Miroslav Singer: The role of creditors and debtors in the world economy

Speech by Mr Miroslav Singer, Governor of the Czech National Bank, at the World Banking and Finance Summit 2012, Official Monetary and Financial Institutions Forum (OMFIF), London, 26 June 2012.

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1. First, let me apologize for not being an eloquent academician addressing world matters. I am a humble central banker from a small central bank in a far away country which some people know very little about. So, I fear I am not going to be a great substitute for the announced speaker. I understand that his speech was to have focused on how awful, extraordinary, and incredible it is that without German willingness to sponsor the solution to the eurozone crisis there is a strong chance that the financial crisis the eurozone faces will deepen even further. Not even daring to mimic, I will just raise few points and issues. Since I doubt I can add value with an analysis of Pacific trade and financial flow patterns carried out from the remote distance of Prague, I will ignore the global dimension of the current problems and instead focus on Europe. At the end, I will try to make up for this shortcoming with questions on global issues for the other panelists to elaborate on.

2. Now, let me give you a few facts about the Czech Republic:

a. It is a net creditor country in terms of its financial sector.

b. It is generally a country of small savers. The median household has more financial assets than liabilities.

c. There is no significant stress in its financial sector at the moment, and none is expected by my central bank in its role of both macroprudential authority and financial market supervisor.

d. We have an extremely open economy. Exports and imports are roughly equal to 80% of GDP, mostly with the EU.

e. Our major trading partners are the EU and Germany, where there are still quite a few opportunities.

3. Consequently, like all of us I have no desire to see the crisis deepen.

However, before I stress a few different issues than the intended speaker, let me borrow some introductory sentences for these topics from Philip Coggan's Paper Promises: Debt, Money, and the New World Order, 2011:

"Economic history is a battle between creditors and debtors, with the nature of money the territory over which they fight. Money has two core functions; as a means of exchange (paying for your daily Starbucks) and as a store of value (making sure you can still afford a Starbucks in old age). Historically, those two functions have been in conflict; …Broadly speaking, the money expanders have been debtors and the money restricters have been creditors." As my last speech here at the OMFIF was motivated by the anniversary of the Bretton Woods collapse, I am particularly fond of this observation: "Over history, creditors have tended to impose systems that control the supply of money – the gold standard, the Bretton Woods system of fixed exchange rates, the euro – that prevent borrowers from repaying their debts in debased currencies. The strain of keeping up this discipline is intense in democracies where more people are debtors. The gold standard broke down in the 1930s, Bretton Woods in the 1970s and the euro is struggling today, as is what might be called the post-Bretton Woods system of independent central banks and inflation targets."

4. And now a few humble observations of my own:

a. Beginning with the fiscal solutions story, this crisis is a deep crisis of the market economy and of financial systems as managed, regulated, and supervised in just a minority of market economies, most of which can now be found in the EU. The USA might have contained the source of the fire, but for three years it has not played a major role in the eurozone and its main role has turned out to be a stabilizing one. Thanks mainly to Fed swaps, EU savers and investors do not have to worry about the general liquidity position of the eurozone. I almost pray that forthcoming political events in the U.S. do not alter this situation.

b. The solution to this crisis involves controlled de-leveraging and the restoration of European and eurozone competitiveness in the developed world. The need for de-leveraging is clear, but the restoration of competitiveness in Europe is also a must, despite the fact that the CA of the eurozone and/or the EU is roughly balanced. Otherwise, the EU will not be able to restore the real growth rates necessary to stabilize eurozone sovereigns in the context of the chief mandate of the ECB, i.e., in a non-inflationary context. I am afraid this may involve quite a few of my fellow European citizens engaging in a bit of metaphorical trench-digging. Hopefully, they will also try other types of productive activities with more value added. I am fully aware of the pain this process is causing, as my country has undergone quite a similar process recently.

c. A lot of commentators have said that Germany has benefited the most from the eurozone, or at least has benefited more than the eurozone countries that are suffering now. However, quite a significant proportion of those observers have also noted that Germany has recorded the slowest growth in wage costs and other income measures in the eurozone throughout the existence of the latter. As a matter of fact, in order to fall to the German level of growth the income measures of most of the troubled "southern" countries would still need to decline by more than one tenth of the growth recorded during the eurozone's existence, and in some of them it would need to fall by significantly more. As I have become accustomed to a rather more pragmatic interpretation of the benefits of the eurozone, I find it quite difficult to reconcile these two statements. The fact that German citizens are being asked to pay up for a second time makes this second payment a less clear moral imperative than many suggest.

d. BTW, talking about growth we have almost forgotten now that the major "marketing" point of the eurozone project was that it was supposed to speed up EU growth. We have forgotten this because we are, unfortunately correctly, too preoccupied with the fear of the consequences of a chaotic breakdown of this project to have a chance to pause to contemplate and remember.

e. Returning to Germany, one of the neglected features of its export patterns over the past decade is the fact that the eurozone now accounts for roughly 40% of its exports, whereas it used to account for the majority of them (I believe about 60%).

f. Even Germany's debt is not so low. Its perceived sovereign risk is really low. In recent weeks, the yields on German sovereign debt have on a few occasions started to move together with the yields of the periphery...

g. Let's turn our attention from clear fiscal solutions to monetary solutions and other ideas. Currently a lot of plans are being motivated by the idea that a eurozone-wide political commitment to a long-term plan for a deeper integration project is going to stabilize the markets. I will neglect the fact that to many observers these plans look like better or worse masked commitments to significant future fiscal transfers within the eurozone and that the markets are rather skeptical about Europe's long-term projects. After all, the eurozone was one such project. In addition, the route to even the earliest targeted dates – in the second half of this decade – takes in one or more elections in most of the countries in question. Perhaps the markets would appreciate a nearer-term plan, one that signals, for example, that political players are willing to shift the voting powers on some pan-European solutions to bigger economies with larger stakes and more resources to spend in absolute terms.

h. Let's go back to Philip Coggan's observation that a "majority in failure" breaks financial systems based on the interests of savers. There are seven clearly conservative creditor countries in the eurozone: Estonia, Germany, the Netherlands, Finland, Slovakia, Austria, and Luxembourg. Seven is some way short of a majority in a group of 17. I wonder whether the ECB's behavior has been limited much more by its status than by the country in which it is headquartered. I suspect even more that Germany's insistence on strict observance of ECB rules stems from a fear that any lenient interpretation will lead sooner rather than later to the total subordination of minority interests in the eurozone, i.e., the interests of savers, i.e., German interests.

i. Anyway, I am afraid that the ability of economic-based reasoning to influence events is gradually declining. Future events will be influenced more and more by decision-makers' communications and gestures or by accidents unplanned by anybody. As an example of the latter, consider how Greece's tourism income might develop this year and the next if its major electricity supplier occasionally switches off supplies due to payment problems, thereby shutting down air conditioning in hotels.

j. But now I am straying away from the topic of imbalances, so I'd better pause to venture one final observation. Germany is currently under financial stress and is full of middle-class savers who are angered by the perceived failure of their state. This situation, I believe, has never been in the interests of my country or in the interests of Europe. Some of us may like to contemplate this a bit.

Possible questions for the panelists (as I have already spoken enough I will reserve myself for the second round of Q+As):

a. How has the financial crisis modified the world-wide pattern of creditor-debtor countries?

b. What are the major causes of the current world imbalances?

c. Do imbalances impede world growth?

d. What are the best (domestic/global) policies to mitigate the imbalances? Are there any chances for (efficient) international cooperation? Who should do what?

e. How are the current changes in regulatory and supervisory frameworks influencing EU-wide imbalances? Are they mitigating them or deepening them?

f. Can creditor countries (such as China or Germany) act as "locomotives of growth" given that the juan is quasi-fixed against the US dollar and the "German currency" is fixed against the "currencies" of many trading partners in the eurozone? And what proportion of the potential fiscal impulse will merely benefit those mainly Asian countries whose products are becoming more and more competitive on EU markets.