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Opening remarks
2nd Annual Meeting CEBRA International Finance and Macroeconomic Program

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Ladies and Gentlemen,

It is a great pleasure for me to welcome you all to the second annual meeting of the CEBRA (Central Bank Research Association) International Finance and Macroeconomics Program, hosted by the Banco de España.

Let me first thank our colleagues from CEBRA for their efforts in co-organising this conference. CEBRA is an association that seeks to encourage applied and theoretical research on relevant topics for central banks, among other institutions. Its research programmes foster interaction among researchers at central banks and in academia. In this vein, the International Finance and Macroeconomics Program (IFM) led by Galina Hale provides an excellent forum to discuss key policy questions that are also relevant to academia.

The title of this conference is: "**Risk, volatility and central bank policies**". Allow me to briefly share with you –from a central banker's perspective– some of our current concerns in relation to the three items highlighted in this title.

Starting with **risks**, in recent months some institutions – including the Banco de España through its Financial Stability Report – have stressed that, although the financial stability environment remains favourable, global near-term risks have increased or have begun to materialise.

In recent years the global economy has experienced a period of sustained and across-the-board growth, supported by unprecedented expansionary and unconventional monetary policies around the world. But this context has also been conducive to the accumulation of certain financial vulnerabilities. In particular, it has led to a "search for yield" by investors who have been seeking more profitable and riskier investments. This is evidenced at least by three facts: increasing leverage, the high share of debt at risk and the relatively high valuations of certain assets.

Now the current phase of ultra-loose monetary policy is coming to an end. In the US, after seven years of interest rates around the zero lower bound, monetary policy is being normalised. Other advanced economies, such as the UK or Canada, have also started to raise interest rates. Regarding the euro area, the ECB Governing Council anticipates that, subject to incoming data confirming the medium-term inflation outlook, net asset purchases will come to an end in December 2018.

In this context, two main developments in international financial markets warrant attention as, in my view, they might currently pose key threats to financial stability and global growth.

First, the economic and financial situation of some emerging markets is under pressure as a result, among other factors, of the combination of monetary policy normalisation and strong fiscal stimulus in the United States. Last summer financial conditions in most emerging market economies were tightened, giving rise to considerable outflows and steep exchange rate depreciations, particularly in Argentina and Turkey. This sharp market reaction should be a reminder of the risks that the normalisation of monetary policy at the global level could entail, in particular for those countries that have accumulated macroeconomic imbalances.

Second, a potential increase in economic and geopolitical uncertainty stemming from escalating trade tensions could adversely impact global growth. In this regard, the latest forecasts by international organisations already reflect some impact and, indeed, global growth and global trade has already begun to lose momentum. In addition to protectionist escalation, sources of geopolitical risk have also grown in Europe as a result of Brexit negotiations and the fiscal situation in Italy.

But how have financial conditions actually evolved in this new scenario? Until very recently, financial conditions in advanced economies remained loose, while conditions in emerging markets had tightened. Interestingly, US interest rates have increased at the longer maturities, but still modestly. Nevertheless, a materialisation of current risks might lead to a "snap-back" scenario of sharply rising long-run yields, driven by a sudden decompression of term premia, that might amplify market stress and harm the economy.

In this context of growing near-term risks, a better understanding of **volatility**, the second topic of the conference, is also crucial for central banks, given the implications for monetary policies and financial stability. The period of ultra-loose monetary policy has driven a prolonged period of low volatilities. Nevertheless, global markets could be entering a new phase of higher volatility or more frequent short-lived bouts of instability as interest rates increase. Moreover, volatility markets – in particular, volatility-linked derivatives – have become more popular in this low-uncertainty environment. Negative surprises in these markets might amplify shocks and impair the functioning of key markets, potentially even affecting the financing of the real economy. The surge in volatility witnessed last February illustrates this point.

Central bank policies are affected by this scenario in at least two dimensions**.** First, it makes more challenging the definition of an adequate monetary policy normalisation path. A too-rapid adjustment of monetary policy could trigger the materialisation of some of the risks mentioned. A too-gradual adjustment may ultimately force policy to be tightened more rapidly to contain overheating, thus giving rise to the "snap-back" scenario. By the same token, the persistence of very easy financial conditions and very low volatility extends the "search for yield" behaviour of investors and the build-up of vulnerabilities in the financial system. In this regard, effective communication by central banks throughout the monetary normalisation process will be key to helping anchor financial conditions, despite the threat of heightened volatility.

Second, in this complex environment, it is particularly important to emphasise the role played by one of the major policy innovations generated during the financial crisis, namely the development of macroprudential policy frameworks.

The proper and timely use of the new macroprudential tools, together with the regulatory and supervisory overhaul of the global banking system undertaken in recent years, should help to contain the build-up of financial imbalances. However, given its novelty it's difficult to know ex-ante how effective these new macroprudential tools will be.

In addition, multiple new challenges remain and need to be dealt with. Let me mention a few of them: (i) the reinforcement of policy measures to address bank-like risks stemming from the activities of non-banks, which have significantly increased in recent years; (ii) the emergence of new risks, such as those derived from financial technology or cybersecurity;

(iii) the strengthening of sustainable finance to address environmental risk, and (iv) the creation or expansion of global and regional backstops.

I am certain that our speakers in this conference will address these and other interesting matters. Indeed we will have the opportunity to explore this subject in depth through nine selected articles by prominent researchers. Actually, we are most privileged to have with us two distinguished keynote speakers, Ricardo Reis and Torben Andersen, who will no doubt illuminate us on these important matters.

This two-day conference is organised in four sessions: the first will address certain money and market-related aspects. During the second session we will try to shed some light on the propagation of shocks when considering higher-order statistical moments of economic and financial variables. The third session will deal with two issues related to risk which are important for central banks, namely the credit risk associated with monetary policy operations and the evaluation of systemic risk measures. Finally, the fourth session on uncertainty will deal with the spillovers from the uncertainty on certain financial markets to the macroeconomy or to other markets.

And now, allow me to introduce you to our first speaker, Ricardo Reis. We are particularly honoured to have him here today. It is most appropriate he should be our first Keynote Speaker given his profound knowledge on the topics to be addressed in this conference. Among his recent honours, I would recall that last year he received the 2016 Bernácer prize at the Banco de España as the best European economist under the age of 40 working in macroeconomics and finance. His keynote speech today will focus on “Central bank swap lines”. Ricardo, we are very grateful to have the opportunity to exchange views with you again in our institution.

The floor is yours.