

JACOB FRENKEL

Chairman of JPMorgan Chase International

Nicolas Barré, Deputy Managing Director, *Les Echos*

The states and the Governments need to act and to reform after the Central Banks do their job. A former central banker will give us his view on the world economy.

Jacob Frenkel, Chairman of JPMorgan Chase International

It is a pleasure and honour to be here and thank you, Thierry, for this excellent programme. I was introduced as a former central banker, and the good news is that the only title that nobody can take away from you is “former”. Let me share something with you before I move on. I will share with you the shock that I got 10 minutes ago. When I came to the meeting, I told the moderator that I had a beautiful presentation that was 45 minutes long. He told me that I did not have that much time. When I looked at the email which I received, I saw that my secretary transcribed it wrongly. I was supposed to have 4-5 minutes of opening remarks and I misread it to be 45 minutes. Let me squeeze the presentation.

I will go through several challenges for the world economy, with the hope that as we move on in the discussion, we will also discuss the solutions to these challenges. I first want to start by sharing the positive atmosphere that was introduced by the first two speakers, a sense of optimism. It is extremely important. I would say now that we should be optimistic but not sanguine. It is an extremely important state of mind. This is because not more than a few years ago the atmosphere was one of Doomsday and of the floor disappearing from underneath us. There was a deep financial crisis that reflected huge vulnerability.

I think this is behind us. We are now in a situation where there are still many challenges, but let us call them challenges rather than crisis points. First, there is good news. The world economy is growing. Some of you look at your neighbours and say, ‘I do not see that,’ but yes, the world economy is growing. 2009 is the year that we would like to forget because the world economy shrank, but since then, it has been growing every year. Why do we feel tension? It is because the centre of gravity of the world has moved. Some parts of the world, especially the industrial countries, have not been growing, particularly in Europe. However, the centre of gravity has changed and that is the major drama of this mega-trend.

In 1990, two-thirds of world output was produced by Japan, the US and Europe. If you wanted to know where the world economy was growing, it was sufficient to look at these three blocks. Today, less than 45% of world output is produced by these three entities. Where did it all go? The centre of gravity has moved to the emerging countries, especially those in Asia. In 1990, only 7% of world output was produced by China and India combined. Today, they produce more than 20%. A decade ago, only 5% of European exports went to China. Today, more than 20% go to China. A decade ago, only 7% of American exports went to China. Today, 25% go to China.

What does it mean? It means that the world’s centre of gravity has moved and that businessmen and entrepreneurs were able to recognise and seize these opportunities. Yet some policy makers have been fighting each other and the dangers of protectionism became very real. A decade ago, when you talked about China in Europe and the US, you would have been told that China is an economic threat. Today when you go to the US and Europe and speak about China, you are told that China is an economic opportunity. That is a very different state of mind. Much of the focus a decade ago was on trade between China and the US and Europe. Let me tell you that the volume of trade between China and the US and Europe is less than half than the volume of trade between China and the rest of Asia. That is where the action is and we need to recognise it.

The second mega-trend is Europe. Not long ago Europe gave us a very pessimistic perspective. Today, it does not, but there are still several challenges. Diversity within Europe is huge. The unemployment rate in Spain and Greece is



more than 25% and if you are young, it may be 60%, and above. Unemployment in Germany is 6.9%. Imagine a conversation between the Minister for Finance of Germany and the Ministers for Finance of Spain and Greece. They have different types of problems reflecting the great diversity. In the past few years the European Central Bank (ECB) has played a central role in keeping the euro zone afloat. The fact is, however, that monetary authorities have done more than can be done and monetary policy has been overburdened. Since many of the issues in Europe are structural in nature they cannot be solved just by monetary policy. The goal of monetary policy therefore is not to solve the structural problem but to give breathing space for the policy makers to address these challenges with the structural tools. That is where the issues are: they are structural issues.

We have an unemployment rate today in Europe of 12.2%. Do you know how many of those people have been unemployed for more than a year? More than 50% of those who are unemployed today have already been unemployed for more than a year. An additional 18% of those who are unemployed today have been unemployed for a period of between six and 12 months. It means that, to a large extent, the unemployment in Europe is structural rather than cyclical. To address these structural issues one needs to invest in human capital, education, job retraining, and enhance labour mobility. As is obvious, these challenges cannot be solved just by monetary policy.

In contrast with Europe, in the US the rapid decline of the unemployment rate from a figure of more than 10% to slightly less than 7% today was not all through job creation. A lot of it is reflected by the fact that individuals got discouraged and left the labour force. In fact, labour-force participation in the US has declined very rapidly. It was 68% a few years ago and it is now significantly less. At the same time in Europe, the rise in the unemployment rate was associated with a rise in labour-force participation. Again, these issues are structural and cannot be solved by monetary and credit policy alone.

Regarding macro economic policies, it is obvious that we have now reached the point in which the conventional solutions are not applicable. Fiscal policies have overextended themselves as national debt increases, while at the same time monetary policies have also overextended themselves as interest rates all over the world are very close to zero. Faced with these challenges, policy makers have searched for non-conventional measures. Let me tell you, those non-conventional measures and forward guidance were very effective in reducing the extraordinary potential loss of effectiveness resulting from a zero interest rate. However, let us not get used to it, because such measures cannot replace the conventional tools and they are much less effective.

As far as I know, every central banker in the world would dream that a time of normalcy would return. This would enable the central banks to have a slightly more positive interest rate, so they would not need to resort so much to non-conventional measures. In order to appreciate the degree of departure from conventional policies, it is enough to recognize that just a few years ago the entire balance sheet of the Federal Reserve, which is the Central Bank of the United States, was composed of Treasury bills. These were very short-term Government obligations of very high quality. Today, there is a very large proportion of the assets that are held by the Federal Reserve that are mortgage-based securities (MBS). Such assets are much less liquid than Treasury bills. The restoration of normalcy would require a significant decline in the proportion of assets which are held in MBS and a corresponding rise in the proportion of assets held in Treasury bills.

Finally, let me join hands with the previous speaker regarding demography. We all know that we are very bad forecasters, but there is one forecast which is robust and that is demography. In the next 20 years, the world will have a population that is greater than it is today by one and a half billion people.

Where will they be? More than 1.45 billion of them will be in the developing world. Only a meagre amount of them will be in the industrial countries. Furthermore, in most of the industrial countries the population is aging rapidly (especially in Japan). The aging process results in significant budgetary burdens, challenges to the social security systems, reduced dynamism and the like. At the same time, the demographic picture in the emerging economies is not monolithic: China's population will increase in the next 20 years by about 100 million people but because of the one child policy the population will be aging. In contrast, India's population will increase in the next 20 years by about 300 million people and the age distribution of the population will be very healthy. Finally, the neglected continent of Africa will enjoy the largest rise in population. In the next 20 years Africa's population will increase by about 450 million



people and will be the largest and the youngest continent. This requires that the continent overcomes the devastating consequences of epidemic health disasters. In short, Africa poses a huge challenge and a gigantic opportunity.