SUERF
THE EUROPEAN MONEY AND FINANCE FORUM

newsletter
March 2008

SUERF and BCL Conference

Productivity in the Financial Services Sector

11/12 November 2008
Banque Centrale du Luxembourg, Luxembourg

BANQUE CENTRALE DU LUXEMBOURG

Call for Papers

Productivity growth reflects improvements in how financial institutions combine their inputs (mainly labour, capital and technology) to create outputs. It is generally agreed that productivity of financial institutions has increased substantially during the last decades, largely thanks to the creative use of the information technology– not only for back office operations, but also for client relations, risk management and for product and services development.

A variety of methods exist for measuring productivity in financial services, but their comparability over time and across institutions is limited because they often rely on very different sources of costs and revenues. Thus estimates are often influenced by regulation, taxation, technology, market conditions, client attitudes, firm strategy, and shareholder expectations.

The operational efficiency ratio (OER), also known as the cost-to-income ratio, is often considered a key factor in the evaluation of the productivity performance of financial institutions. Academics, bank researchers, rating agencies, and equity analysts try to establish a clear view on the OER in this context.

SUERF – The European Money and Finance Forum and the Banque Centrale du Luxembourg are jointly organising a conference on Productivity in the Financial Services Sector.

Content:

SUERF – Société Universitaire Européenne de Recherches Financières

The conference will be divided into four sessions:

1. Sources of productivity
2. The role of information technology in driving productivity
3. Regulation and its relationship with productivity
4. 'Best practices' as a business strategy for improving productivity

Below are suggestions for topics to be discussed in each of the sessions. Papers are solicited on these, or related, topics.

Session 1: Sources of productivity

- Defining output in financial services
- Productivity and efficiency
- Benchmarking versus the production or intermediation approach
- Economies of scope and economies of scale
- Maximising stakeholder or shareholder value: implications for productivity

Session 2: The role of information technology in driving productivity

- Identifying the milestones in ICT developments for the financial sector
- ICT, information (a)symmetries and (better?) access to information
- The role of ICT in expanding economies of scale or of scope
- ICT and back office operations
- ICT as a conductor for fostering new risk management techniques
- ICT as a stimulus of product innovation

Session 3: Regulation and its relationship with productivity

- Is Basel II a challenge or an opportunity for productivity?
- Has the Financial Services Action Plan (FSAP) contributed to higher productivity?
- Is the Single Euro Payments Area (SEPA) the ultimate step in the move to a productive payments system?
- Is the UCITS regulation the missing link for the development of a productive European fund management business?
- The effects of compliance rules on measures of operational efficiency
- Do IFRS accounting standards contribute in the quest for greater productivity?
- Consolidation of prudential supervision and its possible effects on financial sector productivity

Session 4: 'Best practices' as a business strategy for improving productivity

- Internet or direct banking as a productive distribution model
- Employment effects of higher productivity?
- Co-, out or insourcing of back offices: complementary or conflicting strategies?
- The quality and remuneration of human capital as tools to increase productivity
- Concentration, conglomeration and productivity
- Lessons for the euro area from the strong productivity growth in the USA

The Council of Management of SUERF invites prospective authors to submit an abstract of 2–3 pages (or the full paper, if available) **before 30th April 2008**. Papers published prior to the conference are not eligible.

Abstracts/Papers should be submitted by e-mail attachment to **Beatrix.Krones@oenb.at**

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SUERF

SUERF Conference

Financing of SMEs in Europe

11/12 September 2008

Conference Room, Sénat, Palais du Luxembourg, Paris



Call for Papers

Small and medium size enterprises (SMEs) play a key role in the European economy: they account for 99 % of all European Enterprises and provide two-thirds of all private sector jobs. More than 100 millions of Europeans are SME-employees. Start-up firms belong almost by definition to the category. Innovation in SMEs contributes significantly to economic growth. Bank business lending is to a large extent based on credit evaluation of SMEs. Against this background, it is not surprising that the availability of SME financing has attracted political attention. The European Commission and OECD have recently published reports on financing of SMEs and their entrepreneurial activity.

SUERF – The European Money and Finance Forum, with the support of the former **AFCB, Association Française des Centrales de Bilans**, has decided to organize a conference with Financing of SMEs in Europe as conference theme, with a focus on panel or balance sheet data. The discussions at the conference will be divided into four sessions. We invite authors to submit a 2–3 pages abstract or a full paper if available addressing the following questions:

Session 1 – Does a European model exist for SMEs?

- What are the main features of SMEs in Europe?
- How do these features relate to the financing of SMEs?
- Is there a SME financing gap in Europe?
- What evidence do we have about the ownership structure of SMEs in Europe?
- Who are the people behind company start-ups in Europe and how many of them have been successful?
- In which parts of Europe is family ownership of SMEs most important?
- Does the European Venture Capital Industry invest globally or does it focus on European start-up firms?
- Are European private investors ready to buy shares issued by SMEs?
- To what extent do European mutual funds include SME-investments in their portfolios?
- Is there a European shareholder culture developing that might improve the future financing opportunities of SMEs?
- SMEs versus large firms: dominance effect or complementarity?
- How do SMEs cope with globalization?

Session 2 – SMEs and credit risk analysis

- Which are the important steps in credit risk assessments of SMEs?
- Are SMEs more risky than large firms?
- What is the optimal balance between accounting and non-accounting data to analyze credit risk?
- How can investors and banks measure entrepreneurial quality?
- Can an entrepreneur's capacity for innovation be quantified?
- Can potential investors and lenders seek advice at technological institutes or university departments when they want to evaluate the feasibility and potential profitability of business development projects?
- Is there an optimal capital structure for SMEs?
- Which methods should be used to implement stress

testing of SMEs' loans portfolio?

- To what extent can the incentive structure in the contract between a SME and the lenders be used to achieve an appropriate distribution of risk?
- Are options and/or convertible debt appropriate financial instruments to reallocate SME business risk?
- Is pooling of risky projects in special vehicles an appropriate way of diversifying credit risk?

Session 3 – Banks and financing of SMEs

- What are the main financing patterns for SMEs in Europe?
- Do we have evidence on the impact of EMU on SMEs?
- What can be done to reduce the information asymmetry between banks and entrepreneurs?
- What should bankers learn about innovation and entrepreneurship in start-up firms?
- How should banks evaluate the value of SME-owned patents and other immaterial rights?
- What is the appropriate way for a bank to deal with the risk of an SME default?
- Should banks own shares in their SME-borrowers?
- To what extent should banks be involved in the governance of their SME borrowers?
- To what extent should banks include restrictive covenants in their lending contracts with SMEs?
- How patient should banks be with innovative SMEs in financial difficulties?
- Does risk of SME failure scare banks away?
- Should banks own Venture Capital Firms that invest in SMEs?
- Do loans to start-up firms lead to long-term SME customer-bank relations?
- Should banks set an overall limit to their exposures to innovative SMEs?
- Do the LBOs affect positively or negatively SMEs' financial structure and long term performance?

Session 4 – SMEs and regulatory issues

The optimal regulatory response to the SME issues and the relatively low level of venture capital financing in Europe depends on the relative importance of demand and supply problems.

- Do we not have enough able entrepreneurs willing to take risks and consequently low demand for early stage financing or, do we have constraints on the supply of capital to small innovative firms?
- Should it – in order to address the demand side – be a political goal to increase the entrepreneurs' and the European private investors' "appetite for risk" with a view to increasing the global competitiveness of Europe?
- Should Europe have a common regulatory framework for Venture Capital Firms?
- Does an expected positive effect on economic growth justify Government subsidies to innovation activity in SMEs?
- Aiming at the supply side: What can be done by European policy makers to improve the financing of SMEs in the EU?
- Are legal provisions concerning default and creditor protection regarding SMEs similar in the European countries?
- Which kind of investor protection is appropriate in relation to SMEs?
- Are disclosure requirements regarding the activity of SMEs sufficient?
- Which types of regulation of SME financing at the European level are used currently and which types can be expected to be used in the future?
- Should investors, entrepreneurs and SMEs be allowed to deduct (a part of) their risky investments in start-up projects in their income tax?
- Is there a trade-off between the target of reducing the administrative burden and improving the financial disclosure (reduction of information asymmetries)?
- Is "positive discrimination" an appropriate answer of public policies aiming at fostering SMEs' long-term growth?
- Are bank loans to SMEs treated appropriately in the Basel II regulatory framework?

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Abstracts/Papers should be submitted by e-mail attachment to **Beatrix.Krones@oenb.at**

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SUERF c/o OeNB, Otto Wagner-Platz 3, A-1090 Vienna **www.suerf.org**

Tracking Financial Behaviour: Bringing Together Statisticians, Financial Intermediaries and Policy Makers

Some findings and conclusions from a conference jointly organised by SUERF and Pioneer Investments

By Ernest Gnan
SUERF Secretary General and
Head Economic Analysis Division, Oesterreichische Nationalbank

On 3 December 2007, SUERF, together with Pioneer Investments, organized a one-day conference on **"Tracking Financial Behaviour: Where do Macro and Micro Meet?"** in Milan. The conference addressed three questions: **Session 1** offered an update on **latest developments in financial accounts statistics and household finance surveys** and their main results. **Session 2** looked at **policy makers' user requirements on financial statistics**, covering both current practice and deficiencies of existing statistics. Session 3 took financial intermediaries' viewpoint and presented **empirical findings on savings behaviour and financial investment** choices.

Werner Bier, Deputy Director Statistics of the ECB, opened **Session 1** with an account on **Recent International Developments in Financial Accounts Statistics**. He recalled the many dimensions of financial accounts statistics, which combined yield around 1,400 times series to be continuously updated and then available for analysis. Financial accounts are compiled from various data sources – ensuring integration and consistency (e.g. between stocks and flows, between assets and liabilities, between various frequencies) are an ongoing challenge. Bier then illustrated possible insights from financial accounts by showing some interesting figures. For instance, euro area households' total wealth, including financial and housing wealth as well as pension rights, in 2006 amounted to an estimated EUR 50-60 trillion, in other words roughly 10 times households' disposable income. In the short to medium term, valuation gains and losses are the driving force in fluctuations in household wealth (an observation which, in retrospective, seems even timelier in the light of recent asset price developments). Non-financial corporations have over recent years increasingly acted like financial intermediaries. More recently, there is also a certain accumulation of financial assets in the government sector, reflecting the building up of public pension funds. Taking the users' perspective, Bier pointed out that financial accounts support the monitoring of financial stability by shedding light on the financial soundness of households and non-financial corporations (e.g. indicators of household indebtedness, financial leverage, income-based financial fragility). At the same time, the needs of financial supervisors differ in a number of important respects from what financial accounts, which need to be integrated into overall national accounts systems, offer (e.g. host versus home country approach, unconsolidated versus consolidated perspective, degree of detail by asset categories, original versus residual maturity). Bier concluded by outlining some changes in financial accounts statistics brought about by the SNA 2008/ESA 2010 reviews, which include e.g. the treatment of pension entitlements of government pension schemes, valuation of non-performing loans. Envisaged improvements for euro area financial accounts include, for instance, enhanced timelines (lag of less than 3 months), deeper disaggregation by sector and financial asset categories and seasonal adjustment.

Enrico Giovannini, OECD Chief Statistician, argued that **financial accounts** are **a fundamental tool to understand the economy and the society**. He started off with the origins of financial and balance sheet accounts and their evolution over time. National and financial accounts in the modern sense date back to the mid 20th century. The OECD has for a long time played an important role in the development of these statistics. Recently, the OECD relaunched its financial accounts database. In 2007, financial accounts were available for 28 OECD countries. Data start in 1995, while nine countries have longer time series. In view of more complex private household financial portfolios, the large euro financial market and an increased interest in international comparisons in a world of globally integrated financial markets, he called for more detailed financial statistics. At the same time, for empirical studies longer financial accounts time series are needed. An ongoing project, in which the OECD is involved together with Pioneer Investments and UniCredit, has extended backwards financial accounts time series for a group of OECD countries. Giovannini argued that financial accounts are fundamental for economic analysis but their importance is not fully appreciated by both users and producers, which may explain the very limited investments in their production and development. Full integration between non-financial and financial accounts is important. More timely data, more detailed and longer time series would allow deeper analysis useful for monetary policy. To conclude, Giovannini raised two issues: first, the nexus between financial conditions and progress in societies, and which financial indicators one might include in a set of "key progress indicators"; second, what data one would need to better understand the relation between financial conditions, trust, stability and progress in society.

Olympia Bover, Banco de España, presented the **Spanish experience and the European prospect** in **developing household finance surveys**. She started with the observation that in a world where wealth becomes more relevant as an insurance mechanism under conditions of increasing uncertainty, wealth distribution and composition have significant consequences for the macro-economy. Household surveys provide information on how wealth is invested in different assets by different socio-demographic groups. Demographics, institutions and path dependency may explain differences across countries in financial structure. Taking the Spanish example, a large fraction of wealth is tied up in households' main residence and other real estate, which implies a high sensitivity of spending to house price movements. The fact that a large proportion of stocks is owned by wealthy individuals implies that the higher risk associated with this asset class is borne by groups better able to bear that risk. Knowledge about the use of private pension funds by different income and age groups is important to assess the appropriateness and effects – additional savings versus a mere reshuffling between different forms of savings - from tax subsidies for private pension savings. To assess financial fragility emanating from household debt, it is not sufficient to consider the average or median household but one also needs accompanying information on the assets held by individual debtors. Further interesting research questions which can be covered by micro data from household finance surveys include the question as to whether households hold efficient portfolios and whether they hedge adequately against financial and house price risk, the response of credit to changes in interest rates and the wealth effects from changes in various types of asset prices. Bover concluded by providing information about the The Banco de España's survey on household finances, which was started in 2002. Currently, a Eurosystem Research Network prepares a similar survey for euro area countries. After approval by the ECB Governing Council in 2008 the first survey would be conducted in 2009.

Riccardo De Bonis, Head of Monetary and Financial Statistics, Banca d'Italia, inquired **whether financial systems converge**, drawing on **evidence from household financial assets in the main industrialised countries**. Building on a new database on financial accounts for eight OECD countries reaching back to 1980, which was put together jointly with the OECD (see above), the paper finds some convergence in financial structures for total financial assets, insurance products, shares and other equity. Financial deepening, the crisis of public pay as you go pension schemes and the growing role of stock exchanges are proposed as the main explanations. By contrast, no convergence is found for securities other than shares and for currency and deposits. In other words, financial globalization and integration, and the growth of capital markets are common trends across countries; but national peculiarities in households' financial portfolio structures persist.

The panel discussion of **Session 2 on policy makers' needs** was opened by *Jukka Vesala, Deputy Director General, Finnish Financial Supervision Authority*, who called for **enhancing the transparency of risk transfer markets**. The vast growth of risk transfer markets has altered the nature of banks´ business. It has enhanced possibilities to diversify and spread also credit risks. But it has also increased opacity of risk in complex structured products and credit derivatives. Hedge funds and other special investment vehicles have played an important role as risk takers in these markets. The policy approach so far was not to stifle financial innovation and beneficial risk-spreading by extending regulation beyond the set of traditionally supervised intermediaries. Financial stability was sought to be ensured by transparency and disclosure and due intelligence of supervised institutions. Numerous – public sector and private - initiatives since the late 1990s to improve disclosure of regulated and unregulated (e.g. hedge funds) financial intermediaries had only limited success. The ability of authorities to monitor the location of risks has been seriously affected. Events since August 2007 confirm this assessment: There was not accurate and timely information of financial intermediaries´ exposures to credit risk and sub-prime losses, the result being a major confidence crisis and drying up of liquidity in interbank and other financial markets. Authorities therefore need more information on leverage, on liquidity risks, on methods of fund valuation, risk profiles, internal governance and risk management including large individual exposures and transactions. In addition to data on individual institutions, a more explicit consideration of market structure (size of individual intermediaries in a particular market, and thus a possible concentration of risk in a systemically important market participant) is important. Furthermore, supervisors should also step upt the intensity and frequency of their dialogue with intermediaries. The exchange of information between supervisors and central banks (including the ECB and European supervisors) should be intensified, reflecting the insight that one can no longer distinguish strictly between micro and macro-prudential analysis. Also the supervisors and statisticians should relate to one another more closely: for instance, financial sector statistics for financial stability purposes need to be fully consolidated and on a market-value basis. Ultimately, in addition to such better coordination, also additional reporting requirements by financial intermediaries might be necessary.

Paul Van den Bergh, Head of Information, Statistics and Administration, Bank for International Settlements, discussed **what data policy makers need to track financial behaviour**. Data should include information on the many types of financial institutions, on the various components of financial infrastructures and on all segments of financial markets, as well as their relations with the non-financial sector. There are multiple interrelations both within and between these components. Major data gaps exist for non-bank financial institutions, financial infrastructures, non-price data of financial markets (size, microstructure and liquidity), the interrelationships between the system components, and for statistical measures of new concepts, such as financial soundness or vulnerability, early warning signals, risk proneness or aversion, liquidity and exposures. The statistical framework for macro financial data has the advantage of being based on a rigorous analytical framework. While still waiting to be fully implemented, it is at the same time struggling to keep up with innovations and with the need for further refinement. Macro data can be complemented with other data, such as supervisory data, disclosure data, surveys, forecasts and micro data. Conversely, ad hoc data sets can and should be interpreted against the background of the macro data. Improvements should follow several routes in parallel: a better exploitation of existing data, development of new statistical measures to capture financial innovations, as well as surveys to understand particular developments, such as household finance and bank lending behaviour. However, it also has to be recognized that our knowledge will never be perfect and complete.

Carlo Ambrogio Favero, Professor of Economics, Bocconi University, Milan, discussed the development of **euro area money demand**. He raised the puzzle that, while euro area money demand has diverged from the reference value for quite some time now, euro area inflation has so far been broadly on target. While traditional money demand cannot explain this, looking at international portfolio flows helps to shed light on the sources for this discrepancy. Thus, to understand money demand in the euro area and the long-run relation between money growth and inflation, a model should be used, in which wealth-owners hold a diversified portfolio with riskless interest-bearing money, as well as domestic and foreign risky assets. While the assessment of risks for inflation is more uncertain, as asset prices are more volatile than output and interest rates, a real-time assessment of inflationary risks continues to be feasible, given that asset prices are easily available on an ongoing basis.

Huw Pill, Head of the ECB's Monetary Policy Stance Division, followed up on the previous speaker by explaining which **data** the Eurosystem uses **to conduct its monetary analysis**. While short-term developments of M3 money growth typically represent mostly "noise", on occasion it also can provide important information about the impact of shocks. For example, in recent months it has shown that, despite the financial turbulences, the flow of bank loans to the private sector has remained strong. At cyclical frequencies, monetary analysis can supplement the analysis of the business cycle, e.g. the flow of funds matrix is an important element in the assessment of sectoral financing conditions. At low frequencies, the Eurosystem exploits the robust long-term relationship between money growth and inflation. Monetary data reveal common nominal trends in the economy earlier than other data sets. Thus, a key challenge is to identify the underlying rate of monetary expansion that is related to, and which leads, trend inflation in a timely fashion and in real time. To meet this challenge, the Eurosystem uses econometric models, statistical filters, institutional knowledge, and a comprehensive assessment of a broad set of monetary, financial and economic data. As an example of this approach, Pill quoted the correction of M3 growth for portfolio shifts, which successfully explained the acceleration of M3 growth between 2001 and 2003. Pill concluded by pointing out the specific challenges posed to monetary analysis in the euro area, given, inter alia, that retail financial markets remain segmented and that aggregates are continuously changed as the euro area is being enlarged.

Arthur B. Kennickell, Head of the Microeconomic Surveys Unit at the Board of Governors of the Federal Reserve System, gave an overview of the **use of the Fed's Survey of Consumer Finances for policy purposes and related research**. Reflecting concerns about the state of consumer demand, after World War II the Federal Reserve Board initiated and funded some survey research to understand the psychology of consumers and their willingness and ability to take on debt. A wealth survey, which collected extensive information on assets and liabilities, followed in 1962, in order to gain a richer understanding of household portfolios and their implications for the transmission of monetary policy. In 1977, a consumer credit survey followed. The Survey of Consumer Finances, launched in 1983, reflected a growing interest by various parts of government, including financial regulators, in tax issues, pensions and related issues. A 1986 follow-up was for example used to better understand the effects from the 1987 stock market crash. From the late-1980s onward, the Survey of Consumer Finances was firmly established as a valuable data source, supporting the study of monetary policy transmission, bank regulation and competition policy, deposit insurance, consumer protection and savings behaviour. Nowadays, the Survey of Consumer Finances is a routine part of U.S. national statistics and is widely used to understand and illustrate effects of past policies and to simulate the potential effects of possible monetary, fiscal and regulatory policies. It is also important input into other, aggregate statistics, including the flow of funds accounts and consumer credit series. It is the most authoritative source of information on household wealth. Particularly during critical events, it serves as a source of information on the transmission of shocks.

In his **keynote speech**, *José Manuel Gonzáles-Páramo, Member of the Executive Board of the European Central Bank*, addressed **the role of central bank information and communication in the recent financial turmoil**. Informational asymmetries about the distribution of exposures of sub-prime losses across financial institutions were at the core of the difficulties in the inter-bank money market in the second half of 2007. While Eurosystem money market operations managed to stabilise the money market to some extent, the persistence of difficulties, despite sufficient aggregate liquidity, pointed to important limitations for public policies. Central banks cannot be expected to solve the more fundamental problems of commercial banks and credit markets. A return of confidence among banks requires enhanced transparency and more extensive disclosure by both banks and non-regulated entities. While policy makers are used to work under conditions of incomplete information, times of market stress are significantly more challenging, given that historical regularities can no longer be relied upon, while increased volatility blurs the information content of market variables and other indicators. The recent financial turbulence was characterized by an increase in the precautionary demand for liquidity and a change in the temporal pattern of liquidity demand within the reserve maintenance period. The Eurosystem reacted by adjusting its pattern of liquidity provision to the banking system (exceptional operations, shift in the time pattern of liquidity provision within the reserve maintenance period, increased weight on longer-term refinancing operations) and by intensifying its communication with banks, e.g. through the Money Market Contact Group. The latter served both to reassure banks about the Eurosystem's determination to act against excessive volatility and to provide vital market intelligence to the central bank. While the market turmoil proved that the Eurosystem's statistical data framework and network for information exchanges with other central banks and other European authorities work well, it also revealed some information gaps and weaknesses which will have to be addressed in the future.

The financial turmoil also poses some important challenges for a central bank's reputation, both at the operational level and with respect to its primary objective of price stability. Whether central banks' crisis measures truly create problems of moral hazard, depends on how these measures are designed. Aggregate liquidity injections aiming to keep short-term money market rates close to their target level should as such not pose a moral hazard problem. However, once the turmoil is over, it will be important for the central bank to re establish a "reputational equilibrium" for interest rate signalling with banks. It is also crucial for markets and the public to understand the difference between monetary policy implementation and the monetary policy stance. Temporary liquidity injections to restore calm in the money market do not imply that the monetary policy stance is altered. Contrary to the occasional public perception, the Eurosystem's recent liquidity operations have not increased the overall liquidity supply to the banking sector. Central banks, however, need to credibly dispel the impression of "bailing out" excessive risk takers. Emergency liquidity assistance to individual institutions needs to ensure an adequate price to be paid by senior managers and equity (and possibly debt) holders of rescued banks. Widening the range of collateral eligible for open market operations must not favour individual institutions under distress. Easing policy rates in reply to financial turmoil would create the impression that the central bank supports asset price valuations and thus clearly create moral hazard – it should thus be avoided. By contrast, if a financial crisis affects growth prospects, thus lowering the inflation outlook, monetary policy easing would hardly create moral hazard, since it is in line with the central bank's standard mandate and since losses at the level of individual banks stemming from imprudent risk management would not be suppressed.

Session 3 focused on **insights for financial intermediaries**. *Daniele Fano, Head Economic Research, and Teresa Sbano, Pinoeer Global Asset Management, Milan, together with Robert F. Wescott, President of Keybridge Research, Washington*, presented research on **cyclical versus structural factors in household demand for risky assets**. Drawing on a new financial accounts data set extending back into at least 1980, which was jointly developed by Pioneer Global Asset Management with the OECD, they showed that in a long-term perspective, household wealth as a percentage of gross disposable income has increased across 8 large OECD countries. But the composition of assets, as well as its evolution over time, shows considerable differences across countries. The ratio of household financial assets to non-financial wealth increased only in Germany and Japan, reflecting differences in real estate prices. Financial liabilities generally show an upward trend, although at very different levels. In the US, over the past two decades, the importance of pension fund reserves and mutual fund shares has strongly increased at the expense of deposits and currency as well as private business investment (In the UK and in Italy, pensions, life insurance and securities gained at the expense of deposits). Financial innovation enabled access by minorities and young people to home ownership. The decline in US property prices reduces household's ability to withdraw equity from mortgages and might thus affect consumption and savings behaviour. As the US economic outlook deteriorates and the US dollar has been depreciating, the rise in US current account deficits has come to a halt. At the same time, future cheap foreign financing of the deficit becomes more uncertain,

as private foreign investment seems to be fleeing from the US.

Giacomo Campora, CEO Allianz Bank, Trieste, presented Allianz Bank's "KaiZen" approach to **understanding common people's investment choices**. Whereas portfolio managers focus on the business cycle, financial market developments and strategic as well as tactical portfolio choices (the "Markowith approach" – risk versus return), customers' decisions are driven by financial constraints and their investment goals (the "Kahneman approach" – fear, hope and aspiration). The two sides meet where an investment fund matches customers' needs. Financial advisors should create awareness and potential value in customers.

Axel Börsch-Supan, Director of the Mannheim Research Institute for the Economics of Ageing, summarized our **knowledge, and our lack of knowledge, on household savings decisions**. In particular, he pointed out that simple life-cycle patterns such as dissaving in old age are inadequate to explain real-life behaviour. In general, households' portfolio behaviour lacks diversification, with too heavy a focus on assets from one's own employer and country. Savings behaviour has changed dramatically as a result of financial market liberalisation and aging, combined with reforms of public pension systems. Non-discretionary savings (passive or contractual) is prevalent. All these features considerably differ from predictions of standard economic models. For future research and policy, five issues are of particular interest: first, who has (in)sufficient private old-age provision? Second, which channels work best to induce more private old-age provision? Third, is there a crowding out among various saving motives (old-age; health and long-term care; education)? Forth, how to generate more efficient portfolios? And fifth, should savings disbursed through annuities or as lump-sum payments? These distinct questions require different research approaches and data sources to be answered. New and extended surveys may be required. The internet might be used as an information source. There might be scope for laboratory experiments. The scope for international comparisons should be extended. All in all, more quantitative research is needed.

SUERF wishes to thank Pioneer Investments for the joint organisation and sponsoring of this interesting conference, which provided important insights to the 80 participants in attendance.

In a nutshell, the conference showed that financial statistics are a vibrant field of ongoing research, which evolves continuously. It provides important insights into financial market agents´ behaviour, useful for the agents themselves and for policy makers (central banks, supervisors, government) alike. However, given the rapidly expanding volume of financial wealth, the increasing importance of private savings for retirement, health and education as well as the highly complex nature of financial markets and their institutions, it seems that more resources might need to be spent into monitoring and understanding financial behaviour of all agents involved.

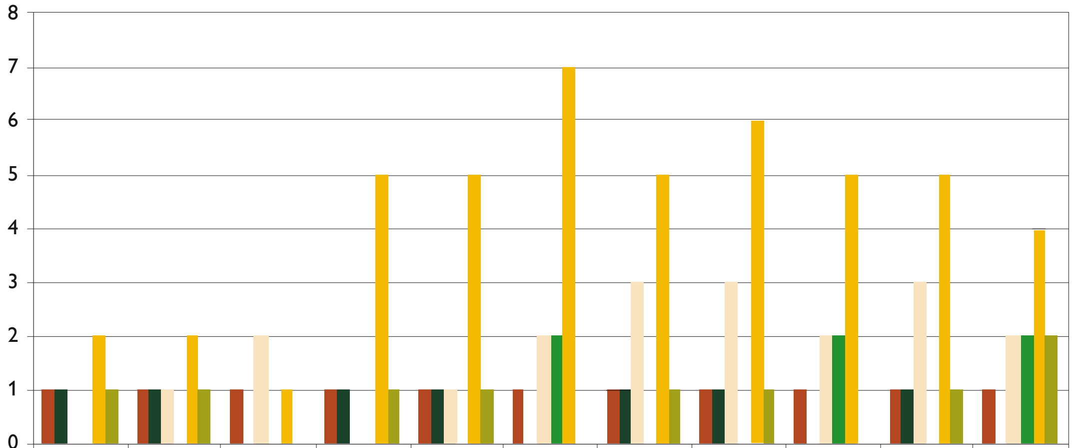
Financial crises put statistical frameworks to the test. On the one hand, in times of crisis statistical information hitherto neglected suddenly comes into the limelight; on the other hand, the weaknesses in statistical frameworks become very apparent. As in other fields, crises can trigger rethinking and improvements in statistical information sets. Given that the recent financial turbulences are not least due to severe information asymmetries and inadequate reporting and transparency rules, it is likely that they will influence and shape the evolution of financial statistics over the coming years.

Recent events have also shown that, in addition to elaborate statistical reporting requirements, in situations of crises direct and continuous contact between the various players – financial institutions, supervisors and central banks – is indispensible. In this light, SUERF's mission to bring together researchers, financial industry practitioners and central banks turns out to be particularly useful.

News from the Council of Management SUERF Highlights 2007

In 2007, SUERF increased its visibility through press coverage – with journalists attending all events and with healthy attendances at all events. 2007 also saw the first ever Colloquium Volume published in-house, as well as a continued output of SUERF Studies and also a joint publication with the Bank of Finland.

Development of SUERF Activities



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Annual Lecture	1	1	1	1	1	1	1	1	1	1	1
Colloquium	1	1	0	1	1	0	1	1	0	1	0
Seminars	0	1	2	0	1	2	3	3	2	3	2
Conferences	0	0	0	0	0	2	0	0	2	0	2
Studies	2	2	1	5	5	7	5	6	5	5	4
Books	1	1	0	1	1	0	1	1	0	1	2

1. Membership

Corporate Membership levels remained stable, thanks to the acquisition of several new Corporate Members, which helped to cushion the losses of Corporate Members as a result of mergers and acquisitions. At the end of the year, Corporate Membership stood at 84 (including 27 Central Banks) an slight increase over 2006. Academic Institution Membership (AIM) saw a net increase of 1 member - to 29 institutions – in 15 countries. Personal membership fell from 232 paying members in 2006 to 212 – although this is common trend, since personal members often join to attend a single Colloquium. Library Subscription Service (LSS) uptake remained unchanged. SUERF members are located in the following 37 countries.

ALBANIA
AUSTRALIA
AUSTRIA
BELGIUM
BRAZIL
CANADA
CYPRUS
CZECH REPUBLIC
DENMARK
ESTONIA
FINLAND
FRANCE
GERMANY
GREECE
HUNGARY
ICELAND
IRELAND
ITALY
JAPAN
LATVIA
LUXEMBOURG
MACEDONIA
MALTA
NORWAY
POLAND
PORTUGAL
SINGAPORE
ROMANIA
SLOVAKIA
SLOVENIA
SOUTH AFRICA
SPAIN
SWEDEN
SWITZERLAND
THE NETHERLANDS
UNITED KINGDOM
USA

2. Activities

Events were held with similar frequency to preceding years, with two seminars, two conferences and an Annual Lecture. Four *SUERF Studies* were published in 2007, with Corporate Members and Academic Institution Members also receiving complimentary copies of the SUERF Colloquium Volume, published in-house for the first time. Detailed information about published SUERF Studies can be found at www.suerf.org. SUERF events were attended by approximately 400 participants, a similar level to 2006 despite the fact that no Colloquium was held in 2007.

Publications

SUERF Studies 1-22 and 2003/1-2005/5 can now be downloaded by everybody from the website. The more recent Studies (2006/1-2007/4) are available to members only, for downloading using a password, which can be obtained from the Executive Secretariat. The Colloquium Volume for the 26th SUERF Colloquium, held in Lisbon in October 2006, entitled *Money, Finance and Demography: The Consequences of Ageing* edited by **Morten Balling**, **Ernest Gnan** and **Frank Lierman** was published in late 2007. A joint volume with the Bank of Finland on *Open Market Operations and Financial Markets* was published by Routledge in their series International Studies in Money and Banking in Spring 2007. This volume contained a selection of contributions that were presented at a joint conference held in the autumn of 2005 in Helsinki, and was edited by **David G. Mayes** and **Jan Toporowski**.

SUERF Events in 2007

SUERF continued to develop its range of activities so as to meet the interests of members and to respond to their suggestions whenever possible. As always, the Council is keen to receive views from members about possible future events and publications.

Annual SUERF Lecture: The 14th Annual SUERF Lecture, held on 22 June 2007, was organized in Vienna in conjunction with the Special SUERF/OeNB East Jour Fixe. The Lecture was delivered by Professor **Paul de Grauwe**, on *Problems and Prospects for Enlargement of the Eurozone*.

Seminar/Jour Fixe: SUERF arranged the following events

- Two day seminar in Nicosia, Cyprus, on *Corporate Governance in Financial Institutions* jointly organized with the Central Bank of Cyprus (29–30 March 2007). This was very well attended by the local financial community and by members and guests from 23 countries and covered many dimensions of the issue of corporate governance. A selection of the papers presented were included in two joint publications – SUERF Studies 2007/3 and 2007/4. There has been considerable interest in these publications from non-members too.

- One day special OeNB Jour Fixe in Vienna, on *Central and Eastern Europe: Is Economic Convergence on Track?* with the Oesterreichische Nationalbank and the Austrian Society for Bank Research (22 June 2007). We were again very pleased to organise this event with the Oesterreichische Nationalbank and the Austrian Society for Bank Research, whose continued support is greatly valued.

Conferences: SUERF arranged the following two Conferences in 2007

- Two day conference in Helsinki on *Financial Markets, Innovation and Growth,* jointly organized with the Bank of Finland (20–21 September 2007).
- One day conference in Milan on *Tracking Financial Behaviour: Where do Macro and Micro Meet?* jointly organized with Pioneer Global Asset Management (3 December 2007).

On behalf of the SUERF Council of Management, I would like to thank all co-organizers for their contributions. We are convinced that our events have made a significant contribution to public debate on important issues.

3. Financial Situation

SUERF's financial situation continues to be healthy. Due to the fact that 2007 was not a Colloquium year, both expenditure and expenses were lower in 2007. On the income side, SUERF remains dependent on membership subscriptions to finance our activities. In 2007 receipts from membership stood at just over € 114,000 an increase of just over € 3,000 from the year before, with Corporate Members and Central Banks contributing approx. € 97,000. Personal members contributed € 10,300 whilst Academic Institution Membership (AIM) and the Library Subscription Service (LSS) contributed approx. € 7,000. Royalties income from sales of SUERF Studies and SUERF Colloquium Volumes were somewhat lower than in previous years.

I would like to extend my special gratitude to all members – Corporate, Personal, Academic – and our customers for their continued support and interest in our products. We do hope that you extend your support and interest also into the future, such that we are able to continue to provide high-quality events, publications and networking opportunities to you.

4. Outlook to 2008

The following SUERF events took place or are planned for 2008.

- A **SUERF Workshop** and Special OeNB Easr Jour Fixe on *Commodities, Energy and Finance* jointly organized with the Oesterreichische Nationalbank and with the Austrian Society for Bank Research on 3 March, 2008;
- The **27th SUERF Colloquium** on *New Trends in Asset Management: Exploring the Implications* sponsored by HypoVereinsbank and jointly organized with the Bayerisches Finanz Zentrum e.V to be held at the HVB Forum in Munich, Germany on 12-14 June 2008, with the **2008 Marjolin Lecture** to be delivered by joint winner of the 1997 Nobel Memorial Prize for Economic Sciences, Professor **Robert C. Merton**, John and Natty McArthur University Professor at Harvard Business School, on *Observations on Future Trends in Asset Management: Challenges and Opportunities*;
- A one and a half day **Conference** on *Financing of SMEs in Europe* followed by the **2008 SUERF Annual Lecture** in Paris on 11-12 September, to be held at the Palais de Luxembourg (the Call for Papers is currently still open);
- A one and a half day **Conference** on *Productivity in the Financial Services Sector* jointly organized with the Banque Centrale du Luxembourg on 11–12 November, 2008 (the Call for Papers is currently still open);

Outlook to 2009 Among other planned events for 2009 that will be announced in due time, the SUERF Council of Management is currently in the process of confirmation the location and topic for the 28th SUERF Colloquium.

5. Miscellaneous

Council of Management

By decision of the **General Assembly** held on 22nd June 2007 in Vienna, **Willy Friedmann**, Head of the Economics Department, Deutsche Bundesbank, was unanimously re-elected to the SUERF Council of Management for a further three year term, expiring on 1st January 2011. **Jan Marc Berk**, Head of the Financial Research Department, De Nederlandsche Bank, **Ernest Gnan**, Senior Adviser and Head Economic Analysis Division, Oesterreichische Nationalbank, and Acting Secretary General of SUERF and **Már Gudmundsson**, Deputy Head of the Monetary and Economic Department, Bank of International Settlements were all elected to the Council of Management for a period of three years beginning retroactively on 1st January 2007. Earlier in 2007, **L. Miguel Beleza**, Advisor to the Board, Millennium bcp, Portugal stepped down from the Council of Management. **John P. Calverley**, Chief Economist and Strategist at American Express Bank stood down from Council in September 2007 after 10 years in Council. **Fernando Restoy**, formerly Director of the Monetary and Financial Studies Department at the Banco de España stood down in the summer, with **Juan**

Ayuso, his successor at the Banco de España, being invited to become an Observer to the Council of Management. **Beat Bernet**, Dean of the Swiss Institute of Banking and Finance at the University of St Gallen, Switzerland, was also invited to become an Observer to the Council of Management.

During 2007, the Council of Management met on four occasions, coinciding with SUERF events to plan the programme of activities and to monitor the association's finances and work of the secretariat. The Presidency also met on two occasions.

Executive Secretariat

The Executive Secretariat continues to be staffed by **Beatrix Krones** (Executive Secretary, full-time) and **Michael Bailey** (Assistant, part-time). On behalf of the Council of Management, I would like to cordially thank Ms Krones and Mr Bailey for their outstanding work. Their commitment to SUERF continues to be unstinting.

Ernest Gnan, Secretary General

Book Review • Book Review • Book Review

Untangling the US Deficit – Evaluating Causes, Cures and Global Imbalances

By **Richard A. Iley**, Senior Economist, US and Canada, BNP Paribas, New York, US and **Mervyn K. Lewis**, Professor of Banking and Finance, University of South Australia and Fellow, Academy of Social Sciences, Australia

Edward Elgar Publisher, Cheltenham, U.K., 2007, 288 pp, Hardback 978 1 845 42 920 1, on-line discount £58.50; this book is also available as an e-book 978 1 84720 705 0

Contents: Preface 1. The Essence of the Problem; 2. The Trade Perspective; 3. National Accounting Perspectives; 4. The International Perspective; 5. Nature of the Adjustment Mechanisms; 6. The Sustainability of the Deficit; 7. The Demand for US Assets; 8. China and the United States; 9. Conclusion, References, Index

This book is well written and does a good job of summarising the debates surrounding the causes and sustainability of the US current account deficit. As indicated by the bibliography, the authors distil information from a wide range of sources including material from policy makers, academics and journalists. Overall, I found this book interesting and it successfully fulfilled its broad-ranging mandate to 'evaluate causes, cures and global imbalances'.

As the use of the word 'untangling' in the title suggests, any discussion of the US current account deficit requires a number of interrelated issues to be raised. To simplify the discussion of causes, the book starts by presenting a taxonomy of approaches: the current account balance of any country can be the result of trade flows, savings and investment imbalances, the difference between aggregate supply and demand (absorption) and financial flows. As the authors acknowledge, these four perspectives are linked by identities, making causality impossible to determine without further information, and indeed they highlight that it is not likely that there is a single causing factor. Instead they ask how well each approach explains the facts. Although I think this way of presenting the possible causes of US external imbalances is a very helpful way of cutting through the complexity, it did result in some evidence and arguments being repeated.

The authors draw several broad conclusions from their review. First, the trade perspective is not very helpful for understanding the evolution of the current account or its sustainability. This conclusion is based on the observation that the decline in exchange rate pass through has dampened the extent to which exchange rate changes can provide an equilibrating force through expenditure switching. This is also used as one argument for why a liberalisation of the Chinese exchange rate is unlikely to significantly improve the US trade balance on its own. The ineffectiveness of relative prices implies that most of the adjustment to the trade balance must come through demand.

From this point, the authors draw their second conclusion that national accounting approaches suggest the main source of the deterioration in the US current account balance is the decline in household savings on the back of rising house prices and low interest rates. Looking at savings and investment imbalances from an international perspective, the authors argue that the Bernanke thesis, which contends that excess saving in the rest of the world has caused the US current account deficit, does not fit all the facts. In addition, they argue that there is a distinct difference between foreign savings causing the US current account deficit and the US currency account deficit accommodating foreign savings, and that the facts do not preclude the alternative explanation that easy monetary policy was an important factor.

Finally, the authors conclude that the perspective offered by financial flows and evolution of financial markets is a very important part of the story. They find some support for the New Bretton Woods thesis, insofar as they find compelling reasons for some countries to accumulate current account surpluses and therefore to fund the US current account deficit. They support the contention that the United States benefits from its special position at the centre of the international financial system and from acting as a venture capitalist by borrowing through low-yielding, low-risk assets to fund purchases of higher-return more risky assets. The authors also find that some weight should be given to the evidence that home bias is falling. This is consistent with the observed increase in gross financial flows and suggests that the level of the US current account could be, at least partially, the result of a transition to a new equilibrium.

After discussing the possible causes, the authors turn to the task of thinking about sustainability. They consider the standard sustainability calculation that asks the question what current account balance is required to ensure that the net foreign liability position stabilises relative to GDP. The authors then focus on two interlinked puzzles presented by US external balances. First, how has the US net income balance remained in surplus even as the net international investment position has deteriorated? The accounting answer is that the US has a higher share of more risky, high-yielding items in its assets than in its liabilities, and earns a higher yield on its FDI abroad than foreigners earn on their FDI in the United States. They put forward differences in the age of asset and liability stocks as the most persuasive explanation for this latter point, but ignore a number of alternative explanations such as differences in reported income driven by tax incentives.

The second question considered is how has the net international investment position stabilised even as the current account has deteriorated? They point to the importance of 'other' valuation effects, and discuss some explanations such as the dark matter hypothesis. Although they correctly note that valuation changes associated with exchange rate movements average to zero over time, they do not discuss the importance of these effects for sustainability during a period where there is a significant depreciation of the US dollar, which can be large and beneficial given the importance of currency mismatches between assets and liabilities. This effect will be much more important than the effect of currency mismatch on net income flows, which are discussed. The authors conclude that there are clearly unresolved data issues and that the best test of sustainability is the ability for the deficit to continue to be funded.

Until recently, demand for US assets has been supported by capital flows from Asia and from other countries with current account surpluses, such as oil producers. The authors point to a number of reasons for this outcome. First, current account balances reflect differences in demographic structure to some extent – capital should flow from 'older' economies, such as Japan, to 'younger' ones, such as the US. Second, and possibly related, there has been a fall in home bias, which has naturally benefited the United States, which offers the largest and most liquid financial markets in the world. In addition, the pace of financial innovation is faster in the United States. In particular, the authors note the expansion of the mortgage backed security market. They do not predict the future of this market, which was a good decision in light of recent events. The section on sustainability concludes with a discussion of why the authors do not think that the US position as the centre of the international financial system and the role of the US dollar as a reserve currency is in danger, particularly from China.

Reviewed by Alexandra Heath
Bank for International Settlements*

SUERF Publications

New SUERF Studies

2008/1 **Monetary Policy Transmission in Poland: A Study of the Importance of Interest Rate and Credit Channels** by Tomasz Lyziak, Jan Przystupa and Ewa Wróbel. ISBN-13:978-3-41-5

Future SUERF Events

The Council of Management is always pleased to consider suggestions for joint events from members.

12–14 June 2008 Munich, Germany	**27th SUERF Colloquium** *New Trends in Asset Management: Exploring the Implications*, jointly organized with Bayerisches Finanz Zentrum e.V. at the HVB Forum (2 1/2 days), inclusive the **Robert Marjolin Lecture** on *Observations on Future Trends in Asset Management: Challenges and Opportunities* to be delivered by **Robert C. Merton** (2 1/2 days)
11/12 September 2008 Paris, France	**SUERF Conference** *Financing SMEs in Europe* (1 1/2 days) – see **the Call for Papers in this Newsletter** – and **SUERF Annual Lecture**
11/12 November 2008 Luxembourg	**SUERF Conference** *Productivity in the Financial Services Sector*, jointly organized with the Banque Centrale du Luxembourg (1 1/2 days) – see **the Call for Papers in this Newsletter!**

For more details and latest news on SUERF Events and for Registration Forms, please visit www.suerf.org

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* *The views expressed in this review are those of the author and do not necessarily reflect those of the Bank for International Settlements.*