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I have the privilege to be the reporter for the group on the workshop on Finance and Economy, under the chairmanship of Jean-Claude Trichet. In a similar workshop at the WPC last year, we noted nine points of attention, which in retrospect we found quite prescient. Notably, we observed that even the comfort of careful central bank policies, inflation prospects remained uncertain, and our jury was out on whether the inflation surge at the time was transitory or would be transformed into sustained overheating. One year later, we have clearly moved to a regime of high inflation. This regime has been engineered as of last year by a combination of demand push through the fiscal expansions designed to alleviate the short-term costs of the pandemic, and of a supply shock through disorganized supply chains and logistical hurdles. The war in Ukraine created another inflationary supply shock with dramatically higher prices for energy and food products.

Our debate this year has pointed to some differences between the United States and Europe, with the demand component of the inflationary shock more potent in the United States, while in Europe inflation seems more supply driven, notably given Europe’s dependency on Russian energy. It was observed that monetary policy is a poor instrument to react to supply driven inflationary shocks because it does not act on supply but can only restrain demand to adjust to the new supply equation. However, the reaction to this surge of inflation has consisted of a very significant, if a bit delayed, tightening of central bank policies, with the difference in nature of inflation between the US and Europe, justifying a more restrained reaction so far from the European Central Bank. Nonetheless, the core inflation in the US and Europe now seems remarkably similar.

Two issues remained uncertain in our debate. One, we can expect post-Covid supply chains to work better, thus alleviating over time some of the supply chain constraints. How much this will contribute to reducing inflationary pressures remains to be seen. Second, the question is whether or not we are already witnessing a wage-price spiral. Some participants argued that this has started to be the case, notably in the United States, or that it is coming soon. Others observed that wages had so far increased much less than inflation, so the debate on that ground is still open. However, the party is clearly over, and we need to understand and adjust to the implications of substantially higher interest rates.

Our debate covered the following issues.

First, monetary policy dilemmas: Central banks face a tough trade off, if they tighten too much they will plunge the economies into a recession that could be unduly severe. If they do not tighten enough that might let inflation out of the bottle, with a risk of having to increase interest rates much more later to correct for insufficient action. Overall, the group was rather convinced that central banks had acted so far with caution, wisdom, and adequate determination.

Second, growth prospects: In that new context, everyone seemed to agree that 2023 would be characterized by a slowdown in growth and possibly by recession. Fiscal policies were seen as largely ineffective, given the size of budget deficits and of public debts. There was an extraordinary situation that was now over, during which governments could accumulate debt and simultaneously see the debt service ratio actually decrease given the very low interest rates. The rise in interest rates now left governments without much margin for maneuver to sustain investment or compensate the poorest segments of the population likely to suffer most from high interest rate and inflation. That led the group to note the political risk and the fragility of the social contracts, and these were mentioned as major concerns with an open question of how to engineer the kind of social contract that would be conducive to a green transition. It was also mentioned that GDP growth was not an adequate objective per se, consistent with a preoccupation regarding climate change and the green economy, nor with the preoccupation regarding social inclusion and distributional concerns, which are not included in the metrics of GDP.

Third, financial market volatility: Participants noted the nervousness of financial markets, where portfolio reallocations take place and assets are now driven back to more realistic values. Bubbles will explode, this is a high-risk situation that is mitigated by the fact that banks in developed countries are much better capitalized now than they were in earlier crises episodes and by the role of the Financial Sustainability Board and the decisions taken so far by G20 countries, since the Lehman bankruptcy. It was also mentioned that the weaponization of finance through resorting to sanctions against an economy the size of Russia, had implications on the assessment of risks and on risk aversion, and could affect the possibility of meeting the extraordinary demands for finance, notably generated by the needs of the green transition.

Fourth, ESG, in the same spirit: how to allocate capital to green transition and social objectives, should we rely on autonomous private decisions driven by ESG concerns? Our debate was inconclusive, but participants emphasized the need for transparency and clarity and on the ultimate role of governments in providing proper regulation and taxation to support the transition.

Fifth, a period of a strong dollar driven by the interest rate differential in favor of the US and by the exposure of Europe to the energy and war shock, and again by the safe haven effect following the return of war in Europe: This is fueling inflation outside the United States through imported inflation, notably in Europe and in developing countries, where it can also generate credit failures. The discussion about the dollar also included questions regarding the prospects for the dollar as an international reserve currency. In particular, sanctions could affect the perceived safety of holding reserve assets in dollars and in euros and could create incentives to diversify reserve assets. However, it was mentioned that the dollar could be expected to remain the major world international currency for the foreseeable future, though no date was given to define what this foreseeable future could be, in particular given the lack of alternatives to the dollar as a reserve asset.

Sixth, the situation of emerging and developing countries, which was mentioned as a source of utmost concern: They have been subject to capital flight linked to reassessment of risk, increased risk aversion, changes in interest and exchange rates, portfolio reallocations. That has left them with a lot of difficulties to refinance themselves and their debt situation is ominous. In contrast to the developed countries, their debt service had already deteriorated, and this is now compounded by much higher interest rates. How to manage this situation, especially in the context of substantial investment needs, was mentioned as a crucial challenge that should lead to strengthening the Tier 1 capital of development finance institutions to allow them to bear first losses. In the face of the likelihood of a series of debt crises, the framework to manage these crises is not in place. Given the rise of new creditors, including China, the Paris Club is no longer an effective coordination forum. The G20 has established a new common framework, but its implementation has been disappointingly sluggish. Coordination across donors, both public and private, and with the aim of avoiding only coordinating public actors and then imposing a solution on the private creditors, was regarded as an urgent challenge that needed prompt action and decisions. We also discussed whether central banks should provide swap lines to ease the financial situations of emerging countries. The debate highlighted the risk of confusion and lack of coordination between, on the one hand IMF facilities and central bank-provided facilities on the other; a preference to rely on the IMF financial facilities seemed to emerge from our discussions.

Last, food security, which will be addressed later in one of the WPC sessions, was mentioned as a crucial challenge in developing countries, which are confronted by a host of simultaneous crises, economic, food, political, security, geopolitical, energy, climate, etc.

Thank you very much. I am sure that my colleagues and the chairman who were present in yesterday's discussion, can complement what I just said.