MONETARY PANEL
Paris - 24 March 2006
Minutes of the meeting

Present

Jean-Jacques REY, President of the Monetary Panel

Austria	Marianne KAGER
Belgium	Wim BOSMAN Paul GOLDSCHMIDT Jean-Victor LOUIS
Czech Rep.	Kamil JANACEK
France	Philippe JURGENSEN Paul MENTRĖ Robert RAYMOND
Germany	Rainer BODEN Ansgar TIETMEYER
Italy	Gianluca SALSECCI
Netherlands	Wim BOONSTRA Cees ULLERSMA
Switzerland	Jean ZWAHLEN

Speakers

Pierre DHONTE, Special IMF Representative for the UE
Christian PFISTER, Directeur de la Recherche - Banque de France

Attended

Daniel DACO - Head of Unit DG ECFIN - EUROPEAN COMMISSION
André ICARD - Directeur général honoraire de la Banque de France

ELEC Secretariat

Jean-Claude KOEUNE, Secretary General

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Introduction

The *President* took the chair at 9:30am, expressing his gratitude to Robert Raymond for taking the preparatory contacts, and to JP Morgan & Cie France for hosting the meeting.

1. Adoption of the agenda

The agenda was unanimously adopted.

2. Approval of the minutes of the last meting

The minutes of the meeting held in Utrecht on 7oct05 were approved.

3. Prospects for global adjustments

The *President* introduced the first speaker Pierre Dhonte, stressing his wide international experience based *inter alias* on his having taken part in 140 IMF missions across 80 countries.

Mr. *Dhonte* gave a presentation on "Global imbalances" in three parts dealing in succession with:
1. the US current account deficit;
2. its background: three factors (structural, more circumstantial, and US-specific) underlying the deficit;
and 3. the issues raised by such imbalances.

The *President* thanked Mr. Dhonte and stressed the need to take a second look at traditional ways of seeing balance-of-payments deficits, before opening the floor for questions and discussions.

Mr. *Raymond* asked why China and India did not develop more rapidly domestic investments instead of accumulating dollar reserves. Mr. *Dhonte* answered that China already invested nearly 50% of its GDP, which was clearly excessive, but was to be explained partly by the absence of a good pension system, which led households to save too much, and by the poor functioning of the financial system, which led enterprises to retain their cash flow and reinvest it: therefore the IMF, for the time being, did not push China toward the revaluation of its currency, fearing the disruptive effect this might have on its financial system.

Mr. *Boonstra* asked whether central banks should not make it their top priority to help generate the IMF's baseline scenario. Mr. *Dhonte* agreed that the longer one waited the more various overhangs would build up, and he referred to the IMF's set of recommendations over the past three years: reduce US deficits - remove rigidities in Europe - fix China's financial system - let other Asian currencies appreciate moderately. Mr. *Daco* noted, behind average figures, growing disparities among US households in the ratio of net worth to income; he also argued that, though a global solution was clearly needed, exchange rate adjustments would not contribute much to it. Mr. *Goldschmidt* wondered whether Chinese political authorities would allow a true opening of the economy and he doubted that rational economic behaviour would prevail.

Mr. *Jurgensen* observed that in India foreign investment was only a tenth of what it was in China and that the trade balance was weak, although India was accumulating foreign reserves at a high rate. Mr. *Zwahlen* expressed concern that no "Plaza agreement" was in sight, and confidence that hedge funds could play a major role in sustaining portfolio diversification; he was also doubtful about flows of OPEC funds which, in his view, now increasingly went to Asia and less to the USA. Mr. *Tietmeyer* asked whether a better coordination of monetary policies might not contribute to global adjustments. Mr. *Ullersma* found too complacent the view that the world saving glut explained the US deficit and saw a clear need to increase saving in the USA. Mr. *Icard* referred to the US enormous accumulation of private debt and wondered about the absorption capacity of the world demand for foreign assets. Mr. *Salsecci* was curious about the kind of policies that might help the IMF's baseline scenario come about.

Answering several of the questions, Mr. *Dhonte* wondered whether policy coordination *à la Plaza* still made sense in today's world and argued that OPEC countries, currently running in the aggregate a $200- or 300bn surplus, still invested the major part in US securities since only US financial markets had the capacity to absorb it. Concerning US domestic developments, he expressed concern about "contingent liabilities" (a.o. social security commitments) in the Federal government's true deficit, and found somewhat puzzling the fact that, with a net saving ratio that had become negative, the net worth of US households was still apparently growing.

The *President* praised Mr. Dhonte for having given a presentation that was both broad and deep, and suggested that it be appended to the minutes of the meeting.

4. Price stability: what are the issues? A central banker's point of view

The *President* turned the floor to Mr. Pfister, whose presentation covered five issues:
1. Why pursue price stability and how to define it?
2. How do prices change in the eurozone?
3. What prices should be kept stable?
4. Are any corrections to observed price developments warranted?
5. How is inflation actually perceived and anticipated?

Mr. *Pfister* next answered questions asked and comments made by:

- Mr. *Rey* on differences in the perception of inflation according to income categories *(A: no research results available on that subject)*
- Mr. *Janacek* on persisting inflation differentials in the eurozone *(A: prices in the eurozone should naturally converge over time towards the highest levels; thus higher inflation in some coutries may be part of the catching-up process)*
- Mrs. *Kager* and Mr. *Raymond* on the merits of including housing costs in the measurement of inflation *(A: the more one increases the weight of housing costs in price indices, the higher measured inflation will be, with the danger of second-round effects)*
- Mr. *Louis* on the potential negative effect of perceived price increases in Slovenia and Malta (where prices already quoted in euro include an exchange commission) after the switchover takes place *(A: little can be done by eurozone authorities, except to play down the expectations of such price changes)*
- Mr. *Boonstra* on the unequal effect on different categories of the population of an average rate of inflation, given the higher rates of price increase observed for medical care, which older people consume in greater quantities *(A: we are not well equipped for the time being to take such heterogeneity into account; one should at any rate strive for greater productivity gains in healthcare)*
- Mr. *Jurgensen* on the methodology of computing price indices *(A: the Paasche method is generally used)*
- Mr. *Boonstra* on the stickiness of prices, which can vary and thus, in conjunction with the frequency of purchases, can produce differences in the perception of inflation, and on the merits of double-pricing for increasing market transparency *(A: no way the authorities can influence price stickiness, which can reflect an implicit contract with customers; double-pricing is useful at the beginning of the switchover process, but should not be prolonged at the risk of inhibiting the necessary mental adjustment)*
- Mr. *Icard* on the danger for financial stability of bubbles in asset prices *(A: asset prices should be monitored in line with developments of credit aggregates; but not all bubbles, when they burst, lead to financial distress)*
- Mr. *Ullersma* on the potential dangers to asset prices of the current driving up of interest rates *(A: long-term interest rates have probably remained very low for too long, but there is little that central banks could do to change that).*

The *President* thanked Mr. Pfister, praising the clarity of his presentation (to be appended to the minutes of the meeting) and the precision of his answers to questions.

5. Future work of the Panel

The *President* announced that Wim Boonstra had accepted his offer to take over the chairmanship of the Panel: subject to confirmation of his appointment by the Central Council in Barcelona on June the 2[d], Mr. Boonstra would chair the next meeting of the Panel in October; therefore, he said, Mr. Boonstra should have a major say in the determining of subjects for future Panel work. The Monetary Panel voiced its approval of the President's choice of a successor.

Mr. *Boonstra* thanked the President and Panel members for their confidence and asked for suggestions of future discussion topics. Mr. *Boden* proposed that the issue of the eurozone enlargement be revisited. Mr. *Raymond* suggested to look at the organization of stock exchanges in the EU. Mr. *Jurgensen* stressed the need to examine Asian countries' exchange rate policies. Mr. *Tietmeyer* gave priority to two subjects: the post-FSAP situation and problems in retail banking; and the stability and growth pact once again. Mr. *Goldschmidt* underlined the lack of coherence between the goals of internal and external policy coordination. Mr. *Louis* proposed to look at further progresses needed towards a true European payments system.

Mr. *Boonstra* thanked the Panel members for helpful suggestions. The *President* recalled President van Rossum's strong wish, expressed in his inaugural speech at the last December Central Council meeting, to see ELEC national sections assume a greater responsibility in the running of its working commissions, and indicated that according to his information ELEC's Dutch section was willing to take charge of the Monetary panel for a period of at least two years.

6.	**A.O.B.**

Since most of the traditional *tour d'horizon* had already taken place during the working dinner at the Banque de France the evening before, the *President* asked Mr. Salsecci to comment on the situation in Italy, both on the political and economic front.

The *Secretary General* informed the Panel that the new *Cahier Comte Boël* final outcome of the October 2005 Utrecht meeting, would be presented at a session, jointly organized with the European Policy Centre and due to take place in Brussels on May the 8th.

7.	**Date, time and place of the next meeting**

On October 19-20 2006. Venue to be determined later.

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