Christian Noyer: Central banking – the way forward?

Opening 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 the International Symposium of the Bank of France "Central Banking: The Way Forward?", Paris, 7 November 2014.

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Mesdames et Messieurs, ladies and gentlemen,

[Je vais parler anglais pour remercier la majorité d'étrangers présents ici, une interprétation simultanée étant assurée en français.]

I am delighted to welcome you to Paris for this Banque de France Symposium. This recurrent event brings together a large number of experts from the world over: not only central bankers – of whom there are more than a hundred in this room, representing all five continents – but also academics, practitioners and members of financial institutions, governments and international organizations alike.

This extraordinary mix of participants will surely provide some answers to the open question concerning the future of central banks, as indicated by the title of this Symposium, "Central Banking: the Way Forward?" Central Banks have been considered the only game in town. Might the very high expectations placed on them backfire in the future? Yet, we all know that central bankers do not act in a vacuum when pursuing monetary and financial stability.

First, monetary policy interacts with fiscal policy, the legacy of which has resulted in high public debt in many countries after the Great Recession. This is the topic of our first session chaired by my esteemed colleague, Haruhiko Kuroda, Governor of the Bank of Japan.

Second, central banks and financial regulators, which work closely together, have had to adapt to important changes in financial intermediation, especially in the aftermath of the financial crisis. My dear European neighbour, Jens Weidmann, President of the Deutsche Bundesbank, will chair the second session dedicated to this question.

Third, globalization means that cross-border flows have to be taken into account and raises the question of the scope and limits of policy autonomy, not only in smaller open economies, but also in larger ones because of spillovers and the resulting feedback effects. This will be tackled in the third session chaired by my good friend, Jacob Frenkel, President of both JPM Chase International and the G30 Board of Trustees.

Last, to wrap up all aspects, what better than a Panel on the future of the policy mix, including monetary, financial, macroprudential, fiscal and structural policies? The latter will comprise five prominent decision-makers, moderated – or, should I say, stimulated – by a "pillar" of our series of Symposiums: Martin Wolf, whom so many of us read regularly in the Financial Times.

Having briefly outlined the programme and mentioned the names of the chairs of each session, I will not list all the eminent speakers, discussants and panellists whom I wish nevertheless to thank most warmly in advance for their contributions. Yet I would like to highlight their diversity in terms of background and experience. I would also like to share with you some thoughts on each session, which – far from pre-empting future discussions – aim to spur the debates with our audience.

The first topic today concerns the challenges of conducting monetary policy with large public debts. Numerous questions arise including fiscal dominance, the trade-off between debt sustainability and fiscal discipline, multiple equilibria and financial instability.

First, I will comment briefly on how high public debt increases the risk of fiscal dominance on monetary policy. Low interest rates may very well be justified by specific business cycle conditions or risks of undershooting the inflation target. They also facilitate the sustainability of higher public debts. Hence the need to ascertain whether risks related to public debt sustainability considerations might in turn jeopardize price stability. Another paramount risk of very low interest rates is to entertain the illusion that governments can continue to borrow rather than make difficult and yet necessary choices and indefinitely put off the implementation of structural reforms. Such risks are very real in the euro area.

Very high public debts are also a factor of financial fragility. Market participants therefore expect central banks to intervene on public debt markets to safeguard financial stability. Indeed, in extreme circumstances a central bank should mitigate the effects of confidence shocks on sovereign yields by purchasing government bonds. Such an action may be vindicated if there are risks to macroeconomic or financial stability or even if self-fulfilling runs on public debt may be a threat to market access, or lastly to avoid the deflationary consequences of a public debt event.

However, one may be tempted to underestimate risks for inflation, especially since they only materialize with a lag, and such interventions could also increase moral hazard in terms of government incentives to keep their finances in order. These considerations explain why, when we set up the OMT, we required central bank interventions to be conditional on resolute fiscal policy adjustments, guaranteed collectively by euro area Member States.

In addition to highlighting the main trade-offs between public debt sustainability and monetary policy, the great merit of Professor Gita Gopinath's presentation is to use a formal model to support her rigorous analysis. In particular, she shows how the degree of commitment to low inflation may change the level of sustainable public debt. This analysis is most welcome, not only because public debts are very high, but also because in several parts of the world inflation appears stubbornly low in spite of extremely aggressive monetary policies.

The second session examines changes in financial intermediation. Hyun Shin will focus today on the surge of bond-financing in the global economy over the last few years and the pros and cons associated with a broader shift from bank to market financing.

Admittedly, our objective as regulators remains relatively simple: it should be primarily to ensure that financial institutions, infrastructures and markets properly do their job of smoothly and efficiently channelling savings into productive investments. Yet our task is difficult as finance constantly evolves as a result of technological advances or as an answer to regulatory changes. This should prompt us to be both resolute and cautious in dealing with many questions such as whether there is an optimal mix of bank and market financing. The financial crisis has indeed revealed at least three major failures of our financial systems, be they bank or market oriented: excess leverage, excess complexity and excess opacity. Corrective actions have been implemented in these three areas.

First, over the past few years, Basel III and various national or regional initiatives have led to a sizeable recapitalization of the banking system and especially SIFIs [systemically important financial institutions]. In the euro area, the Comprehensive Assessment of the balance sheets of 130 major banks shows how much progress has been made. Second, major reforms have been undertaken in order to facilitate the orderly resolution of large and complex financial institutions, thus providing better incentives ex ante to these large financial conglomerates. Such progress can be seen both in Europe, where the Banking Union is a major step forward, as well as abroad. Last, the scope of regulation has been extended to products and markets that remained too opaque in spite of their systemic relevance, such as some major classes of OTC derivatives.

That said, much work still lies ahead to stimulate new intermediation mechanisms in order to diversify the funding of the economy when a single channel, such as the banking system, cannot adequately satisfy demand. The financing of small and medium-sized firms in the euro area is a case in point. In this regard, our new ABS purchase programme in the Eurosystem clearly aims to stimulate this nascent market in order to broaden the sources of funding of medium-sized corporates that do not yet enjoy direct access to financial markets and to free space in banks' balance sheets for financing the smaller SME's .

In an increasingly globalized world, the third session will try to reconcile central banking policy autonomy with international capital flows. Professor Hélène Rey will revisit her groundbreaking conjecture that, in spite of flexible exchange rates, the Mundell trilemma may actually boil down to a dilemma because of the Global Financial Cycle.

True, globalization does not necessarily imply that spillovers cannot be limited. As an illustration, let me take the euro area: since our business cycle differs from that of the USA, the Eurosystem has been able to disconnect the whole yield curve from the expected rise in US interest rates. But the euro area is a large economy.

By contrast, some emerging market economies (EMEs) have learnt the painful way how capital flows can destabilize their domestic financial systems. This raises a series of questions such as: how to optimize the size and use of international reserves while combining them with multilateral tools? How to strengthen resilience and avoid financial protectionism which may hide behind macroprudential policies?

Indeed EMEs have accumulated international reserves, developed local currency bond markets to avoid currency mismatches and resorted to macroprudential tools or even capital controls. Multilateral responses have also been enhanced. Here, I should mention the scaling up of global safety nets, including the diversification of IMF lending facilities, and closer cooperation between central banks, through extensive dialogue and the agreement on a number of international swap lines.

Today's Symposium will close with a Panel on the future of the policy mix that could help address many of the policy challenges mentioned earlier. In particular, while central banks have clearly played a pivotal role in the global policy mix in recent years, they cannot deal with all problems by themselves. In other words, questions asked to the Panel may include to what extent central banking can help governments buy time, and for how long they can bridge financing while waiting for structural reforms to bear fruit.

Indeed, central banking cannot replace decisive structural reforms, which are necessary both for increasing aggregate supply and demand and enhancing our economies' resilience to shocks. However, I shall not stand in for the Panel and will thus shortly conclude this introduction by welcoming in advance the fruitful sharing of experience to which all of you will contribute today.

Central bankers frequently meet in international policy fora, such as those organized under the auspices of the BIS, IMF or G20, etc. Yet I hope today's Symposium will be a special occasion to stimulate this exchange of views and build on it with academics, financial institutions and the public at large, since it is broadcast live on the internet.

Therefore, I would like to hand the floor without further ado to Haruhiko Kuroda.