeting of OMFIF's Dutch advisory board. The 4 July gathering sounded a generally positive note on referendum repercussions, with some form of UK-EU rapprochement foreseen for coming years, striking compromises in areas like freedom of movement to counter immigration worries and allow continued EU-UK trade and investment. Noting the practical difficulties of a complete rupture, as well as room for flexibility, one attendee asked if the next step might be: 'Brexit for the exit.'

Despite the 'Zeitgeist' of anti-EU movements in many countries, including the Netherlands, there would be no Dutch referendum on 'Nexit' – the Netherlands version of the UK departure – participants said. Rather, the Dutch, following a generally successful half-year EU presidency which mitigated some of the bloc's worst challenges, including on migrants, would step up efforts with other EU governments to promote greater integration, including in the military sphere.

Europe would also use budgetary manoeuvring room to try to overcome economic problems, and fight the economic and social frustration and alienation that lay behind the UK outcome. The meeting heard a plea to use concerns over immigration as a lever to introduce longer-term development and governance-strengthening measures in Middle East, Asian and African countries that are sources of migration to Europe.

Although the Netherlands, as one of the EU's principal creditors, is sceptical about the European Central Bank's quantitative easing and negative interest rates, there was a general expectation that the ECB's bond-buying programme would proceed beyond the present cut-off date next March. In a similar way, despite opposition from the European Commission and the German government, the EU was likely eventually to agree the Italian government's emergency national measures to prop up Italian banks. One policy veteran cautioned that repeated concessions by Angela Merkel and opposition from anti-euro parties were severely narrowing the German chancellor's options in domestic politics.

The euro's evident difficulties, including desire for debt relief from Greece, make the next few years replete with challenges, including for the Netherlands. 'Germany will have the economic power. France will have more political power. This cannot be in the interests of the Netherlands,' one official said.

Advisory Board

OMFIF has appointed Tarisa Watanagase and Hans Eichel to the Advisory Board. For the full list of members, please see p. 20-21.

Tarisa Watanagase joined the Bank of Thailand in 1975 and was governor from 2006-10. Her long career at the Bank included responsibilities in economic research, money market operations, payment systems, banking sector policy and supervision, and monetary policy. She also worked as an economist at the International Monetary Fund from 1978-1990 and an IMF-World Bank FSAP independent assessor in 2002. She was instrumental in the 1997 Thai crisis resolution and the ensuing supervisory and financial sector reforms, and the passage of a new act in 2008, which guarantees the central bank's independence.

Hans Eichel is former German minister of finance and a former chair of the G7 and G20 international forums. He served as president of Germany's federal council in 1998-99. In tandem with Chancellor Gerhard Schröder, he oversaw the implementation from 2003 of 'Agenda 2010', aimed at reforming the German welfare system and labour relations to promote economic growth and reduce unemployment. He heads the expert group on sustainable structural development for the Friedrich Ebert Foundation, established to promote democracy and political education in Germany.

Evans outlines Fed's monetary stance

Charles Evans, president and chief executive officer of the Federal Reserve Bank of Chicago, speaking at an OMFIF discussion in London on 2 June, outlined the Federal Reserve's target path for interest rate increases, more aggressive than market expectations.

The meeting took place with the Fed projecting two increases this year and four in 2017 – before the 3 June jobs data showing hiring slowed sharply in May, dampening rate rise expectations. He added that the US economy had undershot inflation expectations for the past eight years. Achieving the 2% target was still challenging, although 5% unemployment, as at present, marked the appropriate rate. He said there was still slack in the economy and scope for further employment growth. *See Darrell Delamaide on p.15*.

'Constraints on way' for central banks

Central banks are threatened with constraints on their independence as they take on extra powers beyond monetary policy and possibly face blame if their role as 'policy-makers of last resort' comes under criticism, delegates at a Czech National Bank-OMFIF seminar in Prague on 6 June were told.

Miroslav Singer, the bank's governor (right), outlined lessons from his six-year tenure at the central bank, which ended on 30 June, when he handed over to Jiri Rusnok.

Boris Vujčić, governor of the Croatian National Bank, outlined independence as a 'device to overcome the problem of time consistency: the concern that policy-makers will in future renege on a policy promise made today'. *For a fuller account of Boris Vujcic's speech, see p.12*.

Treasury's Rice on market stability

Tara Rice, deputy assistant secretary for international financial stability at the US Treasury, at a London briefing on 16 June outlined international actions promoting solid financial markets. Among the topics discussed were the position of large global banks, divergence between EU and US regulation, the status of clearing houses, liquidity in the fixed income market, and reform of secondary market structures.

Concerns were expressed about the resilience of financial institutions, and the danger that renewed financial pressures could set back a still fragile recovery, especially in Europe.

Slovakia growth 'could reach 4%'

Ján Tóth, deputy governor of the National Bank of Slovakia, joined OMFIF for a discussion on 10 June in London. The meeting examined Slovakia's macroeconomic outlook and that of central and eastern Europe and the euro area, at a time when the German economy is still providing impetus to the region but doubts are growing about flagging global growth.

One conversation point was the effectiveness of the European Central Bank's non-standard monetary policy measures. Relatively high Slovak growth is expected to reach 4% by 2018, partly due to investments in the automotive industry. Participants discussed the British EU referendum and heard that a UK exit would have only limited impact on central European economies.

Heathcote calls for infrastructure efforts

Christopher Heathcote, chief executive officer of the Global Infrastructure Hub, spelled out to an OMFIF discussion in London on 16 June the need for a stronger global pipeline of bankable infrastructure projects. Heathcote said investors needed to plug data gaps, including the lack of measures of success for infrastructure projects, the role of multilateral development banks and the relationship between economic growth and infrastructure demand.

British referendum vote fall-out

On 24 June, the aftermath of the UK EU referendum, OMFIF held three telephone 'instant analyses' on the fall-out from the country's vote to leave, geared to audiences from Asia, Europe and the US. The discussion, linking 10 economic and financial experts from four continents, focused on global economic implications, the UK's opportunities for shifting focus towards Asia, Europe's demographic and debt challenges, and the need for coordinated policy actions by governments and central banks.

Dissecting Fed decision to hold rates

Weak jobs data, nervousness over the British referendum vote, and uncertainty over lacklustre economic growth contributed to the Federal Reserve's decision to keep interest rates on hold on 15 June. An OMFIF telephone briefing moderated by Vicky Pryce, former joint head of the UK Government Economic Service, deliberated the issues on 16 June. Participants said the Fed was taking a more global perspective because of the potential impact of international developments on the US economy.

Central bank legitimacy 'under threat'

OMFIF held its first workshop on central bank independence with the Institute of New Economic Thinking in London on 21 June. Participants discussed the increased role of central banks after the 2008-09 crisis and the impact on financial markets, as well as whether central banks have the necessary tools and knowledge to fulfil their new responsibilities. Since the legitimacy of this expanded role is under threat, issues of oversight and co-operation are becoming more important.

OMFIF records fall in GPI assets

OMFIF launched *Global Public Investor 2016* in London on 30 June with a panel discussion linking senior financial figures.

The principal finding was that total assets under management of the 500 largest Global Public Investors fell 2.9% in 2015 to $28.99tn, down $855bn on the slightly restated 2014 figure, with the decline driven primarily by central banks.

Clockwise from top left: Elliot Hentov, Alvaro Lario, David Marsh, Edoardo Reviglio, Frank Scheidig, Eric Usher

Among other highlights, *GPI 2016* documents the renminbi's fresh popularity as a reserve asset – part of a gradual move towards an international multicurrency reserve system – as well as the growth in sustainable investment as public institutions step up their support of a low-carbon economy. Gold's renaissance as a monetary asset was a further feature. *For details of the report visit www.omfif.org/shop*.

Eichel warns on UK concessions

The decision to leave the EU will have negative consequences for both the UK and Europe, Hans Eichel, former German finance minister, told an OMFIF meeting in London on 29 June.

Despite the EU's desire for Britain to remain in Europe, the UK should 'expect no concessions' after the referendum. Eichel criticised George Osborne, the UK chancellor of the exchequer, for campaigning for a Remain vote using undue threats of negative consequences from departure. He said Osborne's warning of an emergency budget after a Brexit vote was unwise and counterproductive.

Referendum aftermath

OMFIF Telephone Briefings on the aftermath of the UK EU referendum

Robert Kahn, Steven Tananbaum senior fellow for international economics at the Council on Foreign Relations; Niels Thygesen, professor of economics at the University of Copenhagen; and Michael Stürmer, chief correspondent at Die Welt.
14 July

Trevor Greetham, head of multi asset at Royal London Asset Management; Alistair Milne, professor of financial economics at Loughborough University; and Avinash Persaud, chairman of Intelligence Capital and non-resident senior fellow at the Peterson Institute for International Economics.
21 July

Korkmaz İlkorur, vice-chair of the finance task force at the BIAC/OECD, and Harold James, professor of history and international affairs at Princeton University.
28 July

To register contact enquiries@omfif.org

Dawning consequences of Leave

Exit has to be clarified to start longer-term negotiations

Niels Thygesen in Copenhagen

The Leave vote's economic and political consequences for the UK are dawning. Most visible are the short-term reactions on financial markets. More significant are downward revisions to the economy's prospects for the next few years. Most important is the longer-term loss of income.

The precision with which official and private sources evaluated this loss during the referendum campaign was ridiculed. But the conclusion the UK will suffer a major loss of income is inescapable – particularly if one takes into account Leave advocates' (politically logical) rejection of continued participation in the single market.

Voters legitimately allow expectations of sovereignty gains to outweigh the likely costs. In the UK's case, the latter are not just economic, but primarily political.

A second Scottish independence referendum has moved closer. Northern Ireland appears unlikely to accept border controls with its southern neighbour. The two main UK political parties are torn by strife.

A double gamble by David Cameron, the British prime minister, has backfired.

An effort to avoid drawing the implications of the vote by not invoking Article 50 of the European treaty would lead to an impasse – for two reasons.

Brexit undermines variable geometry

The first is that the vote rejected not a normal European Union membership, but the exceptionally accommodating position long enjoyed by the UK, further consolidated by Cameron's February renegotiation.

While many in the EU have expressed sympathy in the past for flexibility in membership rules – so-called 'variable geometry' – 'Brexit' has damaged the prospects for this model: it did not work. Experience suggests that renegotiations with a government based on that government's expectations of a subsequent vote are very hazardous.

A second, more formal, reason to start the review of the terms of exit is that this is a prerequisite for starting to clarify the UK's longer-term relationship with EU members. The latter negotiations cannot be brought forward and merged with the exit review. In particular, the EU cannot negotiate new trading arrangements in detail while the UK is still a member.

So it is the duty of the 27 EU member states, not a sign or arrogance of bitterness, to press for early exit moves in order to get to the longer-term agenda without undue delay. However, as only the UK government can take the formal step, there are incentives to express such views in the meeting room rather than in public.

Other EU governments could use the interlude to evaluate where their respective national interests lie in the subsequent negotiations, which should not focus primarily on whether particular steps are more or less favourable to the UK.

We all have a major stake in the outcome. Help to facilitate the UK transition must depend on whether it also in the interest of each of the other 27 EU members ■

Niels Thygesen is Emeritus Professor of Economics at the University of Copenhagen and a Senior Adviser to OMFIF. A longer version of this article first appeared in Danish newspaper Børsen.

Managing centrifugal forces

Referendum shines light on Europe's weaknesses

Philippe Lagayette in Paris

Two factors above all have destabilised the UK situation – immigration and globalisation. By voting No, many people believed that they were negating these threats.

But this is not true. The pressure of immigration will still be there. Britain will still struggle to balance being an open country, commercially and culturally, with regulating the entry of foreigners seeking to settle. There is no quick fix.

This is even more true in respect of globalisation, which will continue to create tensions detrimental to less educated people.

Europe is only the channel for globalisation, at best attempting to use the collective weight of member states vis-à-vis the rest of the world. It is our common 'globalisation manager'.

Brussels has not done everything well – far from it. But it is always a mistake to blame the messenger. Europe should try to help more than it has. A better situation for 'not haves' is primarily the responsibility of national authorities.

Divergence between so-called elites and the people is not the result of a Brussels plot. It is visible in many countries, including the US. There is no miraculous solution; an isolated country will not be stronger in trade negotiations. Even if it is no longer a European body, somewhere an authority or a court will be ensuring that countries participating in globalisation do not escape the rules.

Lengthy negotiations

Europe will not be easier to run following a UK exit. Not only because of the complex and lengthy negotiations to come, which will take up decision-makers' time and energy for years to come. But also because Europe will have to manage various centrifugal forces more frequently as a result of countries being tempted by 'exceptions'.

Europe has a pressing need to reduce the internal weaknesses on which the UK vote has shone a cruel light. The Brussels system of power is too far from the people. This is felt by a part of public opinion in several countries, and has become the basis for populist political criticism, all the more intense because nobody can say it is untrue.

In our western European countries in the 21st century, authorities with political power must be directly accountable to the people, not indirectly connected through a complex system of layers. Now the European level has gained a sizable amount of responsibilities, it cannot stay out of this scheme.

European power appears so complex and so far from the people because nation states want to continue to run Europe. They claim they are the only political power that is democratically legitimate.

We are at a crossroads on this issue. If we want to continue to preserve the dominance of nations in every area of Brussels decision-making, anti-European feeling will deepen. The other route is to accept that, in certain areas of competence, directly elected people will receive power and become accountable. ■

Philippe Lagayette is a former Deputy Governor of the Banque de France, presently President of Fondation de France and a member of the OMFIF Advisory Board.

An unwelcome diplomatic dead-end

US needs to plan for Britain's isolation

Stuart Mackintosh in Washington

Washington remains in shock at the 23 June referendum result, which The Washington Post called, correctly, an exercise in 'collective insanity'.

But policy discussion has moved on swiftly. Already American leaders are looking ahead and assessing the post-Brexit world in a remarkably cool and calm manner – at least publicly.

It is necessary to plan for Britain's isolation and not unduly clutch at the hope that British politicians can or will step back and make a U-turn faced by diplomatic disaster, even if this is theoretically possible.

It is widely forecast that the UK may be pushed into recession. The pound will remain under downward pressure. Foreign direct investment flows will atrophy. Firms will send resources and manpower elsewhere, to Frankfurt, to Paris.

The economic effect on the UK will be lasting and damaging. But the impact on the US will be transitory.

US economists believe 'Brexit' will push the Federal Reserve to delay further rate increases, pushing them further into 2017 as the economic shockwaves of Brexit, and political tensions and turmoil in the UK and Europe, continue to be felt.

In the short term, when the next British prime minister triggers Article 50, further economic shocks are expected as the exit process becomes almost irreversible.

Globalisation can be reversed

The UK vote is viewed as signalling that, as David Lipton of the International Monetary Fund observed, the process of globalisation is not inevitably a forward one, it can be reversed, and that electorates are angry (in America as well as Europe).

It also indicates that fiscal and other steps should be swiftly considered to address those complaints – lest the foundations of political stability more broadly be threatened.

A grappling with this unfortunate reality is being seen on the diplomatic front. US Secretary of State John Kerry has sought to instil calm into the heated European post-Brexit vote debate, to avoid the possibility that it could trigger other damaging dynamics within the European Union.

President Barack Obama was asked on 28 June what role the UK could play as an ally to the US in a post-Brexit world. he calmly replied that Britain could be 'like Norway'.

My goodness: cold, dark, and irrelevant (no disrespect meant to Norway). In five days Britain has gone from America's indispensable ally at the heart of Europe to this unwelcome diplomatic dead-end.

American policy-makers are looking for allies to replace the indirect influence and effect on European policy that they have lost through Brexit. In future, US officials will call or fly first to Berlin and Paris, not London, when seeking input into European discussion of common concern.

Neither Germany nor France can replace the alliance with the UK. But the State Department has to deal with reality and seek alternative paths of influence, even if they are less effective than the old, now closed, routes. ■

Stuart Mackintosh is Executive Director of the Group of Thirty, an international think tank, and a member of the OMFIF Advisory Board.

European ripple effect

Pressure for referendums in France and Austria

Jacques Lafitte in Brussels

If 'out' does not really mean 'out' anymore there will very soon be unrest on the continent too.

Marine Le Pen, the leader of France's right-wing National Front, would put the blame on Brussels not London. This is a matter of days or weeks, not months.

A decent thing to tell the general public in France and elsewhere would be, 'Let's see what happens to Britain first.' But with the 'phoney divorce' between the UK and the European Union now underway, this option is not on the table.

French centre-right politicians are under pressure to offer a fresh EU referendum, this time of the in-out variety.

Opportunistically, Nicolas Sarkozy, the former president and leader of the centre-right Republican party, has once again embraced the referendum idea, promising a vote on a new EU treaty. His support has increased in the polls ahead of centre-right primaries in November.

Hitherto front-runner Alain Juppé has said no to a populist plebiscite on Europe and lost support. He is no longer certain to win the all-important primaries.

If this sounds familiar, it should. Substitute Sarkozy for Cameron and Le Pen for Farage, and this is more or less the sequence of events Britain experienced a few years ago.

For the first time in 40 years France has begun to debate deep supply-side reforms, and all centre-right contenders have placed the bar very high.

Transformational reforms

The country is exhausted by the vicious and increasingly violent tactics of the main communist-controlled labour union, the General Confederation of Labour.

Many have welcomed long overdue moves towards transformational reforms. But the reformist drive in France may now be hijacked by calls to reform the EU instead – or leave if it does not change in the desired way.

Other countries could be even more exposed to such trends than France. In Austria, the constitutional court has annulled the presidential election and a fresh vote will be held in the autumn. No prize for guessing which topic will be centre stage. The loser in the last ballot, the ultra-nationalist Freedom party, has promised an in-out referendum based on the Cameron 'model'.

Unless Prime Minister Matteo Renzi decides against it, there will be a constitutional referendum in Italy in the autumn. Although the anti-establishment, eurosceptic Five Star movement headed by Beppe Grillo announced after the UK vote that it no longer wants a referendum on the euro, a change of tack is likely.

In short, we continue to suffocate.

The UK should invoke Article 50 as soon as possible. And Angela Merkel, the German chancellor, should stop behaving as the objective ally of the worst faction of the 'Brexiteers'. We do not have the luxury of time on our side. ■

Jacques Lafitte is Chief Executive of Avisa Partners, Brussels, and a former aide to Yves-Thibault de Silguy, the European Commissioner responsible for introducing the euro in 1999.

Doubts on ECB controls on euro assets

Central banks' ANFA information gap needs filling

A special correspondent in Warsaw

Questions are reverberating around Europe regarding the degree to which the European Central Bank can control autonomous assets on the balance sheets of national central banks which could potentially interfere with the ECB's overall monetary policies.

Poland, with around $100bn of foreign exchange reserves, is becoming increasingly interested in exploring whether the ECB could use its powers to curb the country's freedom to deploy its large balance sheet after Warsaw's eventual accession to economic and monetary union.

For political and economic reasons, Polish membership of EMU, required under European treaty obligations, is many years away. But lack of knowledge in Warsaw about Poland's freedom of manoeuvre on the ECB's so-called Agreement on Net Financial Assets may be one more reason for Poland and other states to postpone indefinitely their projected starting date.

Partly as a result of pressure from German criticism of the ECB's monetary policies, on 5 February the ECB published details of ANFA, which sets rules and limits for non-monetary policy holdings connected to the domestic tasks of NCBs.

Additional bond purchase suspicions

ANFA garnered much publicity in late 2015 because of suspicions linking it to some central banks using their autonomy to purchase additional holdings of government bonds beyond the limits under the ECB's quantitative easing measures, launched in March 2015.

Central banks around Europe are buying their countries' government bonds according to an overall €60bn a month (subsequently increased to €80bn) bond purchase programme.

Some German economists claimed that certain central banks, such as Banca d'Italia, were using this leeway as a means of financing state deficits in a way that circumvented the European treaties.

Examination of Banca d'Italia's balance sheet reveals, however, that these suspicions appear to have been misplaced. Between March 2015 (when the ECB's QE started) and March 2016, the Italian central bank registered a €109bn increase in securities related to monetary policies (position 7.1 in the balance sheet, which includes the ECB's purchases). Other securities (position 7.2) in the bank's portfolio registered an increase of just €3bn.

All financial assets in domestic currency which are subject to ANFA hardly changed during the period. In respect of net financial assets, Banca d'Italia's annual figures seem not to show any untoward activity, declining in 2015 to €134.9bn from €136.2bn a year earlier.

Another central bank to disclose its ANFA assets is Bank of Portugal. In 2015 these amounted to €16.2bn, an increase of more than €3bn from a year earlier. BoP financial assets subject to ANFA increased by only €1.7bn during the same period. Other securities (position 7.2) were hardly changed, while position 7.1 securities increased by around €11.4bn.

Although German doubts have become less virulent, questions over ANFA have arisen from a different vantage point, namely that of non-euro countries with central banks owning a significant quantity of financial assets. National Bank of Poland is keen to establish where it would maintain autonomy in managing reserves and other parts of the balance sheet.

Denying NCBs the right to manage their assets would be tantamount to converting these national banks into regional branches of the ECB. This would be extremely difficult from a political point of view and add to the considerable obstacles surrounding any Polish decision to join EMU in coming years.

Despite a sharp increase in the Eurosystem's balance sheet, assets controlled by NCBs and not subject to common monetary policy still account for around 45% of assets on the consolidated balance sheets of the European system of central banks, giving NCBs power to influence liquidity levels in the euro area.

Seven new members

The original version of ANFA was signed in 2003. Since then, the euro area has gained seven new members, with their central banks' assets partly absorbed into the ECB system. Since these newcomers are small economies, the task of integrating them into the rest of the Eurosystem has not been excessively challenging. Poland's accession would be more problematic, given the country's economic size and level of reserves.

ANFA's complexity gives rise to two sets of questions. The first surrounds the optimal level of foreign exchange reserves of a country approaching euro membership, and how ANFA restrictions would affect deployment. The second focuses on liquidity issues in the domestic banking sector, and whether a new euro adherent would be better placed with a liquidity deficit or a surplus.

ANFA demonstrates the limits of coordination of monetary and non-monetary policies in the Eurosystem. Publication of the agreement's content earlier this year does not directly address many key questions, since statistics regarding the execution of ANFA remain shrouded in mystery.

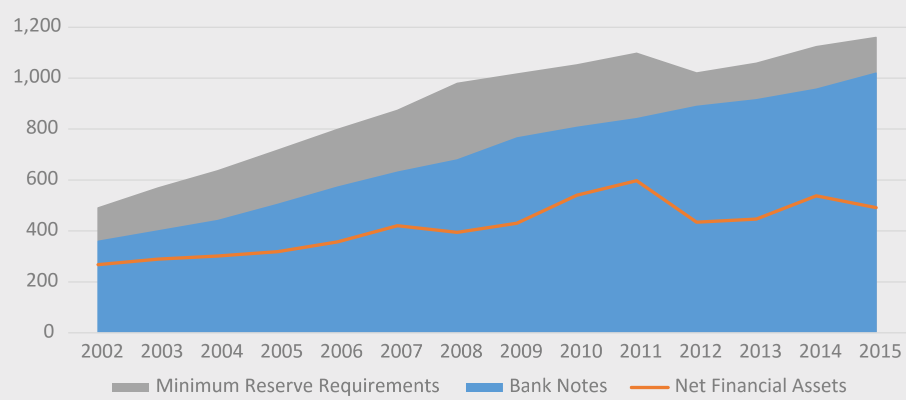
The ECB recommends, somewhat awkwardly, contacting other euro area NCBs to learn more about the agreement. But, with a few notable exceptions (above all the Bundesbank), it is very difficult learn anything constructive about ANFA from NCBs.

This information gap needs to be rectified to give central banks outside the euro area assurances over their status after a later decision on joining the system. ■

The author works for an official institution in Warsaw.

Net financial assets fall while reserve requirements increase

NFA development against minimum reserve requirements & bank notes, €bn, 2002-15



Source: ECB

Post-Brexit challenge for Swiss money

Economy floundering despite negative interest rates

Peter Warburton and Federico Corrado, Economic Perspectives

Swiss monetary conditions tightened abruptly in January 2015 when the currency cap versus the euro was abandoned. Despite the downward shift in interest rates on excess funds held in sight deposits at the Swiss National Bank, at minus 0.75%, there is little to suggest that the monetary authorities have been successful in their attempts at relaxation.

In the run-up to the British EU referendum and in its immediate aftermath, the Swiss franc appreciated by about 3% against the euro. Now that the UK has voted to leave, the markets may be further destabilised by the 'Brexit' fall-out, and the Swiss franc would be one of the currencies likely to appreciate. If this happens, in some quarters there will be enthusiasm for re-introducing a currency cap.

Nominal growth has evaporated

This is an awkward background against which to consider how broad aggregates for the money supply and private sector debt have continued to decelerate, to the point where nominal growth has evaporated.

Negative interest rates under the SNB's relaxation policy have not persuaded businesses to borrow and may have reinforced consumers' determination to save.

Until recently, banks avoided passing on negative interest rates to their clients by cross-subsidising them at the expense of mortgage borrowers, thus protecting their own net interest margin.

However, a Swiss bank now holds the dubious distinction of being the first bank to charge retail customers for holding their deposits. This shows how negative interest rates seem to be having perverse effects.

> ***"Negative interest rates have been ineffective in persuading businesses to borrow and may have reinforced consumers' determination to save.***

Measured by its own high standards, the Swiss economy is floundering. Capacity utilisation in manufacturing is at its weakest since 2013, well below its long-term average. Half of responding companies report underutilisation, with only chemical and pharmaceutical companies assessing capacity utilisation as normal. New orders have recovered over the past year, but they remain soft, particularly in machinery, metals, and watchmaking.

For an economy with an export to GDP ratio of 70%, and where roughly half of those exports are bound for the euro area, the exchange rate vis-à-vis the euro matters a great deal. The capping of the Swiss franc had achieved a measure of success over the 2011-15 period in preserving trade competitiveness.

When the SNB first introduced the cap in 2011, it was in response to an appreciation of about 25%. Given that the central bank already considers the Swiss franc to be significantly overvalued, the threshold this time might be somewhat lower.

Though the primary rationale for lowering interest rates below zero was to dissuade further currency appreciation, there was a presumed benefit to private consumption and borrowing. However, household sector savings have grown faster since the first quarter of 2015, and bank lending growth has weakened.

As of March 2016, loans to households were growing at 2.9% year on year, down from previous quarters and seemingly unresponsive to historically low mortgage rates. Meanwhile, loans to companies were contracting outright.

Contracting investment

Domestic demand is stagnating; consumer spending is barely growing and fixed investment is contracting. Net exports are detracting from growth.

The central bank marked down its GDP forecast for 2016 from 1.5% to 1-1.5%. The unemployment rate (3.5%) has been rising steadily since 2011, and at an increasing pace since the beginning of 2015.

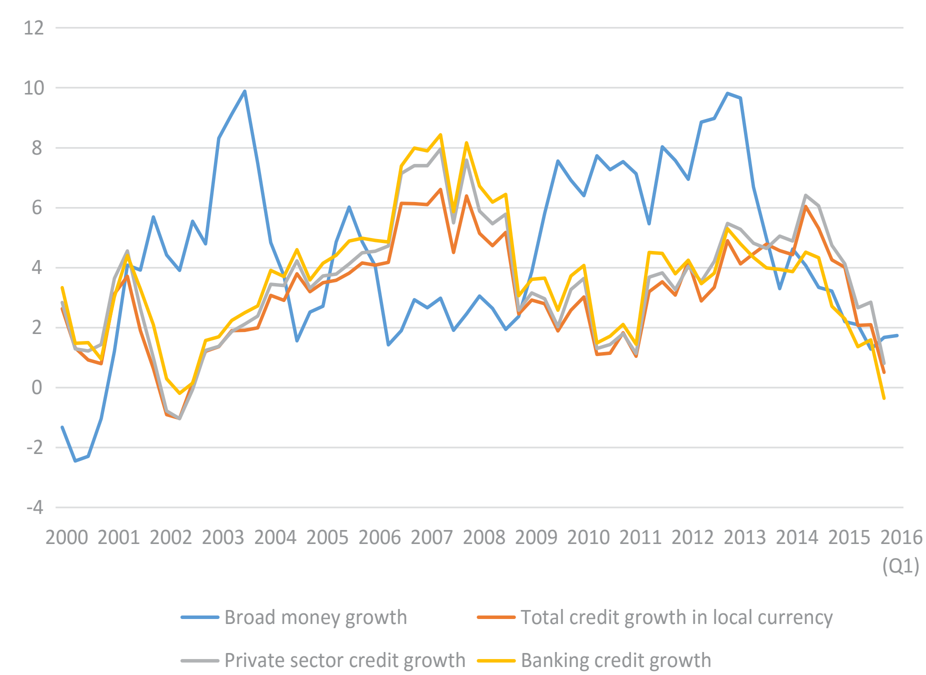
On the inflation front, there are headwinds from global GDP deceleration, domestic slowing and the strength of the Swiss franc, explaining the flirtation with deflation. Average annual inflation since 2009 is an appalling minus 0.25%.

Switzerland's ability to run an independent monetary policy is increasingly circumscribed by the willingness of the European Central Bank and US Federal Reserve to deploy even more desperate measures.

Short of an uncharacteristic bout of fiscal reflation, the Swiss economy looks to be headed for the rocks. ■

Swiss monetary growth showing downward trend

Switzerland money and credit, % pa



Source: Thomson Reuters Datastream

Peter Warburton is Director and Federico Corrado is Economic Research Analyst at Economic Perspectives.

Preserving central bank independence

Democratic legitimacy and policy effectiveness

Boris Vujčić, Croatian National Bank

Central bank independence requires the delegation of powerful authority to a group of unelected officials, to prevent the redistributive consequences of inflation.

More technically, an independent central bank is a device to overcome the problem of time consistency: the concern that policy-makers will in future renege on a policy promise made today.

The consequences, especially in the case of hyperinflation, can be devastating for the economy, and have a deep political impact.

An earlier rationale for central bank independence has re-emerged during the global financial crisis: the need to prevent or limit panics.

There is an unavoidable conflict between the goals of democratic legitimacy and policy effectiveness. The 'anomaly' of powerful authority being in the hands of unelected officials raises questions of legitimacy and fears that power is being concentrated in the hands of a select few.

These can trigger popular discontent, as has been experienced.

Issues of democratic legitimacy

Issues of democratic legitimacy arise primarily within the redistributive realm of monetary policy, namely when monetary policy 'does somebody else's job'.

Ironically, had it not been for the expansion in the mandates (both formal and informal) and expectations of central bank policies, the issues of independence and democratic legitimacy would not have surfaced with such intensity.

Further challenges stem from the inability to numerically quantify the financial system's resilience in the same way as inflation is quantified as a goal of monetary policy.

This is especially true if judging the state of financial stability requires knowledge of privileged information about individual institutions that a financial supervisor cannot disclose. As a result, outside observers will find it difficult to assess objectively progress towards financial stability.

Most observers find the monetary policy goal – price stability – easier to interpret, no matter how complex measuring price stability and understanding the impact of interest rate changes may be.

To make an independent central bank work, political leaders must delegate the necessary powers and establish an oversight regime that ensures accountability without undermining the institution's policy effectiveness.

Central to the issue of price stability as a monetary policy goal is the real impact of low inflation on the economy, which it seems we still do not know much about.

There is little or no evidence that low inflation, or limited deflation, hurts growth. Nor do we know much about monetary policy's ability to affect inflation in a globalised world.

> ***"The 'anomaly' of powerful authority being in the hands of unelected officials raises questions of legitimacy and fears that power is being concentrated in the hands of a select few. These can trigger popular discontent, as has been experienced.***

New economic circumstances and new instruments and mandates create new challenges with implications for central banks' independence, particularly within multinational currency zones and monetary communities.

Distribution conflicts

Distribution conflicts spill over into monetary policy even within a single country. For example, due to strong pre-crisis borrowing, some households became heavily leveraged. Meanwhile, the subsequent fall in real estate prices saw some households go 'under water'. As financial assets are far more concentrated than loans, the two groups of households would prefer different, if not completely opposite, monetary policy stances.

In terms of financial stability issues, recent government interventions in central and eastern Europe represent another challenge. These include Hungary's conversion of Swiss franc loans and a similar exercise in Croatia. Romania introduced 'limited liability' mortgage loans with retrospective effect, and Poland discussed bank taxes and the conversion of Swiss franc loans.

Such a political economy might challenge the conduct of monetary policy and supervision, where the main objective is banking system stability and preventing public funds being spent on insured savings.

Could central banks try to 'optimise' independence by making new circumstances endogenous? For example, they might start treating inflation targets more flexibly, while trying to achieve other, not legally mandated goals, such as debt reduction.

The reduction of an aggregate debt overhang could be fast, though painful in the short term, via some form of debt restructuring. Alternatively, the slow method entails that borrowers' income growth exceeds the rate of interest, while the debt stock is kept fixed.

Lost independence

Many economists have already voiced this 'new reality of lost central bank independence'. They claim that if central banks do not adapt to new realities, the political paradigm about the acceptable model of central bank autonomy may change.

The competing view is that central banks have done a good job in extremely challenging circumstances, and even managed to strengthen independence.

One venue for this is within institutional arrangements that share the responsibilities for supervision and macroprudential policies. These could be national or international bodies that have strengthened and standardised prudential regulation – making national capture, either political or coming from industry, less likely.

Central banks have to be cautious in expanding their mandates and mindful of redistributive effects inherent in non-orthodox monetary policies, negative interest rates and macroprudential policy, for example.

The moment they consciously set out along that road, or 'turn a blind eye' to redistributive effects in the name of higher goals, they risk losing their independence.

In addition, transparency, as a traditional response to strengthen central bank independence, might not be sufficient.

The blow to independence only partially comes from ignorance. To a greater degree it is caused by strong economic interests.

Nonetheless, central banks need to further their understanding of the new economic realities and circumstances. Intellectual capacities and knowledge are often their best defence mechanism. ■

Boris Vujčić is Governor of the Croatian National Bank. This is an edited extract of a speech delivered at an OMFIF Economists meeting at the Czech National Bank in Prague on 8 June.

Big Data: prediction and action

Technology offers new ways of managing risk

Caroline Butler, Advisory Board

Big Data – extremely large data sets that can be analysed to reveal patterns, trends, and associations – is slightly mysterious, perhaps a threat to our privacy.

But Big Data is also creating new revenue streams in industry and better risk management systems in the insurance and banking sectors. Commercial banks have developed Big Data software programmes to predict which borrowers might default or run late or prove fraudulent.

In 2008 the Queen asked, 'Why did no one see the crisis coming?' One answer is that we did not know what to look for. Another is that we did not recognise the risk when we saw it. Could a private Big Data Room at the Bank of England help resolve these issues?

Financial risk is a slippery concept. To some, it means that the price of an asset can vary wildly. To others, it means losing money. To some, it means the likelihood of a high return if all goes well. To others, the likelihood of bankruptcy if all goes awry.

To the public, it conjures the names of Nick Leeson and the end of Barings, the UK's oldest merchant bank, brought to its knees in 1995, or the events of September 2007 and the queues at building society Northern Rock.

No longer can a raised eyebrow from the governor of the Bank of England bring a bank into line. But could Big Data 'visualise' banking risks and give the governor a confidentially accurate picture of what he might wish to raise an eyebrow about?

The beauty of Big Data – the ability to aggregate and analyse massive amounts of data in real time – is that by its very size it enters the realms of statistics, probabilities and predictions.

Batch-orientated programming frameworks using 'Hadoop' or other database analytic systems provide us with the capacity to see patterns in data that were previously hidden. A real Big Data Room exists now at the Data Science Institute, Imperial College. There, you really can stand in a large circular room of screens providing one enormous wrap-around image.

Imperial College's research is pioneering. I saw in real time a traffic management system operating an international city's underground transport system. I then saw the view filmed by Curiosity Rover on Mars, the incredible definition of the images enabling expert physicists to detect previously unrecognised rock formations.

The most exciting programme showed dynamic images identifying simultaneously the volume of Bitcoin live transactions at worldwide servers, a live visualisation of blockchain transactions and two visualisations of blockchain hacking attempts.

These images look like a form of video art. But the managers of our financial sector may find such visualisations create a new understanding of risk as it builds up.

Increasing amounts of data recorded from a statistically large enough universe reveal patterns and correlations which might provide some essential predictive information. Sufficient to enable the governor to know to whom to raise an eyebrow. ■

Caroline Butler is an Associate Fellow of Green Templeton College, Oxford.

The tipping point of blockchain

Regulators monitoring risks and rewards

Steven Bardy, International Organisation of Securities Commissions

As the use of blockchain moves from the conceptual and pilot stages to implementation, regulators are working with market participants to understand the technology and how it might affect markets.

If regulatory intervention is required, the key objective will be letting innovation take place to benefit markets and investors while making sure risks are properly managed.

To date, regulators' approach to blockchain – a form of distributed database comprising a constantly growing list of data records fortified against tampering and revision – has been to sit back, observe and discuss, rather than intervene. To do otherwise would be premature and inappropriate. The challenge will be to decide whether, when and in what manner to intervene. This will be the tipping point at which the momentum and changes being seen are too big to ignore.

Acting too early may stifle development. Acting too late may leave entrenched issues undermining the public and social benefit blockchain offers.

Regulators need to act if they anticipate threats to investor trust and confidence, or to the fair, transparent and orderly operation of markets; and threats to systemic stability.

There are three issues which need to be monitored and assessed. Fragmentation is the risk that different types of systems and protocols will develop, undermining the cost and efficiency benefits blockchain offers. Complexity risk is the challenge to investors and markets in fully understanding the risks blockchain poses. Cyber risks include the threats to the integrity and quality of information stored in the blockchain.

Fragmentation risks are key at this stage. Addressing them will require the development of basic protocols and an overall framework for blockchain solutions. These protocols could address such issues as data standards, digital identity and the operation of smart contracts.

Their development should not be an issue for regulators or policy-makers. Market participants have a deep understanding of the technology they are developing and are best placed to know what is needed.

The official sector will nonetheless have an important backstop role to play. It will need to encourage and facilitate industry developing these protocols, and act in the public interest should progress be either too slow or non-existent.

If it does act, the sector will need to address two important issues. The first is how the new blockchain-enabled environment will fit into the current regulatory framework. The official sector will need to understand whether the regulatory perimeter requires extension or whether the blockchain environment can fit comfortably within the current regulatory perimeter.

The second consists of cross-border issues. Blockchain will not be limited by geographic boundaries. Each jurisdiction acting alone will not be able to address properly regulatory risks and issues. The official sector globally will need to work together in a co-ordinated and consistent way to resolve these issues.

Steven Bardy is Senior Executive Leader, International Strategy, Australian Securities and Investments Commission, and Chair of the Assessment Committee, International Organisation of Securities Commissions. He writes in a personal capacity.

Nihilism crowding out trade debate

Trump rails against America 'in decline'

Peter A. Petri, Peterson Institute for International Economics

Economic integration could become the great casualty of the US election of 2016. The centrepiece of Donald Trump's campaign is ripping up past US trade agreements, which could make 'Brexit' look like a storm in a teapot.

Hillary Clinton has backed away from the Trans-Pacific Partnership that she championed as secretary of state and from President Bill Clinton's signal accomplishments in international trade. These are ominous signs. But a return to reason remains the plausible, if uncertain, outcome.

For the last 70 years, the world trading system has supported innovation and the diffusion of knowledge. It has made luxuries affordable to middle classes, allowed billions to escape from poverty, and enabled peaceful adjustment to huge transitions in technology and economic power. The world economy has grown much faster than ever before.

The US has championed this system. And with chaos in Europe, American leadership remains indispensable.

Competitive US firms

The Trump campaign has turned trade into a monster. Never mind that trade plays a small role in US economic activity; it accounts for only 15% of GDP (and manufacturing trade for less than 10%). Never mind that US trade trends are positive. Exports have grown faster than output and are well above their 2008 pre-crisis peak. The trade deficit narrowed to 2% of GDP in 2015 from 4.5% in 2008. Even with a strong dollar, US firms are exceptionally competitive in energy, agriculture, advanced manufacturing, technology and services. The US still runs a trade deficit. But this is a necessity as long as the dollar remains the world's preferred reserve currency.

The 2016 election comes amid massive technological and international change. World economic growth is sluggish and productivity gains and wage increases have stalled in many countries. The distribution of income has tilted toward the owners of capital and those prepared for the technology-driven economy.

None of these problems is unique to the US and few have anything to do with trade. In fact the US economy is performing better than most others. As technological leader, it is relatively well positioned to manage change.

> ***"The North American Free Trade Agreement enabled US industries to remain competitive through critical supply chains.***

Yet Trump merely sees America in decline. He attributes this to decades of 'stupid' trade agreements and singles out Mexico and China as stealing jobs from the US. In fact, the North American Free Trade Agreement enabled US vehicle and other industries to remain competitive – despite strong challenges at the time from Japan and Korea – by establishing critical supply chains.

He also blames America's supposed decline on China's admission to the World Trade Organisation, which mainly committed China to global rules and difficult domestic reforms.

Trump's claim that the US is 'losing $500bn a year' on US imports from China ignores 200 years of economics – imports are not losses, but goods valued by us. Imports also support export industries and their supply chains, and no doubt help to sell Trump condominiums.

The most pernicious aspect of these nationalist attacks is that they ignore facts, evidence and accumulated knowledge, and put fanciful opinion above difficult analysis.

Michael Gove, UK justice secretary and a leading campaigner for Britain to leave the EU, declared during the campaign that England had 'had enough of experts'. Trump, too, explains that 'my primary consultant is myself'.

Such nihilism crowds out reasoned debate and leads to outlandish proposals, including a wall against Mexican migrants and retreat to the mythical days when the US made 'everything here'. Ratings agency Moody's says parts of Trump's plan would lead to recession. I have reported that protectionist measures against Mexico and China would cause large negative short-term shocks in the US, as well as long-term income declines.

Sensible debate

Some argue that Trump will not carry out his promises. But that is not a risk that Americans can afford to take. The solution is a return to evidence-based analysis and sensible debate.

The next US administration needs to reassure allies, trade partners and investors that America will not retreat from a constructive international role. The TPP should pass quickly – it may never have as good a chance as this year.

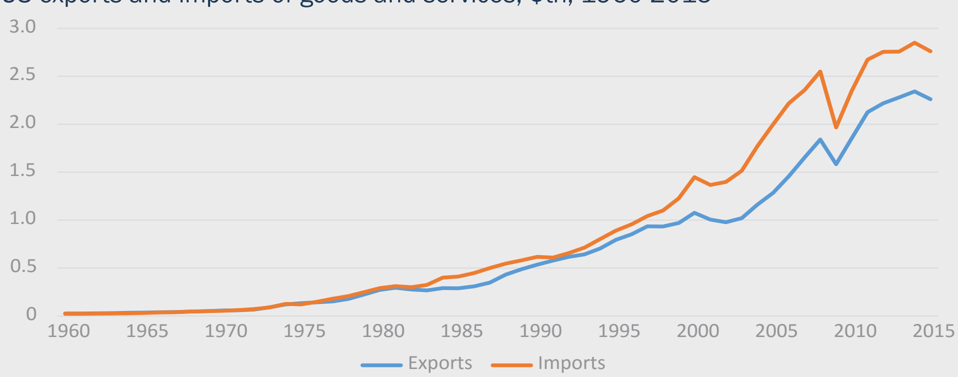
The US must also adopt forceful solutions to income inequality and support for workers adjusting to change. America's middle classes cannot be allowed to drift away from solutions that are likely to work.

Such positive scenarios are within reach. Prediction markets are betting heavily that Clinton will win the election, making Trump's fantasies and political style anathema to future candidates.

The turmoil caused by the UK vote should help voters understand that meaningful plans matter. Even Republican voters are dissatisfied with Trump's lack of substance, so a discussion of substantive policy options may yet begin. The US has a record of making good decisions even as it flirts with occasional disastrous ones. ■

How US trade deficit has widened since 1990s

US exports and imports of goods and services, $tn, 1960-2015



Source: US Census Bureau, Economic Indicator Division

Peter A. Petri is a Visiting Fellow at the Peterson Institute for International Economics and Carl J. Shapiro Professor of International Finance, Brandeis International Business School.

Brexit, economy delay Fed action

Bullard surprises market watchers with policy about-face

Darrell Delamaide, US editor

June was a Janet Yellen month, as the chair of the US Federal Reserve dealt with a laundry list of economic challenges from 'Brexit' to labour market slack and stubbornly low inflation.

In a press conference and appearances before two congressional committees, she analysed the situation, answered questions, and in general gave the impression it might be some time before Fed policy-makers are ready to raise interest rates again.

'Caution is all the more appropriate given that short-term interest rates are still near zero,' Yellen said in her prepared remarks at the mid-June press conference.

'This means that monetary policy can more effectively respond to surprisingly strong inflation pressures in the future than to a weakening labour market and falling inflation.'

She acknowledged that uncertainties about the impact of the British referendum 'factored into' the Federal Open Market Committee's decision not to take any action on interest rates at the June meeting. Circumstances could of course change after better than expected US jobs data for June, published on 8 July.

Impact of Brexit on US policy

The UK referendum 'could have consequences for economic and financial conditions in global financial markets,' she said, 'and in turn for the US economic outlook that would be a factor in deciding the appropriate path of policy.' The surprise vote in favour of a British exit from the European Union certainly vindicated the committee's caution.

But it was also concerns about the domestic economy that prompted the panel to nudge its expectations for rate hikes somewhat lower, as Yellen made clear in testimony before the Senate banking committee the following week, citing the factors that made them cautious.

'The latest readings on the labour market and the weak pace of investment illustrate one downside risk – that domestic demand might falter,' she said in her testimony ahead of the British vote.

In particular, Yellen had noted earlier in the month that the May jobs report, released in early June, was 'disappointing'.

'Although this recent labour market report was, on balance, concerning, let me emphasise that one should never attach too much significance to any single monthly report,' she said at the World Affairs Council in Philadelphia.

'That said, the monthly labour market report is an important economic indicator, and so we will need to watch labour market developments carefully.'

So policy-makers already had other concerns when the surprise referendum result came along. The Fed was quick to reassure markets the day after the vote, issuing a brief statement that it stood ready 'to provide dollar liquidity through its existing swap lines with central banks, as necessary, to address pressures in global funding markets, which could have adverse implications'.

Fed governor Jerome Powell was the first FOMC member to speak after the British referendum. He warned that 'global risks have now shifted ever further to the downside'.

> ***"Concerns about the domestic economy prompted the panel to nudge its expectations for rate hikes somewhat lower.***

Powell enumerated the risks he had in mind in a speech to the Chicago Council on Global Affairs. These were stubbornly low growth and inflation in major US trading partners, as central banks have limited scope to respond, as well as a difficult transition in China away from its export economy, and challenging conditions in emerging markets such as Brazil, Russia and Venezuela.

'Although financial conditions have tightened since the vote, markets have been functioning in an orderly manner,' Powell said. 'And the US financial sector is strong and resilient.'

Banks in a strong position

The Fed's annual stress test for the 33 largest US banks showed the banks in a stronger position than ever to weather conditions much more severe than those resulting from the Brexit vote.

Supplementary materials for the June FOMC meeting showed a majority of participants still anticipating an increase of 50 basis points in the midpoint of the target range federal funds rate this year – implying two hikes of a quarter point each, to 0.875% from 0.375% currently. But markets clearly expect the Fed to postpone any hikes until next year.

Powell's post-Brexit speech omitted any reference to a possible increase in interest rates. This was in contrast to a speech the previous month in which he suggested that any further data showing improvement in employment or inflation would make it 'appropriate to continue to gradually raise the federal funds rate'.

Janet Yellen, Chair of the US Federal Reserve

St. Louis Fed chief James Bullard surprised market watchers between the FOMC meeting and the British referendum with a startling about-face on monetary policy.

Bullard, who had been pushing for earlier and higher rate hikes, said he had changed his view on the economy and now wanted only one mini-hike this year. He would then like to put rates on hold through 2018.

He argued that this median rate of 0.63% is the ideal rate for the economic 'regime' the St. Louis Fed foresees for the next two and a half years. This covers real output growth of 2%, an unemployment rate of 4.7%, and an inflation rate of 2%, based on the 'trimmed-mean PCE' rate calculated by the Dallas Fed, which stands at 1.86%.

Circumstances may lead to a change in this regime – necessitating a change in policy. But this switch, Bullard's team says, is 'not forecastable'. 'We are backing off the idea that we have dogmatic certainty about where the US economy is headed in the medium and long run,' the St. Louis Fed chief said.

Bullard refrained from placing a dot for the longer-run forecast on the Fed's 'dot plot' graphic for forecasting rates. His dot remained stubbornly at 0.63% for 2017 and 2018. His 16 colleagues on the FOMC forecast median rates between 1.375% and 3.75% from 2017 in the long run. ■

Darrell Delamaide is a writer and editor based in Washington.

Mixed signals for US policy-makers

Economy settles into period of low productivity growth

Kevin L. Kliesen, Federal Reserve Bank of St. Louis

Formulating US monetary policy in the current environment may appear challenging. However, the economy seems to have settled down to its long-run growth potential of roughly 2%, with inflation near target and the unemployment rate at a level consistent with full employment.

This is the outcome one should expect given the fundamentals of low productivity growth and a credible inflation-targeting regime. But if productivity growth or inflation begins to pick up, or asset prices start to rise worryingly, policy-makers will need to adjust their approach accordingly.

From a historical perspective, the US economy's current expansion is long in the tooth, entering its eighth year in June. Expansions do not die of old age. Rather, they end because of some unforeseen disturbance that causes firms and individuals to alter their planned expenditures and expectations of future incomes.

Weak pace of growth

The pace of growth during the past seven years has been historically weak. Since the second quarter of 2009, real GDP growth has averaged 2.1% per year. By contrast, growth in the previous three expansions (1982-90, 1991-2001, and 2001-07) averaged 4.2%, 3.6% and 2.7% respectively.

Nevertheless, unemployment has declined from 9.9% (peaking in the fourth quarter of 2009) to 4.7%, a level consistent with most forecasts of full employment, while inflation has remained relatively low. The all-items personal consumption expenditures price index has risen by an average annual rate of 1.5%, below the Federal Open Market Committee's 2% inflation target.

For some time, the majority of forecasters and FOMC policy-makers predicted that real GDP growth would accelerate to around 3% or more. But this has not happened. Real GDP growth has not been 3% or more for an entire year since 2005.

This raises two questions. First, why has real GDP growth declined during the current expansion? And second, why has inflation remained so low despite an extraordinarily accommodative monetary policy – as defined by a large Federal Reserve balance sheet and a persistently low nominal federal funds rate (the FOMC's policy rate)?

The answer to the first question is reasonably straightforward. From a growth accounting perspective, real GDP growth is the sum of labour productivity growth and the growth rate of employment.

Since the end of 2010, productivity has increased at an average annual rate of 0.4%. Over the three previous expansions, it increased by 1.9%, 2.1%, and 1.6%.

The most obvious answer is therefore that the current expansion's weakness reflects a significant slowdown in labour productivity growth. Employment growth accordingly has been much faster than productivity growth, which explains why GDP has grown faster than productivity.

> ***"Monetary policy-makers face a plethora of mixed signals as they decide how to proceed with slowly raising the federal funds target rate to its long-run level.***

Explaining weak productivity growth is less straightforward. One potentially significant explanation is that there has been a loss of economic dynamism in the US.

Although the phrase is somewhat imprecise, the key concept is that there has been a substantial slowdown in new business start-ups. Fewer start-ups implies less entrepreneurial activity and potentially slower productivity growth.

Other hypotheses include increased government regulations, a misallocation of capital due to poor economic policy incentives, and the replacement of retiring, experienced baby boomers by younger, inexperienced workers.

Productivity growth will rebound

The consensus of private sector forecasters is that productivity growth will eventually rebound and begin rising by around 1.5% per year. But there is scant evidence for such an acceleration as yet. The economy appears to have settled into a period of low productivity growth – what some economists refer to as a 'regime'.

The reason inflation has remained so low is relatively clear-cut. From the second quarter of 2009 to the second quarter of 2014, headline inflation averaged 1.8%, while the expected inflation rate over the 10 subsequent years rose from 1.6% to 2.2%.

Perhaps surprisingly, low inflation during this period coincided with three rounds of quantitative easing and repeated FOMC assurances that it would keep its focus on monetary policy. Despite an apparent hyper-easy monetary policy regime, inflation rarely rose above 2%.

Markets, households and firms appear to have viewed the FOMC's promise to defend its 2% inflation target as a credible commitment. Another possible explanation is that policy has not been hyper-easy.

Inflation has declined sharply since the second quarter of 2014, averaging 0.4% per annum. This reflects two key developments.

First is plunging crude oil prices – from an average of just over $103 per barrel to around $33 per barrel in the first quarter of 2016.

Second, a sharp appreciation in the value of the dollar, triggering sizable declines in prices of imported goods and services.

However, measures of underlying inflation that attempt to remove temporary factors, such as the Dallas Fed's trimmed-mean PCEPI inflation rate, show inflation remaining at a little less than 2%.

As the effects of falling oil prices and a stronger dollar wear off, headline inflation should return to 2%.

Oil price rebound

Heading into the second half of 2016, monetary policy-makers face a plethora of mixed signals as they decide how to proceed with slowly raising the federal funds target rate to its long-run level ('normalisation').

Crude oil prices have rebounded to around $50 per barrel and the dollar has retreated modestly from its highs. Both should put upward pressure on inflation.

Real GDP growth remained weak in the first quarter and inflation expectations have fallen slightly despite rising oil prices.

While real GDP growth is expected to have accelerated modestly in the second quarter and into the second half of 2016, there are few signs of a pending acceleration in labour productivity growth that could push growth appreciably higher than what it has been during this expansion.

Inflation is expected to remain near 2% in 2016 and 2017, though it could move higher if oil prices continue to rise and the dollar falls further.

Finally, unemployment could, if forecasters are right, fall further from its average of 4.7% in May. ■

Kevin Kliesen is a business economist and research officer at the Federal Reserve Bank of St. Louis. He writes in a personal capacity. See research.stlouisfed.org/econ/kliesen/ for more research.

Saudi Arabia's diversification drive

Riyadh takes Uber stake as sovereign fund moves ahead

Patrick J. Schena, The Fletcher School, Tufts University

The April approval of the National Transformation Programme (Vision 2030) aims to reduce Saudi Arabia's dependence on oil. It will see the Public Investment Fund – the sovereign fund dubbed the Saudi 'megafund' – take its place among the hierarchy of the kingdom's ambitious development targets.

These include almost tripling non-oil revenues by 2020, reducing public sector wages and subsidies, expanding the use of public debt, and aggressively restructuring and diversifying the national economy.

The PIF is expected to expand to $1.87tn from an estimated $160bn currently (and $94bn based on official figures last year) as a result of transfers of government assets, including state-owned oil company Saudi Aramco, in effect making it one of the world's largest institutional investors.

This is a bold undertaking. But it also raises the question of whether prioritising the PIF's expansion will ultimately be in the best interests of Saudi Arabia's economic transformation.

Economic slowdown

Since the slide in oil prices starting in August 2014 – in part attributable to the kingdom's decision to maintain production levels and therefore market share – the government has been forced to reduce spending levels, significantly draw down fiscal reserves, and institute a global debt programme.

This has left Saudi Arabia facing a critical challenge, accentuated by lower oil prices – how to stabilise the fiscal balance and reduce its dependence on oil through economic diversification, all the while slowing reserve depletion and increasing savings.

Such challenges are not alien to sovereign funds as instruments of macroeconomic policy. The Saudi Arabian Monetary Agency, the kingdom's central bank, has served both stabilisation and savings functions.

With assets once in excess of $740bn, $616bn at end-2015, one of SAMA's roles is to manage the Saudi fiscal buffer – now around $500bn – to mitigate gaps between revenues and expenditure.

A deal in June under which the PIF took a $3.5bn stake in online transport company Uber and two seats on the company's board at first sight may have appeared curious to some observers. In an era of expanding urbanisation and increasing activism on climate issues, Uber's networked model of mobility services could be viewed as challenging the very foundations of Saudi Arabia's oil economy.

> ***"The question is whether prioritising the Public Investment Fund's expansion will ultimately be in the best interests of Saudi Arabia's economic transformation.***

However, a sizable investment in Uber offers the kingdom a long-term financial hedge, as well as a presence on the board of a company that could significantly enhance its competitiveness for years to come.

Investment objective

The PIF does not maintain a website and has not formally disclosed even basic information about its organisation and leadership, sources of capital, investment policy, or governance structures.

Based on Vision 2030 documents, its investment objective is to diversify national assets and to increase the efficiency and return on investments by taking stakes in large global firms and emerging technologies.

Nevertheless, the Fund's projected size, ambiguous mandate and obscure investment policy, and eclectic mix of large domestic and foreign assets, will challenge its management and ability to build effective investment and risk management capacity. Not economies but diseconomies of scale may result.

In addition, size, investment concentration, and an active approach to monitoring will strain its ability to sustain an independent approach to governance.

It will also increase the risk of investment decisions becoming politicised or unduly influenced by factors beyond financial and economic criteria.

Economic re-engineering

Vision 2030 is a highly aggressive platform for economic re-engineering, and its success will depend on Saudi institutions' ability to implement it effectively. The triple challenges facing the kingdom – stabilisation, savings and development – persist.

Any consideration to create focused, separately mandated funds has been displaced by a restructured and expanded PIF under the control of Deputy Crown Prince Mohammed bin Salman. But is 'mega' better? Even if so, it will increase rather than reduce the risks already inherent in Vision 2030.

Either way, the PIF is poised to become a leading actor in global finance. It should lead by example by focusing its investment strategy, articulating its governance model, carefully defining its mandate relative to other Saudi institutions – such as SAMA – and clearly and consistently communicating its investment policy to global markets. ■

Patrick J. Schena is Adjunct Assistant Professor of International Business Relations at The Fletcher School, Tufts University, and Co-Head of SovereigNET: The Fletcher Network for Sovereign Wealth and Global Capital.

‘Brexit’ test for monetary policy

Uncertainty over emerging market response

Ben Robinson, OMFIF

A major question for financial markets after sterling’s sharp post-referendum fall is whether emerging market central banks, led by China, will move funds to the UK – badly needed to plug the country’s worringly high current account deficit.

In principle weaker sterling could encourage exports and boost economic activity, while reducing imports, thereby lowering the deficit, which was running at 7% of GDP at end-2015 and was 5.2% for the whole year. However, after the 2007-08 fall in sterling, UK exports did not pick up following depreciation. Pessimistic market sentiment after the June referendum result suggests an increase in foreign demand is unlikely to occur. Furthermore, if weaker sterling eventually leads to higher inflation (not generally thought likely at present), the Bank of England may have to raise interest rates rather than cut them as Governor Mark Carney projected in the immediate aftermath of the referendum.

Overseas demand for sterling assets

Since the referendum, government bond yields – which for some short-term gilts have turned negative – have fallen sharply, reflecting high demand for safe assets at the substantially weaker level of sterling. A significant volume of this foreign inflow comes from sovereign institutions or Global Public Investors, including China. Overseas demand for sterling assets seems to be holding up despite post-referendum uncertainty.

Strong evidence of buoyant foreign demand comes from official UK statistics, showing that at end-March 2016 overseas holdings of gilts were £462bn (27.0% of the total – a larger share than any other category, including pensions funds and insurance companies with 26.8% and the BoE with 23.9%). The total was up from £449bn at end-December, and almost £45bn higher than a year before. Net gilt purchases from overseas investors were £3.7bn in May 2016, sharply up from £214m in April. Total cumulative gilt inflows by overseas investors were £44.4bn in 2015-16 in comparison to £20.8bn in 2014-15.

The portfolio debt balance, in which foreign purchases of government bonds play a major part, as well as inflows of foreign direct investment, are the main means of financing the UK’s current account deficit, with these two items accounting for £32.3bn of the UK’s £33.9bn net capital inflow in the first quarter of 2016 (see Chart).

> ***“Over the past 10 years valuation effects have become twice as important as the trade balance in determining variance in the current account.***

The UK is the largest recipient of foreign direct investment in Europe and one of the biggest destinations for Chinese FDI. Overall stocks of FDI in the UK reached £1tn for the financial year 2014-15.

Although uncertainty around Britain’s future access to the single market will delay much investment in new productive capacity and capital spending, weak sterling may act as a ‘pull’ factor to attract emerging market investors to UK assets, which should help finance the deficit.

The lower exchange rate could help the UK narrow the current account deficit through valuation effects on investment income. Analysis of UK statistics over the past 10 years show that these valuation effects (determined by returns earned on the UK’s foreign assets less liabilities from foreign investments in the UK) have become twice as important as the trade balance in determining variance in the current account.

Weak sterling will boost the UK’s foreign investment income and reduce outflows related to foreign investments in the UK, factors which have significantly contributed to the UK’s current account deficit over the past decade. For a given country, the size of the stocks of foreign investment in domestic assets determines the extent of the impact of valuation changes on the current account.

China’s attempt to rebalance its economy

Post-Brexit, the renminbi has fallen against the dollar to its lowest level since 2010, but it remains relatively strong against sterling and euro. Along with weaker British growth, these currency changes throw up additional challenges for Chinese policy-makers. This raises the importance of China’s attempt to rebalance towards services and consumption, which are less dependent on foreign demand than production and manufacturing.

This requires moving up the value-added chain including acquiring UK and European technology assets. The UK has many of the industries of most interest to China, including green energy and digital technologies.

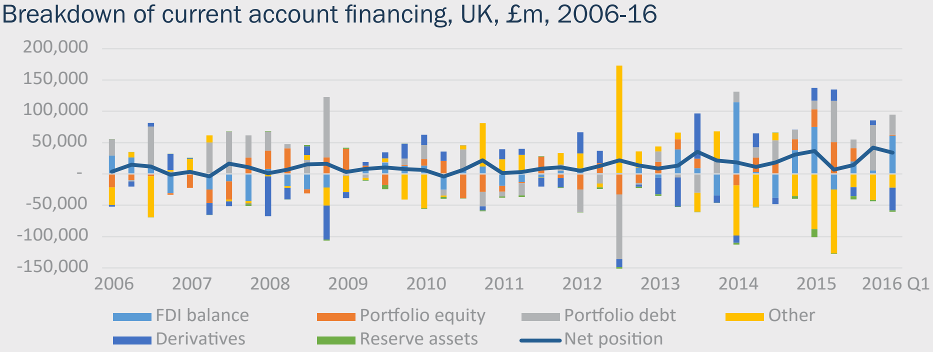
The EU accounts for almost 16% of China’s exports. A one percentage point drop in EU GDP could reduce China’s growth by 0.2 percentage points and harm highly indebted Chinese firms already suffering from overcapacity. Should China pursue monetary easing to realign with these currencies, plugging the UK’s deficit via higher inward investment and valuation changes on its net foreign assets would become much harder.

If a UK interest rate cut does materialise later this summer, this will compensate for lower growth, which most economists expect to be between one and two percentage points lower by 2017. This may well prompt a response from emerging market central banks, including further easing in China. This would make the BoE’s stimulus self-defeating, by contributing to sterling weakness while failing to stimulate foreign investment or narrow the current account deficit.

Given that interest rates are at an already-low 0.5%, a further cut would constrain the BoE’s ability to respond to future shocks. Both for Europe and emerging markets, the UK referendum has made the monetary policy maze more complicated. ■

FDI and portfolio debt finance UK current account

Breakdown of current account financing, UK, £m, 2006-16



Source: ONS

Ben Robinson is Economist at OMFIF.

Integrated impact investment

Finding a formal place in institutional portfolios

Harald Walkate, Aegon Asset Management

The past few years have seen significant progress in the area of impact investment as a tool to help tackle social problems while realising required investment returns. At first the exclusive domain of foundations, family offices and investors driven by socially responsible investing objectives, it is now gaining recognition in mainstream finance.

This is a welcome, and necessary, trend. To have the effect the impact investment community desires, much larger amounts will need to be allocated. This will require unlocking the vast capital pools held by the mainstream sector – pension funds, insurance companies and sovereign funds.

As Antony Bugg-Levine and Jed Emerson write in their book *Impact Investing: Transforming How We Make Money While Making a Difference*, the key will be 'determining where the high-potential capital pools sit, understanding how to motivate their managers to redeploy them, and supporting them do so.'

Engagement for growth

Today investment has reached the tens of billions. But we need to start thinking about how to engage the hundreds of billions, if not trillions, held by those asset owners.

For this, several things still need to happen. First, the impact investment community needs to better understand this 'mainstream' financial sector. It should recognise that, however socially-oriented and sustainable these organisations might be or claim to be, their first priority is matching investments to liabilities on their balance sheet.

This is as it should be: whether for-profit or not, this is what they were created to do: – to pay out pensions and insurance claims at some point in the future.

The majority of mainstream investors take a hard-nosed, no-nonsense approach to asset management. Strict return requirements apply, volatility is thoroughly analysed, difficult questions about liquidity are asked, and regulatory requirements need to be scrupulously fulfilled.

For more than a few asset owners, established asset classes such as equity (not to mention private equity or venture capital) are out of the question.

Impact investors need to understand that, while this restriction often poses barriers to certain impact investments, the barriers are there for good reason and will not vanish in the medium term.

Becoming mainstream messengers

Understanding this will help manage expectations of what mainstream finance can do in respect of impact investing. It will also help impact investors become true 'mainstream messengers' and pitch their investment opportunities more effectively to institutional investors.

Asset owners should take an integrative approach to impact investment, looking for opportunities in existing portfolios and asset allocation processes, not in addition to them.

The report 'Allocating for Impact' by the Asset Allocation Working Group of the G8 Social Impact Investment Taskforce is enlightening, and provides an excellent framework for doing exactly this.

It says that 'The traditional framework for portfolio construction can be used as the guide rails for making what an investor considers to be a reasonable allocation to impact investments.'

It is worth noting that this means impact investors should not ask asset owners to commit to a certain, separately labelled, 'impact asset allocation'.

While such a commitment could have the positive short-term effect of putting the topic on the table, focusing minds on a target, and bringing additional billions into the impact pool, it will not unlock the larger amounts required.

Furthermore, separate allocation reinforces the still common view that sustainable investments are not 'real'

"Asset owners should take an integrative approach to impact investment, looking for opportunities in existing portfolios and asset allocation processes, not in addition to them.

investments, but rather something for corporate social responsibility and public relations professionals belonging to the realm of marketing budgets.

Finally, there is the risk that these asset owners, feeling that they have fulfilled their 'sustainability obligation', will not look for further impact opportunities in their broader portfolios.

Most importantly, asset owners and asset managers need to get to grips with the type of analysis described in 'Allocating for Impact'. This is the hard part.

Bringing change will require impact investors to approach individual chief investment officers, specialists on fixed income or research desks, personnel responsible for asset allocation decisions, or other influential individuals within these organisations.

Note here that personnel without the grand title, but with an open mind and a creative bent, sometimes wield the most power to make little changes to big systems.

They need to be persuaded to start discussions in their organisations about applying the 'Allocating for Impact' analysis across their entire portfolio and to integrate it with their investment processes.

Only by doing so will impact investment find its formal place within institutional portfolios. ■

Harald Walkate is the Head of Responsible Investment & New Business Initiatives at Aegon Asset Management.


Kingsley Moghalu
Senior Adviser


Fabrizio Saccomanni
Senior Adviser


Niels Thygesen
Senior Adviser


Ted Truman
Senior Adviser

OMFIF ADVISORY BOARD

EDITORIAL & COMMENTARY

1. **Peter Bruce,** Business Day
2. **Reginald Dale,** Center for Strategic and International Studies
3. **Darrell Delamaide,** Market Watch
4. **Jonathan Fenby,** China Research, Trusted Sources
5. **Stewart Fleming,** University of Oxford
6. **Harold James,** Princeton University
7. **Roel Janssen,** NRC Handelsblad
8. **William Keegan,** The Observer
9. **Joel Kibazo,** formerly African Development Bank
10. **Thomas Kielinger,** Die Welt
11. **Jürgen Krönig,** Die Zeit
12. **Willem Middelkoop,** Commodity Discovery Fund
13. **Brian Reading,** independent economist
14. **Janusz Reiter,** former Polish Ambassador to US
15. **Anthony Robinson,** formerly Financial Times
16. **David Smith,** formerly United Nations
17. **Michael Stürmer,** WELT-Gruppe
18. **David Tonge,** IBS Research & Consultancy

BANKING

1. **John Adams,** China Financial Services
2. **Yaseen Anwar,** Industrial & Commercial Bank of China
3. **Consuelo Brooke,** Alliance Trust & BlackRock
4. **Moorad Choudhry,** Habib Bank
5. **John Chown,** Institute for Fiscal Studies
6. **Michael Cole-Fontayn,** BNY Mellon
7. **Christian Gärtner,** DZ Bank
8. **José Manuel González-Páramo,** BBVA
9. **Akinari Horii,** formerly Bank of Japan
10. **Korkmaz Ilkorur,** Business & Industry Advisory Committee to OECD
11. **Philippe Lagayette,** Fondation de France
12. **Andrew Large,** formerly Bank of England
13. **Oscar Lewisohn,** Soditic
14. **Wilhelm Nölling,** formerly Deutsche Bundesbank
15. **Athanasios Orphanides,** formerly Central Bank of Cyprus
16. **Francesco Papadia,** formerly European Central Bank
17. **Philippe Sachs,** formerly Standard Chartered Bank
18. **Nasser Saidi,** formerly Bank of Lebanon
19. **Fabio Scacciavillani,** Oman Investment Fund
20. **José Alberto Tavares Moreira,** formerly Banco de Portugal
21. **Jens Thomsen,** formerly Danmarks Nationalbank
22. **Pasquale Urselli,** formerly Crédit Agricole
23. **Makoto Utsumi,** Japan Credit Rating Agency
24. **Tarisa Watanagase,** formerly Bank of Thailand
25. **Ernst Welteke,** formerly Deutsche Bundesbank

CAPITAL MARKETS & INVESTMENT

1. **Andrew Adonis,** National Infrastructure Commission
2. **Bahar Alsharif,** International Finance Corporation
3. **David Badham,** World Platinum Investment Council
4. **Stefan Bielmeier,** DZ Bank
5. **Mark Burgess,** formerly Future Fund
6. **Caroline Butler,** Walcot Partners
7. **John Campbell,** Campbell Lutyens
8. **Stefano Carcascio,** formerly Banca d'Italia
9. **Hon Cheung,** State Street Global Advisors
10. **Peter Gray,** Berkeley Capital
11. **Trevor Greetham,** Royal London Asset Management
12. **George Hoguet,** State Street Global Advisors
13. **Frederick Hopson,** formerly Hessische Landesbank
14. **Matthew Hurn,** Mubadala Development Company
15. **Paul Judge,** Schroder Income Growth Fund
16. **Mumtaz Khan,** Middle East & Asia Capital Partners
17. **Celeste Cecilia Lo Turco,** Italian Ministry of Foreign Affairs
18. **George Milling-Stanley,** formerly World Gold Council
19. **Paul Newton,** London & Oxford Capital Markets
20. **Saker Nusseibeh,** Hermes Fund Managers
21. **Robin Poynder,** formerly Thomson Reuters
22. **Colin Robertson,** formerly Aon Hewitt
23. **Marina Shargorodska,** formerly Quantum Global Group
24. **Gary Smith,** Baring Asset Management
25. **Soh Kian Tiong,** DBS Bank
26. **Marsha Vande Berg,** formerly Pacific Pension Institute
27. **Jack Wigglesworth,** formerly LIFFE

PUBLIC POLICY

1. **Antonio Armellini,** former Ambassador, OSCE
2. **Franco Bassanini,** formerly Cassa Depositi e Prestiti
3. **Frits Bolkestein,** formerly European Commission
4. **Laurens Jan Brinkhorst,** University of Leiden
5. **Colin Budd,** formerly UK Diplomatic Service
6. **Otaviano Canuto,** IMF
7. **Desmond Cecil,** Areva UK
8. **Natalie Dempster,** World Gold Council
9. **Hans Eichel,** former German Minister of Finance
10. **Jonathan Grant,** Policy Institute at King's
11. **François Heisbourg,** Fondation pour la Recherche Stratégique
12. **Karl Kaiser,** Harvard Kennedy School
13. **John Kornblum,** former US Ambassador to Germany
14. **Ben Knapen,** Dutch Senate
15. **Ruud Lubbers,** former Dutch Prime Minister
16. **Bo Lundgren,** formerly Swedish National Debt Office
17. **Denis MacShane,** former British Minister for Europe
18. **Kishore Mahbubani,** Lee Kuan Yew School of Public Policy
19. **Boyd McCleary,** former HM Diplomatic Service
20. **Luiz Eduardo Melin,** formerly Brazilian Development Bank
21. **Célestin Monga,** UNIDO
22. **Murade Miguigy Murargy,** CPLP
23. **David Owen,** House of Lords
24. **Jukka Pihlman,** Standard Chartered Bank
25. **Poul Nyrup Rasmussen,** former Danish Prime Minister
26. **Paul van Seters,** Tilburg University
27. **Christopher Tugendhat,** House of Lords
28. **John West,** Asian Century Institute
29. **Paul Wilson,** formerly De La Rue

EDUCATION & RESEARCH

1. **Iain Begg,** London School of Economics
2. **Harald Benink,** Tilburg University
3. **Gottfried von Bismarck,** Körber Stiftung
4. **Michael Burda,** Humboldt University, Berlin
5. **Nick Butler,** King's College, London
6. **David Cameron,** Yale University
7. **Forrest Capie,** CASS Business School
8. **Mark Crosby,** Melbourne Business School
9. **Jeffry Frieden,** Harvard University
10. **Haihong Gao,** Institute of World Economics and Politics
11. **Hans Genberg,** SEACEN
12. **Steve Hanke,** Johns Hopkins University
13. **Ludger Kühnhardt,** Center for European Integration Studies
14. **Mariela Mendez,** Escuela Superior Politecnica del Litoral
15. **Rakesh Mohan,** International Monetary Fund
16. **José Roberto Novaes de Almeida,** University of Brasilia
17. **Michael Oliver,** ESC Rennes School of Business
18. **Danny Quah,** London School of Economics
19. **Richard Roberts,** King's College, London
20. **Paola Subacchi,** Royal Institute for International Affairs
21. **Shumpei Takemori,** Keio University
22. **Maria Antonieta Del Tedesco Lins,** University of São Paulo
23. **Daniel Titelman,** ECLAC
24. **Linda Yueh,** BBC

ECONOMICS & INDUSTRY

1. **Irena Asmundson,** California Department of Finance
2. **Robert Bischof,** German-British Chamber of Industry & Commerce
3. **Eduardo Borensztein,** Inter-American Development Bank
4. **Albert Bressand,** European Commission
5. **Shiyin Cai,** Business Adviser
6. **Efraim Chalamish,** New York University
7. **Vladimir Dlouhy,** former Czech Industry Minister
8. **Brigitte Granville,** Queen Mary, University of London
9. **Graham Hacche,** National Institute of Economic and Social Research
10. **Hans-Olaf Henkel,** University of Mannheim
11. **Hemraz Jankee,** formerly Central Bank of Mauritius
12. **David Kihangire,** formerly Bank of Uganda
13. **Pawel Kowalewski,** National Bank of Poland
14. **Gerard Lyons,** Greater London Authority
15. **Stuart Mackintosh,** Group of Thirty
16. **Winston Moore,** Moore Asociados
17. **Vicky Pryce,** formerly UK Department for Business
18. **Edoardo Reviglio,** Cassa Depositi e Prestiti
19. **Pedro Schwartz,** CEU San Pablo University
20. **Vilem Semerak,** Charles University, Prague
21. **Song Shanshan,** SDIC CGOG Futures
22. **Gabriel Stein,** Oxford Economics
23. **Takuji Tanaka,** Innovation Network Corporation of Japan
24. **Jorge Vasconcelos,** New Energy Solutions
25. **Obindah Gershon nee Wagbara,** Georgetown University
26. **Volker Wieland,** German Council of Economic Experts

Britain, Europe and a vision to come

Brown's plan for balancing autonomy and co-operation

William Keegan, Advisory Board

Gordon Brown is widely credited with having made a crucial last minute intervention when it looked as though the Scottish referendum was going to lead to an exit from the UK.

Before the UK's referendum on EU membership, when the polls and bookmakers pointed towards a strengthening of the potential Brexit vote, the former prime minister was brought in yet again in a failed 11th hour attempt to prevent the UK's exit from the European Union.

Brown's attempt to hold back the Brexit tide came shortly after his publication of *Britain: Leading, Not Leaving*, in which he makes a powerful case for Remain. And even though the UK has now voted to leave, the book ought still to be widely read, if only to ram home to the electors what a foolish choice they have made.

Exacerbating the immigration problem

This is a wide-ranging history of the country's relations with the rest of the EU. Migration seems to be the factor that ultimately swayed the electorate against Remain. However, Brown makes clear that this issue is far more complex than exit from the EU can resolve.

Indeed, unilaterally bowing out from the opportunity to co-operate with other EU countries, Britain may exacerbate the already acute problem of making the migration problem manageable.

In addition to his intervention in the Scottish referendum, Brown, as chancellor of the exchequer under Tony Blair, was instrumental in keeping the UK out of the euro. But, as this book illustrates, there was nothing 'anti-European' about this decision.

Brown is a passionate European. His credo remains that, by remaining in the EU, the UK can participate in 'a range of decisions that concern every family in our country – the economy and jobs, social justice, migration, energy and climate change, defence and security'. He claims that this is the best way to 'balance national autonomy and international co-operation'.

He swipes at the conservative eurosceptics who constantly refer to former UK Prime Minister Margaret Thatcher's supposed hostility to 'Europe'. Citing her famous Bruges speech, Brown writes, 'Thatcher was at pains to demand a reappraisal of Britain's relationship with Europe, not a severance.' He quotes a passage that her disciples seem to have written out of history: 'Britain does not dream of some cosy, isolated existence on the fringes of the European Community. Our destiny is in Europe.'

> ***"Brown acknowledges that successive governments, including his own, were slow to alleviate the impact on individuals and communities of 'losing out'.***

Globalisation is 'here to stay'

Brown is especially good on the connection between globalisation and our present discontents. He acknowledges that successive governments, including his own, were slow to alleviate the impact on individuals and communities of 'losing out'. But globalisation is 'here to stay'.

He adds that the EU is not the cause of the insecurities people are facing but is part of the solution. 'In fact, the case for British co-operation in Europe is stronger than it has ever been.'

He cites two examples of Britain's role in EU economic policy-making during his own much criticised premiership. These were the UK's influence on the euro area in the bank rescue operations of 2008-09 and the successful opposition to 'federalist' plans for harmonisation of taxation, including savings. As he points out, it is often forgotten by extreme europhiles that the US may be a currency union but is a long way from a harmonisation of state tax regimes.

One of the many oversights of the Leave brigade has been their misunderstanding of the degree to which modern 'British' businesses have supply chains that stretch throughout the EU. These supply routes will be severely disrupted by the inevitable barriers that Britain's departure will bring.

Brown gives a detailed examination of the UK's industrial links with the rest of the EU, not least in the automotive business. As he says, the foreign multinationals that dominate the 'British' car industry 'invest in Britain as their platform for investment in Europe'.

On the big issues of migration and terrorism, he advocates a 'comprehensive Middle East and Africa strategy as bold as the 1940s Marshall Plan, which it is up to Europe to deliver'. Following the vote, Brown will not be able to see his vision realised from a British vantage point within the EU. One must hope that there are other ways of realising these worthwhile goals. ■

William Keegan is Senior Economics Commentator for The Observer.

Limited room for optimism on Greece

OMFIF Advisory Board says fundamental problems to return in 2017

Greece appears poised for a modest recovery in the next two years. Creditors are working discreetly on a landmark debt restructuring deal, part of which could be unveiled this autumn, to fix ultra-low interest rates on around €150bn of Greece's foreign debt for up to 30 years. The political and technical issues behind this debt restructuring are however still a long way from being resolved.

Greece continues to grapple with the aftermath of its debt crisis. On 17 June, the European Stability Mechanism's board of directors approved the release of a €7.5bn disbursement, Greece's first injection of bail-out funds since late 2015, ensuring that it does not default on its creditors when €3.35bn of debt matures in July. The question put to Advisory Board members was, 'When do you expect fundamental problems over the Greek economy to re-emerge?', with four possible answers: a) by the end of 2016; b) 2017; c) Later; and d) Never.

The majority of respondents, 48%, said that fundamental problems over the Greek economy would emerge in 2017. But 38% were more pessimistic, stating that they would re-emerge before the end of 2016. ■

'Greece's financial condition is dire, and the measures necessary for the country to continue to service its debts are almost certainly politically untenable. If the creditor countries insist on Greece fulfilling its current obligations without further debt relief, there will almost certainly be another round of political and economic brinksmanship.'
Jeffry Frieden, Harvard University

'Essentially the optimistic fiscal projections remain the thorny issue in the Greek saga. With the global economy failing to rebound strongly it is unlikely that Greece can achieve the targets set in the rescue programme. Furthermore the adverse conditions spurred by the Brexit referendum will exacerbate the situation.'
Fabio Scacciavillani, Oman Investment Fund

'Periods of stress lead to the re-examination of unresolved problems. Brexit might be thought of as mainy political. Yet economic problems around Europe are the ones that will be highlightd this year. '
Colin Robertson, independent asset allocation consultant

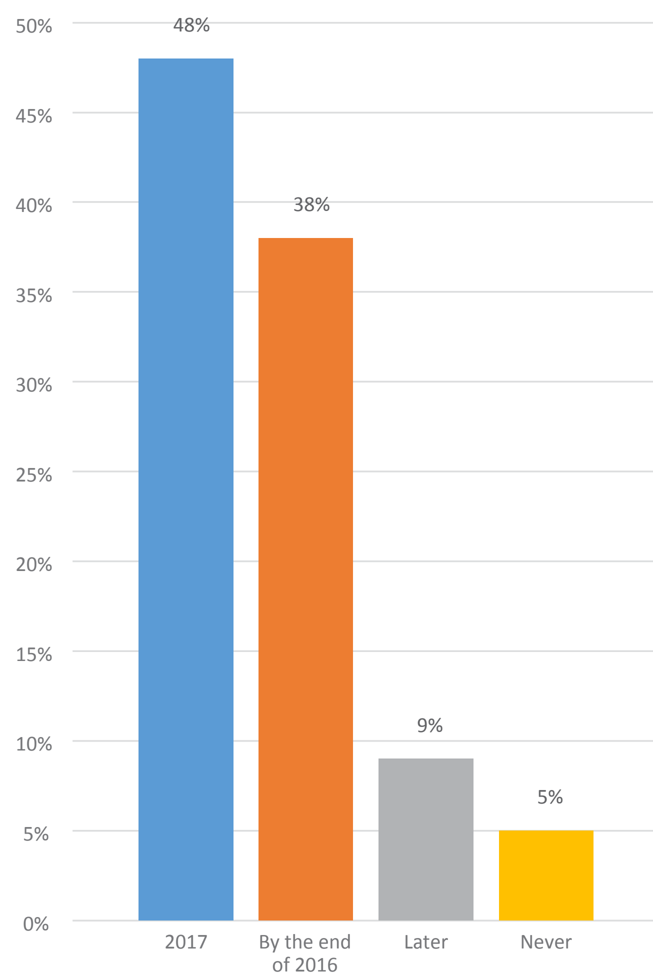
'One still doubts that any real resolution will be achieved. Regular reminders of how much of a mess it all is will trigger a further crisis (a much overused term in EU financial circles).'
Consuelo Brooke, formerly Mercury Asset Management

'Fundamental problems will re-emerge in 2017, and more precisely, after the next German election in 2017.'
Athanasios Orphanides, Massachusetts Institute of Technology

These additional statements were received as part of the June poll, conducted 21-27 June, with responses from 21 Advisory Board members.

Greek problems to re-emerge within two years

Percentage of respondents



When do you expect fundamental problems over the Greek economy to re-emerge?

September's question

Which economy will grow faster in 2017?
a) The UK
b) EU-27

Which model will the UK choose for trade and investment links with EU-27?
a) Single market/Norwegian model
b) Single market/Swiss model
c) WTO rules similar to the US
d) A totally new model

What will the UK's EU departure lead to?
a) More cohesive euro area with stronger euro
b) Less cohesive euro area with stronger euro
c) More cohesive euro area with weaker euro
d) Less cohesive euro area with weaker euro
e) Euro break-up


Volksbanken Raiffeisenbanken
cooperative financial network
BANK ON GERMANY
As a central bank for more than 1,000 cooperative banks (Volksbanken und Raiffeisenbanken) and their 12,000 branch offices in Germany we have long been known for our stability and reliability. We are one of the market leaders in Germany and a renowned commercial bank with comprehensive expertise in international financing solutions, maintaining representations in major financial and commercial centers. Find out more about us: www.dzbank.com.
DZ BANK
Bank on Germany