グローバル経済
米国金融政策正常化への備えは十分か？

The Global Economy
– Is the World Really Ready for Normalization of the US Monetary Policy? –

Occasional Paper No.30

公益財団法人 国際通貨研究所
Institute for International Monetary Affairs

IIMA
Institute for International Monetary Affairs

はじめに

米国で利上げが始まるとされる 2015 年が幕をあけました。世界の基軸通貨ドルの借入コストは無料から有料になります。このことは何年も前から予告されていたとは言え、その影響は世界中の経済に及ぶことでしょう。

欧州や日本では、米国の金融政策との乖離で金利に上昇圧力がかかり、一層の緩和が求められるかもしれません。また、欧州では、いったん薄れかけた Grexit や Brexit という言葉も新たな懸念となっています。エマージング諸国では、中国は、社会不安を惹起することなく投資依存の成長から脱却できるでしょうか。資源依存型エマージング国では、このところの急激な原油安の悪影響が懸念され、非資源依存型エマージング国も、米国へのグローバルマネーの回帰に影響されるとみられます。

こうした問題意識をベースに、国際通貨研究所では3月4日に「グローバル経済～米国金融政策正常化への備えは十分か？」と題するシンポジウムを開催いたしました。本シンポジウムでは、国内外から著名な専門家をお招きし、主要国経済の現状と備えの状況、デフレ脱却への処方箋、Brexit等の政治的社会的背景等について議論していただきました。

本稿は、同シンポジウムにおける各パネリストのスピーチおよびパネル・ディスカッションでの議論を記録にまとめたものです。ご関心のある皆様方の今後のご考察への一助になれば幸いです。

2015 年 7 月
公益財団法人　国際通貨研究所

Preface

The year 2015 has started with an anticipation that the United States is going raise its interest rates. The dollar, the worlds’ key currency, will no longer be available for free. Although this has been predicted for several years, its effect will impact the world economy broadly.

In Europe and Japan, a diverging US monetary policy may put upward pressure on their interest rates, ultimately forcing them to make further monetary easing. Also in Europe the re-sounding words of Grexit and Brexit are again raising concerns. In emerging economies, will China be able to succeed in its efforts to lessen its dependency on investment for growth without causing social unrests? For natural resource dependent Emerging Countries, the effects of the drastic decrease in crude oil prices are a concern, and for other Emerging Countries there will be no countries that would not be affected by the recurrence of global funds to the US.

With these in mind, the IIMA held a symposium on March 4, titled “The Global Economy – Is the World Really Ready for Normalization of the US Monetary Policy?” Prominent panelists from Japan and abroad extensively discussed the current economic situations of major countries and their policy responses, prescriptions for growing out of deflation, political and social backgrounds of Brexit and Grexit and so on.

We sincerely hope this record of the symposium will help give you much inspiration in your business and academic considerations.

July 2015
Institute for International Monetary Affairs

パネリストの略歴／Profiles

ジェイコブ・フレンケル

JP モルガンチェースインターナショナル 会長

Jacob A. Frenkel

Chairman,
JPMorgan Chase International

シカゴ大学より経済学博士号取得。IMF 経済顧問兼調査局長、シカゴ大学経済学部教授、イスラエル中銀総裁などの要職を歴任。現在 JP モルガンチェースインターナショナル会長及び G30 理事会議長。また、ピーターソン研究所等の理事を務める。イスラエル経済学賞ほか受賞多数。

Dr. Frenkel is Chairman of JPMorgan Chase International and also of the Board of Trustees of the G-30. Previously he was Governor of the Bank of Israel, Economic Counselor and Director of Research of the IMF, and Professor of Economics, University of Chicago. He is a member of many boards such as Peterson Institute for International Economics and Trilateral Commission. He is a Laureate of the 2002 Israel Prize in Economics with many other awards. He holds Ph.D in economics from the University of Chicago.

クラウス・レグリング

欧州安定メカニズム 総裁

Klaus Regling

Managing Director,
European Stability Mechanism

ハンブルグ及びレーゲンスブルグ大卒業後、IMF（ワシントン、ジャカルタ）、独財務省、欧州委員会経済金融局長を含む官民分野で要食職を歴任。欧州安定メカニズムの初代総裁であり、欧州金融安定ファシリティ（EFSF）の CEO も務める。

Mr. Regling is the first Managing Director of the European Stability Mechanism as well as the CEO of the EFSF. He studied economics at the Universities of Hamburg and Regensburg and has worked for 38 years as an economist in senior positions in the public and the private sector in Europe, Asia and the U.S. including a decade with the IMF and a decade with the German Ministry of Finance. He served as Director General for Economic and Financial Affairs of the European Commission in 2001-08.

クリフォード・タン
三菱東京 UFJ 銀行グローバルマーケットリサーチ東アジア統括

Clifford C.H. Tan
East Asian Head of Global Markets Research,
Bank of Tokyo - Mitsubishi UFJ, Ltd.

ハーバード大学及びイェール大学より修士号取得。25 年にわたりソシエテ・ジェネラルや CITI グループ、米 FRB 等で活躍のほか、韓国開発研究所の客員研究員を務め、香港大学、スタンフォード大学で教鞭も執る。現在、三菱東京 UFJ 銀行のグローバルマーケッツリサーチ東アジア統括（香港）。
Mr. Tan is East Asian Head of Global Markets Research of the BTMU based in Hong Kong. He has 25 years of work experience in markets and public sector, including as Managing Director/Head of G10 and EM FX Research at Societé Generale; Head of Asian local markets strategy at Citigroup; and the Greater China economist of the US FED. He has been Visiting Fellow at the Korea Development Institute, and teaching at the University of Hong Kong and Stanford University. He has degrees from Harvard and Yale Universities.

アデア・ターナー
新経済思考研究所 シニアフェロー
前英国金融サービス機構 長官

Adair Turner
Senior Fellow, Institute for New Economic Thinking
Ex-Chairman, UK Financial Services Authority

2013 年 4 月より新経済思考研究所シニアフェロー。前英国金融サービス機構長官。マッキンゼー、メリルリンチ欧州、気候変動委員会、ロンドン経済大学等、官民多方面で活躍。著書に「危機後の経済学：目的と手段」他。
Lord Turner has been a Senior Fellow at the Institute for New Economic Thinking since April 2013. Prior to that he was Chairman of the UK Financial Services Authority. He has combined a business career with public policy and academia, serving for Mckinsey and Merill Lynch Europe, and for Climate Change Committee and London School of Economics . His publications include 'Just Capital -The Liberal Economy'(2001) and 'Economics After the Crisis: Objectives and Means'(2012).

山﨑　達雄
財務省　財務官

Tatsuo Yamasaki
Vice Minister of Finance for International Affairs,
Ministry of Finance, Japan

1980年大蔵省（現財務省）入省。国際協力銀行海外投資研究所主任研究員（在シンガポール）、国際局課長、審議官等を歴任、金融庁参事官、国際局次長, 国際局長を経て2014年7月より財務省財務官。
Mr. Yamasaki joined the Ministry of Finance in 1980. He has been Vice Minister of Finance for International Affairs since July 2014. He also served as the Deputy Commissioner for International Affairs of the Japanese Financial Services Agency and Vice chairman, Executive Committee of the International Association of Insurance Supervisors (IAIS).

(アルファベット順／In the alphabetical order)

行天　豊雄
国際通貨研究所　理事長

Toyoo Gyohten
President,
Institute for International Monetary Affairs

1955 年東京大学卒業後、大蔵省（現財務省）に入省、国際機関出向、銀行・国際金融局等を経て 1986 年財務官。1990 年プリンストン大学およびハーバード大学客員教授を務め、92 年東京銀行会長に就任。1995 年より国際通貨研究所理事長。

Mr. Gyohten graduated from the University of Tokyo in 1955 and joined the Ministry of Finance. Serving in a variety of bureaus including Banking and International Finance, and at international organizations, he became Vice Minister of Finance for International Affairs in 1986. He taught at Princeton University and Harvard University before he was named Chairman of the Bank of Tokyo Ltd. in 1992. Since 1995 he has been president of the IIMA.

倉内　宗夫
国際通貨研究所　専務理事

Muneo Kurauchi
Managing Director,
Institute for International Monetary Affairs

1978 年慶應義塾大学卒業後、東京銀行（現三菱東京 UFJ 銀行）入行。国際プロジェクト部、ニューヨーク勤務などを経て、常務執行役員名古屋営業本部長、専務執行役員国際部門副部門長などを歴任。2014 年 7 月より国際通貨研究所専務理事。

Mr. Kurauchi joined the Bank of Tokyo (presently the Bank of Tokyo-Mitsubishi UFJ, Ltd.) in 1978. He took up many important posts including Deputy Chief Executive of Global Business Unit of the BTMU as Senior Managing Executive Officer. Since July 2014, he has been Managing Director of the IIMA.

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本シンポジウムは主に英語で行われました。日本語版は英語での記録を当研究所で翻訳したものです。
The English version is based on the transcript of the speeches and discussions which were mainly conducted in English.

英語版

English Version

Occasional Paper No.30

The 24th International Financial Symposium

The Global Economy

– Is the World Really Ready for Normalization of the US Monetary Policy? –

March 4, 2015 Keidanren Kaikan

Institute for International Monetary Affairs

Contents

1. Opening Remarks
Muneo Kurauchi, Managing Director, IIMA

Our honorable panelists, ladies and gentlemen, Good afternoon. Thank you for joining us in our International Financial Symposium, titled “The Global Economy –Is the World Really Ready for Normalization of the US Monetary Policy.“ With the normalization of the US monetary policy becoming a foreseeable reality, we would like to explore and confirm together with you what effects it will have on the economies in every part of the world.

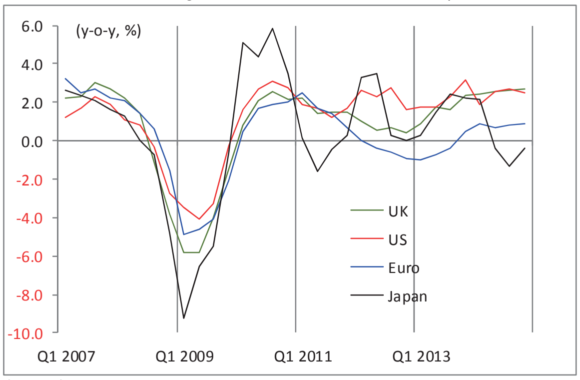
First of all, I would like to simply summarize the current situation of the world economy to provide a common consensus for discussions.

1. The US

Attracting the keenest attention in the international financial market in 2015 is the probable raise of the US interest rates. Helped by improved employment situation, the US economy has shown a strong growth since last year, and it is expected to achieve around 3% growth in 2015. With this background, the monetary policy is finally approaching the exit from an excessively easy money phase. It means that the borrowing cost of the US dollar, the key currency in the international finance, will no longer be free but will be charged higher.

Although this has been predicted for several years, it is inevitable that the influence will be felt in every corner of the world economy.

ユーロ圏、英国、米国、日本の実質GDP成長率
Real GDP growth rates, Euro, UK, US and Japan



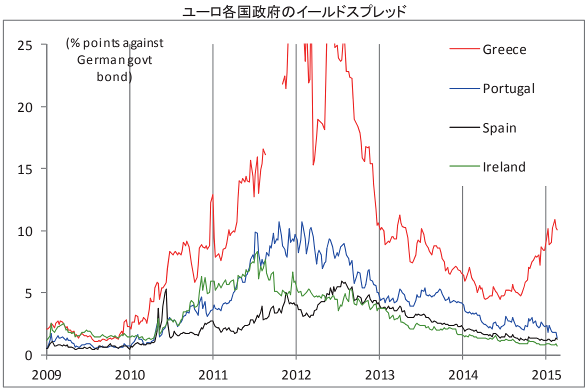
(Source) Datastream

2. Europe

In contrast with the US, an easy monetary policy in Europe is expected to continue or even to be expanded for the moment. This diverging policy direction from the US will help Europe to evade its plunge into deflation on the one hand as a moderate depreciation of the currency will give a stimulus to the economy and a rise of import prices. On the other hand it will be accompanied by a demerit of upward pressure on the interest rates. Currently the European economy has been on a moderate growth route centering around the Eurozone, but if the demerit proves to be greater than expected, the ECB may be forced to step up its quantitative easing further.

Political situation is also a concern. In January, anti-austerity opposition parties won the general election in Greece, amplifying uncertainties around the Greek debt reconstruction negotiations and continued support to Greece from the EU and other international circles. General elections are also slated for in May in the UK, and in autumn in Portugal and Spain, the two countries that just left the international supports. We cannot take our eyes off from the impact of their political whereabouts on the financial market.

Yield spread of Euro area
ユーロ各国政府のイールドスプレッド

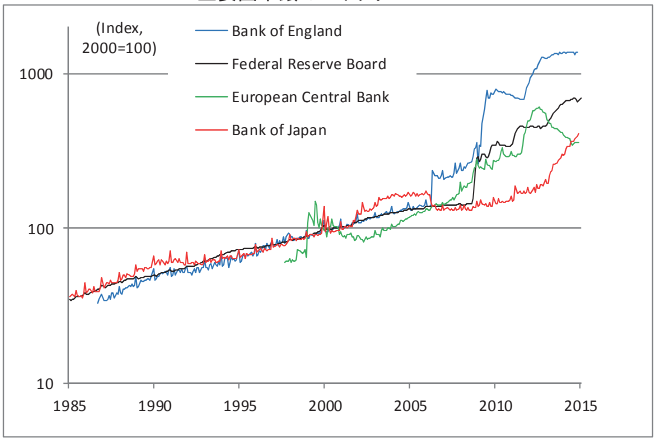


(Source) Datastream

3. Japan

The Japanese economy is recovering from the slump after the consumption tax increase in 2014. The economy will get additional supports for a while from such policy measures as the continued quantitative qualitative monetary easing and postponement of the second increase of consumption tax, as well as from the lower yen exchange rate and fall of oil prices. On the other hand, the postponement of consumption tax raise has worsened the prospect of Japan's fiscal consolidation. The Abe government has been making efforts through Abenomics to make sure the departure from deflation, but in the environment where the domestic demand will naturally dwindle through ageing and declining population, it is much to be watched whether the highly expected third arrow of Abenomics will work effectively to make a significant contribution to the reforms of the health-care, pension and agricultural sectors and revitalization of regional economies.

Monatary base of Major Central Banks
主要国中銀のマネタリーベース

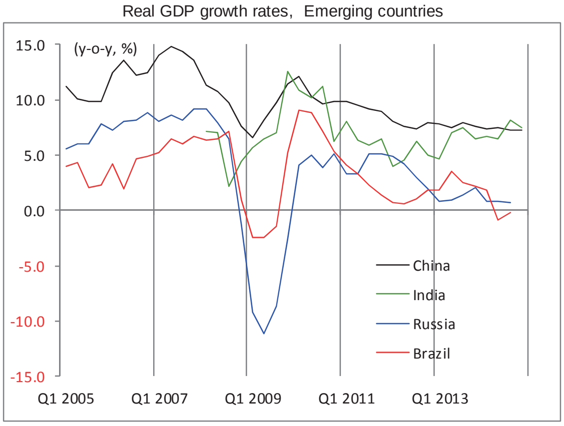


(Source) FRB, BOJ, datastream

4. China

The emerging countries in general are facing with many uncertainties. Among them, China has been trying to break away from the growth depending on over-lending and over-investment that tended to expand asset bubbles. Hence the Chinese economy is expected to experience a moderate slowdown for a while. The government intends to accept this slower economic growth but it will be faced with a difficult policy steering to avoid a social turmoil once the economy decelerates more rapidly and the benefit of the growth does not trickle down to the ordinary people. The redistribution of income from growth will become more and more difficult to implement under the new concept of so-called ‘New Normal’ in China, and I am concerned about to what extent China can allow the economy to slow in view of dealing with the growing social dissatisfaction.

エマージング諸国の実質GDP成長率
Real GDP growth rates, Emerging countries



(Source) Datastream

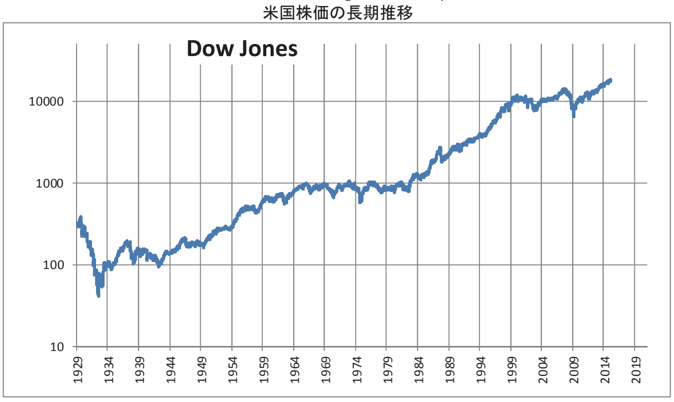
5. Other emerging countries

Other emerging countries (than China) also have many adverse factors. Especially the oil producing countries will face a continued deterioration of the economy because of the income transfer to the oil import countries caused by a rapid fall of crude oil prices. On the other hand, the lower oil prices will give a big bonus of reducing energy costs to the non-oil producing countries. Yet, they may be also adversely affected by the recurrence of international money flows back to the US and a slower economic growth in China. The geopolitical risks in Ukraine and the Middle East are also a big concern.

6. Sustainability of the US economy and its structural change

As is seen, the world economy is likely to maintain a growth at a certain pace as the economies of the advance countries will be recovering while the growth of the emerging countries will moderately slow down. The leading country is the US, but the question is, "is this expansion of the US economy a simple return to its normal economic activities, or is it backed by a new growth mechanism as was seen in the IT revolution in the 1990s? The answer to it will give us a hint to ascertain whether the US, which has been in an extra-ordinary accommodative liquidity for the past 6 years, has any possibilities to be badly affected by its own monetary normalization.

US Stock Prices Long term development
米国株価の長期推移



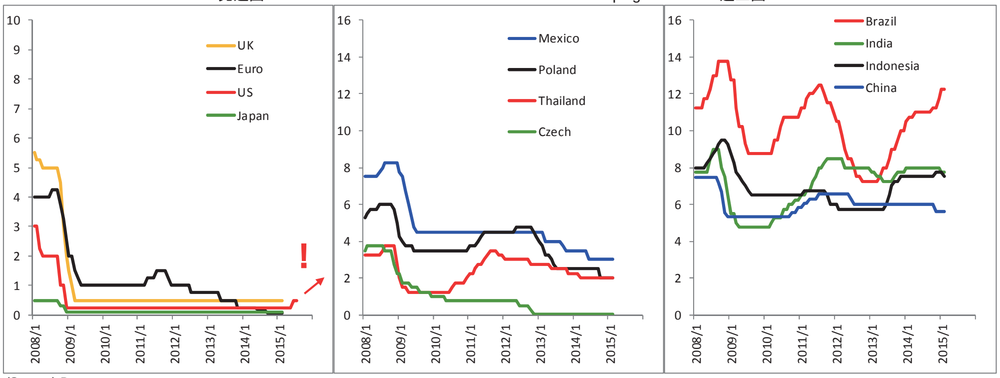
(Source) Datastream

7. Change of money flows following the US interest rate raise

Owing to the fall of oil prices, inflation has subsided in many countries and an increasing number of countries have started to take easier monetary policy in fear of weaker economic conditions. In this context, the raising of the US interest rates signifies that the key currency country is going to have an opposite directionality of monetary policy against many other countries. The change of environment in the international financial market should be carefully watched as it can be accompanied by a big swing of money flows, which in turn will affect the emerging countries among others. Which countries will have the severest impact? Is there anything the advanced countries can do if and when the economy of the emerging countries and their financial and capital markets were to be destabilized?

Policy interest rates 政策金利

Advanced countries 先進国 Developing countries 途上国



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8. Geopolitical risks (Grexit, Brexit, Ukraine)

The geopolitical risks around Europe also continue smoldering. With the birth of anti-austerity new government in Greece, a concern about Grexit (the exit of Greece from the euro system) that will affect the foundation of the euro system has re-emerged. I am much worried about its development to come. Even if Greece decided to remain in the euro zone this time, will there be no need for us to take precaution that in the future some other countries may be faced with the pressure for the exit?

Also the independence of Scotland from the United Kingdom was rejected last September, but still some people watch out for the Brexit, the possibility that the UK will someday walk out from the membership in the EU.

Another concern is about Ukraine. Although the ceasefire deal was finally agreed between Ukraine and Russia, the situation is still in chaos (trouble).

9. Financial business and financial regulations

Last but not least, it will be very useful, taking this opportunity that we have today of the presence of distinguished financial experts from the world, to discuss the future direction of the financial businesses

First, it is essential to review the modalities of international financial regulations. Presently the situation is uncertain. Some people see many loopholes in the present system and think the system is not sufficient for a well-functioning supervision, but some others insist that the regulations are so strict that the financial industry is forced to bear a higher cost, which will promote an oligopolization of players where only small number of strong institutions can survive, only to increase the financial cost of corporations.

Based on this acknowledgement, it is necessary to determine the direction that financial industry to take. The global financial industry had shrunk its activities after the financial crisis of 2008-09, but when it gets out of the stagnation, where should it find the demand and to whom and what kind of services should it aim to provide?

There will be no end to the arguments surrounding the world economy and finance, but I will stop here and would like to have the presentation by the panelists. Please enjoy the symposium and thank you for your attention.

2. Opening of Symposium
Toyoo Gyohten, President, IIMA

Good afternoon everybody, thank you very much for joining us today. My special thanks go to the panelists who took a long journey to join us today.

I think the world economy has been gradually recovering on the whole from the terrible collapse of 2008. Of course the speed and feature of the recovery are quite different from country to country. But one remarkable phenomenon was that in most of the major economies there was recourse to the very aggressive monetary expansion which is known as QE.

The United State was the frontrunner of the QE and indeed made a very significant achievement. But as for many other emulating countries, as far as I can see, the jury is still out. As Ben Bernanke said, the QE is proved right in practice but not in theory.

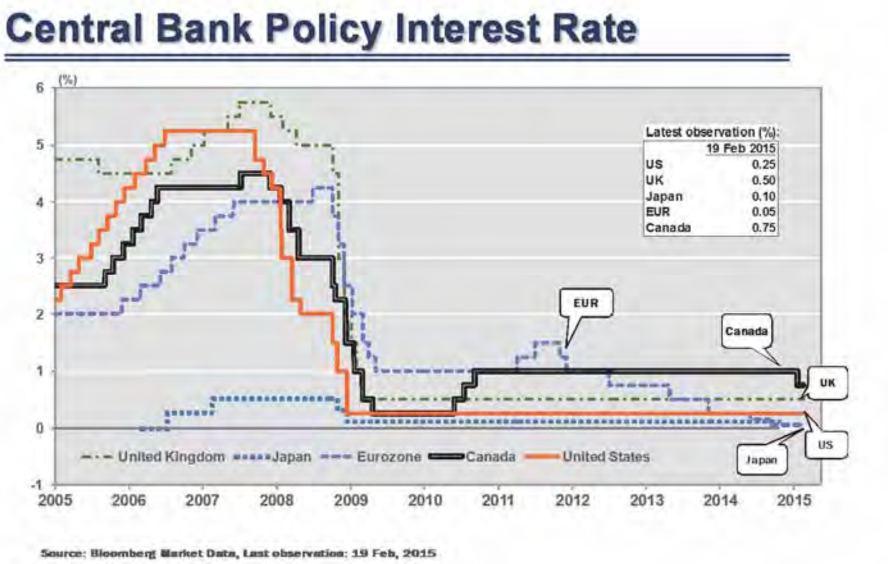
We are like a herd of African gnu, trying to cross a river. We have to be very careful in watching how others are stepping in. Anyway the goal is to cross the river and reach the dry bank as quickly as possible. This is, anecdotally speaking, the main theme for today's discussion.

3. The US Outlook in Brief
Jacob A. Frenkel, Chairman, JPMorgan Chase International

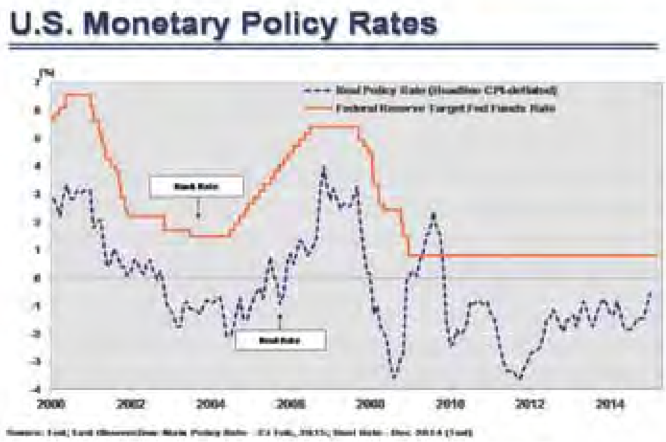
I am very happy and pleased to be here again in Tokyo, to join the symposium held under the auspice of IIMA which is headed by my very dear friend of over 30 years, Toyoo Gyohten-san.

The subject of the conference is, "Is the World Really Ready for normalization of the US monetary policy? I could even hear the music "Really ready?". People say the world is ready - but then comes the question, "Is it *really* ready?" I am asked to address this question specifically from the US perspective. In order to set the tone, I want you to know that from the US perspective I believe that the US is more ready than less ready. The world is getting ready based on three building blocks. First, if you look at monetary policies; second, if you look at the economic activity; third, if you look at labor markets - the world is getting more ready than less.

Let me start with the monetary policy perspective. Interest rates have been close to zero globally in an unprecedented way, for over five years. If you had asked any central banker in the world five or six years ago, when it all started, whether they expect those policies to last for more than six years, they would have said "You are out of your mind. This is a temporary detour until things work out." Obviously, it has taken longer. Interest rates in the world have been close to zero all over the world. We have been very lucky, but let's face it. That's number one.

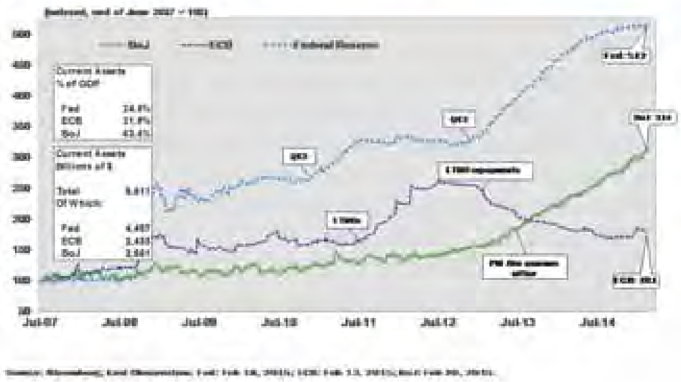


Number two. As a result of QEs, real interest rates, especially in the industrialized world, have been negative for relatively long period of time. This was the same for the US, the largest player .



How did QEs work out? All central banks have expanded their balance sheets, but the US Federal Reserve had done it more dramatically. Today, the size of FED's balance sheet is more than five times larger than what it was before the crisis. Effectiveness had diminished for each consecutive QE. QE1 one was dramatic. QE2 was good but less dramatic and QE3 was so-so and less dramatic. The long journey of FED's QE is now close to the end with its effectiveness diminishing. But the diminishment of the effect of the QE is also happening all over the world.

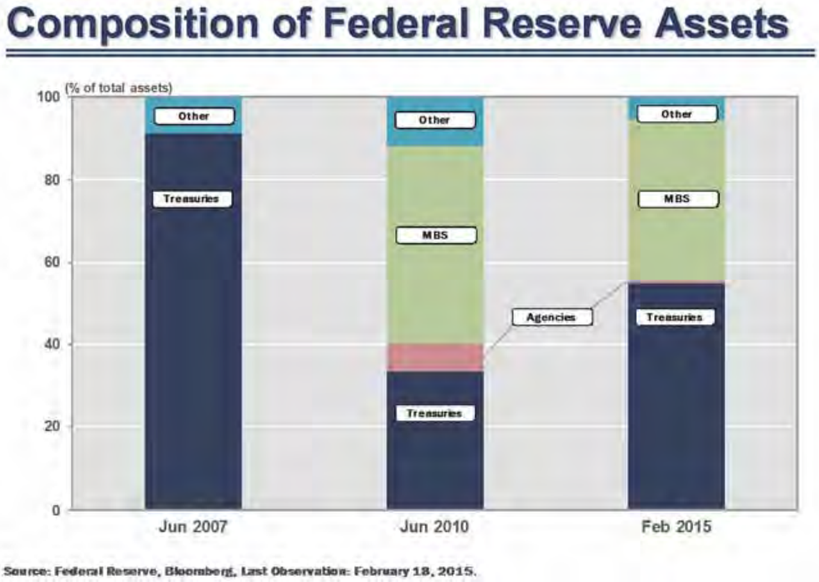
Total Assets of Key Central Banks (indexed levels)



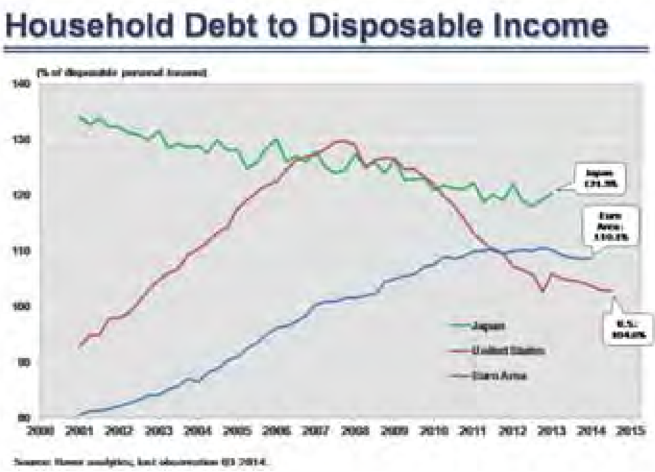
Total Assets of Key Central Banks (share of GDP)

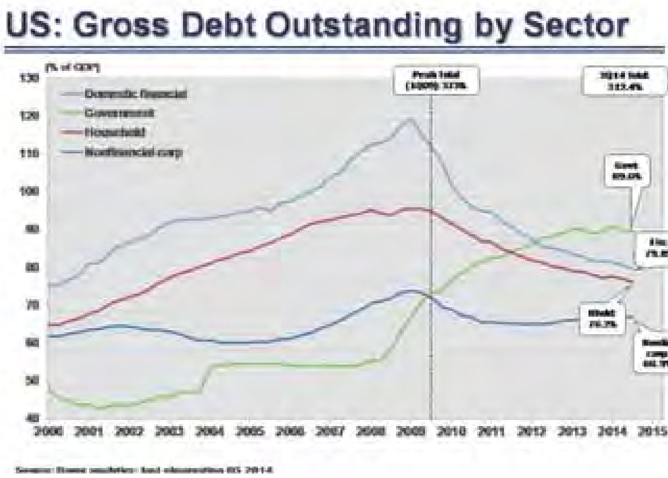
The colleague from Europe will tell us about the European Central Bank, but you can see that though they have tried to expand monetary easing during the last three years, their balance sheet has in fact shrunk. How come? It is because they give the money to the banks, and the banks put it back to the ECB. Money did not go into the economy. There is no question that Bank of Japan's action in the monetary field has been very effective, especially as it changed people's price expectation and had psychological impact towards the economy.

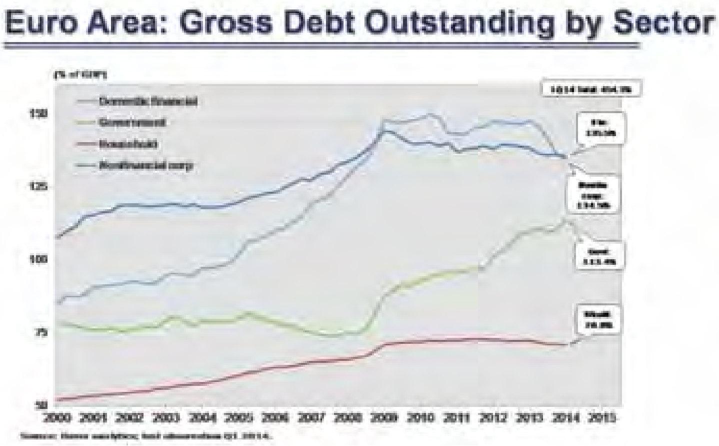
The important point is, however, that the size of the balance sheet of central banks has expanded to such an extent. FED's balance sheet is about 5 trillion dollars, almost equal to the sum of BOJ's and ECB's balance sheet. The change in the composition of their balance sheet is also important. Formerly, most of FED's assets were US government treasury bills - high quality, highly liquid. Few years after, the largest component of the balance sheet had suddenly turned to MBS (Mortgage backed securities), a different type of asset. Today the share of treasuries is up again. Normalization has started.

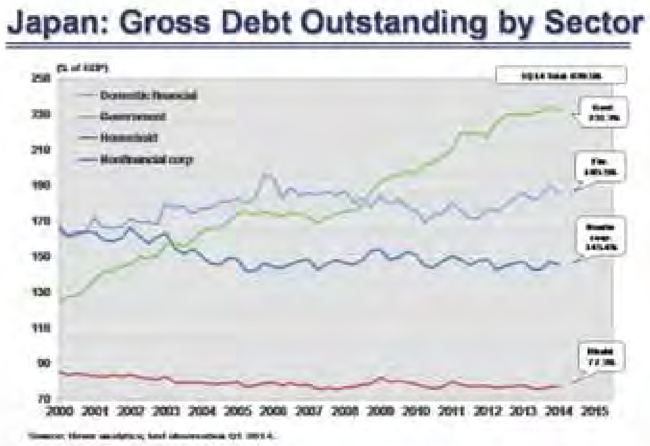


One of the important causes of the crisis was the excessive leverage increased by everyone; the private sector, government, financial sector, households, and corporations. Leverage reduction was a part of the adjustment of the crisis. Households in the US have decreased their leverage, but those in Europe still have a long way to go. So is the world *ready*? From the US perspective, 'yes', from the European perspective, 'maybe'.

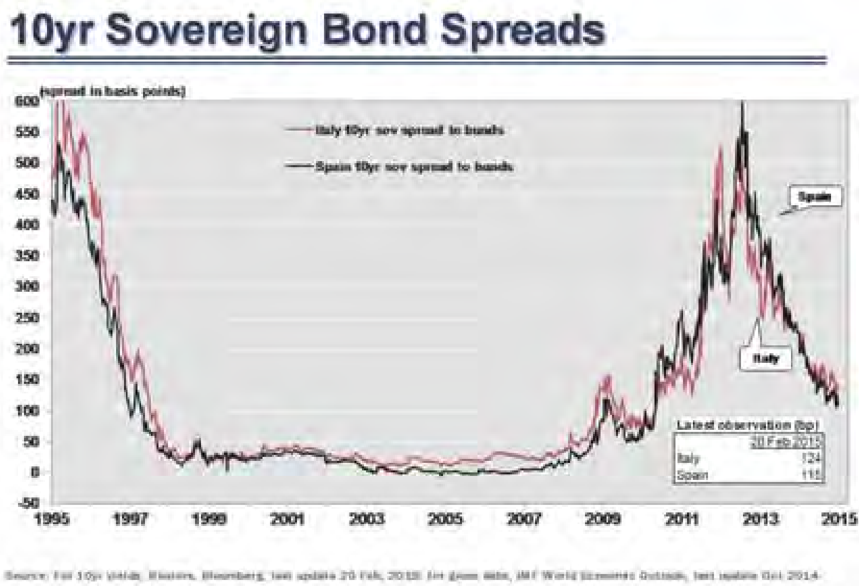




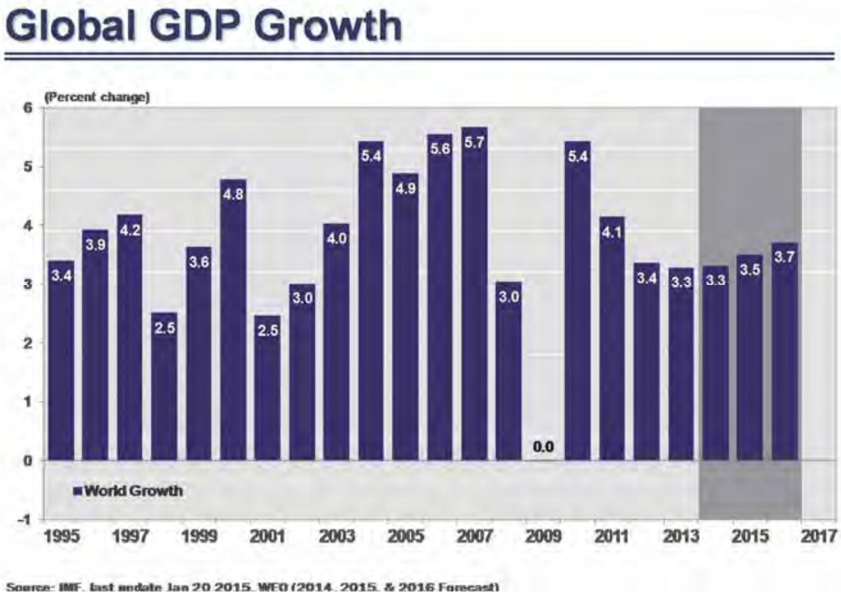


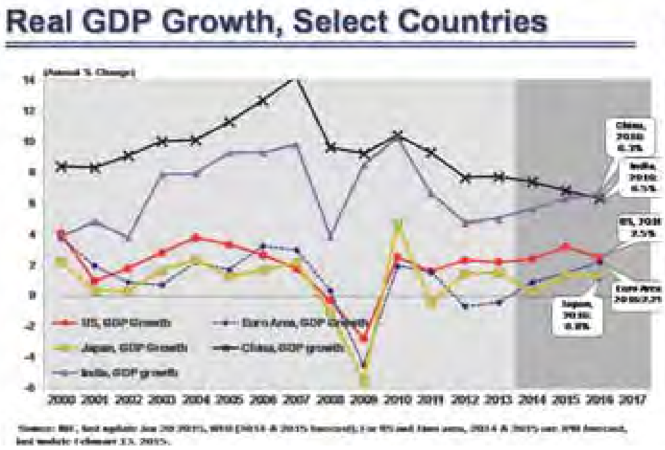


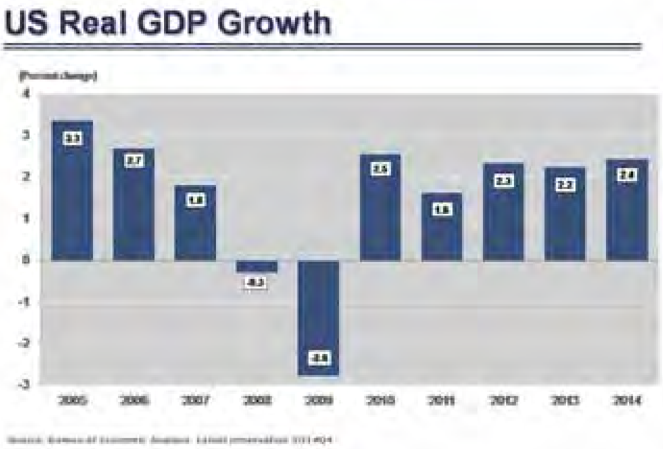
Take a look at the spreads between German and Spanish/Italian government bond yields. They were very tight before the crisis when the market had not properly measured the latter countries' risk. Though the spreads widened significantly with the crisis occurred, recently they are retightening, meaning that normalization is taking place.

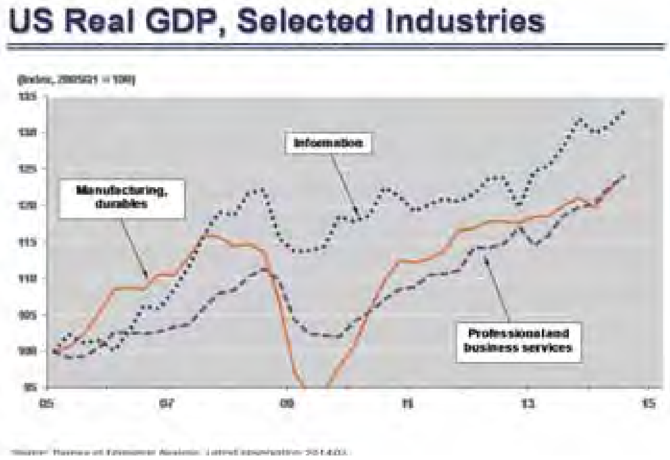


Let me now move on to the world economic recovery. It is taking place in a somewhat slower manner than demanded but it is there. After ceasing in 2009, the world economy growth is recovering though not dramatically. It is now 3.5% or so. GDP of all groups of countries have picked up to the post crisis period, including each and every group within Intra-Europe. US growth rate has returned to 2% level, which is not dramatic but robust. Level of Information industry, the manufacturing industry, professional business services are now all 22 to 25 percent higher than it was 10 years ago. Real economic activities also seem to suggest that the world's ability to sustain an adjustment and normalization has become stronger.

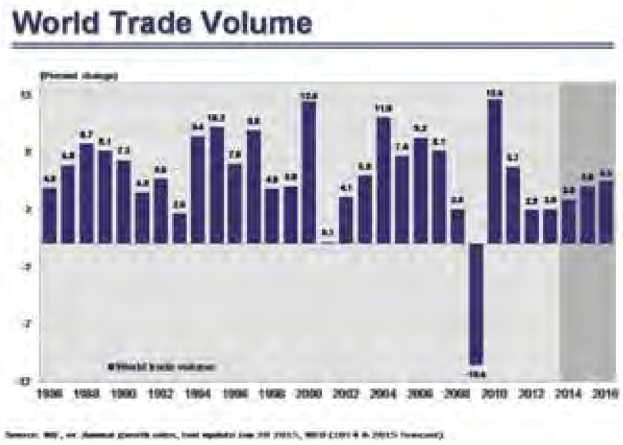


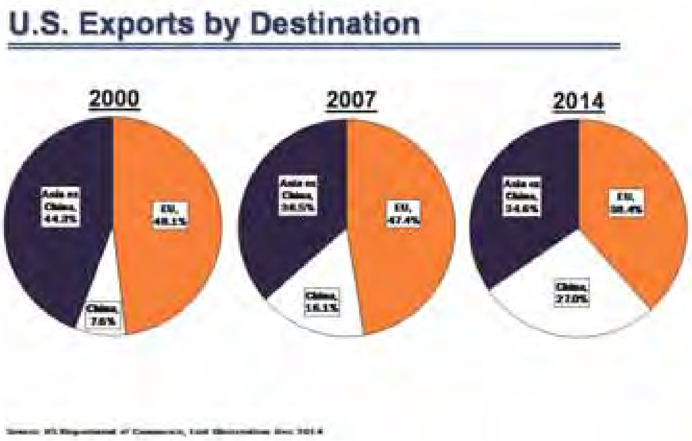




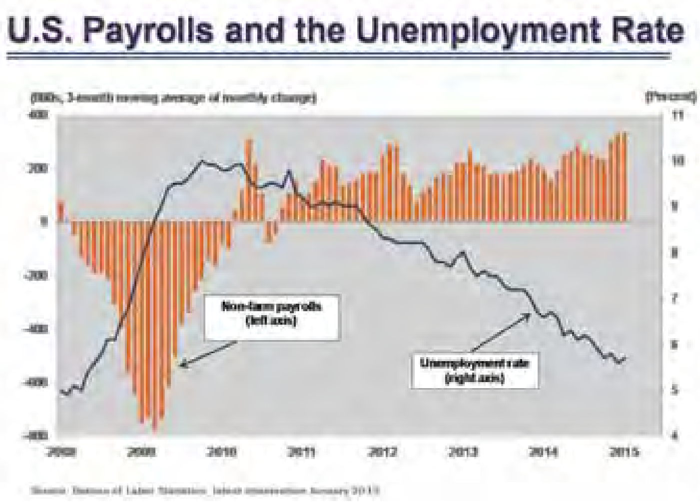


Trade has also picked up from 2009 when the world trade crashed. US exports has seen a dynamic change. Exports to China amounted to only 16% in 2007 but today it has increased to 27%. Exports to European Union decreased from 50% to 38%. The trading partners also show dynamism and ability to match up their opportunities and needs.





Now finally, I will speak on the labor market. Global labor markets are now much healthier. US unemployment rate is declining very rapidly. It had once been close to 10% but today around 5.5%. This was associated with job creation. After the outbreak of the crisis, job creation was observed every year. Therefore labor market is also showing greater robustness. Additionally, there's practically no price inflation or wage inflation, although employment cost index indicates a slight pickup.



My conclusion is that from the US perspective, there is a call for normalization. FED is focusing exclusively on the best way of monetary policy normalization. Though it is not a promise, there is a consensus that within the coming few quarters normalization will begin. I think FED already obtains the credibility that they will not raise the rate until they are convinced that the economy is strong enough to sustain it. This means that FED's rate hike should be recognized as good news, because it is a proof that FED believes the economy is strong enough. FED will not gamble with the economy. I look forward for the ordinary times to come when policy rates will go up and down - not moving to one direction.

Thank you very much.

4. The Policy Response in Europe
Klaus Regling, Managing Director of the European Stability Mechanism

Thank you very much for inviting me. It is a pleasure to be here in this conference. I have been asked to speak about Europe and in particular the Euro area. I will also talk about Greece but I will do it later during the panel discussion. Europe is more than just Greece. And I will not talk so much about monetary policy. I agree with a lot of what Jacob just said. I'm not a central banker. Europe is at the moment more or less decoupled from the US monetary policy and therefore the question of this afternoon of what is the impact of the normalization of the US monetary policy is very easy to explain for Europe; in the short run there will be very little impact. If we look at the cor-relation between European, let's say, German bond rates and US bond rates it is now down to zero or even negative depending on the maturity. The normalization in Europe, as Mr. Kurauchi explained in the introductory remarks, will happen a bit later as we have a delayed recovery compared to the US. So again, monetary policy will react later in Europe. Instead let me take a somewhat broader look at the policy response during the last few years in Europe and why it has been different from the US. I will start with secular stagnation which is a very fashionable concept these days.

Secular stagnation seems to be a global concern, because recovery has been sluggish although it is getting better in the US as Jacob reminded us. Inflation rates are low not only throughout the advanced economies but also in many emerging markets like in China. The combination of low inflation rate and sluggish growth is not only found in the euro area, but also in the UK and the US, where Central Banks have more forcefully intervened and nominal growth has become more robust recently.

There are two different theories to explain why economic growth has slowed down globally. On the one hand, Larry Summers argues that secular stagnation is the result of a lack of demand and, thus, calls for more fiscal stimulus. On the other, Robert Gordon and others argue that the main problem is the dismal behavior of productivity, which is on a downward trend without any turnaround expected in the medium term. According to the latter view, the problem is on the supply side of the economy.

This distinction in diagnosis is well reflected in diverging policy reactions to the crisis.

While the US and UK have relied heavily on fiscal and monetary stimulus to close the output gap, in Europe, much more importance has been given to structural reforms aimed at increasing productivity and potential output. It would seem that Brussels has read Gordon while London and Washington are more in tune with Summers.
In the US and the UK, fiscal policy has been more accommodative and Central Banks have engaged in risk shifting policies by purchasing large amounts of private and public assets. Instead, the European policy mix placed more emphasis on achieving structural reforms and fiscal adjustment. Euro Area countries, especially those under official support, are undergoing significant reforms aimed at improving labour and product market efficiency. On the fiscal side, Euro Area countries have control mechanisms to avoid an excessive accumulation of government debt. With most of the heavy lifting on the fiscal side now behind us, the aggregate euro area fiscal stance is expected to be neutral this year.

Different policy prescriptions are also rooted in the challenges associated with population aging and broader demographic trends. The related shortage of labor supply in the future is more acute in Europe, partly because of a lower birth rate and partly because the US economy has been more open to immigration.
In any case, headwinds to future growth are numerous globally. Various factors are likely to translate into less economic dynamism in the future:
First, demographic trends will have a negative impact on the demand and supply side of most advanced and many emerging economies. Population ageing is likely to lead to increased savings, pushing interest rates downward.
Second, globalization is decelerating. Over the last 30 years, trade grew much faster than world GDP (5.3% vs. 3.2%). While this process of trade integration provided an important growth impulse in the past, it is a one-off factor that will not be repeated in the future.
Third, a similar one-off argument relates to female integration into the labor market, a process that contributed to demand and supply in the past but has been exhausted in the advanced world.
Fourth, private and public debt and financial bubbles cannot push again growth as they did in the recent past.
Fifth, contingent liabilities stemming from social security promises will, in the future, be a huge problem.
All of these points to future trend growth being lower than in the past. In any case, Total Factor Productivity (TFP) remains the main driver of potential GDP growth. The

academic literature suggests that distortions in the efficient sectorial allocation of production inputs may generate very different aggregate TFP levels across countries. For this reason, in Europe much emphasis has been rightly given to structural reforms.

Structural reforms are the key to promote long run growth and an efficient functioning of the currency union in Europe. The implementation of difficult reforms and unavoidable fiscal consolidation has contributed to the unsatisfactory short-term growth performance in most European economies in recent years. These reforms will bring, however, future benefits, and they will make the currency union more stable by reducing disparities among its members. Moreover, the need for additional fiscal adjustment from now on will be much smaller. One should also bear in mind that, in particular in the five program countries in the monetary union - Spain, Portugal, Ireland, Greece and Cyprus - low growth is to a large extent the consequence of excessive growth in the past, which led to and was sustained by the accumulation of imbalances.

Some European economies have been reform champions during the last years. Widely recognized structural reform indicators, such as those prepared by the World Bank, the OECD or the Lisbon Council, illustrate the extent of the effort made by European economies, especially those under adjustment programs. As documented by these institutions, the reforms have translated into lower nominal labor costs and more efficient product market regulations. Countries like Ireland and Spain and Portugal are already seeing the benefits of their reforms in terms of higher economic growth. According to the OECD, Greece also could have high growth in coming decades if its reform efforts continue.

The Union is implementing additional policies to promote growth. First, the neutral fiscal stance, the easing of monetary policy and the related weakening of the euro exchange rate will support aggregate demand and supply.

Second, the recent investment plan unveiled by European Commission President Juncker will strengthen public and private investment in Europe, and thus strengthen demand.

Third, with the aim of restarting the credit channel and limiting the interdependence between sovereign and bank risks, the European Union (EU) is implementing a Banking Union and designing a capital -market union to reduce the traditional reliance on bank lending.

Europe conceived this banking union so that the financial sector would be able again to support a recovery in the European economy and in particular the euro area. In doing so, the immediate problem was to stabilize banks and remove the link between sovereign and banking sector risks. Regarding the medium term, a framework was needed that would reduce the likelihood of future financial crises. Europe responded to this challenge on multiple levels.

The EU has completely overhauled the regulatory and supervisory environment in which banks operate. Basel III is implemented in the EU, the BRRD (Bank Recovery and Resolution Directive) has reformed resolution and shifts the burden of bailout from taxpayers to creditors; and, the SSM (Single Supervisory Mechanism) and the SRM (Single Resolution Mechanism) are ensuring sound supervision and resolution of systemic institutions at the European level. Lastly, the ESM (European Stability Mechanism) now has an instrument to recapitalize banks directly, limiting the burden for the member state. These changes will help the EU becoming more resilient to financial crises than it was when the crisis hit in 2008.

The Balance Sheet Assessment carried out by the ECB (European Central Bank) and EBA (European Banking Authority) last autumn has provided euro area banks with a clean slate and has fostered transparency in the sector. The exercise assessed the asset quality of euro area banks according to harmonized standards to assure a level playing field and to provide maximum transparency to the SSM when it took office. Bank provisioning was also sense-checked to further reduce vulnerabilities. This will return confidence in the sector and help banks focus on new projects. After having raised several hundred billion euro of fresh capital, bank lending in the euro area should no longer be constrained by solvency concerns.

I am confident that, in the medium to long-term, the combination of structural and fiscal reforms and the creation of the banking union will deliver sizeable benefits. The multi-layered Euro Area policy approach, which relies on using fiscal and monetary policies to help the economy accommodate to structural changes, is creating a sound basis for sustained medium-term growth.

Because of these policies, together with stronger and broader framework that enhances policy coordination and the creation of new institutions such as the ESM and ESRB (European Systemic Risk Board), the monetary union will function better after the crisis than it did before. Thank you very much.

5. The Global Economy: Stuck in the Debt Overhang

Adair Turner, Senior Fellow, Institute for New Economic Thinking and Ex-Chairman of UK Financial Services Authority

Thank you Toyoo. I have been asked to make some comments on the economic and political situation in the United Kingdom. But I want to do so within the context of a perspective on what I think is the central challenge facing the global economy.

Seven years after 2008, I believe that many commentators have failed to grasp how deep are the deflationary headwinds facing the global economy as a result of the debt overhang left behind by excessive private sector credit growth. It is predominantly private sector credit growth which has caused the problem.

The most fundamental cause of the 2007 to 8 financial crisis, and in particular of weak post-crisis recovery, I believe, is summed up on Chart 1 – which shows private sector credit in advanced economies growing from 50% of GDP in 1950 to 170% in 2007, and with the vast majority of this growth, involving credit extended to finance real estate. (as Chart 2 shows)

Chart1

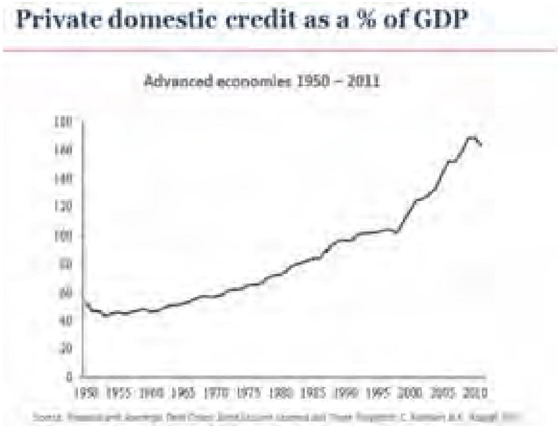
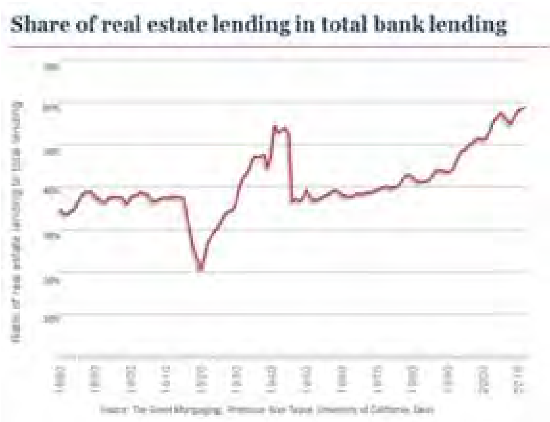


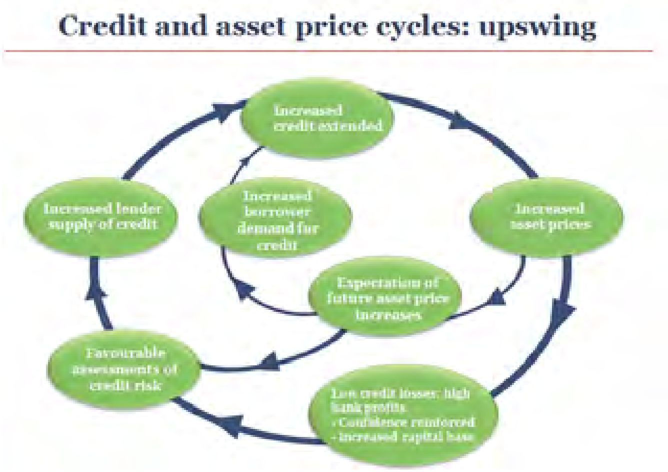
Chart2



This credit growth drove asset price increases, and in particular real estate price increases, in the self-reinforcing cycle which was described by economists such as

Hyman Minsky (Exhibit 3). In 2007/8 we then faced what economists sometimes call a “Minsky moment”, a break in confidence which then drove this cycle into reverse with asset price falls and which left many households and companies feeling overleveraged.

Exhibit3

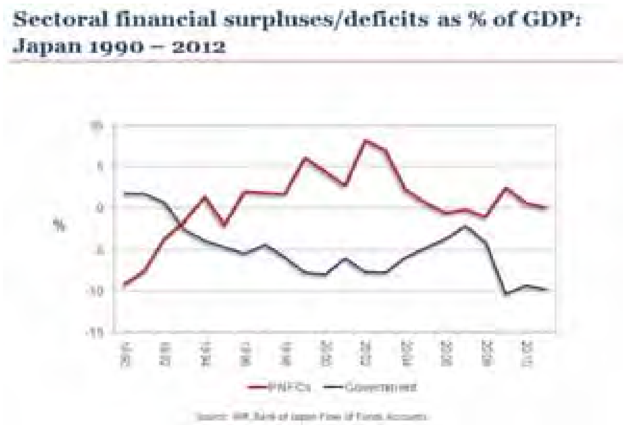


And I believe it is the attempted deleveraging of those households and companies across the world, and resulting low demand for credit, which is I believe far more than impaired credit supply, the fundamental driver of seven years of only weak economic recovery. I think the lack of demand for credit from overleveraged companies and households is far more important than the fact that we have had banking systems unable to provide new credit.

Markets and commentators largely failed to foresee this effect, just as they failed before 2007 to see the crisis coming. And indeed as Jacob Frenkel has said, in 2009 almost no one anticipated that central bank interest rates having first been cut close to zero, would stay there for six years. But we should have foreseen that this could occur after the growth of private leverage because what has occurred in the US, the Eurozone and the UK over the last seven years is straightforwardly a repeat of what happened in Japan in the 1990s.

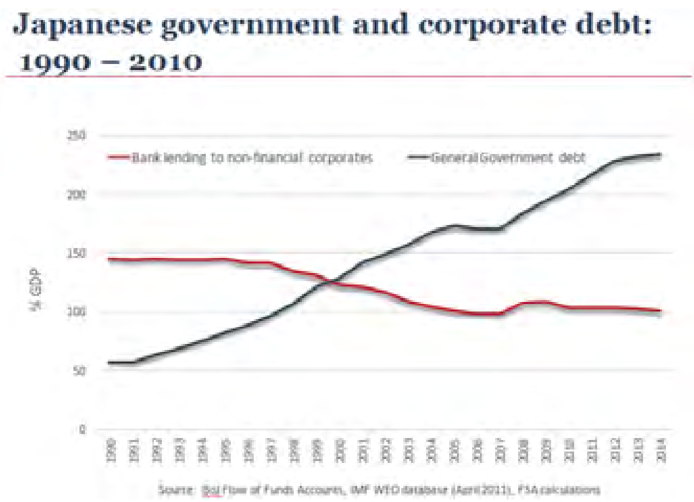
Japan experienced in the 1980s one of the biggest ever credit and real estate booms. The bubble popped in 1990. In its aftermath overleveraged companies were determined to pay down debt, even though the Bank of Japan fairly quickly cut interest rates close to zero . The Japanese corporate sector therefore switched from financial deficit to surplus (the red line on Exhibit 4) as it attempted pay down debt: and the economy entered the recession.

Exhibit4



As a result the fiscal balance, which is the blue line on Exhibit 4, moved from surplus to deficit in what was a natural, automatic and also useful response – fiscal stimulus helping to offset the demand impact of attempted private sector deleveraging. But the inevitable consequence of that was that while the corporate sector leverage slowly declined (Exhibit 5), government debt to GDP increased far more than the corporate sector leverage declined, and total Japanese economy leverage, private and public combined, simply continued to grow pretty much every year since 1990s.

Exhibit5



So, debt didn't go away – it simply shifted from the private to the public sector of the economy.

And it is that pattern which has been repeated precisely across the rest of the developed world after the crisis of 2008. Exhibit 6 is taken from the recent Geneva Report which is called "Deleveraging, what Deleveraging?": it shows some limited private sector deleveraging, but a more than offsetting increase in public debt. Overall across all of the developed economies combined (which is the blue line at the top of Exhibit 7) total leverage, private and public combined, has not declined at all, but has continued to rise since the 2007/8 crisis.

Exhibit 6

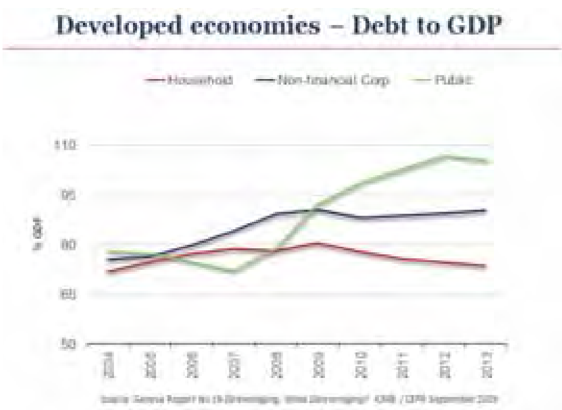
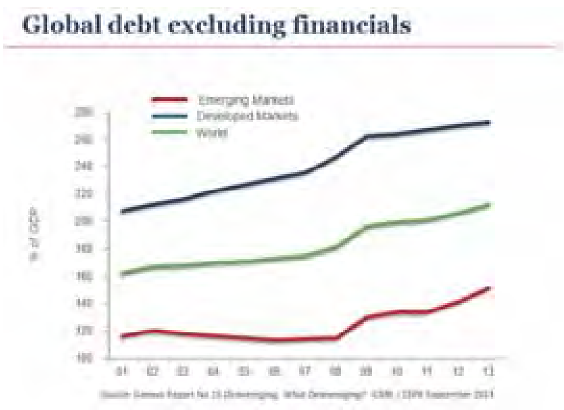


Exhibit 7



And the fundamental problem is that they appear to leave our conventional policy levers either blunted or in danger of producing adverse side-effects.

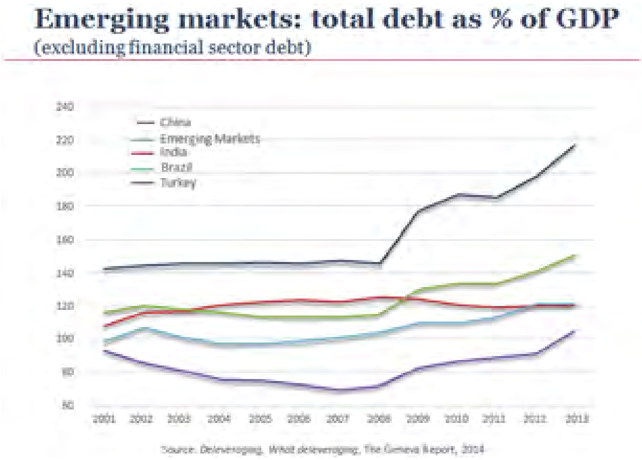
- Fiscal deficits are clearly useful in the short term, because they stimulate aggregate nominal demand: but the resulting rise in public debt to GDP poses the problem of long-term debt sustainability. In response, worried about the long-term debt sustainability, we attempt fiscal consolidation: but that is contractionary, as we have seen both in the Eurozone periphery countries, and in Japan, where the sales tax increase of 2014 has had a significant negative demand effect

- So instead of fiscal policy, we say let's try ultra-loose monetary policy – interest rates at the zero bound plus quantitative easing. But such policies carry adverse side-effects. They work in part through increased asset prices, but that exacerbates already rising inequality; they tend to stimulate leveraged complex financial speculations such as leveraged carry trades before they stimulate real economy investment and consumption: and ultimately they suffer from the irony that they can only work by re-stimulating the very growth in private credit which produced the crisis in the first place.

Once we have excessive debt, we thus seem stuck in a sustained debt deflation trap.

Debt has also shifted across the world, with a dramatic increase in emerging market leverage as you can see in Exhibit 7. And that leverage is fundamentally concentrated in China which is blue line at the top here (Exhibit 8).

Exhibit 8



Faced with the dramatic downturn of the global economy in late 2008, the Chinese authorities unleashed an enormous credit boom to finance property and infrastructure development, driving the economy's already very high investment rate from 42% to 48% of GDP, and driving total credit in the economy from 140% of GDP to about 240% in just five years.

Now that credit boom succeeded in underpinning economic and employment growth, but it was at the expense of enormous imbalances, with 33% of the Chinese economy now in some way dependent on real estate construction.

The risks created by this dramatic increase in leverage and real estate investment has now crystallised, with the Chinese economy slowing very significantly over the last six months, and as a result , I believe, imparting a major deflationary impact on the economies across the world.

Seven years after the 2008 crisis I think we are therefore still facing the deflationary headwinds created by a severe debt overhang, and we have no clear strategy for actually reducing global debt burdens, rather than simply shifting them around.

Indeed I think we have to face the fact that these burdens cannot be reduced simply by paying down debts or growing our way out, but can only be reduced by some combination of debt restructuring and write-off or permanent monetization.

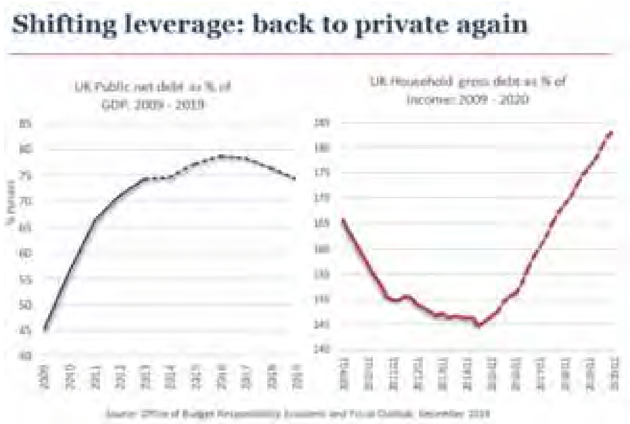
So where does the UK stand within this deeply deflationary global picture?

Well the UK has now in 2014 just recovered to 2007 GDP levels, and that reflects the fact with the bursting of the credit and property boom in the UK caused less severe harm in the UK than in for instance, Ireland or Spain, for three reasons. First, because although we had a credit and real estate price boom, we did not have an over construction boom in the way Ireland and Spain, or a bits of the US had. Second, because we used very significant fiscal stimulus to offset the impact of private deleveraging, with the UK running over fiscal deficits at an average rate of 6% of GDP during the last five years versus 2% in the Eurozone. Third, because we combined that with ultra-loose monetary policy and a floating exchange rate that allowed significant depreciation.

These helped us to recover. But the recovery is very unbalanced. We have not yet managed to rebalance our economy towards exports and investments, and we are running a large current-account deficit of around 5% or 6% of GDP.

And like the rest of the world, we have no answer to the question of how we will reduce the accumulated debt levels. Over the last five years as Exhibit 11 shows, we have achieved on the right hand side significant private deleveraging, but on the left hand side we have had a more than offsetting increase in public leverage. Over the next five years, the dotted blue line on the left, we believe that public debt to GDP will stabilise and then begin to fall, but our independent Office of Budget Responsibility suggests that we will only manage to do so and that will only be compatible with a robust growing economy, if private debt to GDP the dotted red line on the right returns to levels above the pre-crisis peak, with total leverage, public and private combined, higher in 2020 than it has ever been before.

Exhibit 11



Thus having shifted debt from the private to the public sector, we will simply shift it back again to the private sector but with the total level higher than ever before.

So we have unresolved macro imbalances. But more relevant to political consequences, we also have, like the US has, a very uneven recovery in terms of what matters most to ordinary people which is their living standards.

GDP is back to 2007 levels, but GDP per capita is still slightly below pre-crisis levels, and median real wages are some 7% below the level of 2008. GDP growth has in part simply reflected population and workforce growth, and strong employment growth has been combined with very low productivity growth and falling real wages. Asset values for significant wealth owners – whether in bonds, equities or London property – have however very significantly increased. There is therefore a lot of people in the United Kingdom who when they are told that they have the best growing economy in the world say, “Well it doesn’t seem to be reaching me”.

The result, as we approach a general election, is a very sour political mood, with trust in the elites, the financial sector and the established parties very low. In our May general election our two major political parties; Conservative and Labour – which 30 years ago used to get 95 % of the votes between them — will get no more than 65% of the total votes. In England, some 15% of the vote will go to the UK Independence party (UKIP), whose biggest vote winning issue is immigration, and which wants Britain to leave the European Union. In Scotland, despite last year’s narrow 55/45 defeat of the independence referendum, the Scottish Nationalist party look likely to take the vast majority and perhaps the vast majority of seats, wiping out Labour's area of traditional dominance.

We will almost inevitably have another coalition government.

- If it is Conservative led, we will have a referendum on British membership of the European Union, with a 60% chance of us staying in but a non-trivial 40% chance of us leaving, in my estimation.
- And if we have a Labour led coalition, the Conservative party in opposition will swing strongly in a Eurosceptic direction. I also think it will likely fight the subsequent election in an electoral pact with UKIP, leading to a referendum at a later stage, but with a greater chance of a vote in favour of exit.
- And to be absolutely clear, if Britain leaves the European Union, Scotland will leave the United Kingdom

We are in very fractious political times: and the underlying cause lies in the post-crisis Great Recession, as we struggle with the still unresolved issues of debt overhang and deflationary headwinds left behind by the excessive debt creation in the decades before 2008.

And that is also, I believe, the cause of the fractious political environment in Europe where we have extremists of right and left gaining depressingly large percentages of the votes.

So although still our conference asks us the talks about the normalization of interest rates I think we are a long way from the normalization of the global economy.

6. Progress of the Third Arrow of Abenomics
Tatsuo Yamasaki, Vice Minister of Finance for International Affairs, Ministry of Finance, Japan

Thank you very much. I understand that at present, many eyes are on the strength of the U.S economy. But in my view many positive developments are also ongoing here in Japan.

So let me start with fiscal policy. In November 2014, Prime Minister Abe decided to postpone the second round of consumption tax hike. But this was intended to prop up our current efforts to overcome deflation and to achieve sustainable growth. Upon the announcement, the prime minister clearly indicated three things in order to address concerns on fiscal sustainability. Firstly, the consumption tax will be raised with absolute certainty in April 2017. Secondly, the government will keep their commitment of turning the primary balance into a surplus by fiscal year 2020. Thirdly, the government will draw up concrete fiscal consolidation plans to achieve this goal by the summer of 2015.

While securing confidence in fiscal sustainability, the government is also making progress in realizing economic revitalization. FY2015 budget is a clear example. By this budget, the target of halving the ratio of primary deficits of national and local governments combined to GDP from the FY2010 level by FY2015 is expected to be reached. At the same time, economic growth rate in FY2015 is estimated at about 2.7% in nominal and 1.5% in real terms, almost entirely led by domestic demand.

Now let me turn to the so-called "third arrow", or the growth strategy. I hear many voices saying that the "third arrow" of Abenomics is not making sufficient progress or that it is invisible, but this is not the case. The third arrow might fly a little bit slowly since it takes a long time for structural reforms to lead to concrete outcomes. However, hundreds of arrows have already been shot out toward the right direction.

One of the goals of Japan's growth strategy is to shift USD 3 trillion of retained earnings held by Japanese corporations and USD 8 trillion held by households in cash and deposit with banks toward productive investment. This requires Japanese corporations to change their mind set. The key to change is the corporate governance reform.

In 2014, Japanese FSA published Japan's Stewardship Code (JSC). 175 institutional investors have adopted the code and are now required to disclose their voting policies and voting results as major shareholders. Furthermore, Japan's Corporate Governance Code will be formally introduced in June 2015. All listed companies will be required to appoint at least 2 independent outside directors or else to explain their reasons for not complying with the rule.

Another important development is the introduction of JPX-Nikkei Index 400. This index was launched in January 2014. The process of the selection of the constituents includes scoring based on quantitative indicators such as ROE and operating profits. Also, constituent review is conducted every year. Thanks in part to these reforms, ROE of Japanese corporations increased from 5.8% at the end of 2012 to 9.0% in January 2015 and stock buybacks have more than doubled in 2014 from the previous year.

The government is also undertaking the pro-growth corporate tax reform with the aim to reduce effective corporate tax rate from 34.62% to the 20% level over several years. Permanent revenues will be secured simultaneously, including through tax base broadening. As a first step, the government has decided to reduce the rate by more than 3% within 2 years, which leads to over JPY 400 billion net tax reduction in a front-loaded manner. Why will we reduce the tax rate for profitable corporations while the burden on loss-making corporations is increasing due to the broadening of tax base under the tax reform? This is because the reform intends to promote exit of unviable businesses and to enhance competitiveness of others. Further improvements in profitability and continuous wage increase are also encouraged to advance structural changes in corporate sectors' behavior.

Besides the strengthening of the corporate sector profitability, wage increase is also essential for the realization of virtuous economic cycles. In this respect the trilateral partnership forum held by the representatives of the government, labor and employers was convened again in December 2014. The forum issued a joint statement to call for utmost efforts towards wage hikes for the second year in a row. These days we are observing stronger momentum in wage growth. Labor unions of major car makers, electric manufacturers and banks are requesting increase in basic salaries which is expected to be larger than that of previous year.

The government is also undertaking several reforms to promote a shift from savings to investment. One example is the revision of GPIF's investment portfolio announced in October 2014. Its new policy asset mix intends to lower the allocation rate for domestic bonds from 60% to 35%. On the other hand, the rate for domestic and foreign stocks will increase from 12% to 25%. Another example is the introduction of NISA, Japanese version of individual savings account. After its introduction in January 2014, more than 7 million accounts have been opened with the assets size of about 1.6 trillion yen. From FY2016 the government plans to raise the upper limit for annual investment amount for tax-exemption.

The reforms I mentioned so far which are related to corporate behavior or financial market are not an exhaustive list of reforms. In my remaining time, I will briefly discuss some of the actions undertaken as part of the "third arrow" reforms.

Firstly, the government is changing the regulations that lasted for decades with strong determination. To enhance electricity system reform, the framework for full retail competition is planned to be enforced in 2016, and a bill to implement frameworks in 2020 which concerns legal unbundling of transmission/distribution sector and full liberalization of retail electricity rates will be submitted to the current diet session. Those will lead to fundamental changes in the electricity market structure developed around 60 years ago. If we look at the agriculture reform, "farmland consolidation banks" has been established in all prefectures. These institutions play an intermediary role in promoting large scale agricultural business, by consolidating lessors' farmland into large blocks and lending to lessees. Major overhaul of the agricultural cooperative system will also be implemented through the organizational reform of the Central Union of Agricultural Cooperatives.

Secondly, the government is trying to tackle the declining trend in labor forces. To enhance women's participation in the labor market, the government has set a target to increase the number of childcare facilities. The labor participation rate for women aged 25 to 44 has already increased from 70.9 % at year-end 2012 to 74.3% at year-end 2014, leading to the flattening of the so-called M-shaped curve. The government is also trying to accommodate more labor forces from abroad. For instance, acceptance of foreign construction workers will expand from April 2015 in order to address the labor shortage in the construction sector. This could help the preparation for Tokyo Olympic Games in 2020.

Lastly, Japanese economy will be more widely opened to and more integrated with the global economy. Needless to say, it is important for Japan to conclude TPP negotiations successfully. Another positive change is the increase in the number of tourists to Japan. From 2013 to 2014 the number of tourists from overseas increased by 30% and their spending in Japan increased by 40%. From October 2014 the coverage of the goods eligible for tax exempted shopping for foreigners was expanded to foods, drinks and cosmetics.

I will stop here, thank you very much for your attention.

7. Stability in the Time of QE

Clifford C.H. Tan, East Asian Head of Global Markets Research, Bank of Tokyo - Mitsubishi UFJ, Ltd.

Thank you very much, Mr. Gyohten. It's a real pleasure for me to be here with all of you and also a privilege to be with these panelists. I expect to learn a lot and expect that you will as well.

So the title of my talk is "Stability in the Time of QE". Of course this title borrows from a Columbian Nobel laureate Gabriel Garcia Marquez's famous novel, Love in the Time of Cholera. Love and stability both seem to be pretty worthy objectives in normal times, but QE has been inserted in place of "cholera," suggesting it's crossed the minds of EM (including Asian EM) whether QE is really cure or disease?

To begin, and speaking as a markets practitioner who sits in a trading floor all day, this year's #1 Global Theme – policy divergence – could just as well be rephrased as Global central banking is about as uncoordinated as we can remember in 30 years.

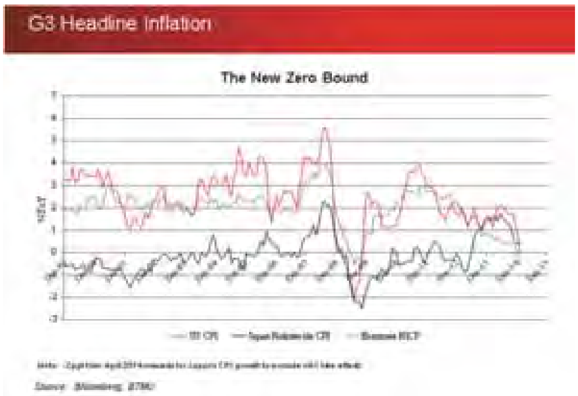
Our Assertion #1 or maybe Fact #1, because I don't think there is much dispute after recent years: The United States Federal Reserve conducts monetary policy with only the US economy in mind. We remember when New York Fed President Dudley paid a visit to Hong Kong in April 2011 and we stood up to ask a question we guessed was on the minds of many in the room that day: Does the US Fed think much about the effects of its policies on other countries around the world? Dudley – who used to be one of us — and his answer were very clear: No. With its twin mandates, the Fed looks only at those and nothing else: So there were no concerns for capital outflows from the US, inflows into EM and stronger EM currencies, if they help the US economy. Any concerns the US might have today about a "strong dollar" follow the same logic: Concerns about capital reflows, or the EM outflows, will exist only if they hurt the US economy. E.g., the Taper Tantrum was mainly a concern for the Fed only if it affected US housing.

This is beginning to nudge us toward a recent debate between former US Federal Reserve Chairman Bernanke and RBI Governor Rajan. We had not been aware until looking up this event on the Internet that there is now an actual search term associated with this interchange (which took place at the Brookings Institution in April 2014, shortly after Bernanke retired) – the Bernanke-Rajan Face Off! If you actually watched the interchange, you will have seen the question-and-response was quite polite, friendly even, but of course the Bernanke-Rajan Lovefest doesn't quite have the same ring to it.

In the exchange Bernanke said a couple of things that caught our ears. The first: "… unconventional policies are demand augmenting, they increase demand in the economy, whereas exchange rate interventions like the tariffs of the 1930s are demand diverting."

All well and good, but then how do you explain disinflation that's crept into the world, especially this past year but also a trend stretching back several? This seems to me the weak underbelly of global central banking today. If QEs are demand-augmenting what explains an onset of disinflation? Lord Turner gave us one possibility and we will discuss that in the panel discussion. For us for many years it has made no sense for the US Federal Reserve to assert with confidence and correctly I might add, that don't worry, QEs won't lead to runaway inflation; but for the Bank of Japan and now the ECB as well to assert with just as much assurance that QQE/QE will certainly produce inflation. Sometimes we wonder: are we all living on the same planet?

This is a big mystery to us, but not just us; we also suspect it's a mystery to the central banks as well. The economics profession has made some advances in recent years about the way micro prices diffuse through the macroeconomy, and with point-of-sale information now available there is also the promise of Big Data to throw hopefully more light and not just more data onto the problem. But for the bigger issue of inflation that we all care about, the models we work with don't seem that much more advanced than models we were using in the late 1970s. For whatever reason, near the zero bound global central banks seem to have problems generating inflation when they need it, which was not a problem contemplated when inflation targeting was becoming the central orthodoxy 15 years ago. To put it in monetarist terms, we seem to have had a large exogenous shift up in the hoarding or money demand function, so that agents around the world are happy to hold these trillions and trillions of units of high-powered money that central banks have created. Why? We don't know.



Nor, we believe, do global central banks. But to add the latest twist of irony, in an age of forward guidance CBs feel the need to sound more confident on this score than perhaps they are. A few years ago at the Hoover Institution's annual conference on monetary policy we stood up to ask Don Kohn, then Federal Reserve Vice Chairman, how confident he was in the Fed's own models to predict inflation. We asked this because the Fed's models were predicting deflation risks in the early 2000s – something Bernanke as Governor highlighted in his speeches at the time – which never materialized. Kohn, who came up through staff ranks, answered in a way that reminded us of the old Fed: Guarded but honest and humble about the limitations of the models. Contrast this with another event in Hong Kong we attended in 2012, when Chicago Fed President Evans visited. We tried to ask why it seemed QEs were not working as implied by the need to have to successively unveil more QEs. He got visibly angry and waved figuratively a sheaf of academic papers at us to assert that, don't be ridiculous, of course QE worked. He also forbade us from asking any more questions.

Being confident about the unknown is a good recipe for future surprises and volatility. Our critique is we feel global central banks are in a way flying blind, but are too constrained by forward guidance to be able to admit it or at least to have a healthy discussion about it.

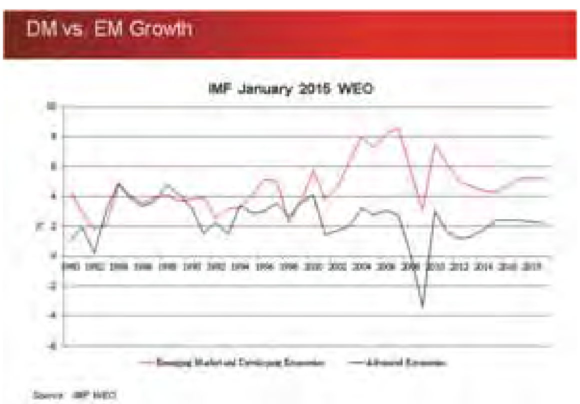
The other thing Bernanke said at Brookings that caught our ears was, "If you have a different empirical assessment than I do, that in fact, emerging markets would be better off if they hadn't been used, then you would have a different view." So what's good for the US is good for EM. Ditto Japan. Ditto Europe.

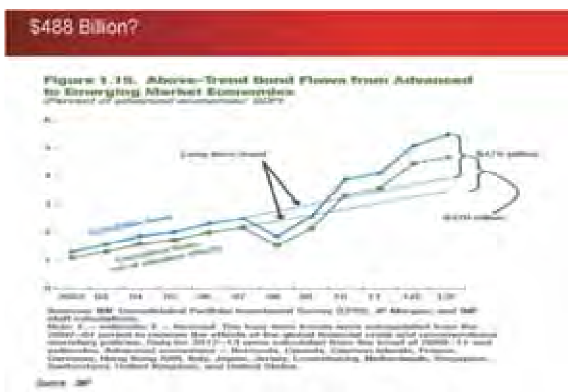
Are we the only ones in this room to whom that sounds a little neo-imperialist?

How do all these broadly relate to China and EM?

China and EM are being asked to stomach wild swings in major currency valuations on the orders of magnitude of 25% points or more. The fact that they are occurring in sequence – the US was the first to experience currency depreciation, then Japan and now presumably Europe – is a small comfort to EM economies that have had to stomach sometimes even more destructive changes to their external terms of trade. For example, think of the hard peg currency advice made just a decade ago. If we look to any country that adopted it, the object of the peg may have swung by 40% or more.

For this stick to be acceptable, the carrot dangling from it would supposedly be "developed market demand". But there are some early evidence that what is occurring lately is not global demand augmenting as Bernanke would say, but rather global demand reallocation. On top of that the confidence of the EM in these prescriptive measures is undermined by the mystery of why disinflation and sometime deflation has once again reoccurred in the QE economies. From the EM point of view it is difficult to





understand why any country's first best response to this is to sit idly by.
Let me be clear. We are not ominously forecasting currency wars. Certainly not in Asia where by now there is a well-known desire for currency stability. We think ominous talk of EM capital outflows in recent years, sometimes by the IMF, may have been exaggerated. A couple of years ago Madam Lagarde of the IMF said in Jackson Hall that there might be 488 billion dollars of excessive inflows into emerging markets. When she said that, I called up an old friend of mine at the IMF and asked where they got this number, because if this was true it was time for me to prepare for a son of Asian crisis. It turned out that the IMF has a nice database table of debt flows and just runs a time trend. I thought this seems to be a little bit of a loose way to estimate excessive capital inflows. To be fair I think the Fund's numbers of other pieces of work have been much more thoughtful than this.

The reason that we have not been that worried against answering the question of this conference which is about EM outflows from Asia is because we have seen a real difference in the impact on EM flows between QE1, QE2, and QE3. We've also seen a real difference in the impact on countries where the flows were predominantly fixed income versus flows that were both fixed income and equity. We can talk more on that in the panel discussion.

We do think that post global financial crisis policy standards of industrial countries provide even more motivation for China and other EMs to search for other platform of stable money, which is an old quest. The onset of QE initially led to some EM searches for alternatives to the USD-standard, perhaps most notably in PBOC Governor Zhou's revisit to the SDR and then Brazilian Finance Minister Mantega's invocation of currency wars. The development of the offshore CNH market is the Chinese response to the inability of Governor Zhou to advance the SDR discussion much. It's ironic China is currently experiencing exchange market pressures through this mechanism which it itself has set up. I will cover more of China in the panel discussion. More recently we believe China has begun to manage its currency with a view to tempering the effects on its REER of both USD strength and also the disinflation, sometimes outright deflation that has set in among some major trading partners. When a REER moves 5% or more in a month, as it did in China in January, we are sympathetic to this response. This is not competitive devaluation. The sensible responses like this from EMs will blunt some of the intent of industrial countries' QEs which is to depend more upon EM demand for global growth.

So our humble conclusion as a markets practitioner at the end of this talk is to perhaps suggest the G20 the needs to discuss QE externalities more seriously – to think about more coordinated fiscal stimulus and less uncoordinated monetary stimulus – otherwise it is really beginning to look like a beggar's banquet out there. So I'll leave you with some of the songs from the Rolling Stones' Beggars Banquet original LP just as a thought.

8. Panel Discussion

Gyohten: I'd like to organize the second session sort of questions and answers. I will pose one or two questions to each one of you starting from Jacob, if I may.

Jacob, what you have told us this afternoon sounds like a big support for the validity of the American economy. Listening to your remarks it looked almost like the US is now the singular winner of the game after this crisis. The first question is: do you think this recovery of American economy was prompted by ordinary revival of demand in response to series of QEs or I think you have alluded somewhat in your presentation that this recovery was supported by some new and different dynamics, different from traditional simple demand revival, for instance, shale revolution or changing sectoral activities in the industry or anything else? That is my first question.

The second question is, you also talked about changes taking place in the global imbalance. Now the Asian surplus is declining, American deficit is also declining and Europe is now turning from deficit to surplus, so if that is the case what will happen to the global growth model? In the past the global growth was very much supported by American household consumption, and huge and increasing external deficit. But if this situation is changing, what will happen to the world as a whole? Is it a part of normalization or is it the beginning of some new paradigm? These are two questions.

Frenkel: Question No.1 was "is the US the only winner and what is the mechanism that brings it about" I think that it will be a sad story if at the end of all this, there is a group of winners and there is a group of losers. I think we need to make sure that there is a win-win situation. And that's really the essence of globalization. And indeed the essence is how to make sure that if we are in the same boat that we stay altogether in the same boat. Let me make one important dictum which is a quote from Churchill. Churchill used to say that "markets are like parachutes. They work best when they are open." There is a lot to it because when there was a crisis, there was a temptation for country to worry about its own destiny and temptation to close up. I thought it was extremely important that the response to the crisis was associated with global approach, G20 meetings and the rest and the IMF and the World Bank which emphasized to the effect "yes, while the impact is differentiated the solutions must be harmonized and globalized".

Having said this, one of the reasons why the US is getting out of the recession first among the industrial countries is that it did its homework first and the main homework was structural policies, flexible economy, flexible labor market so that when you need to adjust to changes there's enough flexibility to bring it about. Does it mean that the US will stay the only winner? Hopefully not, the reason is, as long as we understand the solution for a crisis of this type is not just monetary policy. Monetary policy is important but it cannot be the ultimate solution. That is why the Japanese model of three arrows is so important and the first one is the easiest to implement and the quickest to show results but it will not hold for a long time unless it is supported by the other arrows, especially the flexibility of the economy. That is really the secret of the US. Of course this so happened. It was associated with tailwind which we say the help from the energy sector, the shale revolution etc. and the changes in the price configuration in the energy market will have also profound implications because the lower is the price of oil maybe the lower is the incentive for looking for substitutes. But in the US the shale revolution was indeed very important one.

And your other question is what happened to the growth model. Apparently there's not a single growth model. There's a period in which the locomotive is the consumer, there's a period in which the locomotive is the investors, and like always in life you need to find the right balance. The extreme is seen from China. That's a very good example of where for a long time their focus was an investment-based demand and it was so much so that a lot of distortions emerged. Their environment has been in deep trouble, and they are trying to find ways to switch from investment-based to domestic consumption based. I think this is an extreme change which means that by and large we need to make sure that there is fiscal responsibility, monetary responsibility but most important very well-functioning structural policies. I hope we will have later on a discussion on financial market, but let me say that one of the lessons from this crisis is that unless one has a very strong and robust and well-supervised, well-regulated financial sector one cannot sustain the growth but here we need to be careful of the confusion, well regulated economy does not mean more regulations, it means good regulations.

Gyohten: Thank you, Jacob. I have to add one very mundane question before I will release you. That is, well, in all likelihood, the Fed will start to raise their interest rate sometime this year, if that starts, and if they continue to raise interest rates, what will happen to American long-term rates and also to the dollar?

Frenkel: What you say if that starts? So as an expert of financial market I can only remind us, it has started, in what way it started? Financial markets, if they function well, translate the expectations about the future into the realities of the present. And if all of us know and believe, the debate is, will it happen in September? June? From the markets perceptive, it has started. And when it has started markets are starting to adjust to it and anticipate it. Yes, exchange rates are responding to it and when we say that the European Central Bank is launching now a massive expansion into the future and the US is contemplating not contraction but lowering their expansion, there's going to be a relative change. And what does it mean? It means you will have by and large a tendency for the dollar, if you decrease the supply of the dollars, the dollar will strengthen relatively to other currencies.

But this is a part of the adjustment, because Europe needed a depreciation of its currency. Because it was locked into the Eurozone they lost very important mechanism for improved, at least, competitiveness. There are many, many benefits from the Eurozone. But these benefits cannot be fully materialized unless you have a flexible economy. If you don't have a flexible economy then the exchange rate helps and what you will see now is something that will be productive. So the fact that we are moving to a so called divergence of monetary policy paths is not necessarily a bad thing as long as it is not in the context of currency wars but rather policy adjustments.

Gyohten: Thank you, Jacob. Now may I turn to you, Klaus? I have also two questions to you. One is, as you recall, when the Eurozone was hit by a crisis in 2009 there were many arguments saying "This is due to some structural problems installed in the Euro system itself. They are the lack of banking union, the lack of fiscal union, or the lack of a permanent mechanism to restore balance between Northern and Southern countries in the region, etc. etc. Well, seven years after that, you have established banking union, and I have to say that, you, Klaus are the most instrumental individual who made this happen, I should congratulate you for your efforts.

There have been many progresses made in fiscal consolidation.　However, it seems to me that there is still one big issue which was not fully accommodated since the crisis. That is, as you rightly mentioned in your presentation, the lack of structural reform in many countries.　Well, I fully agree with your argument that the structural reform is what some of the European countries need most now.　However, at a time we have to face with a reality which you find in so many countries there is a growing sense of dissatisfaction about the severity of the cost of reform, like high unemployment or low income.　And I have to say that there is also a strong wish or demand toward Germany to provide more generous support to those suffering countries in the Eurozone.　They say, “Look, although Germany is asking us austerity but in fact Germany also benefited from the existence of those weaker countries, for instance, weak euro supported German exports and low yield on the bonds also supported Germany.　And Germany made a substantial amount of capital gain on their holding of some of those weaker countries’ sovereign bonds, etc.”　I don’t know to what extent these arguments are valid one. But it is very intriguing situation looking from our side.　Germany is certainly considered as a sort of mentor in the Eurozone but there are some countries who feel that there should be more, what I shall say, compatible arrangement to balance differences between strong countries and weaker countries in Europe.　My question is: what would be the German position toward these wishes or complaints from other members of the Eurozone?　I think this is a very practical problem but at the same it’s

in a sense very difficult question to be solved.

Next question is rather a simple one. How high do you think is the risk of deflation in the Eurozone? There have been some talks about that in the Eurozone and recent data indicate that the Eurozone's deflationary risk is not very low, to be frank. So how high do you think is the risk of deflation of the Eurozone and in that respect do you think the recent measures decided by the ECB, it's a kind of QE I think, is enough to stall this risk of deflation or do you think that will not be enough? Thank you, Klaus.

Regling: Thank you very much for these questions. On the first one I could speak the rest of the afternoon because what has been happening in the euro area is indeed fascinating and I am in the middle of that. I think we have made a lot of progress; of course there is a lot of focus on Greece at the moment, but although it's the most difficult case, it's only 2% of the Euro area so one should not exaggerate. In general there has been a lot of progress even with structural reforms. You say it's always very difficult but I can agree with Jacob that the structural reforms are the basis for future growth and he explained why the US is coming out of the problems faster than other countries in the world because they had a more flexible economy. I agree with that. And we see that also in the Euro area.

We see very clearly today that those countries that borrowed under emergency programs from my institutions, the EFSF and the ESM, and the IMF and therefore had to accept conditionality, these countries have implemented more structural reforms than any other country in the world, and therefore according to OECD long term projections have also a very good outlook for potential growth if they continue with their reform process. So a lot is happening here.

But your precise question was whether the current approach of relying on adjustment, fiscal consolidation and structural reforms in weak countries in order to resolve the imbalances in the Euro area is not enough, or whether a new system with additional transfers is needed, you didn't use the word transfers, but this would be the results. For the answers I am speaking not as a German, because I work as a European official.

My judgment is that this will not happen. But I think it is also not necessary for the good functioning of the Euro area to have additional financial transfers and let me explain why. One reason is that we know very well what caused the problems in the Euro area. We had real estate bubbles in Ireland and Spain; we had excessive fiscal deficits in Greece and too high debt in some other countries. So we had real macroeconomic imbalances that one could see looking at current account deficits. These were ignored for too long. These problems have been addressed, in particular in those five countries that borrowed from my institutions. They have basically done most of their macroeconomic adjustment. For instance, even in Greece, the fiscal deficit in Greece six years ago was 15% of GDP. Last year it was one and a half %. This was a tremendous effort - at the time when the GDP dropped by 25%. This was probably an unprecedented fiscal adjustment in a country in such a short period of time. So it's happening and if the countries bring their cost of production again in line with the euro area average, it can work. The large current account deficits have disappeared, and of course the countries are implementing structural reforms to become more flexible and then they can grow faster. All the evidences is very clear on that point. And it is also confirmed in other countries in Europe that have not had financing problems the last few years, when you look at Germany and France for instance, everybody is convinced today that Germany is in a wonderful situation and France is in a bad situation. At the moment that is probably a fair description. But people forget that from 1995 to 2005, during a 10 year period, France had a growth rate of on average 1% point higher than Germany's every year, 1% point for 10 years. Why did it change? Because Germany had a massive reform project from 2004 onward of its labor market and its cost structure, that's why the growth is now so strong. So the evidence why the growth is better in some countries than the others is not only coming from the periphery countries that went through serious crises but we also see it in the core countries. And the debate in France and also Italy is very clear in this respect. They are looking at Germany and they know why Germany is doing better at the moment and they began to implement structural reforms. I'm convinced they will do better in the future.

So that's one reason countries if countries implement the right policies, these problems that we have seen will disappear, and the other reason why I don't expect direct transfers is that countries already benefit at the moment a lot from the existing systems. One is through the EU budget. The budget of the European Union is not very big, but still for countries with low incomes they receive on average net transfers from the EU budget of 3% of GDP every year, including Greece, for instance, every year 3% of GDP. This is the net benefit they derive from the EU budget. This has nothing to do with the monetary union. It has been always like that. This is from the beginning when the European Union was set up. It was always the principle that richer countries would be net contributors to the EU budget, and countries that are poorer would be net beneficiaries. So the countries do get huge benefit every year.

Now in the context of the crisis through the creation of the EFSF and the ESM, we have created a system where without imposing a burden on taxpayers the borrowing countries get significant benefits as they borrow from us, much more than countries that borrow from the IMF. Of course the first benefit is that they get money which when they are in the crisis they cannot get from the markets. But in addition to that we have created a new system in Europe where countries that borrow from us benefit from our very low lending charges, which are the same as our funding cost. Our funding costs are very low because they are based on the very good rating of our strongest member states, basically AA+. And for a country like Greece, we have a case that because they have borrowed so much money from the EFSF, every year's budget saves about 8 billion euro which is 4.5 % of Greek GDP. These are real annual savings because they have borrowed so much from us at very favorable terms. This is unprecedented, much bigger than what the IMF can do because we lend much more money and at lower rates. So we will not have additional transfers on top of that, that would be a burden for taxpayers in Germany and other countries but the countries that borrow from the newly created EFSF and ESM already today have a huge benefit that is truly sizable and Greece is the most extreme case with 4.5% of GDP. There will be no more transfers on top of that. That would also be politically impossible.

On your second question, I can be much shorter. How high is the risk of deflation? I think it's very low in the Euro area. Obviously today there is a negative inflation rate but my definition of deflation would be not just to have a negative CPI. Mr. Blanchard, the chief economist of the IMF uses such a definition, which I consider to be wrong. The IMF's WEO defines deflation as one quarter of negative CPI, and that's why the IMF said last year that the risk of deflation in the Euro area is 30% but I think that is the wrong definition. I think the right definition of deflation is described by a situation where consumers and investors postpone purchases because they expect lower prices in the future. And Europe is far away from that. So I am not saying the risk of deflation is zero but it is certainly considerably below 30%. We have now negative inflation rates like most other countries because of falling energy prices and because countries in the periphery have had for some time falling prices in Greece, Spain, Portugal and Ireland. But this is not happening by accident. This is by policy design. The countries wanted to have falling prices quickly in order to improve their competitiveness. This was a part of their adjustment process. So that will be over very soon as competitiveness is regained and then this problem will disappear. On top of that you see that in the core countries like France and Germany, there's an annual wage settlement of 2to 3%, which is inconsistent with real deflation. The most recent wage settlement in Germany was even 3.7% on an annualized basis for the most important union contract.

Gyohten: Thank you, Klaus. Well, I am sure everybody knows how much painstaking efforts were made by Germans in the past, particularly under Schroeder administration in the sense of structural reforms. And we respect the German efforts. But the problem is in the democratic countries including Europe, and including Japan as well, if I may say so, there is no Odysseus who tell his sons to follow mentor, so that's why people in some countries in Europe feel that the pains they are suffering are not very authentic and they have own right to object to the suffering. I hope that Europe really grasps the message of your remarks and find importance of structural reforms strongly. I think the messages are quite applicable to our situation here in Japan as well, as you know. Thank you very much, Klaus.

Gyohten: Adair, I also have a couple of questions to you. You talked about excessive leveraging, and you said the UK financial sector was not the exception from that situation. As you said I think the United Kingdom financial industries, financial markets have undergone huge transformation during the last couple of decades because of the changes to place in the regulatory framework and also in the market environment. Recently we read or hear quite many episodes of changes taking place in the UK banking and the UK bankers, if I may say so. How do you view these changes, do you think the UK financial services industries are now quite a different creature today compared with, say, 10 years ago or where are they heading now? And what would be the role of the City as an international financial center if those changes keep going on and on?

My second question is rather non-economic, that is about the UK's exit from the EU and also Scotland's exit from the United Kingdom. You gave us rather a piercing remark about the issue. I am sure many of the audience were a bit surprised to hear that. Because, for us outsiders, the UK's exit from the European Union sounds almost inconceivable proposition because we do not know what kind of practical calculations these people have in proposing these ideas of the exit. I think it is quite difficult for us to fully understand the imminence and the reality of the propositions. So if you can enlighten us a bit about that, I would appreciate that.

Turner: Let me start with the issue of the reforms and changes to the financial sector. I think most of the comments I would make in that respect are common across the world rather than specific to the UK because most of the reforms we have introduced to make the financial system safer have been agreed at the global level, they are the Basel 3 rules on capital and liquidity and those actually then achieved in legal forms in the UK through European regulation passed by the European authorities rather than specifically by the UK authorities. So if I try to think how different the financial system is now from where they were 10 years ago, there are common things to say about the world. I think the world financial system itself is considerably safer than it was before the crisis. We have very significantly increased the capital requirements of the financial system and again I think some people do not quite realize what a major revolution of the Basel 3 was, because it operated both in terms of the definition of what we counted as bank equity and it counted operated through how we work out what risk assets are on the denominator and it included significant required increases in the ratio. When you add those three together, I would say the amount of real equity as a percentage of risk weighted assets we are demanding on our major banks, it probably is in the order of magnitude of three or four times what we were demanding before the crisis. Now what we were demanding before the crisis was far far too low under the Basel 2 capital regime. You could get away with a 2% equity against risk weighted assets because you maintain 8% of capital requirement of which half had to be tier 1, of which half had to be core tier 1, so the absolute limit you could get away with 2% and if your mortgages under Basel 2, if you schedule mortgages for really high quality mortgages and you've rated those at 10%, your equity supports your prime mortgages for 2% of 10%, which is 0.2%.

I have to say that you've said to an ordinary citizen. We are running banking system where bank can support mortgage lending with .2 of equity and 99.8 of debt they would say, what unbelievably risky things to do. Of course what they say is absolutely right. What we will do is a major mistake. Now we have made major reforms in that respect. I would say the major UK banks, RBS, Lloyds, HSBC, Barclays are far far less likely to suffer a crisis or anything like 2008. It is also true of JP Morgan, Société Général, Deutsche bank, etc. I think the global financial system itself is in a much safer state. My worry is not so much about the financial system itself rather I say the overhang of debt within the real economy and macroeconomic consequences of that, because I think we have made financial system safer, but I don't think we have had the real resolution of the overhang of the debt in the real economy.

As for the role of the City, the role of the City will continue to be a major center of the wholesale financial services within its time-zone. We know that tends to be within a modern economy. A strong tendency within any time-zone to have a dominant wholesale financial center, obviously not retail, retail is by definition local. But we tend to have dominant wholesale financial centers, New York in America and at the moment it is London in Europe which is a financial center, it is not just bigger than Frankfurt and Paris but it is, in order of magnitude, bigger and it is self re-enforcing economic cluster of scopes and capabilities and that cluster is not going to go away. However it could be one of the things that are threatened if I link this to your second question by UK exit from the European Union. So let me try to explain why there's significant argument in the UK for the UK exit from the EU. What does the UK independent party say?

They say the European Union is a failure and the Eurozone is a failure and that is bad for our economy. They say the UK is a net contributor, as Klaus said they are net contributor and a net receiver, and we want to have our money back. But they say the European Union imposes also unnecessary regulations, often what they told a story about that in their respect is wholly mythical and every now and then they create a story where the European Union has a new regulation that all bananas must be straight and if you carefully check you find out that there's no such regulation. So there's a large amount of myths goes on.

But it's against the background of a populist's on dislike of the European project but actually the biggest single thing that the anti-Europeans talk about is immigration. The UK is now getting large immigration flows. We have net immigration flows of about 256 thousand per year, which is non-trivial, 256 thousand a year means that your population goes up by two and a half million per decade that means that over the next fifty years it's quite possible the UK population could go up from about 64 million to about 80 million. We are of course one of the most densely populated countries in Europe to start with and in particular the southern England is densely populated. So there is a strong anti-immigration element which is partly based simply on our argument that Briton is already too densely populated we don't want more strain in our transport system, strain on our countryside, etc.

It is also obviously driven by issues of ethnic diversity. Of course ethnic diversity issues, you might say it has nothing to do with the European Union, but that does to do with a significant immigration which we' ve had from countries like Somalia and others which have created large imperfectly integrated ethnic communities. But in popular politics the phrase of immigration gets bundled together, a distinction is not made between immigration from Poland and immigration from the places like Somalia and North Africa. But that is the biggest single issue and it is very difficult issue within the context of the European Union because actually one of the absolutely core requirements of the European Union is free movement of people. And that makes it, as the UKIP would say, impossible to control on our borders because free movement of people and if there's illegal immigration to Italy, Spain or France, it is very difficult for us to stop that, being ten years later the immigration of those same people to the UK. That is the most important fact.

Now what will be the consequences of us leaving the European Union? That would be significant adverse consequences. This is what the anti-Europeans deny. They suggest the UK could leave the European Union and still enjoy all of the access to the European market. They talk about the same status for the UK, as Norway or Switzerland have which is what is called European Economic Area Access which involves free movements of capital and of trade but not of people. So if you are in European Economic Area you are able to choose two out of the three freedoms of movement but not the other. And that is what they aspired to. Whatever causes the case Switzerland or Norway in order to have access to European Economic Area Status actually have to accept all of the rules of the EU and so the idea that we could leave and not be subject to the European regulations is a bit of a fantasy. I think it is undoubtedly the case that for us to leave the EU would have some economic disadvantages and in particular I think it is clear that if we left the European Union the rest of the EU countries would try very very hard to, as it were repatriate within the European Union some of the aspect of the City. It would be difficult to imagine Germany and France accepting as just unchangeable, given the City of London should be the wholesale financial services center for the European Union sitting outside the European Union.

Having said that, what will determine this referendum? One of the crucial things about the referenda is that what often determines the result of referenda has things which have almost nothing to do with the questions on the referendum. It's often determined by whether the government is popular, at the time it is occurring, it will be determined by whether the economy is doing well at the time the referendum is occurring, it will be determined by whether the European economy is doing well at the time of the referendum is occurring. That is why, although I think there is the logical case we should stay in the European Union. And although I think that is the majority of result as I cautious person I don't put that probability higher than 60%. I think unpredictable things can happen, the main thing on which the UK would run a referendum will be immigration and set of the other things surrounding it but the immigration will be core to it and like all things in politics there is an element of unpredictability, and I'll put the unpredictable factor as high as 40%.

Gyohten: Thank you, Adair. I think your explanation is very enlightening to all of us. Thank you very much. Now, may I turn to Yamasaki-san?
You know, in the world today many changes are taking place but the area where the most significant changes are taking place is undoubtedly Asia, in terms of economy, in terms of geopolitical issues as well. Particularly China's ascendance as a major global power is really remarkable in terms of production, consumption, investment, trade, and finance etc., every aspect of the economic activities in China is rising. Now, if such a big trend is going to continue in the coming years, in your view, say, 20, 30, 35 years from now, how does the Asian financial landscape look like? And I am particularly interested to know your view of the roles to be played by the Japanese banks and the Japanese yen in that environment. I know this is a very difficult question to answer but I would like to get your view on that.
You also talked about Japanese fiscal situation and told us serious efforts being made by the government in that respect. Now, in my view there are too many people in the world today who have very serious concerns and also serious pessimism about the future of Japanese fiscal sustainability. So my question is, as a senior policy maker in the government, can you provide us with some pragmatic and optimistic view about Japanese fiscal situation, its sustainability, and its viability in the coming years? Thank you.

Yamasaki: Thank you very much for the very good questions. Let me start with the first one. Yes, it is true that, with rapid growth of China, the real sector landscape in Asia has already changed a lot. The size of Chinese GDP is already more than twice compared to that of Japan, and China is now one of the largest trade counterparts for many economies such as the U.S., countries in Asia or the EU. And under such situation, China is now accelerating the expansion of the usage of the RMB as a trade

settlement currency. And in the financial sector the Chinese authority promotes financial reforms aiming for capital account liberalization by 2020. Sometimes the reforms progress at slow speed and sometimes it does speedup. But, as we see, the band for RMB fluctuation per day was expanded to ±2%, the reforms are progressing steadily, and many other financial reforms are also ongoing. I think these reforms will be continued for the next 10 to 20 years.
But I think it remains to be seen how China will play a role in Asian financial landscape after those reforms. The size of the economy is not everything. China still has to address reforms to improve the economic and social environment that will matter a lot in this respect. For instance, China has to address income inequality, which is huge between coastal big cities and inland provinces. It will also have to continue to move towards reliable and predictable legal and regulatory systems as well as market based economy.
Ultimately, I think that a private sector might be more suited to answer these questions. I mean that the question is whether private sector is willing to invest in China in coming 10 to 20 years, just as the same as to invest in the U.S., the EU or Japan. Maybe there will not be substantial increase in investment just because of the big size of the economy.

With regards to Japan or the Japanese currency YEN, two decades of deflation, or even more persistent home-bias of Japanese institutional investors or households are now fading away. As Japanese financial flows increase both for inbound and outbound, the economic relation between Japan and Asia will become even closer, and more international collaborations will be established, such as Chang-Mai Initiatives expansion or the multilateralization, establishment of AMRO, Asian Macroeconomic Research Office, as the treaty based organization and TPP. These are very good examples.

We have already seen some signs in this direction. The credit outstanding of Japanese banks in Asia at the end of 2014 is about 3 times larger than that of in 2007. This pace of increase is much higher than those of the U.S. or the European banks. Japanese foreign direct investment to Asian countries is significantly increasing as well. And at the same time I think it is quite important to enhance the attractiveness of Tokyo financial market. Now not only the government of Japan is making efforts in this area, but also Tokyo metropolitan government and private sectors do so. For instance, Japanese bankers association plans to introduce a new settlement system backed by version-upped BOJ's system which will allow member banks of their settlements for 24 hours and 365 days with the aim to start in 2018. Furthermore in 2014 under the Japan's initiative as the chair, ASEAN + 3 (Japan, China, and Korea) agreed to promote bilateral linkage of national settlement systems in order to promote cross-border financial transactions. I think these efforts of both public and private sectors will contribute to further strengthening of linkage between Japan and Asian countries. So, I am in a sense optimistic about the development of the Japanese financial system which will further contribute to the Asian economy and Asian financial system.

For the next topic, I am astonished to hear that some pessimism about debt sustainability of Japan is prevailing. I think the discussions about debt restructuring, haircut or rescheduling are common in heavily-indebted, low-income countries. In case of some advanced economies it rarely happens, and I think it only happens when such countries have very huge foreign debts.

But it is very clear that this does not apply to Japan, where public debt is mainly held by Japanese. More importantly let me stress that Japan is making progress to achieve both fiscal consolidation and economic growth. It is true that economic downturn after the first round of consumption tax hike in April 2014 was larger than our expectation, but, nonetheless, economy returned to positive growth in the last quarter and we see many positive developments at this moment. As I explained Japan is not only achieving our fiscal commitment to halve our fiscal primary balance by FY2015, but also remain committed to achieve primary balance surplus in FY2020. I think this is really a big challenge but now the government and related councils are intensifying the discussion to draft the concrete roadmap and will draw up this by this summer. These plans will try to strike the best balance among economic growth, tax revenue, and expenditure cuts. So I would like you to wait until this summer. Thank you.

Gyohten: Thank you, Yamasaki-san. Now, Clifford, I have one question about China and one question about Asia. You mentioned about the Chinese growth moderating. I think they are quite serious in their efforts in pursuit of establishing what they call a new normal. My question is in this process of achieving the new normal situation in China, what do you think is the most crucial issue they have to address to? Is it an excess investment; is it over indebtedness of local government or what? And how high do you think is their chance of success for them in their effort? This is one question about China.

Another question about Asia is, as you recall, until recently in East Asia there was a very interesting supply chain structure in which countries like Japan, Korea, and Taiwan produced sophisticated parts and component and exported them to China and there China assembled them into final products and exported them to the US and to the European Union. Don't you think this supply chain is now changing because of, first of all, rapid enhancement of consumption level in the region, in terms of quantity and in terms of quality. Entire East Asia is now becoming a big, huge consumption center. Also China's manufacturing sector has become very much sophisticated. They are no longer simple assemblers. Against these changes, what do you think would be the future shape of this traditional East Asian supply chains or would it affect the global economy?

Tan: Let me answer the first question which is for us the most important thing China can do. Many of us have not met before so let me give you a little bit of background. Two years ago, my chart pack that I was going around with the talks with clients about what was called "China and new normal", and I stole that from Bill Gross and then I guess now that Xi Jinping stole from us, so we cannot use it any more. But we had a fairly calm view about the structural transformation that China is undergoing. But let

me try to boil them down to you. I'm still very much focused on the results of the third plenum which occurred in late 2013 in China. As the third plenum produced, as every plenum always does, the decision document that was 40 thousand characters. If you stood up and tried to read this decision document aloud, it would take you four and half hours. So we told our clients we cannot take up that much of your time and let us just boil it down to five issues in order of importance. And since then I have occasionally gone around the clients talking about the five issues. You know we Chinese are really big on numbers, five issues, four of this, whatever. I've given China a grade on each of the issues, and these are five issues I think you can focus on to see how serious China is about changing, the way that China is talked about.

The No.1 test for me is "overcapacity". I would give China a grade here since the third plenum of about "D" of A, B, C, D, E, F. Good news of overcapacity in China is it is really concentrated in literally a handful of industries. The State Counsel identified these industries. They are cement, steel, aluminum, ship building, and coal. Because they are so sectorally concentrated if you want to do something about it you can. Last year, China announced some plans to reduce overcapacity. Cement is a good example. The kind of plan China announced last year to reduce overcapacity in cement was about two and half % of the capacity, roughly, but they were really needed to do something like 10% in order to have it be a serious down payment. The reason you cannot get more done on that is because of local politics, because many of these enterprises are very important to local governments that employ hundreds of thousand people. So my bet this year is that Mr. Xi Jinping seems like he has made quite a good start in consolidating his political power. So my thinking on this issue is he is going to have more power to be able to restructure more to reduce some of this overcapacity. Let's see if this is true or not. So far my judgment is "D"

Second issue that I look at is the pricing of natural resources. Because China's natural resource pricing is not only a matter of national security, according to the Chinese, it is also extremely irrational, so with the drop of oil prices so far only it is recently, literally only in the last few days, that the Chinese have started talking about some reform of them, for example natural gas prices. So my grade in this area for China is also "D", not a lot of progress.

The third area I want to have you focus on is what I call private investment into the services. I have a macro story for China but I often tell clients what I really want to tell you in addition, to the macro story, if I could find five industries and I feel very confident that China is going to be a world beater or at least with very strong industries they can sustain and maintain growth over the next 10 to 15 years. Then I'm done. I would feel like I have industry complements to my macro story. Two years ago when I was going around with the chart pack, I could find only one industry that I was for sure would be a key part of the Chinese growth story in the next 10 or 15 years, and that industry is automobiles. Last year I found the second industry, and the second industry for China, I think, is tourism, both inbound and outbound tourism. Tourism is an area that's services. I think Chinese economy continues to have a lot of the economy not measured, not measured even today. And the key area is in the area of private services. The government has been trying to get people to invest in the state-owned enterprises which is I think almost certainly going to go nowhere. Why, because the return on asset in state-owned enterprises in China has been falling for about a decade. Why would you want to invest in a sector where you only get minority control on returns that falling anyway? So find it much more promising to look for investment flows, private investment flows, into private services. So in this area I will give China "B-". There are some very interesting areas, I mean; obviously China now has the biggest e-commerce market in the world in absolute terms. What does it mean for future China? I don't know, not yet. You know obviously Alibaba is a big story. And the flow of investment money into the services industry in China, I think, is the key barometer to change.

And final two things which are a little bureaucratic and hard to explain. No.4 is land reform. Land reform is important because they are trying to get over the last five years or so and going forward next 10 years or so, they are trying to move 300 million Chinese from villages to these new smaller cities in the Central and Western parts of China. Just remember small city in China is one million people. China wants to move one and a half of Japan, almost two Japan from the villages to these new cities. To get these farmers to move they have to have money to move. They have no assets right now, so therefore the only asset they have is land use rights. In order for them to have money to move, you've got to have a market in these land use rights. That's why the land reform is so critical. The grade here is "D-", almost a fail, because right now the way the Chinese are talking, even getting the reliable land registration system in the country is probably something that won't happen until 2018 or even later. Now rural urban migration will happen with or without government policy but the kind of demand augmentation they are expecting from this urban migration process depends very critically on this land market getting started in China. We've been going over this for about a decade in China, so this is not new. But the progress is very slow because the local governments get a lot of money from land sales so they are resisting central government's effort to reform.

The last issue is Hukou reform, the household registration system. You know Japan has one and almost every Asian country has one. So they just announced that they are ready to embark on this but my grade for this is "incomplete". Incomplete because key issue here is about who pays for all the new municipal services that would be in demand once Hukou system is liberalized and people can move around more freely. They haven't decided that yet, they haven't decided how much is the local governments pay, how much is the central government pay, and how we are going to finance this.

So I've given you five instead of one answer but I think those are the critical factors.

Now No.2, about supply chains. Let me begin with an anecdote. About a year and half ago I was in Germany, talking to one of our clients who is from a very large German industrial conglomerate. We were having a very good evening, just good conversations. "You know I was getting questions from my management, from my board recently. When we came to China twenty years ago we set up supply chain and the idea was we produce in China and we export back to Europe or to the rest of the world." He said "Lately my board has been asking me "can we use this supply chain for something else, can we use something else? You know, for example, can we use it to produce something that we are going to send back to Eastern Europe?" What we were seeing in the Asian supply chain, in the words of Victor Fung, who is one of the two brothers, heads of a big Hong Kong company Li & Fung who were very involved in global logistics. The key change in the Asian supply chain is that it is becoming more two ways. There's a lot about this exiting supply chain architecture that can be used in new and different ways that maybe we haven't thought about before. For example, right now Japanese companies, automobile companies, are very excited about going to Indonesia to set up production and thinking of it as an alternative to Thailand partly because of political reasons; they set up production base there. I think even that is a little bit short sighted because you really think about that ultimately, I think, Thailand and Indonesia are going to start facing competition from China, from production in China. You know that it is not just because you locate it in Southeast Asia and therefore you produce cars in Southeast Asia. Why can't you produce for Southeast Asia in China?

This leads to the question of competitiveness. In my knowledge there is only one serious study done of unit labor cost in Chinese manufacturing. That was done by the Bureau of Labor Statistics in the US which has been producing these OECD comparisons of unit labor cost for many years. One woman who used to head this Section that did these estimate retired about 10-12 years ago and after she retired she went to China and lived in Beijing for few years working as a consultant. She was the one who did this first estimate. In 2004 they made a careful study of the unit labor cost in Chinese manufacturing. After all the numbers were crunched, you know what is the number for China in terms of the unit labor cost? It was about 75 US cents an hour. The same number for the US that year was about 30 dollars. In the last ten years we've seen a lot of stories about wage inflation in China and so, and if we just ignore any improvement of productivity, which by the way I definitely think happened, maybe I might believe the unit labor cost in Chinese manufacturing has, say, quadrupled over the last 10 years. That means the unit labor cost in China now is three dollars an hour. The same number in the US over the last 10-12 years has actually fallen a bit because of productivity improvement. Now we are talking about 27 dollars in the US.
The point is that for a wide spectrum of manufactured goods China remains very competitive. But as I've been telling the clients over the last couple of years, just at this stage of development China doesn't want to make toys any more, doesn't want to make shoes any more, doesn't want to make textiles any more, and even simple electronic products. In my view, the ship is leaving the harbor, but it doesn't mean China has in some sense lost its place on supply chain. Thank you very much.

Gyohten: Thank you very much, Clifford. I am afraid the time is running out, but I think we have to cover some of the broader based questions toward the end of the meeting. We discussed severity of the financial crisis this time, and when the crisis hit us in 2008 I am sure everybody was surprised to discover there were probably over-expanded activities of the financial services industries in the world at that time and also very inadequate financial regulatory framework. As a result of this discovery as you recall, new wave of regulations has set in. In fact a variety of new steps were introduced, I think Dodd-Frank legislation and Basel 3 and others are good examples of that. All these efforts were aimed at strengthening the oversight and enhancing the soundness of financial institutions.

Already Adair has talked about this issue for some time but I would like to get views from anybody of the panelists that how do you view the current level of financial regulations' appropriateness or adequateness, do you think the new set of regulations we have today is more or less optimum or appropriate for the global situation or do you think, like somebody would like to argue, that the pendulum of regulation has swung too far and as a result we are afraid that because of the excess of regulations the quality of financial services might deteriorate and also we may lose fair amount of competition. What do you think about that?

Also the relevant question is how do you view the future of the role of finance in the world economy? Historically speaking finance was viewed as a very important tool of the public utility but at the same time particularly after the 1980 financial deregulation the financial services industry has become very crucial industry in the world economy as a sort of employment generating, income generating industry. So between these two extreme ideas, public utility on the one hand, or this income and employment generating industry on the other, where can we strike a right balance? This is a big issue, which is too big issue maybe before 25 minutes. Anybody? Jacob?

Frenkel: One thing is for sure the landscape of financial industry in the next decade will be very different than the landscape in the previous decade. One of the reasons is that there was and were a lot of excesses that resulted in the crisis and that have been mitigated and your very appropriate question is "has the pendulum moved too far? So let me articulate two or three points. No.1, this was already mentioned by Adair, the three most important elements that make current financial system more robust and safer than what it has been before is "there is more capital, there is more liquidity, there is less leverage." Not everywhere these three have moved sufficiently to the ultimate equilibrium but those are three important factors and if I have to rank them probably I would put capital as No1.

Second point, the issue I mentioned before is not just the number of regulations but rather the quality of regulations, but even at the preliminary we need to make sure that regulations are actually enforced and this is the business of the supervision. In many occasions the problems with the previous set of regulations has been that they were not always fully enforced and therefore with the crisis, there was a run to have some new regulations. So I think it should be paralleled with the question of what happened to the old regulations that were not fully enforced.

Third point, we need to recognize especially as we compare the Europe and the US the sources of funding are very different in the two continents. In the US about 80% of the funding comes from the capital market and only about 20% from the banking sector. In Europe it exactly is the other way around. Most of the funding comes from the banking sector and less so from the capital market. As we integrate the world financial system, that disparity will shrink. And in the US we will see maybe larger fraction into the banking and in Europe much larger into capital market. There will be a greater harmonization. But still we have to remember they are very different.

Why do I say that? Because one of the issues that Adair Turner has been focused on when he was still in his previous position was how to deal with what we call shadow banking. Shadow banking has to be understood not as something which is shady, something which is wrong, something which is illegal, but rather that is something which is not in the sunshine, something that have is not having complete transparency. So the solution for shadow banking is to put the light on it. Once transparency is fully shared throughout the entire financial system we will have a healthier system. Why do I do that? Because when we have a regulation it creates incentives for activities to migrate, to move from the regulated area to the unregulated area. There the risk is higher because it means that you may end up with a riskier system. The way to avoid that negative side-effect of regulations is to make sure that the shadow part is put under the light so that there is no issue of arbitrage among regulatory agencies and finally plain level playing-field. So the issue is not so much the number of regulation but rather the quality of treatment. And this is to do with various parts of the system and especially cross border activities so that you avoid the wasted resources as they look for less regulated territory but rather the location of resources will be based on economic and financial rationality rather than regulatory arbitrage. Let me stop here.

Gyohten: Thank you, Jacob. Adair?

Turner: I agree with what Jacob has said, but let me pick up your second half of your question to widen the question to what we think is the role of the financial system and does it fulfill its role well? The striking fact about the financial services is that over the last 50 years they've got much bigger in the economy. The figure for the US is, in the 1950 financial services in total accounted for about 2.5% of US GDP and by 2007 they accounted for about 8% of US GDP. And I think we have to ask the question, was this a good thing or a bad thing? Now there are some sectors of the economy where you wouldn't ask that question. Suppose the tourism sector, the restaurant sector, or the automobile sector grew from 3 to 5%, we'd say well they must have grown from 3 to 5% because consumers wanted to have more restaurants and less hotels, more autocars and less computers. We think the shape of the economy has been driven by where the people freely want to spend their money. But you know the finance is different, it's different because it is not an end consumer services. Nobody actually get up in the morning and say what I would do today to have a good fun day. I think I'll go and buy some financial services. That is not what they do.

Our financial services form a function within our economy which is supportive of the rest of the economy. So that expansion is good, if it needed to get bigger, or it is doing its function in more efficient fashion achieving more efficient capital allocation. So you then have to ask why finance did get so big. I know very fine articles by two economists at Harvard one of which is called David Scharfstein and I forgot the other's name. They have broken down that growth of the financial services industry. By the way the figure is exactly the same in the UK, and somewhat similar in the European market though the absolute scale is smaller. And there are really two reasons why the financial industry got bigger. One of which is the chart I showed to begin with, which is more credit provided to the real economy. There is more credit provided to the real economy, and because of more credit. There's also more fixed income asset.

So part of the question we have to answer is do we think it's good that the bank balance sheet got bigger and the economy got more highly leveraged? And I think the answer is that there are some forms of the growth of credit which were beneficial financial deepening and the other which was a harmful creation of excessive credit.

But the other really interesting thing about the growth of the financial sector up to 2007 is in addition to what it did vis-a-vis the real economy. The financial sector did far more things with itself, far more trading activity. If you look at the financial balance sheets of the banks, if you pick up bank balance sheet from 1960 it's quite easy to understand what's going on. You will find out it was dominated by either holding government bonds or lending money to consumers or lending money to the corporates. You look at major banks on the eve of the crisis of 2007 you find by far a bigger balance sheet of banks with things they were doing with another bank, JP Morgan was doing with Goldman Sachs and Goldman Sachs was doing with Morgan Stanley, Morgan Stanley was doing with Deutsche Bank, etc. We created this huge proliferation of activities within the financial center. So again I think I have to ask, was it a good thing or a bad thing?

The argument that it was a good thing was that we have created through the system of securitized credits and derivatives and that's where this whole complex interchange comes from. We have created both more efficient system for allocating capital and more efficient system for distributing risk. And indeed before the crisis there was a great deal of confidence which you can see expressed for instance in the IMF's Global Stability Report of April 2006. This complicated step of things called shadow banking, securitization, derivatives, originate and distribute have made the world a safer place, because I used it several times in my speech I have almost memorized the stage from that report. It basically said it is now widely recognized that the process of securitizing and structuring credit by taking credit off bank balance sheets and distributing it has placed risk in the hand of those best placed to absorb it to manage it and has therefore made the financial system more resilient. This increased resilience, it then says, can be seen in the decreased probability of a major banking crisis and a more stable supply of credit. Those words were written by the IMF's foremost financial stability expert in April 2006, 15 months before the onset of the biggest financial crisis we have ever had. I feared the person who actually wrote those words was subsequently tied up somewhere in the dungeon of the IMF and is no longer allowed to meet the general public because it would be a bit embarrassing to let him or her out any longer.

The crucial point I make is we clearly made some enormous intellectual mistakes in our understanding of that very complicated mash of derivative trading, securities origination, trading, structuring and restructuring and re-hypothecation which we created before the crisis. I think we know that an optimal financial system should have both an element of a banking system and an element of capital market system.

But I think what we also learned after the crisis that particular form of securitized credit which we created before the crisis, which was characterized by multi-step changes by very complex and extended origination and trading schemes, far from reducing risks of the banking system by taking securities off the banking system and distributing them, actually managed to recreate the same risks that the banking system has, which is leveraging and maturity transformation, but do it in a more complicated fashion and outside a regulatory approach. So that I think is a crucial area which we need to get right for the future. We need forms of a nonbank credit intermediation which are actually stable forms of non-bank credit intermediation rather than the over complex and risky forms which proliferated in the years before the financial crisis of 2007 and 8.

Gyohten: Thank you, Adair. Yamasaki-san?

Yamasaki: Thank you very much. Let me answer to your first part of the question because latter part was well addressed by other speakers. I am now responsible for the macro economy and once I was in charge of the supervision of financial institutions so my views are from both perspectives. I think we have made significant progress in financial regulation after the financial crisis and now our focus is on the implementation of these new rules. At this stage it is quite important to take into account the effects of the new regulation onto the real economy and secure appropriate time for preparation. And furthermore we have to recognize that agreed reforms are so broad and complex that when they are implemented simultaneously, there would be unintended and unexpected negative impacts which might adversely affects the financial system or real economy, which could hinder financial intermediation function to support economic growth. It might be difficult to anticipate these risks at this moment; however we should be vigilant against them by carefully following the effect of the new regulation. And if unintended negative effect were to realize, we should not hesitate to review and potentially modify the past agreement. Thank you.

Gyohten: Thank you. Clifford?

Tan: I am really hesitating to speak because of the grave task of this panel here and their experience, but I would like to make a couple of remarks, one of which might really surprise you. The first simple remark is, we in a market, the regulators are going to set new rules, we just had to follow them, so the key question is about regulatory arbitrage. As long as new rules are consistent across most of the major markets we will follow them. However I have perhaps a little surprising view, again let me say I am speaking on my own personal capacity, has nothing to do with my institution, I couldn't say this three years ago before I work for a Japanese organization but I would say that traditional architecture regulation here in Japan. First of all despite the yen's movement or whatever, I still think Japanese companies because of demographic here, they are still kind of in this long run phase of moving more abroad, maybe partly it is the result of Abenomics, who knows, and banks have no choice but to follow them elsewhere. Most of regulatory changes around the world are about making, reducing leverage, about increasing oversight and reducing risks because of that. But I think we will find that in order for Japanese banks to function efficiently we may need to actually relax the regulatory structure they face in order for Japanese banks effectively to serve their clients as well as compete with major global banks. That is a conjecture, I am not saying that that is definitely going to happen but you know what I am trying to point out is we have got this kind of global trend moving this way, quite interesting undercurrent, when it comes to the case of Japan in terms of what Japan really needs over the next 10-15 years.

About the Chinese banks. I am reminded of a story that I remember of reading in the Economist magazine I think in1990 there was an article in there about how Japan, at that time something like, I forgot exact number, but 5 or 6 of the top 10 banks in the world by assets in the article like that, and in retrospect thinking about the article we should have taken that as a very huge warning sign at that time. Now Chinese banks today look about the same. They are the biggest banks in the world by assets. What I hope will happen in the regulatory push that we were talking about is for China this is actually quite hopeful. They could take on some of the global concerns, because you know right now very late, I am reading Geithner's memoir. In the early part of his book he is talking about we are recognizing that there was a huge system there was getting built up outside of our regulatory overview and this huge system there was built outside of regulatory overview had no capital requirements, had no rules of behavior. When I read it I think about Chinese banks, it is a little bit scary. I certainly hope that the regulatory push is going on globally and will have some impact on China in the same direction, but the undercurrent in Japan could be quite surprising. Thank you.

Regling: Just a few points to add. I very much agree with what Jacob and Adair said. Your question "has the pendulum swung too far and may have a negative impact on the financial services industry to provide financing for the real economy?" is difficult to answer but I think it is much easier to say that before the pendulum had swung too far in the other direction, that is clear by now. And once the pendulum starts to swing there is a risk that it may swing too far. But here I think one has to differentiate between banking and shadow banking. As Jacob said, for the shadow banking I am sure the pendulum has not swung too far. For Banking, this is more difficult to answer. Here it is also important to recognize the European situation. As Adair pointed out, in Europe 80% of financing comes from banks, while in the US only 20%. Therefore whatever happens on the regulatory side with banks will be much more serious in Europe than in the US. There we may see some developments that might have an impact on competitiveness.

On your other question "was the financial service an employment and income generating industry?" This is something I cannot accept fully, because financial service is something that should serve the economy, not be self-serving. And we have seen some of that in the past. We know that balance sheets of banks were blown up through trading among themselves and thus excessive incomes were generated. We know that before the crisis some banks had expectations of a return on capital of 20 to 25 % which would be seen as excessive today, and it should have been seen as excessive at the time compared to other industries. Also, if I remember the number correctly, in 2007, about half of total profits in the US economy were generated by the financial service industry. So all these are indication that there were clear excesses at the time and which had to be corrected. It means that the business model of some banks needs to be adjusted, the expectations on return on equity must be adjusted, income expectations of bankers must be adjusted, and I think we are in the middle of this process which I am sure is painful for people and companies involved, but I think it is unavoidable. I would not accept that financial services should in themselves be an income generating industry and be protected for that reason.

Gyohten: Thank you, Klaus. Adair, do you have last words?

Turner: One very quick comment in relation to Clifford's point about whether Japanese banks need a little bit relief in order to be able to compete with the rest of the world. Four years I chaired the Financial Stability Board or major policy group, so I was closely involved in the issues of development of Basel 3, rules of derivatives, “too big to fail”, “cities”, etc. In the course of that I would often meet with senior people in the industry around the world and after a while what struck me was the pattern of the discussions that I would have. Which is that when I was talking with the Chief Executive of Deutsche Bank or Société Général, they would say to me, Adair we completely and utterly support these tighter regulations to make us safer but we are really worried that these regulations are much tighter in Europe than they are in the US. And then when I will be sitting down with the head of Goldman Sachs or JP Morgan they would say to me, Adair we are totally supportive of these really tight new regimes but we are really worried that they are being applied much more strongly in the US than they are in Europe. I think we have done not a bad job and having something like a level playing field, because I thought the fact that both of them were complaining about the unfair treatment they were getting was probably an indication that we got it roughly right.

Gyohten: Thank you, Adair.
Well, It looks like we have arrived the end of our session in an appropriate time. Maybe I am supposed to make my final wrap up of the discussions but I will not be doing that because it is impossible and I don’t think it is very much necessary, because I am sure after listening to this truly exciting discussions you might find that a situation now is the glass half empty but at the same time you might find as well it looks like the situation is a glass half full. I think both of them are right because the situation we are faced today is quite fluid and you have seen different views but one thing quite obvious is that there is no room for complacence because the world, not only in economic situation but also in other sectors’ activities, is faced with very challenging situation every day. So I think we cannot be complacent about the situation and each sector or position or industry. We are very much expected to try more efforts in achieving the goal of a collective recovery from the most serious crisis in the century so far.
Having said that I’d like to declare the meeting is adjourned but before doing that I would like to ask all of the audience to give the warmest applause to our panelists who provided us with such a big guidance. Thank you very much indeed, thank you. My thanks of course also go to the audience and also to the group of simultaneous interpreters over there who have done a wonderful job. Having said that, let me adjourn the meeting and have a good day. Thank you very much indeed.

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