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of the Deutsche Bundesbank

Opening address

at the Second Conference of the Monetary Stability Foundation on
“Financial Stability and Globalisation”

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It is an exceptional pleasure and an honour for me to welcome you to the Second Conference of the Monetary Stability Foundation.

I would like to extend a special welcome to the distinguished members of the diplomatic corps present this afternoon, Peter W Bodde, US Consul General in Frankfurt and Leonidas Contovounesios, Consul General of the Hellenic Republic in Frankfurt.

It is a great pleasure to be able to welcome governors of central banks from all over Europe: Jaime Caruana, Governor of the Banco d'España, Ljubisa Krgovic, Governor of the Central Bank of Montenegro, and Dr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank.

I am exceptionally pleased to be able to welcome Professor Helmut Schlesinger, President of the Deutsche Bundesbank from 1991 to 1993.

I am glad to have with us today Jürgen Hettinger, President of the Frankfurt Regional Office of the Deutsche Bundesbank. Thank you for hosting this conference.

And, last but not least, I would like welcome the distinguished speakers who will make this conference an inspiring event: Professor Giancarlo Corsetti, Professor Gerhard Illing, Professor Philip Lane, Professor Andrew K Rose, Professor Karlhans Sauernheimer, Associate Professor Philip E Strahan.

Ladies and gentlemen!

I came into office as President of the Deutsche Bundesbank only five weeks ago. I have my roots in academia, and in this line of work I have participated frequently in conferences on monetary issues, not least various conferences hosted by the institution I am now entrusted with. Therefore, my introduction “it is an exceptional pleasure and an honour” is meant literally.

1 The importance of monetary stability

The overarching purpose of the Monetary Stability Foundation is to strengthen public awareness of the great importance of monetary stability. This objective is to be pursued mainly by means of financing research on monetary issues, thereby broadening the intellectual foundation of stability policy.

In December 2002, the Monetary Stability Foundation held a first conference. Since then, developments — and debates — have underlined just how important the non-stop emphasis on stability is. I would like to briefly comment on three issues that stand out in this respect. They also link the Stability Foundation's academic approach to central banking in practice.

1 Over the decades, inflation was occasionally declared dead. The latest events in this strand took place in the wake of the New Economy. At the time, it was widely hoped that globalisation and new technologies would put an end to inflation.

   The recession following the bursting of the New Economy bubble then even brought about a serious debate on whether deflation had replaced inflation as the main threat to monetary stability. As the world economy regained strength, this perception reversed itself. In the current environment of substantial global economic growth, high energy prices and ample liquidity, the focus has shifted back to inflation.

   The hopes for an end to inflation did not materialise.

2 The second development underlining the importance of the Monetary Stability Foundation is being observed in the institutional environment. The institutional framework for monetary stability featured as the topic of the first conference of the Monetary Stability Foundation.

Since then, the institutional foundations of the euro area have repeatedly been faced with the danger of being undermined. The European Convention presented a draft for an EU Constitutional Treaty that might considerably weaken the institutional framework of the single currency agreed in the Maastricht Treaty. European Monetary Union is characterised by two key features designed to guarantee monetary stability: a primary objective of maintaining price stability and central bank independence.

The euro is still a very young currency with only a short — albeit encouraging — track record. The sound institutional framework lends credibility to the euro. One of the objections presented by European central bankers has recently been sustained: price stability will remain one of the EU's goals. I fully appreciate this response to our repeated intervention.

European central bankers' remaining key concerns in the field of the Constitutional Treaty pertain to the independence of national central banks, an abridged procedure for future changes to the monetary framework, and the ECB being listed among the "other European institutions". Politicians must not jeopardise the foundations of a stable currency.

This holds also true for the Stability and Growth Pact. This second pillar of the European monetary framework has also come under stress. Governments that hesitated to consolidate their budgets in times of plenty have recently faced the headwind of a weak economy. However, a regulation should not be classified as being inadequate just because it is causing the regulated parties to feel some discomfort.

The objective laid down in the pact, namely achieving a budgetary position which is at least close to balance in the medium term, is an important feature of a stable environment conducive to economic growth. The debate on changing the pact is the wrong debate. The pact is fine. Its enforcement, however, must be improved.

3 The third development, an intensification of the international debate on financial stability, also links the first and second conferences on monetary stability. In the context of the institutional framework for monetary stability, issues such as crisis prevention and crisis resolution, transparency and how to best organise prudential supervision have already been discussed in this forum.

At this year's conference we will focus on financial stability issues arising in the context of globalisation.

2 Globalisation and financial stability

Globalisation entails considerable benefits for the world economy. They come in the form of higher standards of living not only for the residents of advanced countries, but also for the people in the less and least developed countries, which have increasingly been integrated into the world economy.

The liberalisation of international capital flows started in the early 1980s. Since then, the volume of international financial transactions has risen both substantially and rapidly. The opportunities for international portfolio diversification and risk reallocation have broadened markedly.

However, the deregulation of international capital flows seems to have come at the cost of an increasing number of international financial crises. In terms of output and welfare losses they tend to be costly.

To gain, to maintain and — if necessary — to regain financial stability is a major challenge in a globalised world. In order to properly design appropriate institutions, tools and procedures, we need to understand how globalisation impacts on financial stability. With this conference, the Monetary Stability Foundation seeks to contribute to the understanding of financial stability in the context of globalisation.

3 Tour d'horizon of this conference

The conference will start with a stock-taking exercise. The first panel will provide an empirical assessment of how far the "International integration of financial systems" has advanced. The level and composition of gross and net holdings of foreign assets and liabilities are surely a good starting point for quantifying the state of financial globalisation. Their evolution over time may provide useful help in identifying the driving forces behind the growth of international holdings. What is behind what looks like a widespread shift from debt to equity and FDI instruments? What implications should we expect from the ensuing changes in cross-border flows of investment income?

The quantitative picture of the web of international financial linkages will be amplified later this afternoon by three contributions highlighting "International contagion in financial markets". Contagion has become an issue after the Asian financial crisis. To define contagion is not a trivial issue. Did countries suffer from crises in other economies because they were fundamentally in a similar position? Or were economies infected despite sound fundamentals? How and when does contagion happen? Can a country effectively "immunise" itself from contagion?

Tomorrow's session will start with a panel on "Exchange rate regimes and worldwide stability". Exchange rate regimes are among the main suspects in creating financial instability — if domestic macroeconomic policies are not in line with the chosen exchange rate regime. In choosing an exchange rate regime, it has to be decided which is more important: the advantages afforded by flexibility for domestic policy or the monetary policy credibility that may be gained by an external anchor. Contrary to the widely held bipolar view, intermediate exchange rate regimes have shown some durability. How can the choice of exchange rate systems contribute to worldwide stability?

A panel on "Internationalisation of banks and the risk implications" will attempt to shed light on the impact of banks' international assets on financial stability. It will strive to enquire into the net effect of financial institutions' international portfolio diversification on financial stability. The stabilising effects of international portfolio diversification contrast with potentially destabilising effects resulting from faulty risk assessment due to information asymmetries.

The fifth and last panel of this conference will explore financial stability issues of "Financial systems in emerging markets". As regards investing financial institutions, the question is which specific risks they incur when "setting up shop" in emerging markets. As regards emerging markets, the internationalisation of the financial system has been deemed as both a blessing and a curse. Host countries sometimes fear that an internationalisation of their banking systems, eg via foreign direct investment, will entail more volatility and more vulnerability. However, the east European has shown that internationalisation has had very positive effects on the efficiency of their financial systems and the economy in general.

4 Concluding remarks

This conference is academic in nature; the majority of speakers therefore come from academia. Thank you all for contributing to the Second Conference of the Monetary Stability Foundation.

I am glad that the Bundesbank has again been successful in talking several distinguished policy makers into speaking at this conference. Thank you for enhancing theoretical approaches with the view from the business of policy making.
I am especially delighted that Jean-Claude Trichet will join us tonight and will speak at our conference dinner.

As I approach the end of my remarks, I would like to thank Professor Hermann Remsperger, Chairman of the Supervisory Board of the Monetary Stability Foundation, and Dr Reiner König, Chairman of the Executive Board of the Monetary Stability Foundation, for conceiving and preparing this conference.

It is my wish that this conference will ultimately help to improve our understanding of financial stability in a world experiencing rapid globalisation. I now officially declare this conference open and shall give the floor to Professor Remsperger, who will chair today’s session of the Second Conference of the Monetary Stability Foundation.

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