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Report on the Lámfalussy Lectures Conference held on 12 February 2018*

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This year, the Lámfalussy Lectures Conference was staged for the fifth time. Under the title "Great Transformations", the 2018 event featured leading financial professionals and academic researchers from all over the world, focusing on major transformations taking place across the globe, with particular emphasis on the shift in the weight of the world economy towards the East.

The opening address was given by Magyar Nemzeti Bank Governor *György Matolcsy*. He pointed out the major transformations we are witnessing in the world, the EU, and Central and Eastern Europe. A new wave of globalisation is underway, one of the main drivers being technologies such as 3D, robotics or artificial intelligence; additionally, future developments will be shaped jointly by economic policies, monetary policies and geopolicies.

Following the Governor's address, the Deputy Governor and two Executive Directors of the Magyar Nemzeti Bank gave an account of the transformation that has taken place in the Hungarian economy over the past few years. MNB Deputy Governor *Márton Nagy* gave an overview of twelve areas in which the Hungarian economy was stabilised by the action taken, including the labour market, the tax regime, the system of incentives, public finance, public debt, public deficit (EDP procedure), monetary policy, lending, the foreign exchange structure of consumer lending, the central bank balance sheet, economic growth and convergence. The measures have laid down not only the foundations for sustainable growth but also significantly reduced Hungary's vulnerability, and this may become particularly valuable in more turbulent future periods.

MNB Executive Director and chief economist *Dániel Palotai* presented the measures taken by the targeted and innovative central bank policy in recent years. The base rate has reached a historical low, and inflation is currently below the central bank's 3 per cent target, which justifies maintaining accomodative monetary conditions in the future. In this context, the MNB decided to apply targeted nonconventional measures. The central bank's Self-financing programme has helped reducing the share of FX-denominated public debt from 50 per cent to below 22 per cent, which

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decreases further over the forecast horizon and demonstrates good cooperation between the two branches of economic policy. The central bank's Funding for Growth Scheme was necessary to avoid a credit crunch and reach a turnaround in lending. The integration of the financial supervisory authority into the central bank has given the MNB more objectives and a greater variety of tools at the same time, the scope of the central bank supervisory function includes the regulation of macroprudential, microprudential and resolution areas, which in turn led to a more stable financial system.

MNB Executive Director *Barnabás Virág* presented the key pillars of sustainable convergence. The initial years of the period dating from 2010 were characterised by efforts to decrease vulnerability and bring about a turnaround in fiscal and monetary terms, with growth driven by improved labour intensity, i.e. an increase in the employment rate and tax reforms to provide incentives for work. Going forward the focus will be on capital-intensive growth, including greater productivity, improvements in competitiveness, research and development, better trained labour, innovation and creative industries. The country is facing multiple parallel challenges: demographic trap, global lack of skilled labour, the trap of low domestic value added, duality and financial trap, and weak social cohesion. However, new global megatrends: the rise of global middle-class, the scarcity of essential resources, urbanisation, industrial revolution 4.0–5.0, new forms of globalization, fundamental changes in the energy-mix, modern infrastructure, the new global economic map and the age of low interest rates. The 21st century provides new interfaces though, like biotechnology, e-mobility, digitalisation, robotisation, fintech, recycling, tourism and the health industry. Through growth-friendly policy, continued tax reforms and wider e-government, the State is providing the foundations to hold up the five pillars of human capital development, industry and export strategy, innovation capabilities, modern infrastructure, and geostrategy; these pillars are associated with competitive financial intermediation. This is an opportunity for the country to be a bridge between China and the West.

Morning session: "Great Transformation: East"

The talks of the MNB executives were followed by a keynote presentation by *Li Yang*, President of the Institute of Political Science at the Chinese Academy of Social Sciences, on China's deleveraging. Li Yang pointed out the fact that deleveraging is a challenge not only for China but throughout the world. Although countries worldwide committed themselves to reducing debt in the aftermath of the crisis, debt has continued to increase globally due to the headwind that deleveraging has been creating to economic stimulus. China's debt as a percentage of GDP is not particularly high in an international comparison, given the higher level of aggregate debt in a number of developed economies, including the US, Italy, France, the

UK and Japan. Other than debt to GDP, it is appropriate that the balances of the economies are also taken into account, considering both the liabilities, i.e. debt, and the assets that an economy has. In China, a major part of debt has been used to finance investments. China's public assets are estimated at USD 35.8 trillion and its liabilities at USD 20.3 trillion, providing public equity of an estimated USD 14.6 trillion. China is pursuing the broader objective of economic growth, one pillar of which is financial stability and therefore the management of financial risks, as part of which China has committed itself to economic deleveraging at the highest political level. In terms of deleveraging, favourable trends can be observed in the corporate and public sectors, while consumer lending continues to grow for the time being.

In her talk, Senior Fellow *Alicia García-Herrero* from European think tank Bruegel discussed the question of how Europe could open to the East in a 21st century that will likely belong to Asia. Europe is seen as increasingly small from an Asian perspective. Virtually all aspects of global growth between 2015 and 2025 may be dominated by Asia, which is expected to account for 63 per cent of economic growth, 60 per cent of the middle class globally, and approximately 40 per cent of the 500 largest corporates of the world in 2025. China and India are becoming the two main economies. The EU's relations with China may be crucial for the EU to be able to benefit from Asia's century. For the time being though, Europe has a significant trade deficit with China. A breakthrough could be provided with the export of services; but the share of the segment remains small and so it needs to be increased. While major growth potential can also be identified in foreign direct investments, efforts are still needed to create a more level playing field and to clarify the rules, and in addition a bilateral investment agreement might be appropriate.

Park In-kook, Chair of the Korea Foundation for Advanced Studies, discussed the new characteristics of global changes. The first key change is the political transformations taking place worldwide. While the advances made in the fields of democracy, free trade and globalisation used to be seen as a unidirectional process, more authoritarian political forces have gained ground in a number of countries. Another important change has been the shift in China's attitude to global developments. Up to 2009, China had simply taken an open stance, whereas since that year it has become increasingly resolute in asserting its interests, which is more likely to lead to a conflict with the United States. The third key change is the potential spread of nuclear weapons. The emergence of North Korea as a nuclear power could drive other countries in the region, such as South Korea, Japan or Taiwan, to build up sufficient retaliation capabilities. Within the fourth group of parallel developments, mention should be made of the drawbacks of globalisation that are felt on a large scale, including the destabilising effects of dependencies, weakening national independence, increasing wealth inequalities, and the growing power of monopolies; among other things, these developments contribute to further impetus for protectionism.

Lawrence J. Lau, Professor at the Lau Chor Tak Institute of Global Economics and Finance of the Chinese University of Hong Kong, confirmed the trends described previously, i.e. that while Europe and the United States are losing their prominence in the world economy, Asia is gaining. A number of Asian countries emerged after WWII. The talk explored the common characteristics that facilitated the convergence process. The argument highlighted the shared features of high savings rates, a significant volume of available labour, an increased commitment of resources to research and development, ensuring macroeconomic stability, economies opening up and becoming export oriented, and continuity in political governance. Apart from potential drawbacks, a constant governing power may provide a number of benefits, including the continuity of economic policy, and greater predictability for the private sector.

In his talk, *Renwei Huang*, former Vice-President of the Shanghai Academy of Social Sciences, currently Chair of the Academic Committee and a Senior Fellow for international strategic studies, gave a summary of the development and characteristics of the Belt and Road Initiative. The Initiative was announced by China's president, Xi Jinping in 2013. The Asian Infrastructure Investment Bank (AIIB) and the Silk Road Fund were set up by 2015. In November 2017, the 19th National Congress of the CPC also confirmed the importance of the Initiative. According to the participants' shared vision, economic globalisation is entering a new phase, there is a need to discover a new way of global governance, a new infrastructure network may be established between Europe and Asia, there may be shifts in the weight of industrial chains and departments and in the weight of international capital flows, while the new structure may require both bilateral and multilateral cooperation, and international business may need new rules based on a mutual understanding between cultures. The new regime offers plenty of opportunities for acceding countries; for example, benefits are currently available to Central and Eastern Europe through infrastructure investments. According to the lecturer, the gradual approach to progress may be effective. However, it is worth noting that the regime is very much influenced by specific characteristics of Chinese culture, such as building bridges before riches, giving more and taking less, avoiding pressuring others in fields that we do not want for ourselves, or preference for internal improvement over external change.

Afternoon session: "Great Transformation: West"

The afternoon session opened with an address by the Central Bank of Poland's Governor *Adam Glapinski*. In a changing world, it is important for a central bank to act as an anchor of stability, and not to overreact the momentary volatile movements of the markets. In Poland, the base rate has remained constant at 1.5 per cent for around 3 years. Over these years, the central bank has come under multiple pressures, initially towards easing and then towards tightening; however, it resisted and pursued a consistent policy of no change, which it saw as the best way to achieve its objectives. While a constant policy rate may superficially appear old-fashioned and boring, council members in fact considered the options at each rate-setting meeting, yet each time, based on the analyses available, the central bank came to the conclusion that the best option was no change. The results of recent years have confirmed the central bank's position.

In his keynote address as Chair of the afternoon session, *György Szapáry*, Chief Advisor to the Governor of the Magyar Nemzeti Bank, pointed out the need for the renewal of the EU and the euro area in order to increase their resilience and improve their operations for the long term. While consensus has been reached over certain issues such as the completion of the Banking Union and the establishment of the Capital Market Union, or the transition from ESM to EMF, opinion has remained strongly divided regarding numerous other key matters, i.e. expanding the ECB's lender of last resort role, tax harmonisation, eurozone budget, financial incentives for joining the eurozone, EU enlargement to offer membership to Balkan countries. Szapáry demonstrated that growth in the EU is being driven by new Member States, given the significant transfers of human resources from the CEE to western Member States. He added, that besides these, the European Union must face other challenges, such as Brexit, migration and a two-speed Europe.

Former President of the Eurogroup Working Group and of the EU Economic and Financial Committee, *Thomas Wieser*, underlined the pressing need for deeper integration within the EU due to the developments previously explained, i.e. the shift in the weight of the world economy towards the East. Strengthening the internal market is a prerequisite for ensuring the EU's greater weight internationally, in the meantime though, Brexit poses the risk that the EU's international weight will diminish further. Apart from external challenges, the EU also needs to respond to many internal challenges such as the division of opinion between North and South, low productivity, and the efficient distribution of responsibilities between Brussels and nation states. At this point, many of the major global issues are being answered without any EU involvement; EU Member States are small in a global sense, but may be strong if united.

Marco Buti, Director-General for Economic and Financial Affairs at the European Commission, thinks that it is early to lament over the decline of Europe. We should not underestimate ourselves, as current developments in the economy are favourable and enable sufficient progress to be made on integration for Europe to rise to international prominence. EMU must deal with its internal issues as the current status is unsustainable: there is a need for a more appropriate distribution of risks to individuals and communities, monetary policy is overburdened, the adjustment mechanisms are insufficient and there is no central fiscal stabilisation function. Regarding a financial union of greater depth, the most urgent priority for EMU is to establish the Banking Union and the Capital Market Union, as the mitigation of income shocks via financial markets remains low. One advantage of a fiscal union is that it may improve the resilience of the economy and the ability of the region to stabilise itself. The achievement of stronger economic and fiscal cooperation may be followed by further efforts to deepen cooperation on institutions and governance.

Reza Moghadam, Vice-Chairman for Global Capital Markets at Morgan Stanley, argued that Brexit was in fact the result of the UK's identity crisis. Currently the UK lacks a clear consensus on the nature of the relations it should have with the EU; moreover, power is being held by a minority government, which makes virtually any outcome possible as regards Brexit negotiations: a beneficial agreement, a so-called hard Brexit, or even a new referendum. Despite the uncertainty over the short-term outlook, he considers the UK economy to be resilient in the longer term. Business requires clear perspectives and a legally enshrined vision for the sake of predictability.

John Lipsky, a Senior Fellow with the Johns Hopkins School of Advanced International Studies, and former first Deputy Managing Director of the International Monetary Fund, addressed EU developments from a US perspective. He explained that despite the criticism voiced by some US economists about the construction of the euro, it was mostly welcomed by participants in the business community. While a single currency may support the deepening of the single market, there would be benefits in knowing the EU's ultimate intentions concerning a deeper union. The EU banking system was deeply hit by the crisis, which may call for a more effective distribution of risks and a greater degree of federalism. The Banking Union and the Capital Market Union could be game changers.

The conference was concluded with a few words of thanks by Governor Matolcsy. He pointed out that while the conference talks highlighted the major transformations taking place worldwide, there are deadlocks in other fields at the same time, such as Brexit or the relations between Brussels and the V4. He proposed moving forward out of these situations, calling for new visions, strategies and structures. In view of the unpredictability of the future, several visions may co-exist, and the next conference may provide a good opportunity to discuss them.