BANK FOR INTERNATIONAL SETTLEMENTS

Welcoming remarks

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Introduction

Good afternoon, everyone. It is a pleasure to extend my warmest welcome to all of you to the Second BIS Research Network meeting.

The BIS Research Network was set up last year as part of our effort to serve as a bridge between central banks and academics to tackle some of the most pressing conceptual and empirical questions facing central banks today. The network brings together active researchers from academia and central banks to meet regularly and share findings on issues related to banking, monetary policy, regulation and financial stability. We hold two network meetings a year, alternating between micro- and macro-related themes.

The inaugural meeting of the BIS Research Network in September last year was "Banking and asset management", and it explored the interaction between capital and liquidity regulation; the adjustment of bank capital to Basel III; the cyclical behaviour of leverage; asset management flows; and equilibrium asset prices.

Today, the second research network meeting is organised around the theme "Macroeconomics and global financial markets". Judging by the quality of the papers and the authors on the programme, we will have another very fruitful meeting that can enrich the research agenda on the functioning of the economy and its interaction with the financial system. The significance of this interaction has arguably been underestimated. And it would be especially useful to understand how the underlying links have evolved since the global financial crisis.

Four challenges – many questions

To help set the scene, let me highlight four key challenges that policymakers face today, and pose some of the questions that we at the BIS have been grappling with.

The first challenge is to better understand the current environment of ultra-low interest rates, ample liquidity and unconventional central bank policies. Interest rates in many countries are now incredibly low, or even negative. Quantitative measures have resulted in large central bank balance sheets. How far can this go? As even long-term yields have turned negative in some cases, we may need to revisit all the familiar analytical rules of thumb that were developed in a world of positive rates and ask how things will work in this new environment. Are such low rates effective in stimulating demand? Can they also have side effects that influence the profitability of the financial industry, the build-up of financial risks and the efficiency of resource allocation? Do they have an unusual impact on income and wealth distribution?

The research to be presented today in the first session sheds light on some of these questions – in particular, the measurement of unconventional monetary policies and their macroeconomic effects. But clearly more research is needed, especially to clarify the effects of unconventional monetary policies.

A second challenge is to understand better how financial risks have been migrating and morphing, and how much of this is due to central bank policies. Financial markets have been buoyant in recent years, and accommodative monetary conditions have arguably been an underlying factor. The dependence of markets on central banks, however, carries the risk of sharp market corrections and evaporating market liquidity, if and when expectations of central bank support are disappointed or are being questioned. At the same time, as the banking system has been made safer, bond market actors have come to play a bigger role in intermediating funds, as evidenced by the growth of the asset management industry.

These developments pose several questions. How can we understand the broader impact of central banks on asset prices and risk premia? How is the behaviour of market participants – their risk-taking and investment decisions – influenced by monetary policy? Have new risks been emerging in the less regulated parts of the financial system, such as the asset management industry? Such issues are addressed by the research papers in the second session.

The third challenge is the fall in inflation below objectives in several countries, which has prompted more discussions on the risk of deflation. How serious is this risk, and what are the potential costs? How effective can monetary policy be in reducing it, especially when interest rates are already very low? Can downward wage rigidity be of help, by limiting second-round effects, or be harmful, by increasing the output costs?

Our view here at the BIS is that while we should be alert to deflation risks, we should also be mindful of the risk of overreacting. Understanding the drivers of disinflation is critical to understanding its potential costs. And we do not have a good handle on how long-term inflation expectations are formed. The papers in the third session will examine these issues.

The fourth challenge is the high level of debt. At the global level, total non-financial sector debt is at a record high and seems to be still on the rise. In other words, outside the financial sector, deleveraging has been limited in the past six to seven years. A key question for policymakers is how far debt can rise before it becomes a drag on growth or poses a threat to financial stability. In other words, what is a safe level of debt in an economy? How much is growth dependent on debt, and is there a way to reduce this dependence? Is fiscal consolidation self-defeating when the economy is weak, or can it help an economy rebalance? In the aftermath of a financial crisis, is a strong macroeconomic stimulus to mitigate recessions always a help, or would it at some point become a hindrance to the reallocations of resources necessary for sustaining long-run economic growth? Research on these critical issues is unfortunately scant. The papers in the fourth session will try to shed some light.

Closing

The questions are many and the challenges novel. Top-quality research is more important than ever for policymakers. And this is precisely the reason why we invited you here today. I am sure that you will come up with a few answers. But more importantly, I hope you will come up with good and relevant questions. So let me thank the presenters and all those who will be actively contributing to the discussion. I wish you a successful and fruitful meeting.