# JACOB FRENKEL

## Chairman of JPMorgan Chase International, Chairman of the Board of Trustees of the Group of Thirty (G-30), Former Governor of the Bank of Israel

**Arthur RUTISHAUSER, Editor-in-Chief, *SonntagsZeitung***

Mr Frenkel, you are probably looking at this more from the outside, from an American point of view, and if you ask people in the US, they do not really understand how the Europeans tried to manage the crisis with the Stability Pact and so on. They always said it would not work, and in the end they were right; it did not work, and the European banks did something else. What do you think of Mr Trichet's statement.

**Jacob FRENKEL, Chairman of JPMorgan Chase International, Chairman of the Board of Trustees of the Group of Thirty (G-30), Former Governor of the Bank of Israel**

You have asked the wrong person, because I am known as somebody who normally agrees so much with him, so you will not be able to create a wedge here. My first remark is that the European project in its historical dimensions is one of the biggest projects of modern humanity, because it has much wider implications beyond currencies. Remember the context in which it was all initiated in the post-World War Two period. There was scepticism and there are people who are still sceptical, but with the passage of time people now know that this is part of the scenery and the scenery will not change, although the windows may be cleaned and some polish added.

Let me return, however, to the earlier subject, because we are all full of praise, and properly so, for the initial response to the crisis, where central banks and governments, in a way, saved the day. However, there are two elements to all medicines. Firstly, there are diminishing returns. QE1 was effective, QE2 was effective but a little less than QE1, QE3 was effective but a little less than QE2, and so on. We have had a situation where interest rates have been close to zero for a very long period of time. There was a good reason for that in the beginning, and now is a good time to ask whether there are unintended consequences that we need to prevent in order to ensure that saving the system is a permanent feature.

There is more and more understanding and realisation that much of the debate about normalisation was about the cost of normalisation, and of course if you discuss the cost of normalisation, the tendency is to delay it because cost is involved. A more balanced discussion today should also be the cost of delayed normalisation. What are the typical costs? Financial markets are so important in the modern era and yields are close to zero, which provides incentives to everyone to look for yields elsewhere, and if you do that, you typically end up in situations that are riskier – higher yields come from higher risk – and normally they will come from areas that are less regulated, so from the system perspective the risk is a little higher.

We also know that assets, especially in the housing market, are artificially inflated if interest rates are too low for too long. Bubbles typically happen when interest rates are low, not when interest rates are high. Those are all well-known facts. However, if you feel that the economy is normalising, then it is a good time to say that policies are normalising. I can speak about the US, and it is not a secret. The US Federal Reserve has said very clearly that they look at three elements in order to decide what to do. The first element is what happens to growth, and in this respect growth has improved significantly. There is no question that growth in the US has been resumed. Will there be less growth than in the previous decades? Yes, and hopefully so, because previous growth was not healthy growth, so in terms of the growth part you can tick the box and say it is ready to normalise.

The second criterion is labour markets. We had 10% unemployment in the US a few years ago, and we now have 5%. The duration of unemployment is diminishing. Labour force participation, of course, is a little low, but by and large, all the results from the labour markets convince most observers that you can tick the box and say it is ready to normalise. The third element that they look at is what happens to wage and price pressures, and there current inflation is still very low, although even yesterday the numbers show a small uptick. However, central bankers do not need to look at inflation today, which measures the events of yesterday; they need to look at inflation tomorrow. A lot of arguments were made that one of the reasons for the current low price inflation in the US is that it reflects a very sharp fall in commodity prices, which is spreading itself over time but will evaporate, and a sharp change in the US Dollar, which is also temporary by its nature and is already correcting.

Therefore, when all is said and done, many of them feel that the third box, inflationary pressures and wage pressures, are either neutral or ready to go, and this is why everybody talks about December as the change. Let me make one point. When we meet here next year and we discuss rate rises in the US, whether in December, February or last year, history will not change from that, as it is not critical. You are talking about 25 basis points when you start around zero distance from the long term. However, the issue is strategy and when the journey should start. They will not hesitate to raise interest rates by 25 basis points, but they do ask, and properly so, whether this is time to start a journey, a sequence of gradual rises over some time. There is more and more discussion about this coming December, and it will probably be a correct decision, but the issue is that it reflects a shift from discussing the cost of normalisation to the cost of delayed normalisation and finding the balance.