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Concluding Remarks

My task is to provide you with some concluding remarks. First of all I want to make a list of main messages that have been given over last day and a half in individual papers or presentations.

I think during this seminar we have covered a lot of subjects. In the opening speech, which was kindly delivered by Governor Jean-Pierre Roth, the logic of the seminar and the sequencing of sessions was explained to us.

In the first session, skillfully chaired by Dr. Werner Hermann, our attention was drawn to a couple of elements of the situation that existed prior to the crisis.

The trio led by Pinar Yesin provided us with some reassuring news. Namely we were told that small companies in the European transition economies were not reckless. In principle, they behave in a rational manner. If they borrow in foreign currencies, this is mainly because they receive income in foreign currencies. In addition, unhedged currency bets are not a massive phenomenon. Nevertheless, it is still dangerous to borrow in currencies other than those in which people earn or companies receive income from their sales or exports

Another trio, headed by Marcel Peter, looked into another aspect of the same matter, that is borrowing in foreign currency. They gave us also somewhat reassuring conclusions. According to their findings, we should not be scared to death by the fact that a significant part of housing loans taken by the Austrians are denominated in Swiss franc. The profile of the typical borrowing household is important here, and they describe it as risk-loving, wealthy and married. That means that it is less likely that they will have problems with future service of the loan as compared with other borrowers, however, one should be sure that some risk will remain.

The paper by the Polish duo presented here by Joanna Tyrowicz, deals with a different subject. The question is posed whether it is possible to design a fiscally neutral instrument of fiscal policy that may contribute to the financial stability of the mortgage banking when labour market conditions worsen to such an extent that part of borrowers are unable to service their debt. And her answer is “in principle yes”, for example if the government reshapes the unemployment benefits so as to redirect them –at least partially – in order to supplement the debt service paid by those unfortunate borrowers who temporarily lost the job.

In the second session, which I had the pleasure to chair, our attention was focused on selected aspects of outcome of actions of destabilizing forces that had taken hold of our economies for many recent months and quarters.

Krzysztof Makarski, on behalf of another Polish duo, depicted the effects of the credit crunch on the Polish economy, which –by the way- is still doing quite well as compared to other New EU Member States in Central Europe. He raised a question to what extent the recent decline of Polish GDP can be attributed to shocks affecting the financial markets. It was explained in the discussion that shocks here took form of abrupt changes in spreads caused by sudden changes in risk management policies of parent banks. Having applied the DSGE model the authors come to the conclusion that financial frictions **do** matter and can explain much of GDP decline.

Another tandem, but from the Swiss National Bank and led by Tommaso Mancini, made a research on deviations from the covered interest parity revealed during the crisis. Such deviations were empirically observed in spite of theoretical preclusions. The explanation provided to us point at a peculiar situation in which speculators, when being deprived of access to funding in the currency in high demand, cannot affect the forward price of this currency. This explains very short deviations from the covered interest parity.

Barbara Rudolf with a colleague from the SNB investigated the impact of various types of policy interest rates on the volatility of macroeconomic variables and on differences in market interest rate volatility. This examination confronted a pre-crisis situation with a crisis one. The choice of concrete type of policy interest rate matters, and according to the authors in a crisis situation the long-term money market rate appear to be the best strategy.

Thanks to the participants from Azerbaijan, Bulgaria, the Kyrgyz Republic, Romania, Russia and Turkey, we have been given first-hand details on the current state of their economies. The short presentations were concentrated on the impact, symptoms and macroeconomic consequences of the crisis., as well on remedies undertaken to counteract these negative phenomena. For me this part was particularly enlightening, and I thank to all of those who have contributed to it.

The third and last session, which Dr M. Brzoza-Brzezina kindly accepted to chair, was devoted to various policy responses and instruments that can, are and should be applied when fighting with the financial crisis and the subsequent economic recession.

Laura Kodres from the IMF described the nature and directions of capital flows to Central and Eastern Europe. The perspectives for capital flows to this region are meager. What the countries could do to be attractive in the future it is to

- improve the quality of institutional framework, because it reduces the volatility of capital inflows;
- maintain or even increase financial openness, being cautious however that the liberalization of capital flows is beneficial in the long run, though in the short term needs to be accompanied by appropriate conditions.

Piotr Szpunar (NBP) told us about a number of measures taken by the National Bank of Poland in response to the crisis to bring stability and confidence into the financial market. He explained how various risks may materialize via different channels.

The stabilizing measures taken by the SNB were depicted by Signe Krogstrup. It was interesting to learn that Switzerland's financial stability heavily depends on very few huge banks. This makes both macro- and microprudential supervision quite difficult. Swiss banks need more capital, more liquidity, better risk management, improved transparency and sounder remuneration incentives. On the basis of these needs, new regulations are being prepared.

Finally, Martin Schlegel of the SNB elaborated on the situation of the Swiss money market and the tensions there. He explained that tensions in the market consists in the shortage of liquidity in the interbank market that cannot be satisfied by regular central bank repos. That is why the SNB started to use a range of new instruments.

This is more or less what we have discussed so far. To sum up in a snap-shot: we had a group of excellent speakers who discussed three things, namely the roots of the today`s problems, their nature reflected in the impact of the crisis on the economy and policy responses. Obviously, we cannot pretend that we have completed a thorough analysis of all causes, symptoms and remedies for problems Europe is facing today, but beyond any doubt many interesting observations and hypotheses have been formulated. I suppose that all of us have now a more clear picture of what the background and nature of today`s problems is.

I would like to recollect that the title of the conference says about "The challenges for central banks". This means that we have concentrated our considerations on areas of competences of central banks. What is more, so far we have dealt with mainly Southern, Eastern and Central Europe. But after all there are other regions and continents. It seems that for me the only way to contribute anything to the discussion is to widen the scope of it. In order to do so, let me propose a simple conceptual framework (table below), which should show other elements of the mosaic of policy responses to the crisis and recession.

In the framework three levels are distinguished – global, European and national. This is obvious and does not require any clarification apart from that in this seminar we basically covered the national level.

Non-exhaustive draft mapping of policy responses to crisis/recession

		Target area of policy response to the financial and economic crisis				
		Monetary policy/macroecon. stability	***Financial stability***	***Fiscal stimulation***		
				Suport to businesses	***Public investment***	***Labour market measures***
LEVEL	***Global***	**IMF+FSB early warning exercise; enhanced focus on financial stability in the macroeconomic surveillance**		**Additional financing from World Bank**	**Additional financing from World Bank**	
		IMF – new SDR allocation				
	European (EU)	**De Larosière`s proposals: ESRB, ESFS, ESAs, harmonized rulebook for cross-border financial supervision**		**EIB additional lending 15 bn € +EBRD additional 5 bn €**	**Front-loading of EU structural funds; incentives for R&D; EIB loans**	
			Increased deposit guarantees; redefinition of IASB asset valuation methods (accounting)			
	National	**Lower policy interest rates; lower reserve requirements; additional liquidity; currency swaps; softened conditions for collaterals**		**State guarantees; state aid schemes; CIT cuts; export credit insurance or guarantees**	**Additional spending on physical infrastructure, on investments projects in education, healthcare etc.**	**Short-term work allowances; rebates on social security contributions; longer unemployment benefits**

In the columns we have various areas of policy responses. Again, our attention was focused on two columns only, that is monetary policy and financial stability. It seems that the border line between them is sometimes artificial. This crisis has alerted economists, central bankers and other decision-makers to be much more sensitive to interactions and interdependences between monetary policy and financial stability. These are not separate worlds; from now on monetary authorities need to look in a more systemic and coherent way on implications stemming from the monetary policy for the medium- and long-run behaviour of financial institutions.

But what is strikingly obvious from this slide is that there are many other levels and fields of fight against the crisis and recession. As the title of this slide says, this is not by any means an exhaustive list of actions and policy instruments. When I was sketching this table my intention was only to situate our discussion in a broader and wider global setting. One can see that there are plenty of other actions going on in the world economy, in international financial institutions and in regional groupings. These actions are aiming at bringing more stability and reducing high costs of recession.

Looking from the EU perspective, one should mention the fiscal policy response, called the European Economic Recovery Programme. In principle, it is a pool of similar actions foreseen by individual governments. It is complemented, however, by measures designed at the European level, the value of which is estimated by the European Commission at €30 billion. According to the Commission, out of this amount, EUR 7 billion is dedicated to Central Europe. For New Member States the frontloading of EU funds from the EU budget to their economies constitutes the core of the Programme. The Programme appears to be based on the assumption that a discretionary fiscal stimulus will revive aggregate demand. In the Central European economies, part of this demand is generated as a result of the inflow of funds transferred from the EU budget. Diminishing private consumption and investment is supposed to be supplemented by additional public investment supported by EU funds. In other words, it is hoped that if the transfer of funding from the EU budget is accelerated as compared with its "normal" schedule, it will provide an additional stimulus to aggregate demand, helping the economies to regain previous high growth rates in the future.

Obviously, the frontloading is likely to substitute for part of the diminishing private demand. Nevertheless, even if frontloading produces some additional demand, it is clear that it cannot prevent the region from sliding into recession. This is inevitable, because there are at least two powerful sources of recession which were also discussed here at this seminar, in particular by Krzysztof Makarski.

Firstly, banks have reduced lending due to the suddenly elevated risk management standards imported from foreign parent banks losing mutual confidence. Secondly and more recently, Central European companies suffer from shrinking export markets in Western Europe, where recession is already well underway.

There are many advocates of fiscal stimulus as **the** way to reinvigorate the economies in Central Europe. Even the IMF recommends diversified instruments boosting spending rather than tax reductions should be applied. There are, however, economists who have doubts relating in general to the effectiveness of fiscal stimulation. They point to the pessimism of consumers and entrepreneurs as the source of reduced private spending. They say that a large fiscal stimulus would increase public indebtedness considerably, imposing a burden on future growth.

These doubts are shared by some governments in Central Europe. The skepticism about the need of pursuing an expansionary fiscal policy is based on the fear that the debt service cost will go up. In Central Europe, the country risk is perceived as much higher than in the euro area. Risk aversion and the flight to quality of many investors described in Laura Kodres's presentation have already produced considerable depreciation of exchange rates in those among Central European economies that have floating exchange rate regimes. The depreciation alone has already substantially raised the cost of external debt service, therefore those governments do not want to add fuel to the flames by borrowing more.

This has been my 5-minute "fiscal supplement" to the conference.

Finally, let me end with a couple of words addressed to our host, that is the Swiss National Bank, Dr. Werner Hermann personally and all other persons who have made our discussion so well-prepared. Thanks to the extremely thoughtful planning of the programme, the choice of speakers and thanks to your numerous efforts I think that I can declare on behalf of all participants that we feel very, very satisfied. You have made our stay in Zurich very comfortable, and I am sure that the seminar will bring a lot of very pleasant and colourful memories to the participants in the future.

The very last thing that I want to say it is that the National Bank of Poland would be happy to continue next year with a series of our joint seminars with the SNB and in 2010 we will be looking forward to having you and your colleagues in Poland.