2013 – SUERF’s 50th Anniversary Year

After another active and successful year in 2012, SUERF – The European Money & Finance Forum can really look forward to its 50th Anniversary in 2013, which in itself is no small achievement for a membership-based association. The programme of conferences for 2013 has already been finalised, and we hope that many SUERF members will join the events that we have planned during our golden jubilee year.

We have used the Association’s 50th Anniversary as an opportunity to contact past SUERF presidents and eminent people from money and finance in Europe with SUERF connections to get them to pass on their thoughts about the major changes in money and finance while and since they were actively involved with SUERF. In addition, we have also asked them for their thoughts on SUERF’s role as an association. The first interview, with Niels Thygesen is included in this Newsletter.

An anniversary year is, however, more than just an occasion for looking back at past events, and it is for this reason that SUERF’s events, while reflecting in their locations around Europe the long standing and loyal support provided to the association by our partners in particular in Austria, Finland, France and The Netherlands, are examining issues that are of current and future importance.

Our anniversary year’s programme begins with a one-day conference on “The Future of Sovereign Borrowing in Europe” to be held at the Oesterreichische Nationalbank in Vienna on 8 March 2013, where our secretariat continues to be housed. Participant registrations are already being accepted through the SUERF website. On 13 June 2013, SUERF will once again join forces with the Bank of Finland, for a conference of “Banking after regulatory reforms – business as usual?” to be held in Helsinki. We are particularly pleased that Governor Liikanen will be delivering a keynote address at this event.

On 4 October 2013, we will hold a joint one-day conference with De Nederlandsche Bank and Rabobank Nederlands in Amsterdam on “The value of banks and their business models to society” and the 2013 SUERF Annual Lecture will open this conference. Finally, on 22 November 2013, SUERF will hold a joint conference with the Banque de France in Paris on “The Financial Reconstruction of Europe”, and we are particularly pleased that Governor Noyer will speak at this event.

We are already able to look forward to a full year of SUERF publications – and to tie-in with SUERF’s golden jubilee year, work has already begun on a special 50th Anniversary Volume – to be called “50 years of Money and Finance: Lessons and Challenges” to be published towards the end of 2013. The economic history of the past five decades since the early 1960s will allow conclusions to be drawn for the future. It will focus on important developments and their interrelations. The dramatic changes triggered by the financial and economic crisis, developments and changes in the more recent past since 2007 will of course be given particular prominence. The book is designed to be policy-oriented, practitioner-friendly and should provide value added and new insights, with a European focus, although the analysis will naturally be embedded into the global evolution of economic developments and thinking.

On behalf of the Council of Management, I would like to take this opportunity to thank you for your continuing support of SUERF and its activities, without which the Association would not have been able to operate for the last half a century.

Urs W Birchler, SUERF President
SUERF/Oesterreichische Nationalbank/BWG Conference

The Future of Sovereign Borrowing in Europe

Friday 8 March, 2013

Kassensaal, Oesterreichische Nationalbank
Otto-Wagner-Platz 3, A-1090 Vienna, Austria

Conference Programme

Notes on the Conference Topic:
The financial, economic and sovereign debt crisis has fundamentally changed the rules of the game in sovereign debt markets, particularly but not only in the Euro Area. While some countries enjoy a safe-haven status, others face soaring risk spreads. Sovereign rates of crisis countries have been downgraded dramatically, but also safe-haven countries’ prime rating has been lost or is under close scrutiny. Sovereign bonds as a broad category have lost their – previously widely perceived – status as “risk-free” assets. The crisis countries face unsustainably expensive financing costs (or even a loss of access to bond market financing), pushing them towards shorter financing or forcing them to rely on financial support by other countries and the international community or massive intervention by central banks.

08.30 Registration

09.00 Opening and welcome
   Ewald Nowotny, Governor, Oesterreichische Nationalbank
   Urs Birchler, SUERF President and University of Zürich

09.15 Keynote Session – The Future of Sovereign Borrowing
   Chair: Ernest Gnan, Oesterreichische Nationalbank and SUERF
   The Future of Sovereign Borrowing
   Alessandro Missale, UNCTAD

10.15 Coffee Break

10.45 Session 1 – European sovereign borrowing – adjusting to the new environment
   Chair: Otto Lucius, Austrian Society for Bank Research
   The investor perspective
   Christopher Marks, BNP Paribas
   The issuers perspective
   Hans Blommestein, OECD and Tilburg University
   The crisis resolution perspective
   Juha Kilponen, Bank of Finland

12.15 Lunch

13.15 Session 2 – Sovereign debt, monetary and financial stability
   Chair: Peter Mooslechner, Oesterreichische Nationalbank
   The role of sovereign debt in monetary policy implementation – an international comparative perspective
   Ulrich Bindseil, European Central Bank
   How does the crisis affect the interaction between monetary policy and sovereign borrowing?
   Eric Leeper, Indiana University
   On the treatment of sovereign borrowing in banking supervision and regulation
   Martin Hellwig, Max-Planck Institute for Research on Collective Goods

14.45 Coffee Break

15.15 Session 3 – Towards more prudent sovereign borrowing
   Chair: Martha Oberndorfer, Austrian Federal Financing Agency
   Risk management of debt portfolios
   Maria Cannata Bonfrate, Italian Treasury
   GDP-indexed bonds – a tool to reduce macro risk?
   Mark L. J. Wright, UCLA
   Principles of sovereign lending and borrowing
   Yuefen Li, UNCTAD

16.45 End of Event

Registration & Hotel Reservation Forms: www.suerf.org/vienna2013
In response to the global financial crisis and the large trading losses at many banks, the regulatory reform agenda to limit excesses in banks' risk taking and to make banks more easily resolvable has grown quite ambitious. The Euro crisis has also strengthened the need for an overhaul. In addition to the Basel III reform and the plans to create or strengthen resolution and recovery frameworks for banks, structural reforms have been adopted or proposed, led by the Liikanen Group, Vickers Report and Volcker Rule of the Dodd-Frank Act.

The aim of the regulatory reform agenda should be to improve banks' resilience and to correct for distorted risk-taking incentives, arising from explicit and implicit public safety nets. Prerequisites for stable long-term economic growth should hence be improved. However, significant short-term costs might be involved, arising from the transition and increased uncertainty as regards the final form of the reforms. What will bank business models ultimately look like? Will safety, economic efficiency and true risk-awareness actually improve?

The Bank of Finland-SUERF one-day conference will address these issues in Helsinki on 13th June 2013. All conference speakers will be invited from among leading experts and academic researchers on banking, regulation and supervision.

Further information: www.suerf.org/helsinki2013

SUERF/DNB/Rabobank Conference & 2013 SUERF Annual Lecture
The value of banks and their business models to society
Friday 4 October 2013
Duisenberg School of Finance
Amsterdam, The Netherlands

Further information: www.suerf.org/amsterdam2013

SUERF/Banque de France Conference
The Financial Reconstruction of Europe
Friday 22 November 2013
Banque de France
Paris, France

Further information: www.suerf.org/paris2013
On 5-6 September 2012, Urs W. Birchler, SUERF President and Professor at the Department of Banking and Finance, University of Zürich, opened SUERF’s 30th Colloquium on “States, Banks, and the Financing of the Economy”. Around 120 participants gathered at the University of Zürich, Switzerland, to discuss the complex interrelations between states and financial systems, which have developed over the past five years of the economic, financial and sovereign debt crisis. Instability in banking has spread to states and vice versa, with failures in both sectors looming. Economic and political fragility are feeding each other. The crisis increasingly hurts the real economy. This in turn further worsens public finances and bank balance sheets.

The opening plenary session was chaired by Ernest Gnan, Oesterreichische Nationalbank and SUERF Secretary General. Jean-Pierre Danthine, Vice-President Schweizerische Nationalbank, called his keynote speech “Taming the financial cycle”. The US subprime crisis has had lasting consequences. The ongoing financial crisis has very high costs. There is no room for complacency. Systemic risk arises because an optimising financial institution does not take full account of its influence on other financial institutions. Banking is a high-levered activity and there is a tendency to excess risk taking in good times. During down turns, pro-cyclical behaviour is reflected in the sale by banks of risky assets in order to maintain the capital base in line with regulations or internal risk measures. This implies asset price declines and further worsening of the banks’ capital situation etc. A more comprehensive financial stability framework is needed. It should strengthen the resilience of the financial system and prevent the build-up of imbalances in line with the principle of “Leaning against the wind”. In Switzerland, the interest rate instrument is not available to put a brake on the upturn in the property- and mortgage market due to the situation in the foreign exchange market with upward pressure on the Swiss Franc. So, in June 2012 a new package of measures including counter cyclical buffers (CCBs) was introduced. In boom periods additional capital buffers can be built up, and they can be diminished in down turn periods. The Swiss National Bank can propose to the Swiss Federal Council to activate CCBs, when there is a need to do it. The goal is to smoothen the cycle, but realistically not to remove it. The availability of a tool such as the CCB is a significant step forward. It can and will be used in a balanced and flexible way to deal with specific cyclical risks to financial stability. In the following discussion, it was argued that political disagreement about the need for increasing capital buffers during up-turns could be expected, that it was very difficult to forecast house prices and that there might be a conflict between micro and macro policies.

Axel Weber, Chairman of the Board of Directors, UBS AG started his speech with an evaluation of the current global economic outlook. Growth perspectives are very uncertain. The biggest uncertainty of all concerns the pricing of political risk. Only if the current actions by the ECB succeed, will markets move towards more risk-taking. The downturn in the summer of 2012 is the second leg of a double-dip. European countries lack fiscal space to counter the recession. The US economy is in the process of a cautious revival. But there is high political uncertainty up to the presidential election. The situation may improve after the election. Emerging markets now face inflation problems. They are not able to sustain growth at rates experienced over the past decade. So, the rest of the world cannot draw Europe out of the recession. There are no quick fixes to the European
problems. Europeans are divided about a possible banking union. Structural reforms are urgently needed. Central bank intervention can only buy time. Ultimately, a fiscal union should supplement the monetary union, but it is difficult to see how EU countries would accept the required harmonisation in their budgets. In the financial industry, funding for banks remains scarce. Banks under pressure are backtracking to their home turf. To an increasing extent, domestic banks will finance domestic firms. Cross-border bank business is declining. Banks are cutting costs. The cost of credit will go up. The market for corporate bonds will develop at the expense of direct bank credit. Merchant banking in the traditional sense will be strengthened. Banks will offer their clients corporate equity services. In the years to come, the development of financial markets will depend on a reduction of political uncertainty, better cooperation between regulators and banks and better designed regulation. There is a challenging decade ahead. During the following discussion, the movement of banks back to their core business and to, as Weber argued, “merchant banking” as seen in the 1990s, the difficult search for safe assets, the need for a dialogue between regulators and banks and the fact that some solid corporations can borrow at better terms than their banks and other topics were raised.

Jean-Charles Rochet, Professor of Banking, University of Zurich talked about “Liquidity and interbank markets”. Repo markets have played a big role during the financial crisis. Central banks have established temporary repo facilities in order to provide liquidity to market participants. In the US, a few large institutions have a dominating position in the interbank market. There is a risk of contagion through OTC derivatives dealers. In Europe, there is fragmentation of settlement procedures. The traditional role of banks is maturity transformation – short-term deposits are transformed to long-term opaque loans. We need a new model for dealer banks. In the Northern Rock case, the run was lead by wholesale depositors. There is a complex nexus of OTC transactions, where market participants do not know who their counterparties are. There is uncertainty about loss-sharing rules. A solution could be to adopt a Central Counterparty Model for vital market participants. This would reduce contagion risk and provide more transparency. But of course the centralised clearing process should be regulated.

The 2012 SUERF Marjolin Lecture on “Money and banking in times of crisis” was given by Lorenzo Bini Smaghi, Harvard University. He compared Europe with a journey. The Common Market, EMU and maybe a forthcoming fiscal union are bringing people closer together. The journey entails further political integration. In the US, Alexander Hamilton convinced the Congress to merge the debts of the states. This was vital for the formation of the United States of America. Perhaps something similar could happen in Europe. In solving the current European problems the key questions are: What shall be done? Who should do it? And how? The ECB can only aim at the average economic situation in the euro area as a whole, but there is wide dispersion in the Eurozone. Seventeen governments are accountable to their citizens. The ECB has adapted its monetary policy during the crisis. The move to a system where counterparties can apply for liquidity was intended to be temporary. The unlimited provision of liquidity allowed banks to postpone needed structural changes. With the benefit of hindsight, the ECB Governing Council underestimated the full extent and long-lasting nature of the crisis and initially insisted too much on the temporary nature of non-conventional measures. Cross-border money market flows have declined. Banks refrain from placing funds in stressed countries. We no longer have a single euro area money market. The ECB plays a large role as intermediary in the money market. Claims are safe if channelled through the ECB. More supervisory powers should be transferred to the ECB. In the bond markets, the prevailing spreads are out of line with equilibrium in the Euro area. The monetary policy transmission mechanism needs to be fixed. Markets must be convinced that the ECB and governments will do what is needed. Politicians cannot at the same time ask for more “Europe” and more “sovereignty”. The euro area crisis has reached a stage where member states must commit themselves to deeper European integration and transfer of sovereignty. During the discussion the issue of the exit strategy from unconventional monetary policy was raised. The speaker answered that the ECB will exit from the market, once market functioning and the functioning of the monetary policy transmission mechanism have been re-established. The precautionary demand for liquidity by banks must come down first. When interest rates are raised, the incentives of banks to use the Eurosystem's facilities will fall. The ECB should not, however, communicate that it is ready to exit tomorrow. Another participant questioned whether we can just wait and see. The speaker agreed that the ECB and governments do not have plenty of time left: There is an urgent need to act.
In line with SUERF's tradition, a considerable part of the Colloquium work took place in three parallel commissions, which reflect three key areas of interest in the current crisis: the role of monetary and fiscal policy, the role of markets and financial institutions, and the role of regulation and resolution rules.

Commission I on “The role of monetary and fiscal policy” was chaired by Morten Balling, University of Aarhus and Peter Egger, ETH, Zürich.

Harald W. Stieber, European Commission, explained the complex legal foundation of economic governance Economic and Monetary Union (EMU). The incomplete architecture has contributed to uncertainty in markets about the finality of economic and financial integration in Europe. The speaker focussed on the concept “enhanced cooperation”. In the 2012 Fiscal Compact, the contracting parties express their wish to make more active use of enhanced cooperation. In a diagram, the speaker explained the various methods available to implement economic governance in Europe. Changing the treaties is the most inclusive method, but also the slowest. The intergovernmental method is faster and flexible as it can function with few participants but the flexibility is paid for by lack of enforceability. Opt-out clauses, however, introduce some variable-geometry even in Treaty changes.

Stavros Vourloumis, Athens University of Economics and Business, offered a critical view of the Stability and Growth Pact (SGP). The sanctions that should strengthen the SGP have not been implemented adequately. An important step in changing the framework for coordination and surveillance of fiscal policies is the “European Semester”, put into practice for the first time during the first half of 2011. In December 2011, the “Economic Six-pack” entered into force. It covers fiscal surveillance and the surveillance of macroeconomic imbalances. The package includes increased EU surveillance of national budgets, a new enforcement regime, and an early warning system based on a scoreboard of ten indicators. The principal change introduced by the “Fiscal Compact” is the obligation of member states to maintain balanced budgets or budgets in surplus. The new framework for fiscal policy represents a move from “soft” to “hard” policy coordination. The reforms of the framework were evaluated by the speaker in the three dimensions of governance: obligation, delegation and precision.

António Afonso, ISEG School of Economics & Management, called his presentation “Fiscal policy and growth in the EU”. Government deficits have increased in virtually all countries during the crisis since 2007, and so have debt to GDP ratios. The speaker presented an analysis covering a large number of countries and showed that government size has a significant negative effect on growth. Institutional quality, by contrast, influences GDP per capita positively. When government expenditures are decomposed, the author observed that public wages, interest payments, subsidies and government consumption affect output growth negatively, while government spending on education and health boosts growth. In the following discussion, the increasing demand for public services played a considerable role.

Franco Bruni, Bocconi University focussed on the Italian sovereign debt problem. He listed seven ingredients of a recipe which can contribute to a solution and increase the credibility of national policy makers and European institutions. 1) there should be domestic rules and incentives to adjust fiscal disequilibria, 2) there should be supranational centralisation of economic policy decisions, 3) the central bank should provide collateralized short-term financing, 4) the EU member state governments should, through various technical channels, provide medium to long financing, conditioned by the adoption of economic policies and measures agreed with the Commission, 5) an adequate degree of solidarity should be developed reflecting the fact that financial and economic stability is a collective international good, particularly so in a single currency area, 6) a clear set of appropriate rules for euro-sovereigns’ defaults should be adopted, and 7) European regulation for bank resolutions should be adopted. The need for a credible recipe is underlined by the fact that many European banks continue to have large portfolios of sovereign debt and that the debt levels of several European governments have been, or might be, increased towards unsustainable levels by the costs of bailing out failing banks.

Maartje Wijffelaars, Antwerp University, focussed on the linkages between banking sector performance and government fiscal sustainability. She presented an equation with the factors that influence the current sovereign debt/GDP ratio: the interest to be paid on the debt, the previous debt/GDP ratio, the GDP growth rate, the primary balance to GDP ratio and stock flow adjustments. The interest burden on government debt can have a “snow ball effect”. There is a two-way causal relation between bank weakness and government weakness. Banks’ own government bonds and measures by governments to support the financial system contribute to the growth of the sovereign debt/GDP ratio. The speaker presented a table showing the impact of financial sector crisis support on government debt as a percentage of GDP in some euro-area countries. On top of the recorded sovereign debt there are contingent liabilities related to government guarantees. Her conclusion was that only a full banking union can break the link between banking and sovereign weakness in the euro-area.

Séverine Menguy, Université Paris Descartes, gave an overview of the literature of the advantages or drawbacks of issuing Eurobonds. Partial mutualisation of European sovereign debt could contribute to reducing the risks of speculative attacks against a highly indebted
country, it could reinforce financial stability, and it could contribute to the creation of a deep and liquid market for European sovereign bonds. Mutualisation could, however, also encourage budgetary laxity and create moral hazard problems in some member countries. Common Eurobonds would prevent financial markets from exerting discipline through higher interest rates, and they would undermine the “no bailout clause” that protects member states from liability related to the debt obligations of other governments. Eurobonds seem therefore to necessitate tighter accompanying rules for budgetary discipline. In a model presented, equilibrium of the interest rate on public debt requires very restrictive conditions. The implication is that only “healthy” countries should be allowed to participate in the issuance of common government bonds.

Thorvald Grung Moe, Norges Bank, presented a chapter from recent American economic, financial and fiscal history. The chairman of the Board of Governors of the Federal Reserve System from 1934 to 1948, Marriner S. Eccles, was a close adviser to President Roosevelt and played a key role in the reforms of the Banking Act 1935. He was the main architect of the new Federal Reserve System. After the Second World War under President Truman, he was deeply involved in a conflict over coordination of monetary and fiscal policies between the US Treasury and the Fed and also in the formulation of the Accord in March 1951, which solved the conflict. The speaker gave an overview of some lessons from the 1951 Accord with relevance for the current fiscal and financial crisis in Europe: There is a permanent need for coordination between fiscal and monetary policies. Central banks should not be omnipotent. Central banks should fight inflation but also prevent deflation. Central banks need to regain control of the money supply. Central banks should support fiscal policy in a depression. Against this background, the speaker concluded that a change in the current central banking paradigm is needed; according to him, is time for a more balanced central banking paradigm supporting compensatory policies – in the spirit of Eccles.

Georg Erber, German Institute for Economic Research, Berlin, raised the issue of “What is unorthodox monetary policy?” The speaker explained how the ECB and Fed gradually have been involved as lenders of last resort to distressed governments, which could no longer refinance their deficits in private capital markets. Central banks have provided easy credit to finance unsustainable public deficits. The ECB has lowered its standards for repo operations and is running a risk of losses from toxic assets accepted as collateral. The ECB has become a stakeholder in a possible Greek default. Mario Draghi’s plan for the purchase of sovereign bonds is a high-risk strategy. Its success depends on the willingness and ability of the crisis countries to get their economies back on track. The plan faces strong resistance from Germany.

The Bank of England and the Fed have already become institutions to finance public deficits on demand.

Allard Bruinshoofd, Rabobank presented a paper by Wim Boonstra, who is a member of the European League for Economic Cooperation. It contained a proposal for a temporary programme of short-term Eurobonds (euro T-bills). He argued that the introduction of effective Eurobonds could restore calm to financial markets without introducing moral hazard. The fragmentation of bond markets means that financial markets have the possibility of speculating against the continued existence of the euro zone. This fragmentation is one of the euro zone's biggest design flaws. Eurobonds are bonds issued by a central European agency in order to finance participating member states' national debt. In order to be successful, a Eurobond programme should: 1) give all countries access to funding under reasonable conditions, 2) produce notable benefits for all participating states, 3) have a disciplinary effect on policymakers, 4) preferably be self-funding, 5) break EMU member states' strong financial links between national governments and local banking systems, and 6) free the ECB of its interventions in national sovereign debt markets. The programme should be open to all solvent member states.

Francesco Passarelli, University of Teramo, treated systemic financial risk as a pollution issue. He compared financial regulation with taxation. In the real world, dominated by uncertainty and asymmetric information, policymakers usually choose financial regulation to curb investors' risk taking, while taxation is used to a lesser extent. Measuring the toxicity of financial instruments is difficult. Rules and taxes are applied to differently distorted measures of toxicity. He considered a tax on financial transactions. A political distortion may occur when the decision about taxes is made by voting. This may cause inefficiency losses. However, the distortion is considerably different when voting concerns a tax instead of a rule, especially if there is a problem of measurement bias. Too restrictive rules are more likely to emerge than too restrictive taxes. The cost of regulation tends to be concentrated on high risk investors. The burden of a tax on transactions will to a large extent be carried by small risk investors. This helps us to understand reality, in which taxes on risky financial instruments are usually rare and low, whereas financial regulation is much more frequent.

Dieter Wirth, PricewaterhouseCoopers, Zürich, called his presentation “Taxation as a threat to banks: FTT as example”. Statistics on taxes borne and taxes collected by the speaker mentioned corporation tax, withholding tax, securities transfer tax, value added tax, and several other tax types. He gave a survey of securities transaction tax systems in selected countries. On top of the collection of
the various tax types, the financial industry carries the cost of tax compliance. So, taxation is a threat to banks. Commission 2 on “The role of markets and financial institutions” was chaired by Catherine Lubochinsky, University Paris 2, and Bertrand Rime, Schweizerische Nationalbank.

Malgorzata Pawlowska, National Bank of Poland, looked at the substitution between trade credit and bank credit during credit rationing. The econometric model used panel data for 2001 to 2009 from information reported by Polish enterprises. The study shows that substitution of bank credit by trade credit is intensified in times of financial crisis (2008 and 2009). Companies for which access to credit is limited raise funds through trade credit, i.e. they borrow from their suppliers of goods and services. Small companies are influenced by restrictive credit policy to a greater extent than large companies.

Simone Westerfeld, University of Applied Sciences Northwestern Switzerland, presented a study of credit assessments for 3542 small businesses by nine Swiss banks using an identical rating model over the period 2006-2011. The aim of the study is to assess loan officers’ use of discretion to smoothen credit ratings of their clients and to assess whether this use of discretion is driven by information about the creditworthiness of the borrower or by the insurance of clients against fluctuations in lending conditions. The study shows that loan officers make extensive use of their discretion to smoothen clients’ credit ratings across all rating classes. Discretionary rating changes seem to have limited power in predicting future loan performance, indicating that the smoothing of credit ratings is only partially driven by information about creditworthiness.

Jana Ohls, Deutsche Bundesbank, presented a paper on “Banks and Sovereign Risk: A Granular View”. Sovereign bonds play an important role for the risk management of banks and were typically considered to be the safe assets by banks and regulators. But the European sovereign debt crisis has shown that this assumption might be violated, and there may be negative feedback loops between sovereign stress and risk in the banking sector. The authors analyzed bank-level incentives for investments into sovereign bonds and the impact of these investments on bank performance. Using detailed bank-by-bank data taken from the Deutsche Bundesbank’s Securities Holdings Statistics, the authors investigated the determinants and effects of investments into sovereign bonds before and during the sovereign debt crisis, as well as contagion from sovereign risk to risk in banking working through banks’ sovereign bond holdings. They found, first, that larger banks and banks with a greater securities portfolio invest more into a particular country, and sovereign bonds issued by larger countries attract higher average volumes of investment. Second, banks with a low degree of capitalization (and in

this sense more risky banks) invest more into sovereign bonds. Splitting the sample into different banking groups, the authors found that for the smaller savings and cooperative banks, sovereign bond holdings seem to have an impact on performance. Third, banks have restructured their portfolios away from relatively risky assets in the European periphery to relatively safe assets from France and Germany. Thus, the determinants of banks’ foreign assets change over time.

Per Östberg, University of Zürich, looked at the connection between the interbank market for liquidity and the broader financial markets. The existence of this connection has been documented by the recent financial crisis, which saw both a breakdown in the interbank market and a collapse in the prices of financial assets. The focus of the presentation was, however, rather on the day-to-day interaction between the interbank market for liquidity and financial market activity. The so-called liquidity pull-back hypothesis addresses how demand for liquidity by banks influences financial market activity.

Pierre Pessarossi, University of Strasbourg, presented a study of debt choices by Chinese firms between bonds and syndicated loans. Floating costs, asymmetries of information, and renegotiation and liquidation costs influence the choice of debt in line with former studies in the context of regulatory influence in the bond market. The role of central state ownership on debt choice is included in order to assess to what extent corporate debt choices are politically or economically driven. On the basis of a dataset of 220 listed Chinese firms the authors conclude that central state owned firms are more likely to issue bonds. Financial factors seem to play a minor role in corporate debt choices compared to other countries.

Zeynep Önder, Bilkent University, Ankara, looked at the lending activities of respectively state-owned and privately owned banks during the period 1992-2010. The aim of the study is to find out whether the credits these banks provide affect local economic growth in Turkey during crisis periods and in election years. The share of state-owned banks in the credit market is found to be significantly higher than the share of private banks in crisis periods and local election years. Although state-owned banks might issue loans for political reasons during election periods, they can still have an important role in offsetting the adverse effects of economic shocks, especially in developed regions, and in smoothing credit cycles.

Mohammed Omran, Arab Academy for Science and Technology, Alexandria and IMF, presented a study of 12 Egyptian banks from 1996 to 1999, during which control was transferred from the state to the private sector. The aim was to analyse the impact of bank privatization, which is an important issue for the Egyptian economy. The results from post-privatization provide strong evidence that banks with higher private ownership involvement are associated with a better performance.
Peter H. Egger, ETH Zürich, analysed regional policy in the European Union. He presented an analysis of EU structural funds transfers to regions of EU member states below a certain income level. It turns out that only a minority of the regions is able to turn transfers into faster per-capita income growth and per-capita investment. The speaker argued that differences in the absorptive capacity of the recipient regions to a large extent explain differences in the effectiveness of such transfers.

Commission 3 on “The role of regulation and resolution rules” was chaired by Patricia Jackson, Ernst & Young and Ernst Gnan, Oesterreichische Nationalbank.

Lev Ratnovski, IMF, looked at the link between bank bailouts and bank risk taking. The expectation of government intervention in favour of failing banks creates moral hazard and encourages risk-taking. However, when a bank's success depends on both its idiosyncratic risk and the overall stability of the banking system, a government's commitment to shield banks from systemic risk may increase their incentives to invest prudently. The issues are explored in a model of financial intermediation where a bank's survival depends on another bank's success. The positive effect from systemic insurance may dominate the classical moral hazard effect when the risk of contagion is high.

Andrew Gimber, European University Institute, looked at the design of bank resolution regimes. He presented a theoretical model in which a government must decide how much to invest in the efficiency of its resolution regime. In the presence of moral hazard, the optimal policy can depend on whether or not the government can costlessly commit not to bail out failed banks. The benefits of improved bank resolution regimes and similar reforms may be greater than a consideration of their ex post benefits alone would suggest. At the end of the Colloquium, the author was awarded the Marjolin Prize 2012 for having made the best contribution to the Colloquium by an author below the age of 40.

Rajna Gibson-Brandon, University of Geneva, examined the relationship between banks' lobbying activities, their size, financial strength, and sources of income. Banks are, according to the study which uses US data, more likely to lobby when they are larger, have more vulnerable balance sheets, are less creditworthy, and have more diversified business profiles. There is also a tendency that banks engaged in securitization, trading and insurance, hire more lobbyists and spend more on lobbying.

Laurent Weill, University of Strasbourg, presented a study in which the influence of bank ownership on credit supply in Russia is examined. It seems that bank ownership affected credit supply during the recent financial crisis. Foreign-owned banks reduced their credit supply by more than domestic private banks, while state-controlled banks reduced their credit supply less than private banks. One interpretation is that foreign banks are “less loyal” to domestic customers during a crisis. Another interpretation is that state-controlled banks are more inclined to support the domestic economy during economic downturns.

Linh Nguyen, Monash University, Australia, examined the association between government ownership and bank stability over the years 1997-2010 across a sample of 103 countries. The background is that the share of banks owned completely or partly by governments globally has increased somewhat in recent years. The association seems to depend on a country's economic development and regulatory quality. In rich developed countries, the degree of government ownership is positively associated with bank distance to default. Contradictory findings are reported for developing, middle and low-income countries. Bank distance to default is positively associated with efficiency and bank capitalization.

Leonard Nakamura, Federal Reserve Bank of Philadelphia, tested whether, as is commonly assumed, the riskiness of bank loans is fully captured by bank internal ratings. The data are drawn from the interagency Shared National Credit (SNR) Review, which has been performed annually from 1977 to 2010. The study suggests that while the banks in the US whose loans are observed do appear to generate private information about the riskiness of their loans, the riskiness of these loans is not fully captured by bank internal ratings and may be improved by adding information from bond rating agencies despite the fact that the ratings of the latter are public information.

Anna Hryckiewicz, Goethe University, Frankfurt and Kozminski University, Warsaw, asked whether government interventions restore or destroy financial stability in the long run. She argued that in general, government interventions have a negative impact on banking sector stability, increasing its risk significantly. According to the evidence presented, government involvement in the banking sector exerts a negative effect on credit supply, reducing its availability to borrowers. Nationalizations and asset management companies contribute most to these effects. The evidence strongly encourages regulatory authorities to rely on market mechanisms for resolving systemic banking crises.
Mark Mink, Dutch National Bank and University of Groningen, studied the relationship between bank risk-taking and the existence of a “Lender of Last Resort” (LLR). Banks are stimulated by the LLR to increase leverage, diversify, and lower their lending standards. When competing banks pass on the gains from maturity transformation to their customers, lending standards deteriorate. The interplay between these factors can put at risk systemic financial stability. The provision of illiquidity insurance by the LLR is a particularly important institutional arrangement. This is demonstrated by use of a stylised approach. Banks can effectively borrow at a lower cost than their shareholders such that bank leverage increases shareholder value.

Alex Cukierman, Berglas School of Economics, CEPR and Tel-Aviv University, gave a presentation about regulatory reforms and the independence of central banks and financial supervisors. One beneficial effect of the crisis is that it induces institutional changes designed to reduce the likelihood of systemic crises through reforms of the regulatory and supervisory systems. The short-run response of monetary policy, and subsequently of fiscal policy, has created a new state of affairs in which the central bank holds a large share of debt in the economy and in which the share of public debt in GDP is expected to increase substantially. When the economies emerge from the crisis, this new state of affairs may create a painful trade-off between price stability and financial stability. The central bank’s role as owner of many sovereign bonds and its potential role as macroprudential regulator have implications for central bank independence and the independence and professionalism of other financial regulators.

Andreas Pfingsten, University of Münster, presented a model to analyze the regulatory risk assessment of individual banks. The model uses a unique database on German banks' supervisory risk profiles from the years 2006 to 2008. It uses both quantitative and qualitative factors. The quantitative factors are based on the so-called “Camel Rating”: A bank specific CAMEL-vector contains the financial profile components: Capital Adequacy, Asset Quality, Management, Earnings and Liquidity. The qualitative factors are taken from the German supervisors' partial grading of the banks' internal governance, its internal capital adequacy assessment process (ICAAP), interest rate risk, and other qualitative risk categories. Better capitalization and bank reserves, higher profitability and large asset growth increase the likelihood for a bank to be graded in a better risk profile category.

Edward J. Kane, Boston College, discussed gaps and wishful thinking in the theory and practice of financial regulation and supervision. Safety-net subsidies were characterised by the speaker as the favourable side of an implicit political contract that allows regulators at their discretion to transfer losses incurred by large and politically powerful institutions to ordinary taxpayers. There exists in fact a shadowy “taxpayer put”, which is not reported in government or bank accounting statements and therefore not understood clearly by those who are obliged to pay the bill for its exercise (i.e. taxpayers). The speaker proposed that banks and their regulators should be obliged to measure and disclose variations in the size of the taxpayer put, when the safety nets are adjusted, and to strengthen regulators with technical expertise and sufficient ethical commitment to control the regulated on behalf of the public.

The closing plenary session, chaired by Haig Simonian, most recently Swiss Correspondent for the Financial Times, featured four speakers from the central banking and financial practitioners’ community.

D. Wilson Ervin, Senior Advisor to the Chief Executive Officer, Credit Suisse, opened the session with a presentation of Bail-in, an idea launched by him in early 2010. Bail-in is a way to resolve banks safely and handle cases of financial difficulty. He pointed out the multitude of solutions on the table to solve the current crisis and to prevent future crises. Some of these proposals are good, many are irrelevant, and some are outright detrimental. The Financial Stability Board has devised three options in case a bank becomes insolvent: first, to sell the bank – this solution is useful only for small banks and may cause severe challenges as a consequence of the takeover. Second, bridge banks are a time-tested and useful tool but often the bridge bank relies on some sort of state protection. The third idea, which works without resorting to taxpayers' money, is to recapitalise banks through a bail-in of stock and bond owners. In effect it amounts to a high-speed recapitalisation of banks without the injection of government funds, while systemic functions and customer activities are unaffected, thus preserving the bank's franchise value for creditors. It may be seen as a US Chapter 11 procedure adapted to banks. Using the example of the Lehmann failure, he showed that a bail-in could have saved Lehman Brothers at a much lower cost to stock and bond owners, while in addition avoiding the huge systemic consequences caused by the failure of Lehman. Bail-in should work not only for individual situations, but also in the case of a larger systemic event. Bail-ins would solve many moral hazard problems associated with state-sponsored bank rescue actions, while at the same time avoiding contagion effects to be expected in the event of failure. Bail-in is now in effect official US policy, not least since there is no more public willingness to use any further public funds to rescue banks. Also in the euro area, bail-in is actively discussed. Switzerland was a very early mover in this discussion; contingent capital can be thought of as a structured, contractual form of a bail-in mechanism. The issue currently discussed actively is whether the mechanisms should only relate to Switzerland itself or whether a global approach should be taken. In the view of the speaker, the latter route would clearly be preferable.
Stephen Cecchetti, Chief Economist, Bank for International Settlements, raised the issue as to whether, in the light of the crisis, we need to reassess the impact of finance on growth. On the one hand, well developed financial systems contribute to growth by reducing transaction costs and by improving the allocation of capital and risk. On the other hand, there is also a “darker side”: the financial sector can detract resources from other important tasks. It can create vulnerability and misallocate resources. Thus, the current consensus is that the relationship between financial development (proxied e.g. by financial sector employment or financial sector value added) and labour productivity growth is inversely u-shaped. I.e. beyond a certain point, further development of the financial sector becomes detrimental to growth, and therefore also undermines a state’s tax base. The negative externality from over-developed financial systems would call for the introduction of a Pigovian tax to internalize these costs. In other words, one could argue in favour of something like a carbon tax on excessive finance. According to BIS estimates, the turning point may be in the order of magnitude of 3.2 % of employment and 6.5 % of value added by the financial sector in the total economy. Clearly, prior to the crisis, financial sectors in countries like Canada or Ireland were too big by this measure. Action by Switzerland and other states to reduce their financial sectors thus seems to be appropriate. On the other hand, Ervin pointed out that financial sectors may also be seen as an important export industry, which may justify big financial centres.

Martin Maurer, Secretary General, Association of Foreign Banks in Switzerland, pointed out the great uncertainty about banks’ and other financial intermediaries’ behaviour during the transition to tighter financial sector regulation. Herd behaviour may ultimately just move, rather than reduce, risk. He also argued for simpler supervisory rules. Current regulation also pushes out small banks. The current discussion of breaking up too-big-to-fail banks should also be seen in conjunction with the experience that most recent large bank mergers ultimately failed. Shareholders’ interests should gain more weight compared to managers’ in such far-reaching decisions.

Yves Robert-Charrue, CEO Switzerland, Bank Julius Baer, remarked that his institution is a mid-sized bank, “small-enough-to-fail”, which focuses on private banking and operates globally. Any bank needs to sometimes balance conflicting interests of clients and shareholders. The larger the bank, the more difficult this trade-off may become to solve. Currently, there is too much credit in the financial system, an issue that needs to be resolved as a precondition for lasting economic recovery.

In the ensuing discussion, Haig Simonian asked the panellists about how worried they were about the current situation, in particular in Europe. After all, history – including the more recent examples of Iceland and Ireland – has shown that, albeit after severe downturns and with huge costs incurred, ultimately economies recover after financial crises. Ervin emphasised that there are important outstanding issues to be solved before financial markets become more confident. Before this, there may well be several further cycles of hope and disappointment. Cecchetti stated that regulation is never final, and will always provoke reactions by market participants, and thus needs to evolve continuously. Charrue expressed deep concern about the further development of European crisis countries.

Regarding the relationship between governments and banks, and government intervention to rescue banks, Simonian pointed out many possible examples of successful bank rescues. According to Robert-Charrue, more state intervention and regulation implies higher costs for banks, which ultimately will end up with customers. Maurer had no big concern about more post-crisis state involvement in banks. According to Cecchetti, states’ involvement in banks varied across countries, but there has always and generally been substantial state involvement in banks, as part of industrial policy. This also reflects, according to Ervin, banks’ involvement in money creation, but now, state involvement has gone too far. With regard to the impact from financial markets on the real economy, Robert-Charrue saw substantial effects from the financial sector, both prior to and during the crisis (bubbles, recessions etc.). The coming challenge will be inflation. Maurer raised SMEs’ insufficient equity in Switzerland which may hamper their credit financing as well. Cecchetti emphasised much further need for balance sheet repair both among banks and borrowers from the real economy. Ervin pointed out a tendency towards renationalisation of banking, with banks refocusing on their home core markets and, if squeezed, withdrawing from foreign markets.
Property prices and real estate financing in a turbulent world

Report on the SUERF/Nykredit Conference in association with Danmarks Nationalbank held in Copenhagen on 15 November 2012

By Morten Balling, SUERF, and Jesper Berg, Nykredit

75 conference participants gathered in the auditorium of Nykredit on the harbour front in central Copenhagen. Jesper Berg, Senior Vice President, Regulatory Affairs and Rating, Nykredit and Frank Lierman, SUERF Vice President and Belfius Bank gave welcome addresses.

The first session was chaired by Ernest Gnan, Oesterreichische Nationalbank and SUERF. Per Callesen, Governor, Danmarks Nationalbank gave a presentation “Property prices, debt and financial stability”. He characterised the subsequent documentation as stylised facts rather than scientific evidence. The speaker showed in several diagrams the development of house prices in a number of European countries. In many countries, house price movements tend to be correlated with output gaps. In Denmark, another important factor is the tax value of interest rate deductions, which has been reduced in steps since 1982. Movements in the after-tax interest rate tend to be correlated with movements in real house prices. Whereas changes in interest deductibility has made house ownership less attractive, recent changes in property taxes has had the opposite effect. One diagram illustrated the development of property and land taxation in Denmark. The property tax curve for owner occupied single family houses has been completely flat for several years due to a political decision by a majority in the Danish parliament. The speaker characterised the policy of keeping property taxation low also in boom periods as “not healthy”. Over the years, there have been many changes in Danish mortgage market regulation. The mixture between annuity loans, loans with constant instalments, fixed rate and floating rate loans, and interest only loans have changes several times. With reference to the implications for financial stability, the speaker seemed to have a sceptical attitude to floating rate loans and interest only loans. In a slide, housing wealth, pension wealth, other financial wealth and net wealth in a sample of countries were compared. In Denmark and the Netherlands, both pension wealth and debt represent a high proportion of disposable income. The build up of gross positions reflected favourable tax treatment of both debt and pension. Thus, one should be careful not to interpret the large household debt as a source of weakness. Other slides illustrated recent data on housing expenditures in per cent of disposable income, arrears on mortgage or rent payments and loan impairment and foreclosures. In Iceland, Greece and Ireland, property owners and mortgage lenders seem in recent years to be in more serious trouble than owners in the Northern part of Europe. The speaker concluded by repeating that in all countries tax policy matters a lot for the property market.

Giovanni Favara, IMF gave a presentation “Credit supply and the price of housing”. The underlying paper is co-authored by Jean Imbs, Paris School of Economics. The authors identify exogenous shifts in the supply of credit through changes in the regulation of credit, trace their effects on the size and standards of mortgage loans,
and evaluate their end impact on house prices. In the US it is possible to point out episodes of interstate branching deregulation that can be used to answer the questions: 1) did branching deregulation impact the mortgage market? 2) did branching deregulation impact house prices? And 3) is the end effect on house prices channelled via a response of the mortgage market? Detailed information on mortgage loans is available from the Home Mortgage Disclosure Act (HMDA) database. County-level house price indexes are available from Moody’s Economy. com. It is thus possible to document that the lifting of branching restrictions increases the number and volume of mortgage loans and decreases denial rates. Deregulation enables non-local banks to enter new markets and obtain real geographical diversification gains. Based on a comprehensive regression analysis, the speaker concluded that a causal chain from deregulation via mortgage credit to house prices has been uncovered.

Session 2 was chaired by Klaus Willerslev-Olsen, Danish Bankers Association. Kristian Vie Madsen, Deputy Director, Danish FSA gave a presentation on “How legal rules on loan-to-value ratios, maturity, repayment profiles and refinancing options can contribute to financial stability”. The speaker started with a number of diagrams which illustrated the price development in Denmark of owner occupied houses, rented houses, agricultural properties and other types of real estate. Impairment rates on mortgage loans have varied considerably across different types of property. Recently, developers and farmers have caused relatively high losses for banks. Losses in mortgage institutions have been much lower than losses in commercial banks. From 2008 to 2010 there was a decline in lending by banks and mortgage institutions. The FSA uses a so-called “Supervisory Diamond” as a tool to assess the potential vulnerability of a bank. The “Supervisory Diamond” includes inter alia measures of capitalisation, liquidity, large exposures and exposures to real estate. The experience shows that many banks with a high exposure to the commercial property market have been in trouble. The FSA has also formed a task force on how to deal with price bubbles on the property market. It aims to further better risk management in banks. In Norway, Sweden and Finland, the supervisory authorities have issued guidelines that should put limits on leverage and improve the credit evaluation of mortgage borrowers. In Denmark, there are loan-to-value (LTV) requirements for mortgage banks. However, the LTV requirements are not adjusted to reflect risks of a price bubble. In addition to adjusting lending limits, changes of capital requirements may be used counter-cyclically. In response to a question from the audience, the speaker confirmed that the potential use of variable capital requirements had to be planned within the framework of EU’s Capital Adequacy Directive.

The title of the next presentation by Thomas Sangill, Danmarks Nationalbank was: “Liquidity of Danish real estate mortgage bonds versus liquidity of Government bonds”. The relevance to banks of liquidity has been enhanced by the recent Basel proposal on a liquidity coverage ratio (LCR) requiring banks to hold a buffer of high quality liquid assets (HQLA). A 2008-2012 diagram with outstanding government bonds and covered bonds broken down by investor sector shows that Danish MFIs own a considerable part of the outstanding covered bonds and only have limited government bond holdings, reflecting the low Danish government debt. Data on liquidity comes from MiFID transaction reports 2007-2011. The dataset includes all transactions in Danish government and covered bonds carried out by an investment firm or a credit institution in the EU as one of the counterparties in the transaction. All transactions below DKK 10 million are removed. In the sample, short-term covered bonds are defined as bonds with maturities less than 1.2 years while long-term covered bonds are standard 30-year fixed rate callable bonds. In the sample, short-term government bonds have a maturity of less than 5 years while long-term government bonds have maturities from 5 to 10 years. By means of a measure of price impact and a measure of liquidity risk the speaker characterises the behaviour of the bond markets in respectively a crisis period (August 2008-December 2008), a post-crisis period (December 2008-April 2010) and a sovereign crisis period (May 2010-December 2011). The conclusion of the analysis is that the differences between liquidity and liquidity risk in the two markets are economically small and that both markets were fairly liquid during the crises. There is therefore no empirical support for the BCBS proposal of giving covered bonds a lower weight than government bonds in the LCR.

Session 3 was chaired by Esa Jokivuolle, Bank of Finland and SUERF. John Muellbauer, Nuffield College, Oxford University gave a presentation: “When is a housing market overheated enough to threaten stability?” In many countries, house prices are subject to boom/bust cycles and in some these are linked to severe economic and financial instability. In the decade 1997 to 2007, the rise in real house prices was unprecedented in many countries. OECD data allows cross-country comparisons of boom/bust cycles in property prices. The speaker selected respectively four Anglo-Saxon countries, four countries from the Eurozone and a special group consisting of Germany, Italy, Japan and Korea. A great heterogeneity in boom/bust cycles appear.

Researchers at IMF have constructed indicators, which should reflect house price gaps. These indicators were criticised in rather tough terms (“Sausage-machine approach” to large multi-country data sets) by the speaker for having too weak a theoretical foundation. Feedback loops via construction, via consumption and via the financial system are ignored. Much depends on the land use planning regime, which profoundly affects
the supply response. It is, according to the speaker, high
time that central banks and other policy makers conduct
regular quarterly surveys of house price expectations
of potential housing market participants to help assess
the degree of overshooting. Credit supply conditions
in the mortgage market are the “elephant in the room”.
You need to take them into account. A credit conditions
index can be extremely useful, but the results need
careful interpretation. Important factors to include are
the vulnerability of consumption to higher levels of
household debt, the degree to which mortgage debt has
floating interest rates, and the role of property taxes.
Because of the large number of determining factors and
important feed-back loops, any model of early warning
must be rather complex.

The next presentation “Identifying the fundamental
economic trend of commercial real-estate in UK: with
applications to pricing derivatives on the IPD Index”
was given by Radu S.Tunaru, University of Kent. He
investigated empirically what determines the dynamics
of an Investment Property Database Index (IPD), which
is representative for commercial real-estate in the UK.
The analysis covers the period January 1987 to December
2011, and it is conducted at monthly frequency and at
quarterly frequency. The motivation is to provide a tool
for pricing IPD property derivatives and other investment
and risk management applications based on these financial
products. The model can be used for risk management
purposes and for trading strategies. A model-determined
fundamental economic term (FET) return is confronted
with the actual observed index return. When, during a
boom, the observed index return departs from the FET
return too much and for too long, then the fall in the
property prices becomes inevitable. The speaker used the
expression “market sentiment” to describe the reason for
the difference between observed and FET-based property
prices. Between January 1993 and July 2007, all IPD
index logarithmic returns were positive. After 2007, they
were negative but to a different extent. The variables
spanning the FET returns at monthly and quarterly
frequencies are often quite different. Large departures
from FET signal market corrections. Hence, the model
can be used not only for pricing IPD derivatives but also
as a basis for trading strategies and policy making and
intervention.

Session 4 was chaired by Philipp Hartmann, ECB and
SUERF Giovanni Dell’Ariccia, IMF gave a presentation
“Dealing with real estate booms: Policy options and
institutional design”. Before the crisis, monetary policy
focussed on inflation and the output gap. Asset prices
were a concern only through their impact on GDP and
inflation. Benign neglect was justified by the observation
that bubbles were difficult to identify, and that the costs
of cleaning up afterwards were limited. Then the crisis
came with enormous negative consequences. The limited
effectiveness of traditional policies was demonstrated and
there were large fiscal and output costs. A benign neglect
approach could no longer be accepted. There were,
however, problems and difficult trade-offs with a more
interventionist strategy. It was difficult to detect bubbles
in real time. There were risks associated with pricking
bubbles and with the ineffectiveness of traditional
policies. Housing markets are special: Many owners
are highly leveraged, houses represent large storages
of wealth, and there are major supply-side effects and
network externalities. The speaker presented a diagram in
which historical house price appreciation was confronted
with mortgage delinquencies in different states in the
US. In another diagram, house price appreciation in a
sample of countries was confronted with indicators for
the severity of crisis. The bottom line is everywhere that
there seems to be a strong association between real estate
boom-busts and financial distress. Leverage is key. In
his conclusion, the speaker described advantages and
disadvantages of using respectively monetary policy and
macro-prudential tools to deal with real estate boom-
busts. Ensuring financial resilience and avoiding boom-
bust cycles are not mutually exclusive. The division
of responsibility for respectively monetary policy and
macro-prudential policy depends on the institutional
design. He mentioned pros and cons related to separate
agencies and a centralised organisational structure.

The next presentation “Macropreudential measures,
housing markets and monetary policy” was presented by
Margarita Rubio, Banco de España. The recent financial
crisis has made clear the necessity of introducing policies
and regulations that restrict credit. In many countries,
loan-to-value (LTV) ratios had increased a great deal,
enhancing the housing bubbles. New policy intervention
may follow a so-called macropreudential approach to
mitigate systemic risk. Tools should dampen the build-
up of financial imbalances and thus build defences that
may contain the speed and sharpness of subsequent
downsprings and their effects on the economy. The
housing sector plays a key role during crises. It is crucial
to understand how the new macropreudential measures
affect the conduct of monetary policy. In the presented
paper, the author tries to evaluate the effects of a rule
on LTV. This is done by means of a DSGE model with
equations for saver, borrower and firm behaviour. The
author assumes that there is a macropreudential Taylor-
type rule for the LTV ratio, so that it responds to output
and house price changes. During booms, a lower LTV
is triggered. The effects of three types of shocks are
analysed. It is demonstrated that a LTV rule dampens
the effects of house price shocks and also the response
of inflation to monetary policy shocks. The effects of
different Taylor rules are compared. LTV rules are also
welfare enhancing because they contribute to a more
stable financial system.
The Federal Reserve Bank of ... the role of financial structure and regulation”. The speaker said in his introduction that he would talk about mortgage finance system design, competition between and regulation of financial intermediaries, consumer protection regulation and housing policy. He referred to a comprehensive IMF study of capital inflows and structural factors in credit booms in 47 economies in the period 1960 to 2010. Causality between capital flows and credit booms goes both ways. Particularly in emerging economies, mortgage lending has often been driven by active capital imports initiated by investors seeking attractive investment possibilities, while in industrial countries with highly developed financial markets passive capital inflows often seem to be related to insufficient domestic supply of mortgage financing. On the macro level, European commercial banks did not materially act differently from US institutions involved in mortgage financing. The main carrier of credit boom in both cases was debt securities. Debt securities and transactions via the interbank market allow lending beyond an exhausted local deposit base. Regulators could intervene via leverage, mismatch and valuation of respectively real and financial assets. While LTV ratios generally increased monotonously until the crash, the LTV-curve is hump-shaped in the UK with a maximum in the middle of the 1990s. Americans, despite the high homeownership ratio, do not save ex-ante for housing. In Germany, in contrast, prior savings are required to buy a house or an apartment. Housing demand for those, who have no savings is met by a well developed social housing rental market. Thus, Germany has avoided the subprime problems of the US. Recently, adjustable rate loans (ARMs) have on average been more than 70 % of all loans in Europe. In many countries, they have been introduced by commercial banks in competition with traditional mortgage banks. Collateral valuation seems to be passively tracking house price inflation rather than protecting consumers. In the view of the speaker, a conservative bias was desirable. All in all, regulators should look carefully at rules concerning LTVs, maturities, amortisation, interest-only loans and spreads. Regulators could introduce “Volcker Rules” for the mortgage markets to discourage interest rate risk speculation.

Ronan C. Lyons, Oxford University presented the paper “Inside a bubble and crash: evidence from the valuation of amenities”. The speaker started by saying that property is at the heart of modern economies. Shelter is the most important consumption good. Real estate is the most important investment asset class. It is therefore important to understand the internal workings of the housing market. Housing markets play an important role in the economic history of all OECD countries. Ireland is a particularly interesting case. We need to understand the market for location-specific amenities. We have data on respectively the sales segment and the lettings segment. From consumer attitudes surveys we know that important factors are proximity to employment, environmental amenities and transport amenities. The rich Irish dataset include prices, time, location and property characteristics. The study applies 22 different amenities. Hypotheses concerning property valuation across segments and over the cycle are tested. Proximity to employment is shown to be a primary amenity. As expected, distance to the coast has a positive impact on prices, while distance to polluting institutions has a negative impact. Urban green space and school quality have a positive impact. It is less likely that bubbles overstate the fraction of housing wealth in amenity-rich areas than in low-amenity areas.

Session 6 was chaired by Klaus Kristiansen, Realkredit Danmark. Kevin J. Lansing, Federal Reserve Bank of San Francisco and Norges Bank gave the presentation “Housing bubbles and expected returns to home ownership: lessons and policy implications”. Asset prices appear to exhibit “excess volatility” when compared to the discounted stream of ex post realized dividends or cash flows. Fundamental explanations of volatility require rational agents discount rates to be extremely volatile (e.g., habit formation). If true, then agents should expect low future returns after a sustained price run-up. Survey evidence reveals the opposite: Investors appear to expect high future returns after a sustained price run-up. Models in which agents employ extrapolative or moving-average forecast rules are a promising way to capture excess volatility and can deliver a positive correlation between price-rent ratios and expected future returns. Should central banks take deliberate steps to prevent or deflate suspected bubbles? If so, what policy instruments should be used to do so? A balanced approach involving both macroprudential regulation (first line of defense) and interest rate policy (second line of defense) may be the best way to prevent credit fuelled financial imbalances. The speaker presented several diagrams with loan-to-value (LTV) ratios and debt-to-income (DTI) ratios. There is a clear pattern showing that countries with strong increases in house prices 1997 to 2007 have also strong increases in LTV- and DTI-ratios. Quotations from Alan Greenspan and Ben Bernanke were used by the speaker to demonstrate a gradual change in the attitude of the Federal Reserve concerning the policy to deal with real estate bubbles. From “we do not try to contain bubbles – we focus on policies to mitigate the fallout when they happen” to “pre-emptive action is preferable to cure”. The Financial Crisis Inquiry Commission used strong words in its 2011-report: “in the mid 2000s the authorities demonstrated pervasive passiveness”. Mervyn King, Bank of England was also quoted by the speaker for having said: “Risks must be dealt with beforehand”. 
Session 7 was chaired by Morten Balling, Aarhus University and SUERF. Morten Baekmand Nielsen, Nykredit gave a presentation “Recent developments in mortgage lending in the EU”. It was based on a paper co-authored by Jesper Berg, Christian Sinding Bentzen and Henrik Schönenmann. The speaker started by showing diagrams with stylized balance sheets for respectively deposit taking banks issuing covered bonds and specialized mortgage banks. An important difference between the two types of institutions is that the combination of deposit taking and sale of covered bonds imply a certain subordination of depositors. The speaker listed four possible objectives for mortgage systems: 1) affordability for households, 2) resilience towards falling property prices, 3) robustness during and after periods of stress, and 4) minimization of the need for Government support. The average cost of housing loans in 12 EU countries in 2003, 2007 and 2011 was used to illustrate affordability. It turns out that households in Spain, Ireland and Italy on average face lower interest on their mortgage than the typical German or Dutch household. By combining data on house price dynamics and housing debt dynamics one can make the observation that the countries experiencing the largest pre-crisis increases in house prices also tend to be the countries with the largest declines during the crisis. To some extent resilience can be evaluated by comparing ratings of covered bonds. Collateral risk, with a few exceptions in particular related to countries that have suffered during the debt crisis, does not differ that much. What differs and also matters most is market risk. High market risk can result in demands for overcollateralization of covered bonds well above 50 percent. This can be a severe constraint on lending and also increases the risk of subordination. The robustness of a mortgage system can be evaluated by studying the development of mortgage lending during and after crises. Data shows that growth in mortgage lending in Europe did slow down after the collapse of Lehman, but with the exception of Belgium and Ireland, all countries maintained positive growth rates in mortgage lending. Looking at owner-occupied housing, it is striking that the Nordic countries with their welfare state models seem to have taken a much more market oriented approach to housing finance than the US, where FHA, GNMA, Fannie Mae and Freddie Mac have been supported heavily by the Government. The speaker concluded that European mortgage systems have generally done well in terms of maintaining the capacity to lend during the crisis and with significantly less need for government support than in the US. Within Europe, there seems to be a case for mortgage lending by specialised institutions that do not take deposits, in order to avoid structural subordination, and a strict management of market risk to limit overcollateralization requirements.

The last presentation “Which types of financial institutions are most efficient in housing finance?” (or “The good, the bad and the ugly”) was given by Alan Boyce, CEO, Absalon. The speaker praised the Danish mortgage system. Danish covered bonds are still the safest in the world. Danish borrowers have lots of choices and they are all priced by the bond market. During the crisis, Danish mortgage credit institutions, regulators and the Government have made some mistakes but they have shown leadership on moral hazard and bank resolution issues. A large part of Danish mortgage loans are provided for commercial, agricultural, rental housing and social housing. Those loan segments have natural preferences for adjustable rate mortgages (ARMs). This explains a large part of the Danish ARM issuance. There are roughly 1.2 million households with loans. 44 % of these loans are ARMs. The ARM frequency is much higher for loans to commercial, agricultural, rental housing and social housing. There is some risk, but according to the speaker there is plenty of Danish capital to deal with worst case situations. Based on data on external debt and net financial assets, the speaker observed that Denmark is rich. The Government debt is only 35 % of GDP and the entire pension funding system is solvent at market discount rates and underweighted in mortgage bonds. Households own the country and the companies. Danish households are the most indebted in the Nordic region, but also the most wealthy. Other countries could benefit from introducing the Danish standardized bond market solutions.

The SUERF Vice President Frank Lierman concluded the conference by thanking Nykredit for hosting and sponsoring the event, Danmarks Nationalbank for financial support, the organisers, the speakers and authors and the participants.
In the first in a series of interviews to coincide with SUERF’s forthcoming 50th Anniversary year, Niels Thygesen (SUERF President 1988-1991) reflected on a number of questions relating to SUERF’s activities and Money and Finance in Europe, the hot topics at the time of his presidency and the current situation.

Niels Thygesen is Professor Emeritus of International Economics at the University of Copenhagen. He obtained his undergraduate and graduate degrees there and an MPA from Harvard University. After working for the Danish government, Harvard’s Development Advisory Service (in Malaysia), and the OECD in Paris, he held a Chair at the University of Copenhagen for more than 30 years, serving also as Adviser to the Governor of Danmarks Nationalbank, Chair of the Danish Economic Council and member of various expert groups on European monetary and financial integration – the subject area of most of his research and publications over the last four decades – and international economics. He was an independent member of the Delors Committee which prepared the outline of Economic and Monetary Union in Europe in 1988-9, a member of the committee advising the government of Sweden on an exit from the crisis of the early 1990s, a member of the Group of Independent Experts evaluating IMF surveillance following the Asian crisis, and he chaired the Economic and Development Review Committee of the OECD which evaluates the economic performance and policies of member states 2000-8. He is a Founder Member of the European Shadow Financial Regulatory Committee since 1998 and the only Honorary fellow of the Danish Economic Association.

1. Which monetary and financial issues were at the top of the European political agenda, when you were president of SUERF?

I was elected at the Helsinki Colloquium in May 1988 and stepped down at the Lisbon Colloquium three years later. The main issues at the time - and particularly for me - were the ideas for Economic and Monetary Union in Europe. The Delors Committee on EMU was set up in June 1988, and the Maastricht Treaty was already half way three years later.

2. Which are the most striking changes, when you observe the monetary and financial issues that dominate the European political agenda today?

Completing the work in progress left by the Maastricht Treaty, not least by recognizing that financial integration required some attribution of responsibility for financial stability to the European level.

3. The structure of the European financial industry has changed fundamentally in the last five decades. Which are seen from your perspective the most important causes and implications?

The removal of capital controls, the adoption of the single currency and the liberalization of financial services have all contributed to the integration of financial markets and to cross-border activities by banks, long supported by market participants. In the past three years this trend has, hopefully only temporarily, been reversed, as country risk reappeared.

4. How do you evaluate the interplay between academic research and practice in financial markets and institutions today compared with the interplay, when you were SUERF president?

The interplay has become more intense, particularly with respect to input from financial economists into asset management and into financial regulation/supervision.

5. It is SUERF’s mission to bring academics and financial practitioners, central bankers and supervisors together and to further their mutual understanding of the financial system: Has SUERF in your view been successful in this respect?

This mission has been performed well by SUERF and the intensity and the professional level of conferences and seminars have impressed me greatly over the recent period.
6. If you are asked to list 3 persons who have contributed the most to monetary and financial integration in Europe in the last 50 years, who would you choose? And why?

I would mention Mario Monti who launched the Financial Services Action Programme in 1998, Alexandre Lamfalussy who addressed the weaknesses of EU regulation of financial markets in 2001, having already prepared for the euro and the ECB in 1994-97, and Jacques de Larosière whose 2009 report prepared for European financial supervision. Maybe not by accident, the first two are major figures in the history of SUERF. If one were to name a practitioner, my choice would be Josef Ackermann, CEO of Deutsche Bank and Chairman of the Institute of International Finance, both for more than a decade.

7. What is in your view the proper balance between National and European financial regulation and supervision? Should the ongoing trend towards European solutions continue?

There will always be a role for national supervision, though not regulation, in Europe and we may be going a bit far in assuming that centralization is always preferable, or safer.

8. Since SUERF was established in 1963 we have seen a breakdown of the Bretton Woods System and a global transition to a mixture of floating exchange rates and regional monetary arrangements and unions including the EMU. Have your views on the role of monetary cooperation and integration in Europe changed since you were SUERF president?

No, my views have not changed much. Europe made a constructive contribution to the global monetary system by merging a number of national currencies into the euro, though it has yet to rise to the challenge of participating in the management of a multipolar global system.

9. Would you like to give coming SUERF presidents some advice concerning the choice of topics for future SUERF Colloquia, other events or publications?

The current practice is fine; clearly financial topics have increased in importance relative to monetary analysis, but this may already be adequately reflected in recent activities.

Report from the 2012 SUERF General Assembly

The 2012 Annual General Assembly of SUERF was held at the conclusion of the first day’s proceedings at the Zurich Colloquium. Urs Birchler opened the meeting by conveying a message from past SUERF President and Honorary Member Jean-Paul Abraham who was unable to attend the Colloquium due to ill health. He also paid tribute to the previous SUERF President, Catherine Lubochinsky, whose second term as SUERF President had ended earlier in 2012.

In the subsequent elections, Allard Bruinshoofd (Rabobank), Jakob de Haan (De Nederlandsche Bank), Patricia Jackson (Ernst & Young) and Christian Pfister (Banque de France) were elected to the Council of Management, for a three year term retroactively from 1 January 2012. The mandates of Ernest Gnan (Oesterreichische Nationalbank), Ryszard Kokoszczynski (National Bank of Poland), David T. Llewellyn (Loughborough University) and Robert N. McCauley (Bank for International Settlements) were extended for a further three years, effective from the expiry of their present mandates on 1 January 2013.

Since the last General Assembly held in Brussels, there had been conferences in Helsinki, Berlin, London and Vienna as well as the ongoing 30th SUERF Colloquium in Zurich. Council also unveiled the programme of events for 2012-13 (as listed elsewhere in this Newsletter) as well as giving details about recent and forthcoming SUERF Studies.

SUERF’s Honorary Treasurer, Donato Masciandaro, reported that SUERF’s financial position remains sound. Particular thanks were given to the Association’s Corporate Members and Central Bank Members, for their continuing support of SUERF’s activities in light of the necessity to increase Membership Fees from 2012, as well as to the institutions with which we have organised and will be organising events.

Michael Bailey, Executive Secretary
SUERF Council of Management

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Robert N. McCauley  
Christian Pfister  
Jürgen Pfister  
Jens Ulbrich

Contact details and curricula vitae of Council Members can be found on the SUERF website at www.suerf.org
Forthcoming SUERF Events

The Council of Management has approved the following forthcoming events in 2013. Further information about each event can be found, in the first instance, by consulting the microsite of the event.

8 March 2013  
Vienna, Austria  
**SUERF/OeNB/BWG Conference**  
*The Future of Sovereign Borrowing in Europe*  
Conference Microsite: [www.suerf.org/vienna2013](http://www.suerf.org/vienna2013)

13 June 2013  
Helsinki, Finland  
**SUERF/Bank of Finland Conference**  
*Banking after regulatory reforms - business as usual?*  
Conference Microsite: [www.suerf.org/helsinki2013](http://www.suerf.org/helsinki2013)

4 October 2013  
Amsterdam, The Netherlands  
**SUERF/DNB/Rabobank Conference and 2013 SUERF Annual Lecture**  
*The value of banks and their business models to society*  
Conference Microsite: [www.suerf.org/amsterdam2013](http://www.suerf.org/amsterdam2013)

22 November 2013  
Paris, France  
**SUERF/Banque de France Conference**  
*The Financial Reconstruction of Europe*  
Conference Microsite: [www.suerf.org/paris2013](http://www.suerf.org/paris2013)

Further information about all forthcoming events is available from the SUERF website at [www.suerf.org](http://www.suerf.org)