# Christian Noyer: Public and private debt – imbalances of global savings

Introductory speech by Mr Christian Noyer, Governor of the Bank of France and Chairman of the Board of Directors of the Bank for International Settlements, at Session 3 "Public and private debt – imbalances of global savings", Aix-en-Provence Economic Forum, Aix-en-Provence, 6 July 2012.

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In introduction to this session, I would like to make seven remarks.

***My first remark*** is inspired by the very title of this session. In advanced countries, the average public debt to GNP ratio is 100%. In emerging countries, the figure is 30%. This is a very wide gap, and it represents one of the global economy's largest imbalances. And one of the least mentioned. It also represents a complete reversal of the situation compared with just over twenty years ago. At that time, I remember well, I was chairman of the Paris Club, and emerging countries came to ask for the rescheduling of their debt.

***Second remark***, global demand is still fairly concentrated on the advanced countries. Not only is their debt higher, but their savings (as a ratio of GNP) are lower. The G7 countries alone still account for 56% of global consumption. The problem is clear. How can we hope to raise our level of consumption if we need to reduce our level of debt and increase our savings? And if the advanced countries' consumption stops growing, what will happen to global economic growth and particularly that of emerging countries with entirely export-oriented economies?

Which brings me to my ***third remark***: we need the emerging countries to continue investing their savings in advanced countries. We therefore need properly functioning international financial markets. In a world where the savings and financing needs are so geographically dislocated, properly functioning financial markets are a prerequisite for economic growth. But, today the capital markets appear very unsettled and full of anomalies, and not just in Europe.

- For example, certain sovereigns (the USA and UK for example) borrow today at historically very low nominal interest rates and at negative real interest rates despite the fact that their deficits are around 10% of GNP and that doubts exist regarding the future evolution of their debt levels.
- Another anomaly: large corporations have accumulated unprecedented cash reserves (several trillions of dollars) despite numerous highly profitable and unexploited investment opportunities around the world, unsatisfied infrastructure needs and investment bottlenecks in commodities production.

***Fourth remark***. We can identify two reasons for this situation:

- The first is the general and exceptional uncertainty weighing on the global economy. Uncertainty makes liquid and safe assets more attractive. It makes investment less attractive. It can therefore partly explain the phenomena that I have mentioned.
- The second reason is more structural: a malfunctioning of our financial intermediation mechanisms. There are doubts about the solidity of banks in numerous countries. Debt markets are profoundly disrupted and international movements of capital have been highly volatile over the last two years.

***Fifth remark***. The intervention capacities of central banks are of course limited. They can remedy temporary market disruptions and situations of illiquidity caused by uncertainty. Recently they have intervened to an unprecedented extent, as reflected in their balance sheets. But they cannot permanently substitute financial markets and banks when financial intermediation malfunctions. Likewise, low or zero interest rates can contribute to stabilising

the economy in periods of crisis, but if maintained over a protracted period, they can create distortions, encourage the formation of bubbles and create risk for long-term investors.

Indeed, on this topic, I would like to make one observation. The question of monetary financing of deficits was raised by David Thesmar. Such financing cannot in any way resolve the problem of the dislocation between savings and investment, either at the national level or at the global level. Some central banks have developed large-scale public debt acquisition programmes. They have done so for reasons relating to immediate macroeconomic stabilisation... to go beyond the zero-interest rate limit. The Eurosystem as well intervened on a much smaller scale when malfunctioning debt markets prevented the effective transmission of monetary policy impulses. There is not a single central bank that is seriously considering the monetisation of deficits with the more or less declared intention of reducing the weight of debt via inflation. In my view, this notion is nothing more than a financial analyst's fantasy. In fact, over the last six months, we have seen constant confirmation of the anti-inflationary stance of monetary policy with, for example, the FED actually establishing a quantitative definition of price stability for the first time (in fact, identical to the one used by the Eurosystem).

***Sixth remark***. Our immediate priority is therefore to construct or reconstruct the mechanisms and structures of a sound and efficient financial intermediation framework. That is why, at the euro area level, the financial union project is fundamental. At the global level, the FSB's role is crucial in developing a robust technical, regulatory and prudential architecture, adapted to the interconnection of our economies.

***Seventh and last remark***: fiscal policy and debt management. Here, I would say that we are all guilty of a certain degree of ambiguity, both at the market level and at the political level:

- on the one hand we want public debt markets that are broad, deep and liquid, because they form the base on which our entire financial system is built. In particular, government bonds are the safest and the most liquid assets. They act as reserves of value for a large number of investors, starting with the central banks themselves which hold them as foreign currency reserves or as monetary policy collateral.
- And on the other hand we want solvent States, i.e. with perfectly controlled deficits and levels of public debt, which logically places limits on the growth of public debt markets.

This contradiction is known by economists as the "*Triffin dilemma*". It was first identified in relation to the U.S. balance of payments deficits and the value of the dollar, but it can also be applied to fiscal equilibrium. The economy needs a growing volume of risk-free assets, but the more they are issued, the more risky they become.

We cannot totally side-step this dilemma, but we can avoid making it worse. It is clearly not good for major developed countries to find themselves in a situation where their solvency is put into question, or to allow markets to think that under certain circumstances, they may be unable to honour all their commitments. But this is what we have done in Europe, against the better judgement of the ECB, by introducing the principle of private sector involvement. The idea is attractive in theory. However, its consequences for financial stability are extremely negative. There has never been any doubt about whether the United Kingdom or the United States would honour their debts. Today they are enjoying very favourable interest rates compared with Spain and Italy even though the latters' fiscal fundamentals are better. I know that some attribute this difference in borrowing conditions to the actions of the UK and U.S. central banks. I do not agree. I believe that Europe has a major project ahead of it to recreate a broad, deep and liquid public debt market that is completely and unambiguously free from insolvency risk.