PIERRE JACQUET

Professor of Economics at the École nationale des ponts et chaussées (ENPC), member of the Cercle des Économistes

Good morning and thank you to so many of you for being here for this early morning session of reports from the working groups.

I have the privilege to report for the workshop on finance and economy, which took place under the chairmanship of Jean-Claude Trichet. Our discussion covered the overall economic situation, the outlook for international trade, the potential risks involved with cryptocurrencies, and there was quite a lively discussion on major issues in development finance.

Let me start with the economic situation. Last year, we were not even in the middle of the storm at a time of surging inflation and we discussed the reactions of central banks, the likely timing of interest rate rises, and the probability of recession. This year, participants noted that while inflation was still a bit too high, it had started to abate in major economies and the question this year was rather when central banks would start to cut interest rates. That will probably not happen before mid-2024 but the tightening cycle was clearly coming to an end.

The discussion on current economic prospects underlined the difference between the United States and Europe. In the United States, relative optimism prevails in an economy at full employment, experiencing a rise in business investment, notably in response to the expansionary Inflation Reduction Act. The policy mix in the US was thus characterized by a cautious monetary policy expected to ease only when unemployment starts increasing, and by a fiscal policy that is not expected to undergo any major change in 2024, but whose expansionary effects would continue to be felt. As a result, in a textbook Mundell-Fleming model, for those who have been exposed to economic modelling, economic growth was expected to continue, interest rates would remain relatively high and start declining later in 2024, and the dollar would remain strong. At least in the United States, the soft landing scenario seemed to be becoming a reality.

In contrast with the apparent prosperity in the US, growth was much more subdued in Europe, notably due to higher sensitivity of the shock represented by the war in Ukraine. This divergence in the US was expected to continue to at least the end of 2024.

The Chinese economy was facing the implications of the industrial property bubble and a growth slowdown with a paralysis of entrepreneurship. It was mentioned that manufacturing was sensitive to cycles, as in countries like Korea, Japan and other economies, and even Germany and that in turn, the Chinese economy itself was entering a regime of economic cycles with recurring ups and downs.

Overall, prospects for 2024 were expected to be rosier with two potential downside risks, of course, a further slowdown in China and a worsening of the international crisis, notably the crisis in the Middle East. The latter presented a risk of increased energy prices, a rise in defense investment, declining world trade, declining global confidence and a rise of global uncertainties, an increase in market volatility and a risk of the return of inflationary pressures. However, it was noted that so far stock markets do not seem to have been affected too severely. Altogether, the geopolitical risk could fully derail this relatively quiet scenario and the group seemed reasonably confident but recognized that this confidence was fragile and unfortunate surprises might sanction any undue complacency.

As part of our discussion of the economic situation, the rise in public indebtedness was also mentioned as a source of concern. This was especially the case in a situation where there might be doubts about the evolution in the foreseeable future in the difference between growth rates and interest rates, which is a major indicator of the sustainability of the debt burden. This was seen as a further argument to credibly bring inflation down as a way to restore the capacity to bring interest rates down.

Moving to the outlook for international trade, while trade grew faster than global production between 1950 and 2008, this has not been the case since around 2012. Trade is now growing more slowly than global GDP. This is expected to continue in the context of a weakening World Trade Organization, WTO, with the adoption of many new protectionist measures and where the commitment to achieving the Doha round remains a dead letter and the WTO dispute settlement is in disrepute. A characteristic of the post-World War Two order has been liberalization of trade driven by gains in cost and economic efficiency, supported by growing evidence that import substitution strategies did not produce lasting growth. However, there was now a shift to new considerations with significant concerns about security, broadly speaking, across energy supplies, food and health and the control of technologies. This shift could be attributed to the so-called 3 Cs, conflict, Covid and climate concerns, all of which are leading to potential trade barriers. In addition, the emerging focus on technology and industrial policy is resulting in new forms of subsidies and trade restrictions. There are also trade diversions, earlier Chinese-manufactured exports are now sometimes diverted by industrial delocalization of Chinese firms to nearby expanding countries. In this context, the call by the G20 to reaffirm support for a rules-based system, including fair, open, non-discriminatory, inclusive, sustainable and transparent trade, centered around a strengthening of the WTO, a commitment to fully restore its functioning dispute settlement mechanism, all appeared as a set of promises that were, at least not yet, backed by an active agenda.

In terms of financial innovations and financial risk, we had a brief discussion of the financial innovations introduced by cryptocurrencies, and a debate about central bank electronic money. First, the total amount of cryptocurrencies in circulation was estimated to be around EUR 1 000 billion, half in Bitcoin and half in other cryptocurrencies, which is actually around half the balance sheet of a big bank like BNP Paribas. The point is that the development of these cryptocurrencies, while highly speculative, is not creating any systemic risk. However, it was emphasized that they were introducing a real risk of fraud, criminal activities and the risk that they finance terrorism. In contrast, other financial innovations could be considered as a major change and revolution for retail banks, such as electronic payments by smartphone, which have become a major part of retail payments. Central bank electronic money was also under active discussion and was expected to present a real threat to retail banking, as well as introducing major questions about the future of banks. However, central banks are conscious of the risk involved and seem to be keen on introducing central bank electronic, CBEM, versions that would not threaten the stability of the banking system.

Finally, we had a very active and in-depth discussion of development finance issues. Many developing countries, especially in Africa, are suffering from a severe credit crunch, with many in debt distress after piling debt over the years as abundant liquidity was recycled in quest of higher returns in the context of very low world interest rates. Today, the situation is radically different, in a very tense geopolitical context people in developed countries are less and less interested in the rest of the world, billions are committed but seldom made available and there are rational reasons for diminishing private flows. In addition, governments in developed countries face high public debt and tight fiscal constraints, while they again resort to active industrial policies, and risk aversion has increased again. African countries in debt distress do service their debts because they realize that the costs of default are extremely high but it leaves them without resources to pay for health, education, basic services and not to mention, the need to finance sustainable green growth strategies and the energy transition. In fact, many countries now receive less new finance than they pay in servicing debt, they experience net negative transfers from developed countries. Some African countries are even under net negative transfers from China, so they pay more to China than they receive from China.

Today, developing country debt is characterized by the weight of private creditors, notably in the form of bonds on the one hand, and the importance of non-Paris Club members, including China on the other hand. China has emerged as the first bilateral creditor for public and publicly granted debt for developing countries, which can be understood by the fact that other traditional creditors were no longer available to fund the needs of Africa and other developing countries. It was pointed out that there is no pro-China ideology in African countries, but simply given their situations they were welcoming new money whenever available. However, new money is very scarce right now and China is no longer providing new funding and is not likely to resume it in the near future. This combination makes debt negotiations particularly difficult since China is not bound by the discipline and experience established by the Paris Club and private actors are not keen to consider debt reduction or rescheduling actions.

So far, G20 initiatives like the Common Framework, have met little success in terms of implementation. More recently, the Global Sovereign Debt Roundtable has been set up as a low-profile initiative involving lenders and borrowers, both public and private, and the sentiment in the group is that this would be more effective than past attempts. It was agreed that we do need to bring China to the table as well as private funders. There is a dramatic contrast between this credit crunch situation and a broad international agreement that financing should be scaled-up and forthcoming, both because of development needs and the imperative of dealing with climate change and such a scaling-up should be supported by the mobilization of private finance. However, none or very little of this is happening and instead, ODA flows are increasingly absorbed by a number of needs that go well beyond genuine development finance, for example, funding refugees in donor countries themselves, or funding for climate change mitigation. It was pointed out that despite an increase in ODA statistics, actual ODA going to Africa had in fact decreased and there was a major issue related to the effectiveness and timeliness of ODA in the nature and implementation of conditionality.

Developed countries intentions are plagued by confusion and an inability to use existing instruments, such guarantees, including the World Bank's MIGA, or to actually and effectively leverage private finance. On one hand, there is some confusion between climate adaptation needs, which would actually be mainstreamed as what should be considered a basic good development strategy. While on the other hand, climate change mitigation objectives really only concern around a dozen emerging countries where it is likely to have an impact. A lot of African countries are too small to have any mitigating impacts so the focus there should be on adaptation and development. However, multi-development banks, the MDBs, are not equipped to selectively allocate mitigation related funding to these countries as a priority. It is now important to think about ways to differentiate support for mitigation on one hand and for adaptation and broader development on the other.

As for the mobilization of private funding, it has been largely unsuccessful and this is mainly due to a prevalent culture of risk aversion in development finance institutions. Such risk aversion not only affects decisions and the capacity to innovate, it also penalizes the implementation of decisions, existing instruments and potentially promising initiatives, with the requirements of increasingly complex due processes intended to control risk in development finance institutions. While understandable, this appears to be a major impediment in the effectiveness and availability of development finance. As a result, there is a lot of talk about and agreement on the need to react urgently to the current emergencies but subsequent action does not look like any emergency.

For all the focus in our discussion of these tough issues, the general impression in the group was that the global economy has so far muddled through and shown impressive resilience. It was felt that we should focus our attention on actually implementing initiatives and commitments, and that inclusive dialogues and debates were necessary to make this happen.

Thank you very much. I now give the floor to group two.