

World monetary system in turbulence



**Searching for a pilot:
maybe from Asia?**



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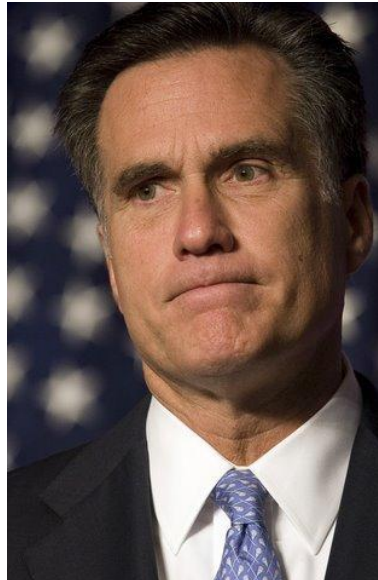
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US – strong, but no longer what it was



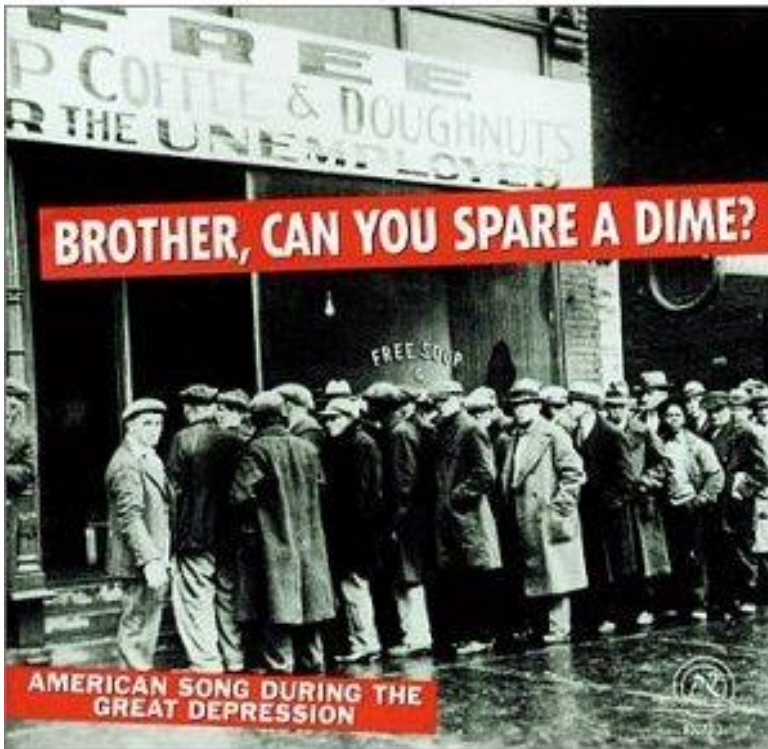
No
real
answers

What was
the question?



Europe's "big shift" – looking to Asia for help

Asia: Bankers to Europe as well as America



Asking world for
rescue funds

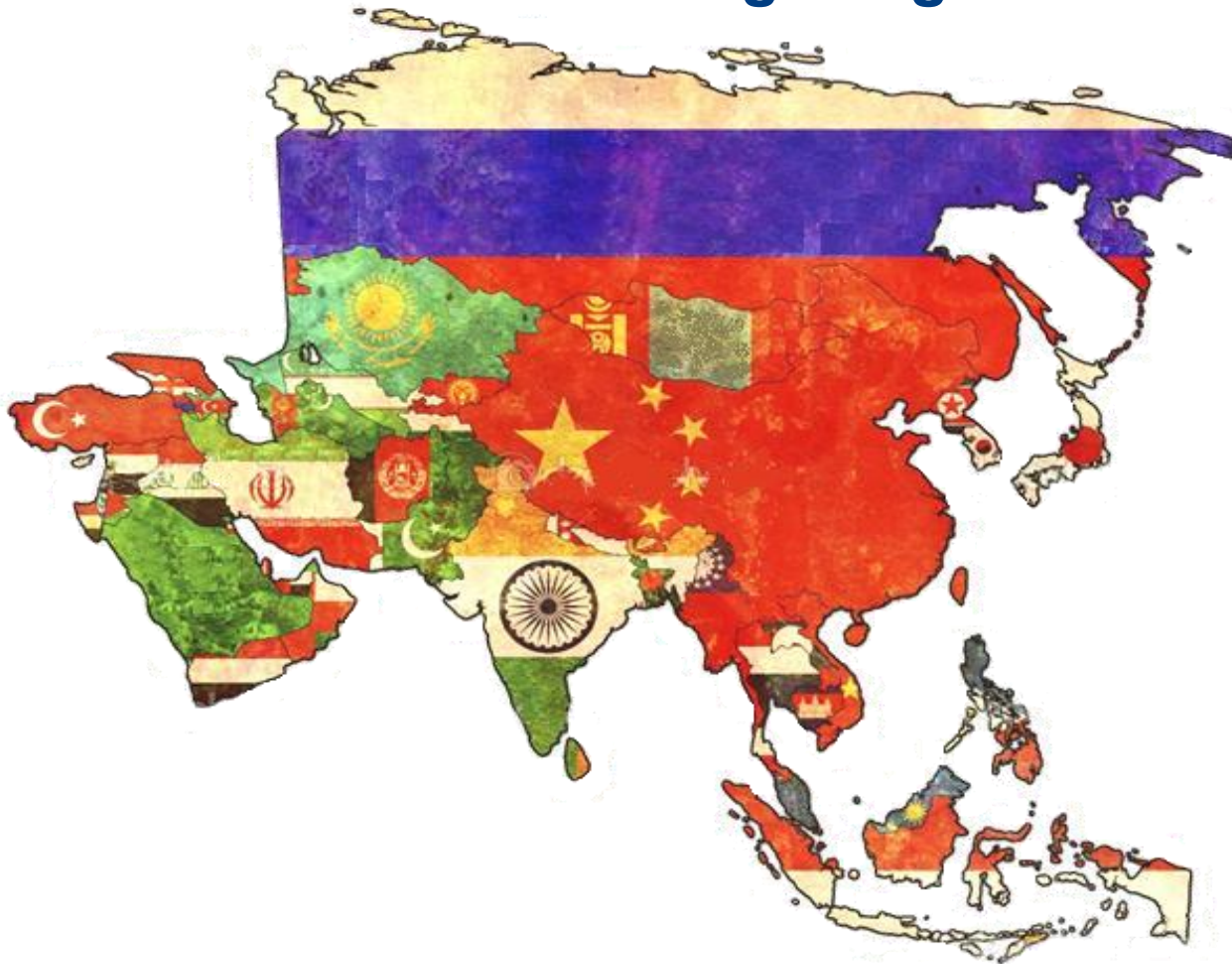


Sarkozy and Hu
October 2011

Outcome of West's growth & debt problems

Shifts ahead: Towards an Asian “coming of age”?

Dollar, euro
malaise
forcing Asia
towards
economic,
monetary
maturity
quicker than
expected



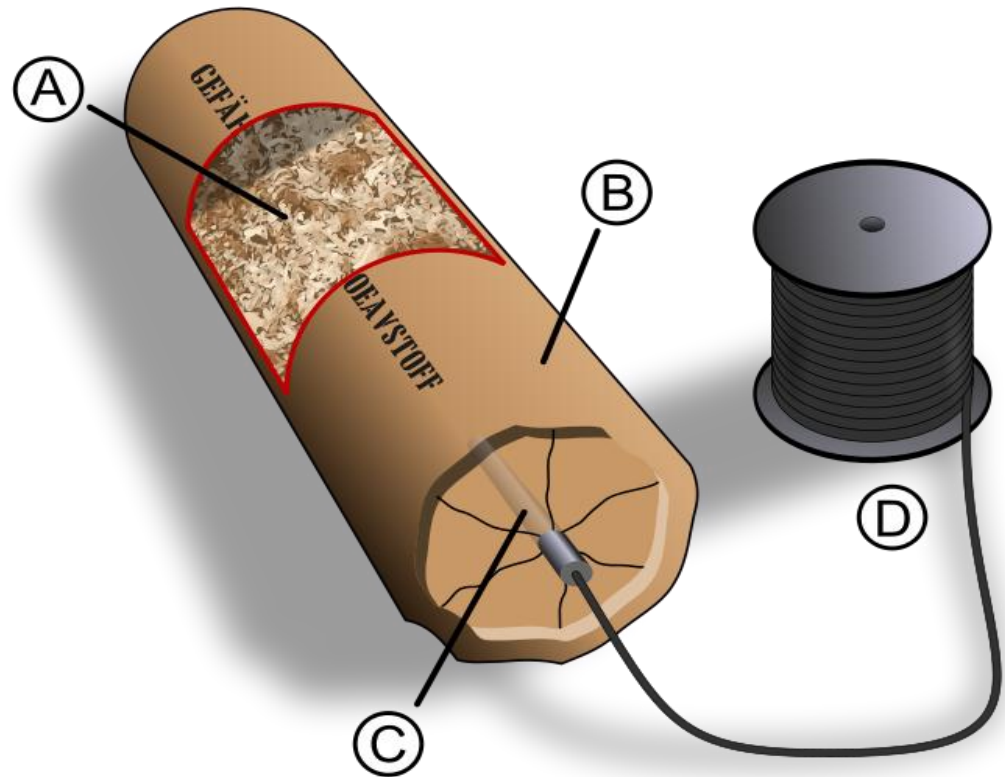
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Asia's burden: peril of “negative carry”

Reserve countries' revenge: exorbitant privilege

Asian
reserve
holders are
sitting on an
explosive
mixture of
low-yielding,
depreciating
dollars and
euro



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The paradox of European corporate value

Good corporate values (low euro) despite political vacuum



Henry
Kissinger's
question still
unanswered

“Who do I dial if I want
to dial Europe?”



Industry more attractive than politics

Results of EMU were predictable and predicted

Pleasure gives way to pain: Pinocchio's Pleasure Island



D/W/W



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Currency mechanism spiralling out of control

Modern-day version of “the sorcerer's apprentice”

“Tired of fetching water by pail, the apprentice enchants a broom to do the work, using magic in which he is not trained. The apprentice cannot stop the broom because he does not know how.”



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Reasons for the euro dream

Goal No. 1 – Complete Europe's single market



Jacques Delors
single currency for single market



Reasons for the euro dream

Goal No. 2 - Forge European political union



Franco-Prussian war 1870-71



President Mitterrand, Chancellor Kohl, eastern France, 1984



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Reasons for the euro dream

Goal No. 3 – Provide rival for the dollar



Both France and Germany wanted in different ways to curb dollar's 'exorbitant privilege' permitting 'deficits without tears'



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Reasons for the euro dream

Goal No. 4 – Keep the Germans under control



Ex-President Giscard d'Estaing:

“We need an organised Europe to prevent German domination”



Objectives and outcomes of euro experiment

The four reasons for the euro

- Underpin European Single Market by eliminating exchange risks
- Complete Franco-German post-war political rapprochement
- Create a rival/complement to the dollar as world money
- Shackle united Germany in a constructive European community

Results have not lived up to expectations

- Trade integration held up by poor macro-economic picture
- Franco-German ties weakened under Merkel-Sarkozy-Hollande
- Dollar is still the world's dominant currency
- Germany is stronger than ever as a result of export surge

Monetary union needs political union

Chancellor Helmut Kohl got it right

**December
1991:
“Monetary
union
without
political
union would
be a castle
in the air.”**



September 2012

Asian and European crises compared

Europe 2010-12: Partial re-run of Asia 1997-98?

- Current account deficits in Europe twice as large, persisted for twice as long as in Asia
- Competitive pressures eased far more quickly in Asia by devaluation – not possible for Europe
- IMF / official lenders more compliant with Europe than Asia – mismanagement over Greece
- Pain, resentment and search for scapegoats will last far longer in Europe than Asia

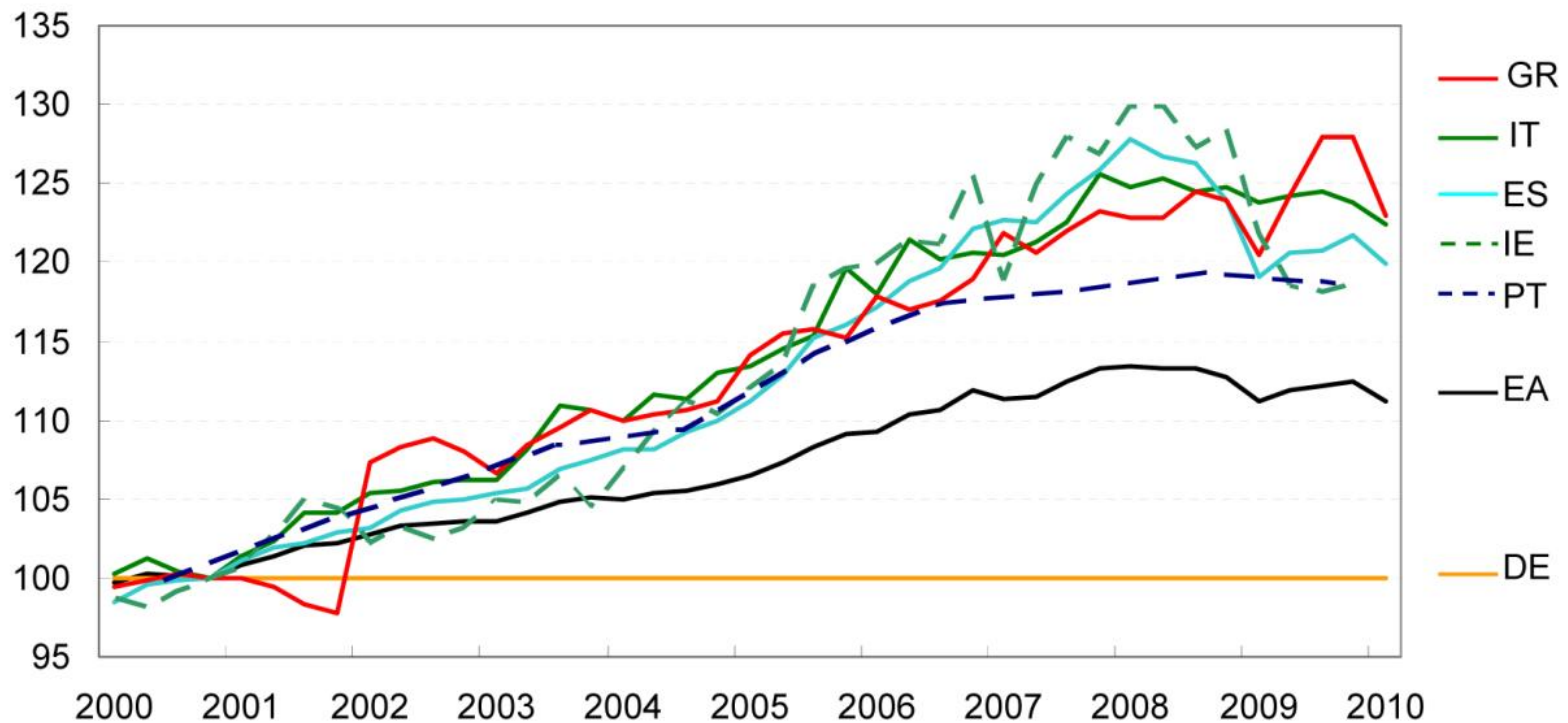


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Europe unable to manage currency adjustment

Diverging real exchange rates & competitiveness



Competitiveness gaps - growth in unit labour costs

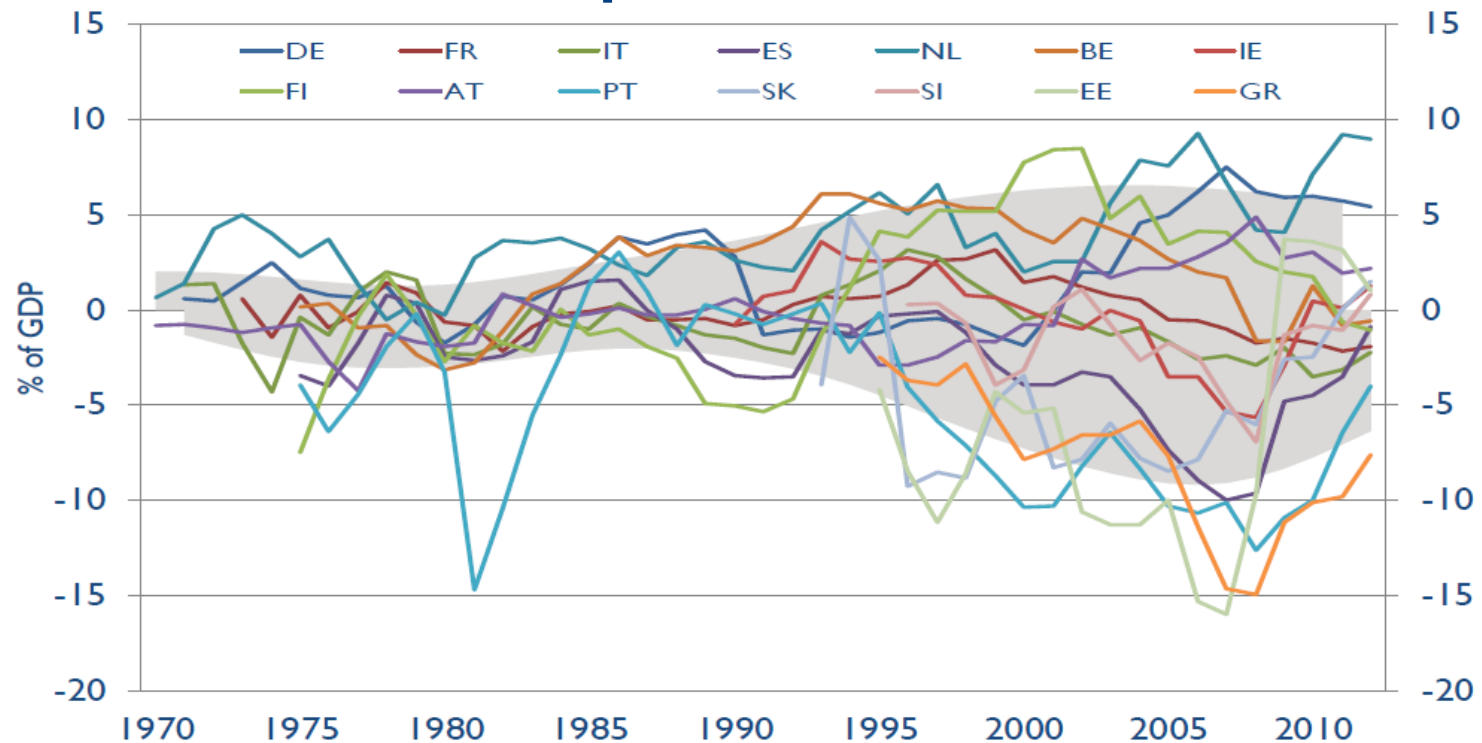


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Severe current account imbalances in Europe

Inevitable effect of competitive distortions



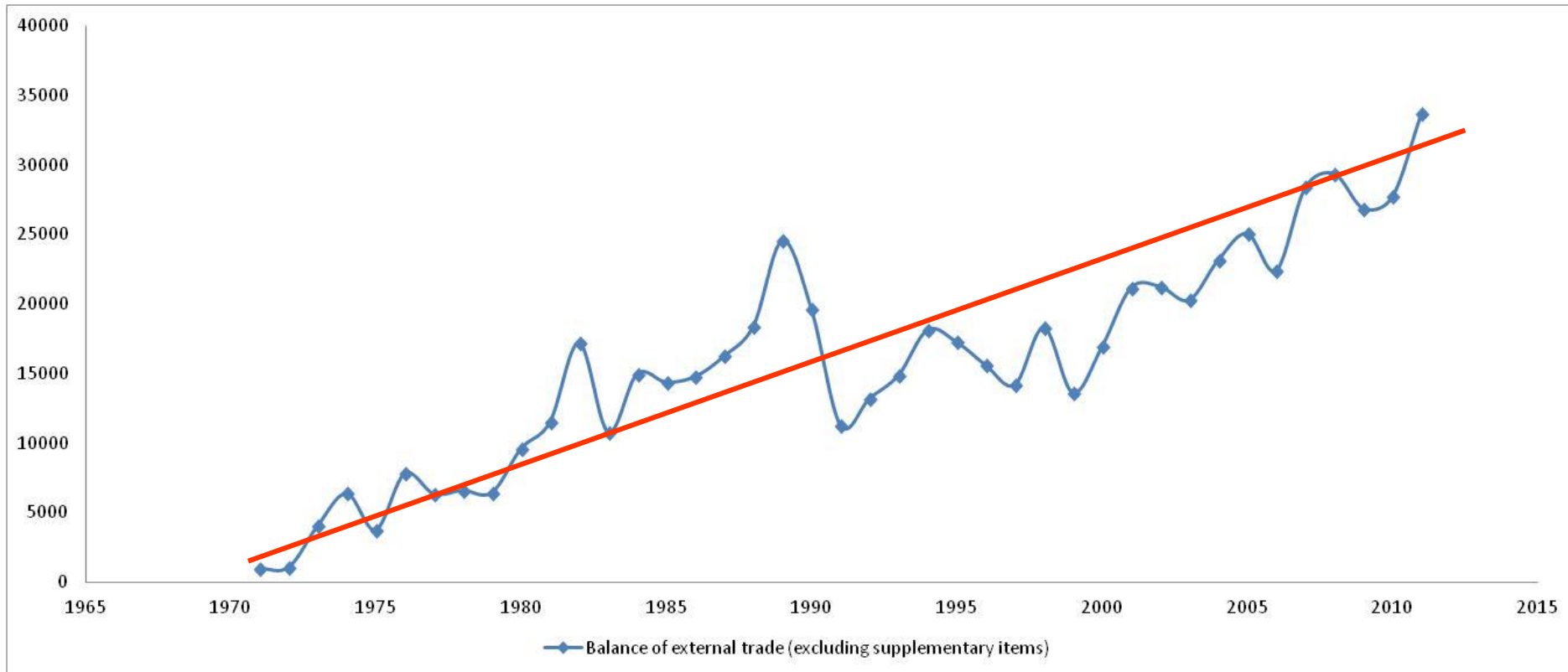
Note: The grey area represents the difference between the HP filtered trend of the 90th and 10th percentile of the current account balances across countries.

Recession drives reversal of imbalances after 2010

Source: OECD and ECB calculations.

France and Germany move apart

Unstoppable rise of German trade surplus with France



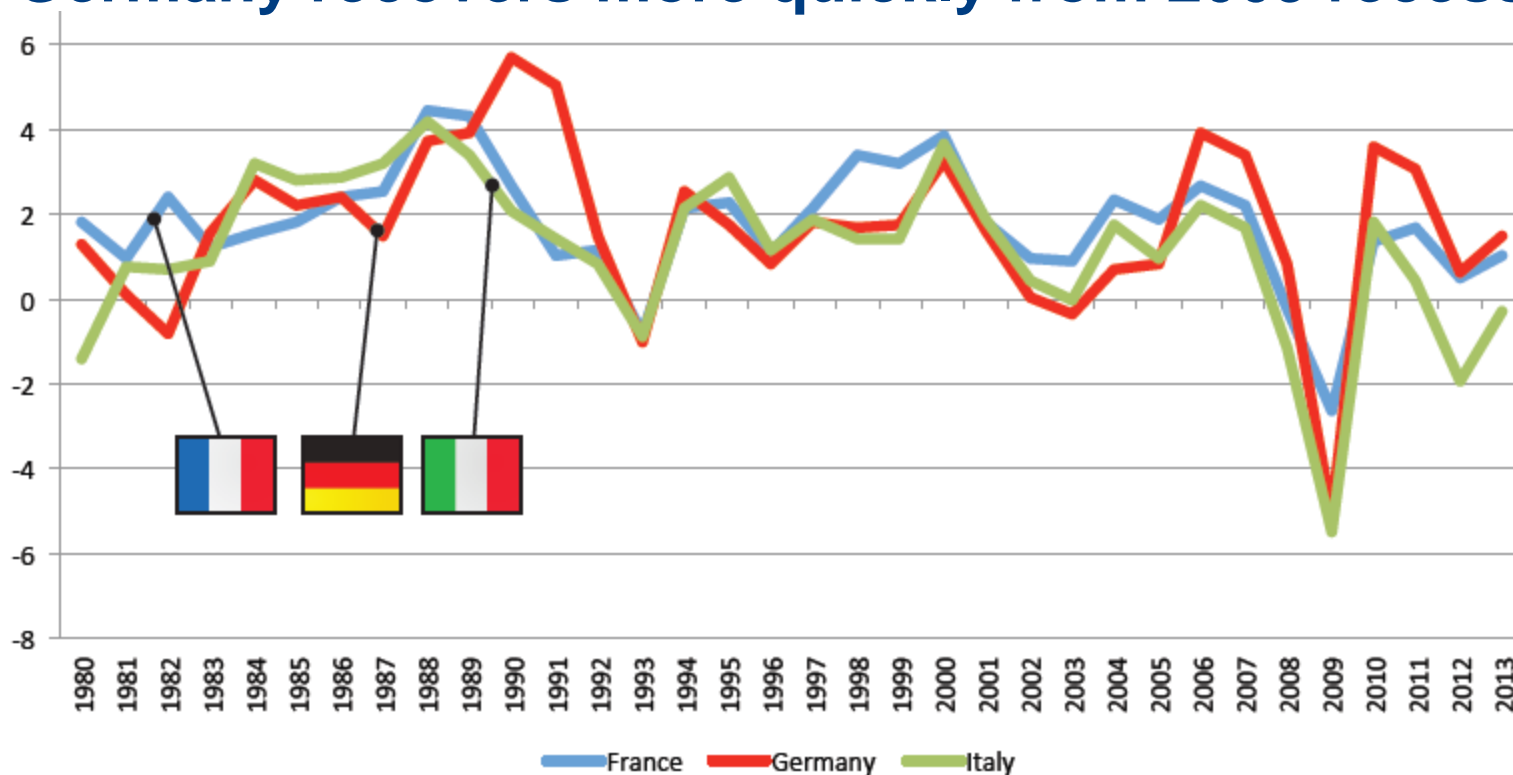
Germany's shift: integrating with non-euro area

Trade outside euro area up 3x faster than within EMU

- German trade with EMU up 4% a year in last 10 years (exports 4%, imports 4%)
- With France up 4% (exports +4%, imports +3%)
- With Turkey up 10% (exports +13%, imports +6%)
- With Brazil up 9% (exports +7%, imports +10%)
- With China up 16% (exports +18%, imports +15%)
- With India up 14% (exports +17%, imports +12%)
- With Russia up 12% (exports +13%, imports +11%)

German GDP growth forges ahead of rivals

Germany recovers more quickly from 2009 recession

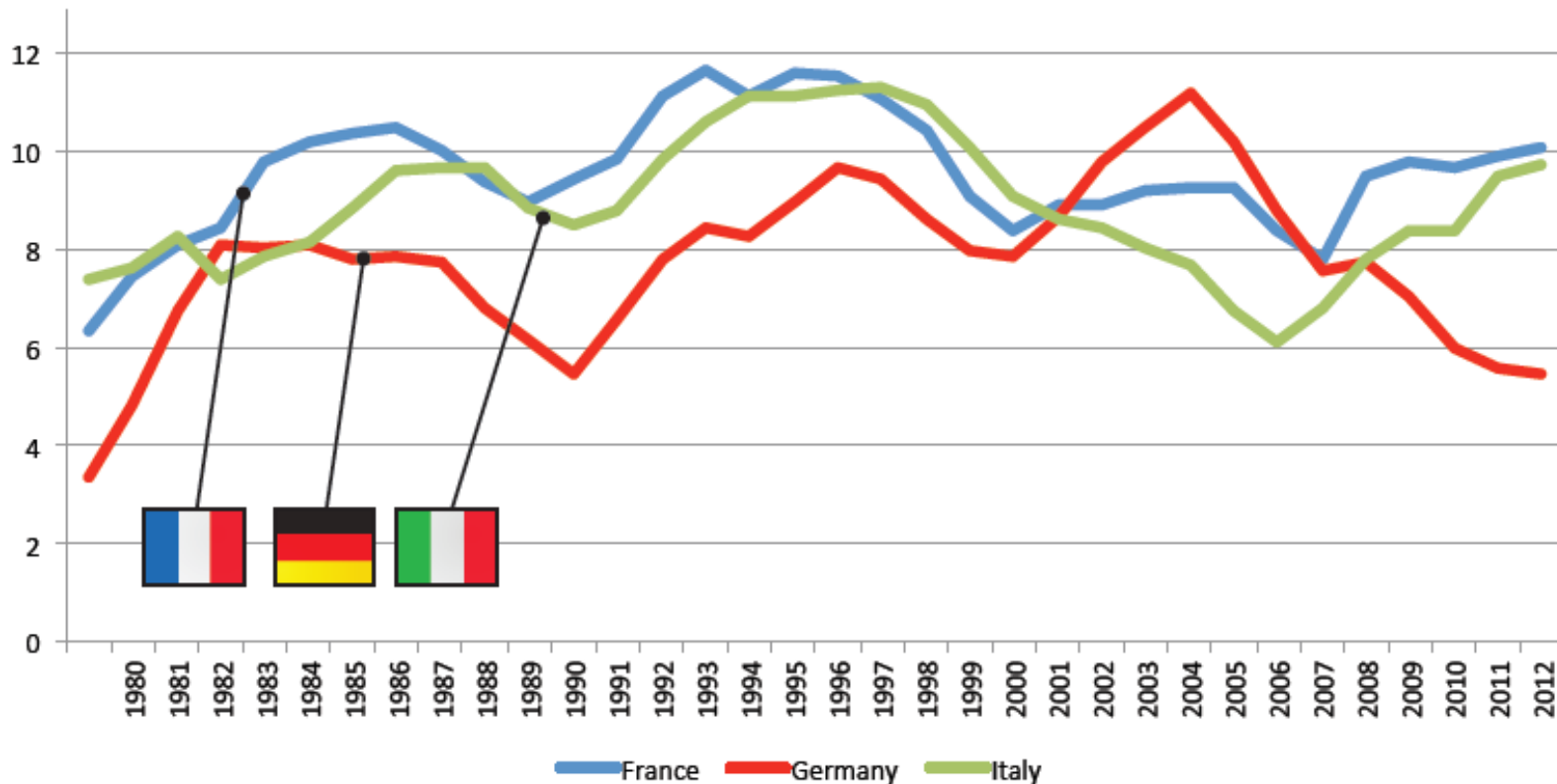


Source: IMF (2012-13 figures are projections)

Annual GDP growth 1980-2013 (%)

German unemployment outperforms the others

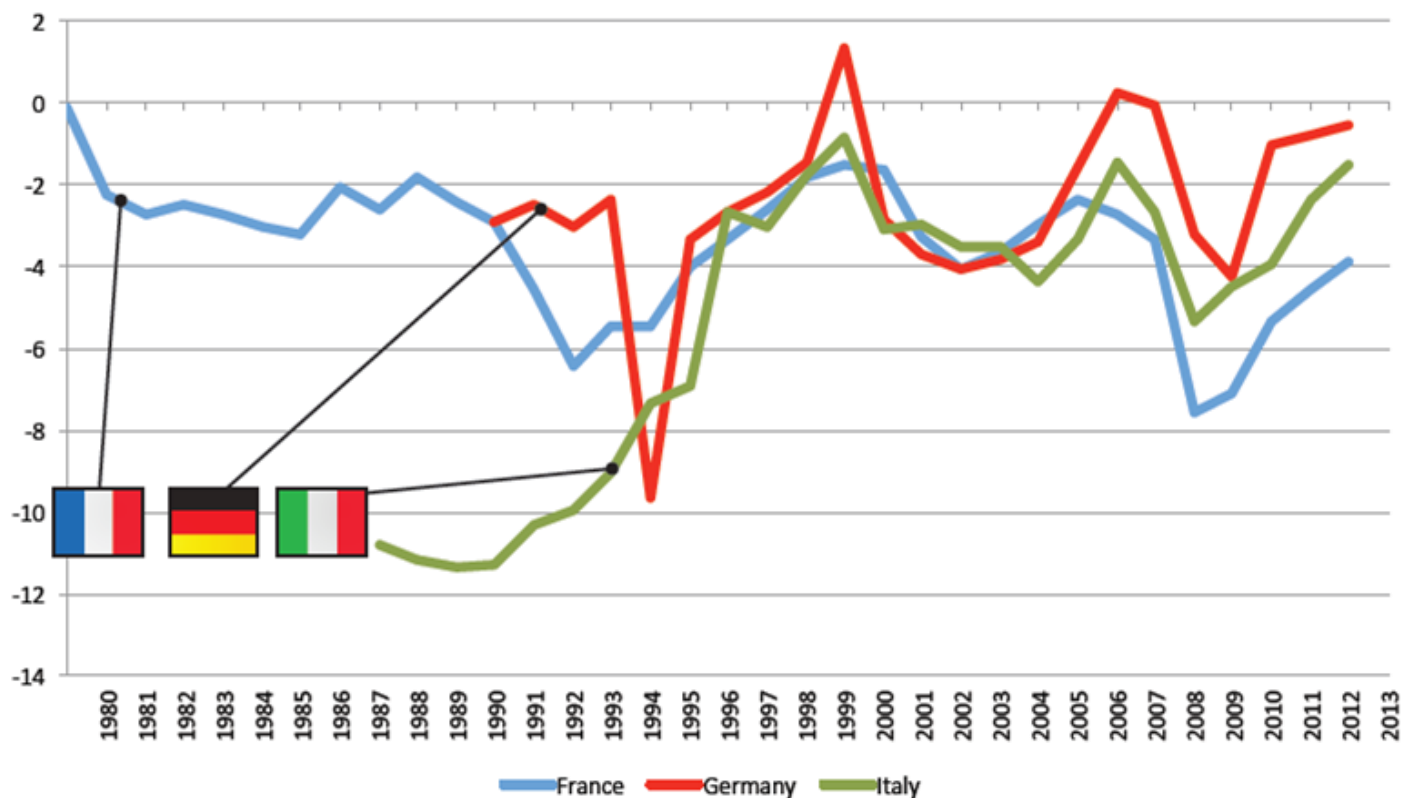
Labour reforms revitalise German jobs after 2004



Source: IMF (2012-13 figures are projections)

Germany gets government deficits under control

German spending cuts early in cycle pay off

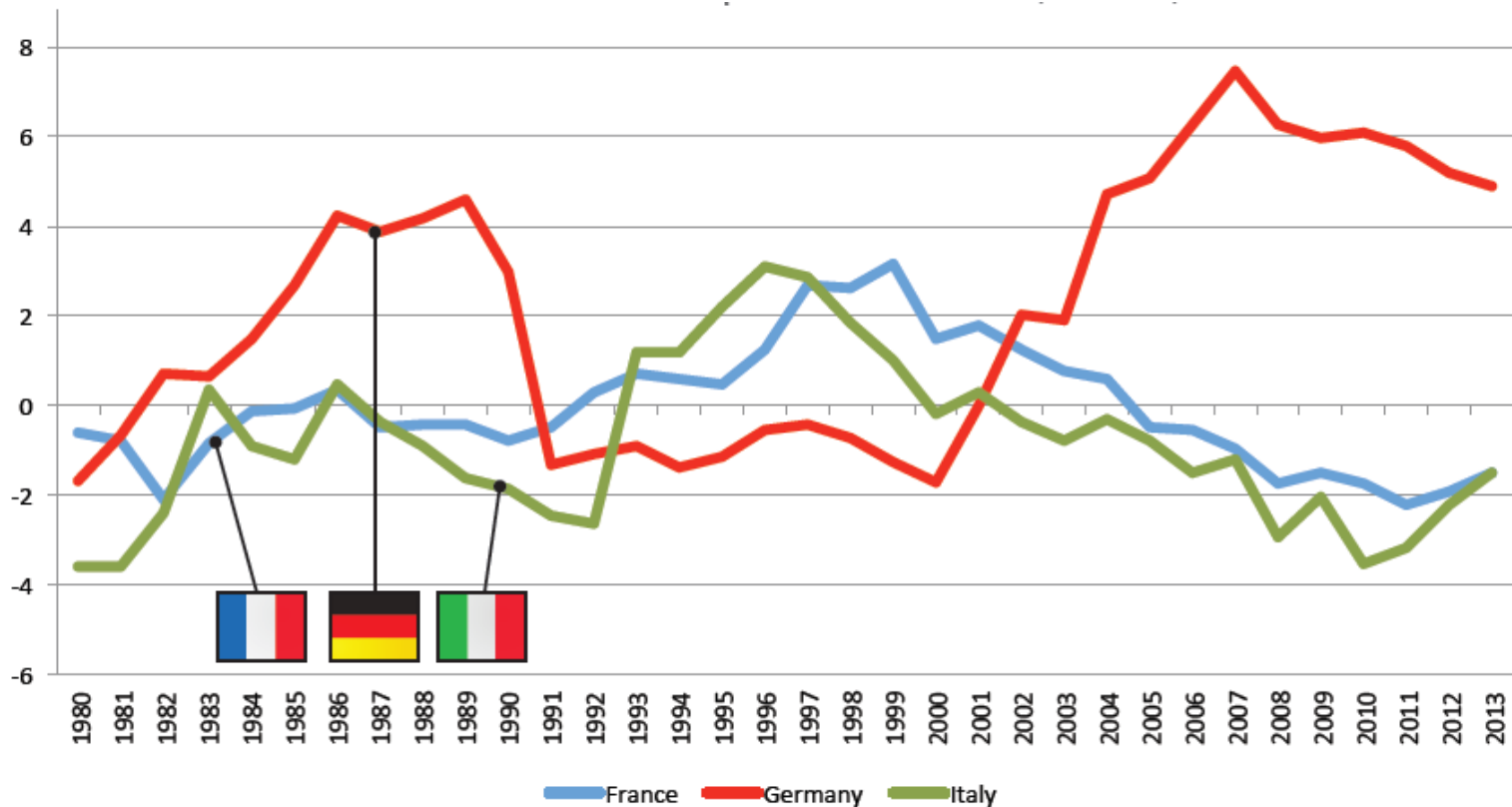


General government net borrowing (% of GDP)

*Data series for Germany and Italy starts from 1991 and 1988 respectively.
Source: IMF (2012-13 figures are projections)*

German current account surplus remains high

EMU enlarges German surplus



Annual current account surplus / deficit 1980.2013 (% of GDP)

Source: IMF (2012-13 figures are projections)

What's worse? German dominance....



Angela Merkel in driving seat



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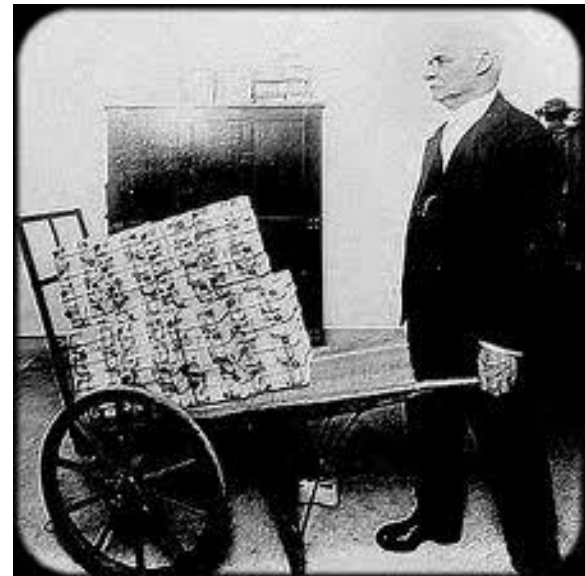
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.... or German Angst?

**Fear that Germany
loses Triple A rating**



**Fear of 1920s-style
inflation and social unrest**



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Overall conclusions for Asia

Making the “big shift” hit home for growth & prosperity

- Work your way round Europe
- Focus on ends not means
- Gradual trade/financial integration, not “grand scheme”
- Work out governance for multi-polar world
- Invest in real assets
- Learn from others’ successes & mistakes
- Cooperate with neighbours
- but keep control of your own policies



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