Mr George paints a broadbrush picture of challenges and change for the markets as the year unfolds

Speech by the Rt Hon Eddie George, Governor of the Bank of England, to the Euromoney International Bond Congress at the QEII Conference Centre in London on 16 February 2000.

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It's a pleasure, as always, to have been invited to bring proceedings at this great annual event to a close. You seem to go from strength to strength - from what I hear your sixth Congress has been as lively and interesting as its predecessors.

Lively and interesting are pretty good words to describe the last twelve months in the markets too. When we were together here last year there were still plenty of clouds around. The emerging markets in Asia were still only in the early stages of patchy recovery. Russia was still fragile and there were real fears of another round of financial upset in Latin America, particularly Brazil. In the industrial countries, too, the prospects were for slow growth - some were even still forecasting recession. I concluded that we'd all need strong nerves in the year ahead.

Well, by and large we kept our nerve, and the skies have brightened over the past year as the clouds of financial instability and global economic slowdown dispersed. The focus now is not on how we keep the ship afloat but how we keep her on a steadier course - which, if you're a sailor is a comparative luxury. That still leaves us with quite enough to worry about - and who ever met a central banker - or a sailor - who didn't worry about what was coming next - it would be a contradiction in terms. The immediate challenge is to cope with the imbalances within and between the industrial countries, and we have more work to do to improve our defences against volatile international capital flows more generally.

But for the time being, the rate of world output growth, which had fallen to only about 2% in 1998, about half its long-term trend rate, and which was widely expected to fall further, is now expected to bounce back to around trend over the next couple of years. And whereas, a year ago, many industrial countries were still in the process of easing monetary policy, to offset the impact on world demand of the interruption of the flow of credit and investment to emerging market countries and transition economies, we have recently seen a quite widespread increase in interest rates, designed to moderate the pace of domestic demand growth. And rising interest rates - I need not remind you - are a reflection of a strengthening economy.

Against this backdrop of strong economic growth and official tightening, it is not surprising that bond markets in most developed economies have responded with higher yields over the last 12 months. Since this time last year 10-year government bond yields in the major markets - with the notable exception of Japan - have all risen by over 100 basis points. And with credit spreads widening during much of the summer, the rates that corporate borrowers have faced have shown even greater increases. Despite this, however, it has been another very active year for you all.

Over the past few years a notable feature of the international bond markets is that each subsequent year has set a new record in terms of volume, and 1999 has certainly been no exception to this. What is of particular note about issuance in 1999 though is the scale of this increase: up by almost a half from the level of 1998 - a pretty remarkable performance.

I think that there are two major reasons for this increase:

First, and most obvious, is the successful introduction of the euro. I can best demonstrate this with the fact that international issuance in the euro in 1999 was more than double that of the level that legacy currency issuance reached in 1998. This is a clear indication that the euro has established itself as a currency for international finance in its first year of existence. Not only did the volume of issuance rise, but perhaps even more strikingly, the diversity of issuers increased too. This illustrates how the creation of the euro has opened up new funding sources for a wider range of issuers, and I have no doubt that the euro-denominated high-yield bond market will continue to grow as confidence in the euro bond market increases.

A second reason for the large increase in issuance in 1999 was the increase in confidence of both investors and issuers as the effects of the emerging market crises subsided. With this increased confidence came increased appetite for credit, and this not only gave borrowers from further down the credit spectrum the opportunity to access markets - which they took - but also allowed issuers who had pulled out of the markets during those turbulent times to return.

So overall it is satisfying to note that the bond markets were not only more active than they have been in previous years, but that they have also been accessible to a wider range of borrowers than in previous years.

Finally, right at the end of the year - literally - we all faced the challenge of preparing for Y2K. As we know now, the world's financial markets survived the dreaded Millennium Bug, thanks in large part to the efforts of very many of you, and your IT colleagues, in making sure that we would. And we at the Bank like to think we played our part too. Now I am not one of those who feel that all our work, yours and ours, was unnecessary. If I had to choose a motto for a central banker, I think "better safe than sorry" would be very high on the list! More importantly we collectively showed that the London markets were equal to the challenge - even a once-in-a-millennium challenge - and were determined to make sure that come the first day of the new year London would be "open for business as usual".

What of the coming year? Well, I can predict that, after two years of new year working, we will all be able to enjoy our New Year's Day bank holiday for a change next year! But beyond that, my crystal ball is no better than yours, and I am afraid that if you are looking for me to predict the course of exchange rates or interest rates over the next 12 months I am going to disappoint you. I would like instead to pick out a few themes which I think will be of increasing importance as the year unfolds.

Firstly, I think we will increasingly see a fall in the absolute size of government bond markets, although once again Japan remains the exception. This is already happening here in the UK and in the US, as fiscal surpluses reduce bond issuance, and as the recovery in the rest of Europe continues budgets will increasingly move towards balance there too. One side effect of this is of course that outstanding government bonds can become very much sought after, and nowhere is this more true at the moment than in our own market. But I think a much more significant change will be to encourage corporate issuers to take up the slack, as it were, and fill the resulting hole. Europe does not yet have a corporate bond market to compare with the US market, but I think the current situation in the markets, with reduced government issuance, the opportunities afforded by Monetary Union and growth of the private pension industry in continental Europe, all combine to provide a very promising environment for the establishment of a genuine European corporate bond market.

Secondly, the electronic revolution will continue to gather pace. There are those who wonder if all the hype about dot.com this and e-that is overdone, and certainly some of the current IT stock valuations seem to build in expectations not readily captured by traditional valuation methods. But in the financial markets, I think if anything the effect of the electronic revolution will exceed even the boldest predictions. I am told that there is at least one major securities house which is assessing the ongoing viability of each of their current functions in a future where both data storage and data transmission are characterised by infinite capacity and zero cost. If the function adds value even under such a scenario, then it will be retained, but if not, then the house concerned sees no long-term future for it. I think the challenge facing financial markets and market participants is to identify where they can add value and which services the consumer will continue to pay for: not all will pass the test and survive.

My third theme combines both my earlier ones, and concerns the role of market intermediaries. Disintermediation is an ugly word, but it is a trend that exists today and will I am sure continue to grow in importance. Electronic secondary trading of securities is becoming more common, and we have also begun to see electronic primary distribution - the issuance of securities on the Internet, and, in some cases, without the involvement of an issuing house. Now some people see in this a threat to markets themselves: everything, they fear, will migrate to the web and fragment, with a loss of the transparency and regulatory framework that organised and official markets provide. I do not share this view, nor do I think that there is no future role for markets and market intermediaries. But I do think that the marketplace of 10 years hence will be very different from the one we have now - just as the screen-based markets of today are very different from the physical market floors of the past.

Earlier I offered you a possible motto for central bankers. Let me complement that with one for markets: “Adapt and survive”. But let me add the positive rider - “Those who survive will thrive”.

What is the role of the authorities in this future I have described? It is, very simply, to provide as best we can the economic and regulatory environment in which financial markets can do their job - of allocating capital to where it can be most productively deployed - more effectively. On the economic front that means steady growth with low inflation. On the regulatory front it means a framework of rules that provide for the transparency that is essential for the proper assessment and management of risk and sets clear behavioural standards which do not unnecessarily distort business decisions but provide clear guidance to market participants - whether they are end-users or intermediaries - as to what is expected of them and what they can reasonably expect of others.

The picture I have painted is one of challenge and change. The flip-side of course is great opportunity. In fact there has never been a time when the markets here in London did not face change and uncertainty. But there has never been a time either when you, we, all of us, did not rise to the challenge. I am sure we will all do so again - and I wish you all possible success.