MONETARY PANEL
Warsaw - 18 April 2008
Minutes of the meeting

Present

Wim BOONSTRA, President of the Monetary Panel

Andorra	Jan-Olaf SIPKES
Austria	Marianne KAGER
France	André ICARD
Germany	Rainer BODEN
Netherlands	Ruben van LEEUWEN Fred von DEWALL
Spain	Rosa Maria GELPI
Un. Kingdom	Graham BISHOP

Speakers

Elwin DE GROOT - Head Financial Market Research - Rabobank International
Andrzej JONAS - Chief Editor - The Warsaw Voice
Wlodzimierz KICINSKI - President of the Management Board - Nordea Bank Polska
Krzysztof OSTROWSKI - Director of the Intervention Bureau and Representative of the Business Centre Club in the European Economic and Social Committee
Katarzyna ZAJDEL-KUROWSKA - Vice-Minister of Finance of Poland

Attended

Maciej DOBRZYNIECKI - President of the Polish Section of ELEC
Thomas NECKMAR - Head of New European Markets - NORDEA BANK
Wojciech RYBOWSKI - Secretary general of the Polish Section of ELEC
Edmund WITTBRODT- Senator, Chairman of the European Union Affairs Committee
+ other members of ELEC in Poland

ELEC Secretariat

Jean-Claude KOEUNE, Secretary General

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Introduction

Mr. *Jonas* took the chair for the first part of the meeting at 9:35, greeted participants, and proceeded to give the floor to Mr. Boonstra and Mr. Dobrzyniecki.
On behalf of the Panel, Mr. *Boonstra* welcomed the Polish section's guests and expressed his personal pleasure at being in Warsaw, as well as the Panel's gratitude to the Polish section and its President Maciej Dobrzyniecki for having taken the initiative of hosting the meeting which, he said, was excellently timed and had been preceded the night before by a congenial working dinner, enriched with a lively account by Mr. Thomas Neckmar of Nordea Bank's experiences in Poland. Mr. *Dobrzyniecki* briefly presented ELEC's Polish section to the Panel, stressing that it was always ready to welcome meetings such as this, which had besides given it the opportunity to invite younger ELEC members or would-be members.

1. Adoption of the agenda

The agenda was unanimously adopted.

2. Presentation of the PRO EURO Initiative

The *Chairman* gave the floor to Mr. *Ostrowski*, who first said Poland had not decided yet when to enter the eurozone, and underlined some of the concerns (price increases and job losses) felt by a number of its citizens at this prospect. He then reminded the audience that the Business Centre Club had always advocated euro-membership, and he presented its Pro Euro initiative, a country-wide information and education campaign aimed at dissipating the popular fears he had mentioned. Mr. *Sipkes* asked if the campaign had already succeeded in changing attitudes toward euro adoption. Mr. *Ostrowski* replied that businessmen were already convinced and that the results of a survey on the public-at-large's attitudes would be available by the end of May.

3. Prospects for introducing the Eurocurrency in Poland

The *Chairman* welcomed the Vice-Minister of Finance and gave her the floor. Ms. *Kurowska* stressed at the outset that Poland, by having signed the adhesion treaty, was committed to join the eurozone, though the treaty had not specified a date. She then proceeded to examine Poland's situation with respect to the Maastricht convergence criteria. On the fiscal side, she indicated that Poland's new convergence programme aimed at reducing the budget deficit by 0.5% of GDP each year and at reaching a structural deficit not greater than 1% of GDP in 2011: the fact that an impending tax reform was likely to reduce revenue in the years ahead, she said, made the dynamics of expenditure-cutting even more necessary. On other criteria, she noted that inflation was now above 4% and a more restrictive monetary policy was needed, though this would only be compatible with a more rigorous fiscal policy. As to the exchange rate, she observed that it would be difficult for the zloty, which was now floating, to enter the ERM-II mechanism in the current period of market turbulence, owing to the risks of speculative capital inflows. She felt that 2012 might be a good year for entering the eurozone (in combination with the European Tennis Championship to be held that year in Poland) but stressed that no official date had been fixed yet. She concluded it was most important for the time being to show European authorities that Poland was seriously committed to its deficit reduction plans.

The *Chairman* thanked the Vice-Minister and opened the floor for discussions. Mr. *Boonstra* asked whether reductions in government spending might not undercut public support for the euro and to what extent it would be possible to skip the criterion of two-year prior participation in ERM-II. Ms. *Kurowska*'s answered to the first question that her government was indeed under pressure for having simultaneously to cut spending and deliver on social promises already made.
On the second question she thought that, although she really liked the idea, it would be difficult to change the rules while the game was still in progress, though she feared the attraction of speculative capital inflows might exert upward pressure on the currency. Mr. *von Dewall* remarked that capital inflows could on the other hand make real convergence easier, and thus needed not necessarily to be feared, whereas skipping the exchange rate criterion could be dangerous.

Mr. *Bishop* observed that such skipping could not occur since the criterion was in the Maastricht treaty, though it remained in theory a political prerogative of the European Council to admit into the eurozone, against the Commission's recommendation, a country that did not fully comply with the Maastricht criteria. He thought moreover that once a country had achieved market credibility, and provided economic conditions were correct and public support strong enough, speculative attacks against the currency were unlikely and ERM membership carried no real risk. Mr. *Boden* stressed it would be unwise to change the rules of the game in a context that could become difficult for the euro in view of growing discrepancies in the eurozone. Mr. *Boonstra* reminded that the exchange rate criterion had been designed to prevent a country from devaluing its currency prior to joining the eurozone, and that the context was now different.

Mr. *Rybowski* asked what a good rate of exchange between the zloty and the euro might be, and to what extent Poland might unilaterally decide to adopt the euro. Ms. *Kurowska* replied to the first question that this would partly depend upon the future euro-dollar exchange rate, still unknown, and to the second question that this appeared highly unlikely. Mr. *Bishop* added that such a move would not give Poland a seat in ECB's board nor access to ECB's discount facilities. Ms. *Kager* recalled Germany's experience of entering EMU at too strong an exchange rate, from which her economy had suffered for several years.

The *Chairman* thanked the Vice-Minister for her brilliant speech and frank answers to the questions. Mr. *Stanislaw Sipowicz*, on behalf of students in the audience, stressed their belief in European values, the importance of the Pro Euro initiative, and the need for the political world to heed the voice of young generations.

4. Current characteristics of the Polish banking sector

The *Chairman* gave the floor to Mr. *Kicinski*, who described the situation of the banking sector in Poland, stressing its small degree of concentration (the leading 5 banks having less than 50% of the market versus 90% in Sweden for instance) and high degree of market competition, which had required the creation of innovative strategies toward competition on the part of new entrants in general and Nordea Bank in particular. Further, he analyzed the implications for banks in Poland of the future advent of the euro, stressing the importance of information, communication and education in a country where the proportion of households having bank accounts (two thirds at present) needed to be increased. Finally, he presented the special information programme initiated by Polish banks, with the support of Poland's National Bank, and aimed in particular at secondary schools and higher-learning institutions.

The *Chairman* thanked Mr. Kicinski and opened the floor for questions. Mr. *Bishop* asked whether Polish banks were ready for SEPA, arguing that if this was the case, the change-over to the euro should be easy. Mr. *Boden* inquired about newcomers on Polish banking markets. Mr. *Ricinski* answered to the first question that their preparation was under way, with the help of a project coordinator appointed by the Polish banking association. To the second question he replied by stressing that new Polish players on banking markets were very efficient operators and that the banking supervision system was more than adequate.

5. The international credit crisis and it consequences

The *Chairman* gave the floor to Mr. *de Groot,* whose presentation was entitled "Credit crisis: looking back, looking forward". Looking back on a turbulent year, he identified the first signs of forthcoming troubles and the sources of the problem, described the various phases of its development (sharp rises in credit spreads and risk premia, succession of write-downs having shocked investors, intensification of deleveraging), and analyzed the negative feedback loops now in operation as well as their likely economic consequences, with lending conditions being progressively tightened by European banks, although credit growth to the corporate sector continued to accelerate, which he found puzzling.

The *Chairman* thanked Mr. de Groot for his presentation and opened the floor for discussions. Ms. *Kager* observed that corporate deposits continued to increase as well, notwithstanding a general lack of trust in the financial industry, and she inquired about the leverage of hedge funds. Mr. *de Groot* answered that there were great differences between hedge funds, though they were on average highly leveraged institutions, with presumably more deleveraging to come. He also deplored the lack of transparency concerning this segment of the industry, and expressed concerns over pension funds.

Mr. *van Leeuwen* remarked that securitization in itself was good, but that indeed it had occurred without sufficient transparency and given rise to excess leveraging. In a longer-term perspective, he inquired about the US current account deficit and the possibility of further dollar depreciation. Mr. *de*

Groot replied that the US deficit was slowly improving, but that taking it onto a sustainable path would require, in his view, more painful decisions, whose effects probably were already discounted by forex markets. Mr. *Boonstra* observed that paradoxically the US net financial position had improved owing to gains made by US residents on their foreign holdings thanks to the dollar depreciation.

Mr. *Icard* commented on the absence of a credit crunch in Europe, noting still strong demand for credit on the part of SMEs in France as well as continuing activity in mergers and acquisitions. Observing that the total cost of the crisis could reach, according to the IMF, close to one trillion dollars, with 50% to be born by banks, he inquired about the other half, and expressed concern - relayed by Ms. *Gelpi* - about more bad news in waiting. Mr. *de Groot* replied that the still buoyant M & A activity might be a French phenomenon, but that credit demand for investment remained generally strong in Europe. In the US, he said, a big question mark hung over consumers' confidence, as many of them might become increasingly worried about their financial future in view of the high rates of foreclosure and delinquency in the housing market and the potential losses that this might entail.

The *Chairman* concluded the morning discussions by thanking the speakers and participants and expressing his satisfaction at the transparency with which the Panel's debates took place. He then gave the chair to Mr. Boonstra, President of the Monetary Panel, for the part of the meeting restricted to Panel members.

6. Approval of the minutes of the last meeting

The minutes of the meeting held in Amsterdam on 9 Nov. 07 were approved.

7. International economic environment

The *President* opened the floor for a discussion of the international environment and possible dichotomy between developments in the financial sector and the real economy. Mr. *Bishop* observed that equity markets were weak but not indicative of a bear market yet, but expressed concern that in the UK the housing market would have a negative impact on the rest of the economy. Mr. *Boden* stressed, for the UK, the important role of the City in the total economy. Mr. *Sipkes* alluded to the possibility of a "North-South cleavage" occurring in European cyclical developments. Mr. *Boden* said that a new test for the eurozone might be coming, with the growing likelihood of France and Italy being submitted to SGP procedures in coming years.

Mr. *Icard* commented on France, noting that industrial production was still steady, with a pending question whether consumers would reduce savings to maintain consumption levels or not. Two big problems, he said, were the fiscal deficit (2.5% of GDP in 2008 according to official forecasts, based on very optimistic growth assumptions), and increasing inflation which was eroding purchasing power. On Spain Ms. *Gelpi* pointed to the negative cyclical impact of declining construction activity, which could possibly be mitigated by using the substantial fiscal surplus to stimulate activity, but she stressed the structural competitiveness problem and the fact that too few investments in new technology had been made. On Italy Ms. *Kager* said that the economy was handicapped by the fact that the restructuring of utilities had come very late and that the services sector was lagging; moreover, the SMEs were no longer the bastion of economic strength they had been before, losing little by little their competitive advantage in supplying quality products. On Germany, Mr. *Boden* said that the figures remained astonishingly good, with exports still very strong, inflation at 3% but likely to come down to 2% at the end of the year, and unemployment having fallen below 8%. Structural concerns were the demography, and the fact that the reform process initiated by former Chancellor Schröder was stalling or even being cut back.

On the United Kingdom Mr. *Bishop* stressed the danger of a crash in the housing market, which would be painful for many people, the collapse of confidence in Mr. Brown's government, and the fact that the fall of sterling over the past few months was as great as on the "black Wednesday" of 1992, which made it more difficult for the Bank of England to cut interest rates. Austria, Ms. *Kager* said, was

experiencing a growth slowdown, though not severe, with inflation at 3.6% and a fiscal deficit of 0.5% of GDP, but a serious problem of financing social security was looming ahead. In Belgium, according to Mr. *Koeune*, the main concerns were now inflation (above 4%) and the fiscal situation, with a 2008 budget theoretically balanced - as in previous years - but "full of holes", and the fact that fiscal surpluses would have been needed instead in order to tackle forthcoming problems of funding the pension system. For the Netherlands Mr. *van Leeuwen* stressed that growth was still good, the labour market rather tight, producer confidence high but declining, and evidence - contrary to Spain - of a backlog in construction orders.

8. Publication of Cahier Boël n° 13 on Pan-European Retail Banking

It was proposed and agreed:

(1) that a mention should be made, concerning the three contributions in part II, that they had been written in the Spring of 2007 for presentation at the Rome meeting of the Panel on 30 March 2007, and that Ms. Schwimann- and Mr. Gobbi's agreement on this mention should be secured;

(2) that a public presentation of this *Cahier* should be made in Brussels, preferably with EPC (European Policy Centre) as it was done for the previous one in May 2006, and that this event should ideally take place at the end of June or early July (mid-July at the latest). Suggested names for speakers were Marianne Kager and ELEC President Anton van Rossum.

9. A.O.B.

Mr. *Icard* informed the Panel about the conference to be organized in Lyon on 21 June 2008 by the National Council of the European Movement in France, with a collaboration of the French section of ELEC on the subject "Economic nationalism or European patriotism".

10. Date and place of the next meeting

Friday 7 November 2008 in Brussels, on the subject: "Forthcoming changes in banking supervision and financial regulation". Suggested names for speakers were Alexandre Lamfalussy (as dinner speaker for the Thursday night), Peter Praet, Jean-Paul Servais, and David Wright.

The meeting adjourned at 3:30 pm.

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