BANK FOR INTERNATIONAL SETTLEMENTS

Welcoming remarks

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Introduction

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

The BIS Research Network was set up in 2014 as part of our effort to tackle some of the most pressing intellectual issues facing central banks today. The network brings together researchers from academia and central banks who are working on issues related to banking, monetary policy, regulation and financial stability, and serves as a platform for exchanging ideas to further our understanding of those issues.

The research network meeting today will cover two themes that are currently challenging central banks and other policymakers. The first is the extraordinary growth of the asset management industry and its implications for the financial system. The second is the role of financial intermediaries in allocating resources to generate economic growth.

These two themes are intimately interlinked. The rapid growth of the asset management industry – and capital market financing more generally – has the potential to diversify sources of finance and to increase the resilience of financing to the real economy. Similarly, "fintech" innovations are creating new business models that connect creditors and debtors. That being said, new financing models and practices could also pose new risks.

Calibrating regulatory responses is a major challenge for policymakers. Any regulation needs to balance the benefits that may come from rapid changes in financial intermediation against the new financial risks that could ultimately destabilise the real economy, as happened in the Great Financial Crisis. Research that improves our understanding and illuminates these trade-offs is an essential ingredient in designing and calibrating this response.

Challenges in financial intermediation

To help start the discussion, let me highlight three current challenges facing policymakers and investors alike in relation to some of the topics that we will analyse in the meeting today.

A first challenge is to understand how institutional investors are responding to the unprecedented low interest rate environment and what this might imply for the system as a whole. The volume of bonds trading at negative yields exceeded $10 trillion over the summer, pushing asset managers towards riskier securities in their quest to deliver returns. Portfolio concentration in risky assets can pose systemic risks for the financial system, in particular if asset managers were forced to unwind similar positions at the same time. It is, therefore, of extraordinary relevance to better understand how asset managers are navigating the low- or even negative-yield environment.

A second challenge is to understand how financial intermediation is changing. New regulatory frameworks, as well as new business models and increasing reliance on technological innovations, are recasting the role of institutional investors and banks. Increasingly automated trading exposes the markets to the risk of flash crashes or rallies, crowded trading strategies and sudden liquidity droughts. The retreat of banks from some key markets and intermediation activities suggests a decrease in arbitrage capital in the economy. This could explain the persistence of some market anomalies, such as a widening cross-currency basis and negative US dollar interest rate swap spreads. A better understanding of the interplay between banks and institutional investors is essential in order to decipher current market pricing.

A third challenge is to ensure that financing reaches the real economy and allocates resources efficiently. Despite unprecedentedly low global interest rates, corporate investment has remained weak. At the same time, global productivity growth has slowed down in the last decade and today remains below historical trends. This development seriously complicates policy challenges such as dealing with high debt levels and ageing populations. The slowdown in productivity growth is a complex process with many factors at play, many of which are outside the usual remit of central banks. But flawed financial intermediation and unconstrained financial cycles may also have contributed to the slowdown. Easy financing during a boom can drive resources into sectors with low productivity growth. But when the boom turns to bust, it takes time for the misallocated resources to shift back to more productive uses. A better understanding of the interaction between bank strength, incentives and credit allocation over the financial cycle is therefore essential.

Closing

These are just a few of the challenges that policymakers need to deal with today and possibly for some years to come. The extraordinary burden placed on central banks since the Great Financial Crisis is generating growing strains. Markets and the public at large have increased their dependence on and expectations about what central banks can do. The wish list has become quite long, including: delivering a foolproof financial system, restoring full employment, and ensuring steady growth. This is a tall order, and central banks alone cannot deliver it.

In the past, academic research has been vital in defining what central banks could and could not achieve. Today, central banks need research that can help them cope with this extraordinary burden. This is precisely the reason why we invited you here today. So let me thank the presenters and all those who will actively contribute to the discussion. A prerequisite for good research is to ask the right questions. I hope this gathering today will provide an opportunity for you to pose the relevant questions and possibly come up with some answers.

I wish you all a productive day with fruitful discussions.