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In this issue

Long-run saving and monetary policy
Peter Praet, Member of the Executive Board of the ECB

Consequences of present Euro area monetary policy on savings and capital wealth formation
Jacques de Larosière, President of the Observatoire de l'Epargne Européenne

Effects on providers of long term savings and other players
Andreas J. Zehnder, Chairman of the Association of Private Bausparkassen e. V.

Speeches pronounced during a parliamentary evening on "Challenges for long term savings products in the context of the zero-interest rate policy", organized in Brussels by the Land of Bavaria, the Association Verband der Privaten Bausparkassen and the OEE, on 14 November 2016

15 rue Martel • 75010 Paris • France • Tel.: +33 (0) 1 43 12 58 00 • Fax: + 33 (0) 1 43 12 58 01
E-mail: contact@oee.fr • www.oee.fr • Siret: 424 667 947 00024

Long-run saving and monetary policy*

Peter Praet
Member of the Executive Board of the ECB

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The European Central Bank (ECB) has carried out a number of unconventional monetary policy measures since the crisis to bring about a return of inflation to our objective. These measures include targeted long-term repos, negative deposit facility rates since 2014 and large-scale asset purchases. We have received criticism of these unconventional policies from some quarters surrounding their potential negative consequences. In the light of that criticism, I wanted to answer three crucial questions tonight relating to our unconventional measures: Why have we implemented them? Have they been successful in their aims? And, finally, have they had unduly large negative side effects on the distribution of wealth and income?

The determination of long-run interest rates

First of all, I would like to spend a few moments discussing the determination of interest rates and what has happened to long-run interest rates over the past three decades. These two things have significant bearing on the rest of my remarks.

Put most simply, saving is the decision to forgo consumption today, in return for higher consumption in the future. Since people are by nature impatient, they require compensation for delaying consumption, compensation usually in the form of interest payments. That compensation is paid for by those seeking to spend more today than their current income, such as people buying houses, or firms investing in new capital, who in return will not consume all their income in the future to repay the debt. There are two parts to interest payments – the real component which is the extra amount of goods and services you can buy in the future relative to today and the inflation component which compensates for the changes in the prices of goods and services in the future.

Long-run nominal interest rates have been falling across major advanced economies for more than three decades. In major part, this is due to the success of central banks in taming inflation. The expected inflation rate and the inflation risk premium incorporated into long-run interest rates have fallen. Yet changes in expected future inflation that are in turn realized are benign for savers – it is changes to the amount of goods and services that can be purchased in the future that matter, not changes in nominal prices.

But it is not just long-term *nominal* interest rates which have been declining; long-term *real* interest rates have also fallen. Factors beyond monetary policy have played a role in driving real rates lower, which are less benign. There has been a secular decline in productivity growth rates in advanced countries, and increased pessimism about future growth.

But it is not just long-term *nominal* interest rates which have been declining; long-term *real* interest rates have also fallen. Factors beyond monetary policy have played a role in driving real rates lower, which are less benign. There has been a secular decline in productivity growth rates in advanced countries, and increased pessimism about future growth. With lower expected return on capital, firms are more reluctant to invest.

There has also been a savings-investment imbalance beyond that explained by the fall in productivity growth, often referred to as a "global savings glut". In part, this is explained by the ageing populations of advanced countries, driving up the demand for safe assets at a time when they have become increasingly scarce.

This falling real rate is bad news for savers since it means lower future returns in terms of consumption of additional goods and services. And in the long run it is the concept of the natural rate that determines the return to saving, not short-term movements in monetary policy.

This concept of a natural rate of interest represents the real rate consistent with saving and investment being in balance, output being at its potential and neither upward nor downward pressure on inflation. While the natural rate may change over time, it is unobserved and can only be estimated. Such estimation is relatively imprecise, with different models giving a range of estimates making it uncertain as to the true level of the natural rate [1]. Nonetheless, the natural rate does appear to be lower than in the past [2].

Why unconventional measures have been necessary?

Developments in the natural rate matter for the conduct of monetary policy in the euro area. To stimulate the economy, central banks steer short-term real interest rates below the natural rate to encourage the public to bring forward spending, be it in the form of consumption or investment. As the natural rate falls, so does the rate that stimulates the economy. With the natural rate now lower in the euro area, and the significant downward shock to output and inflation from the crisis, negative rates, and our other policy measures, have been necessary to stimulate demand and drive inflation towards our objective.

There is a limit to how low short-term rates can go. Since the return on cash is zero, at some point the public will switch to using cash and disintermediate the banking sector. Of course, there are costs involved in holding large quantities in cash, so the crossover point lies a little way below zero.

Given that there is a limit to how low interest rates can go, other unconventional measures have to come into play. There is not just one short-term interest rate that matters for saving and borrowing decisions. Our asset purchase and targeted long-term repo programs seek to influence the entire constellation of rates that affect economic conditions. We have provided guidance that we will not withdraw stimulus until output and inflation are on sustainable paths. But let me emphasize once more, these measures were necessary given the size of the crisis and the already low natural rate.

Effectiveness of the unconventional measures

That brings me to my second question, have the unconventional measures been successful? The short answer is yes. The euro area economy is recovering steadily. Unemployment is falling, reaching 10% in the third quarter. Youth unemployment fell to 20.6% in the third quarter and continues to decline more rapidly than the overall unemployment rate. Bank lending to households and companies is growing, while demand for loans is rising.

ECB simulations showed that euro area GDP would be cumulatively at least 1.5% lower between 2015 and 2018 without the expansionary policy measures, with worse outcomes for inflation. And more than that: by acting timely and decisively we preserved future growth prospects. There is a growing awareness of the potential permanent negative effects of prolonged downturns, a process termed hysteresis.

There are a number of channels through which hysteresis works. Unemployed people lose valuable human capital and skills that may take time to recover. They may also become permanently discouraged from working, reducing long-run participation in the labour force. The distressingly high rates of youth unemployment witnessed in many euro area economies are likely to cause some labour market "scarring".

Prolonged downturns may also cause businesses to become increasingly uncertain about future prospects, causing them to delay investment. This has the dual effect of depressing current economic activity, which reinforces the downturn, and reducing the amount of capital available for future production. Lower future growth translates directly into lower natural rates today, something I shall return to shortly.

Other potential consequences of unconventional measures

While our measures have been successful in their aim of stabilizing output and inflation, they also carry risks in terms of allocation of resources and distribution of wealth and income. Potential risks include blunting the creative destruction of the crisis by allowing unproductive, zombie firms to remain in business and permitting the inflation of asset bubbles. Some have also raised concerns that low interest rates have reduced incentives for governments to carry out difficult fiscal and structural reforms.

These topics are complex and deserve a greater depth of comment than I have time to cover today. Given the audience here tonight, I wanted to focus on two particular potential consequences of our unconventional measures: the impact on the distribution of wealth and income, and the impact on bank profitability.

To an extent, monetary policy always works through a redistribution of activity. Lowering interest rates encourages households to bring forward to today some consumption planned for the future. Some have argued that negative rates have the perverse effect of forcing savers, such as those with a fixed savings target for retirement, to save more.

But such an argument is not borne out by the data. Since the introduction of the negative rate on our deposit facility, saving rates across the euro area have remained broadly stable, or have fallen. The only major country to have some rise is Germany. However, the profile of the German saving rate also reflects the ongoing recovery in the residential investment sector.

But before I analyze more deeply the distributional impact of monetary policy action by the ECB, let me first consider the distributional impact of monetary

policy *inaction*. These effects are clear. Economic activity would have been lower and unemployment – particularly youth unemployment – higher. This would have had a disproportionately higher impact on the incomes of the poor and the young. At the same time, inflation would have been lower, which research shows transfers wealth from younger households to older households, who are more likely to be savers [3].

So the ECB not acting also carried distributional implications. Further, the deeper and more prolonged recession would likely bring about greater hysteresis, depressing future growth and hence returns for savers. Overall, households would have been worse off had the ECB not acted.

Counterfactual discussions aside, how have households fared across the euro area? To gauge the effect on different euro area households, we can draw upon results from the Eurosystem's Household Finance and Consumption Survey (HCFS), conducted in 2010 and 2014. Even though these surveys do not cover the period since the introduction of the negative deposit facility rate, they do coincide with declines of 2-year euro area benchmark bond yields by 130 basis points and 10-year bonds by 110 basis points.

Euro area net financial income as a fraction of total household income fell slightly. When looking more closely at households grouped by wealth quintiles, we find that households with the lowest net wealth, whose debt payments are higher than their financial income, had an unchanged position. Households with the highest net wealth, whose financial income is much higher than their debt, had the most marked fall in income.

But while net financial income has fallen for the wealthiest households, the same is not true for wealth. Wealthier households tend to have a greater amount of housing wealth and house prices have risen since the introduction of negative interest rates. Extrapolating the HFCS forward using changes in equity, bond and house price data shows increases in the net wealth for every wealth quintile.

The ECB's policy measures have been unambiguously positive for euro-area governments. Germany alone saved approximately 28 billion euro in 2015 in lower than expected interest payments. Such payments would ultimately have been financed from lower spending or higher taxes. Broadly speaking, the lower income the household sector has received from income payments from government bonds, either directly or intermediated through the banking sector needs to be offset against lower tax liabilities now or in the future.

Indeed, research by Deutsche Bank[4] shows that the impact of low and negative interest rates on the returns of German household financial assets has been limited so far. This was in part due to revaluation gains on the back of the ECB's asset purchase program as well as interest income from investment funds and insurance and pension products. It is still possible for savers to gain positive real returns by holding a diversified portfolio of assets. Bank deposits may currently be giving a negative real return, but as research by the Bundesbank also shows, negative real returns on bank deposits is the norm, not the exception in Germany [5].

But savers are not the only sector potentially affected by negative rates. Low and negative rates depress net interest margins for banks since lending rates fall, but there is a floor to deposit rates caused by the effective lower bound. To date, ECB staff estimates show the impact of our policy measures has been net positive for banks [6].

Net interest margins have certainly been compressed, but that has been offset by a greater flow of lending as economic activity is higher, lower incidence of non-performing loans, again due to lower servicing costs and greater levels of activity, and revaluations of fixed income portfolios.

Over time, the revaluation effects will fade and the squeeze on net interest margins may intensify. Future expected profitability may also suffer if banks react to lower overall returns by extending riskier loans, which in turn may sour. Overall, potential negative side effects from low rates on banking sector profitability are likely to intensify the longer they are used, which is precisely why they are envisaged as short-term measures.

But our unconventional measures are not the only headwind for financial sector profitability in the euro area [7]. The overhang of non-performing loans from the financial and sovereign debt crises continue to weigh on banks' profits. At the same time, a number of jurisdictions are marked by overcapacity in banking and have average cost to income ratios markedly above those seen elsewhere in Europe and other advanced economies. Finally, banks are under increasing competition from non-banks and the FinTech sector. It is certainly a challenging time on many fronts for euro area banks, and many will have to consider carefully their business models.

Such efforts need to go hand-in-hand with further steps towards closer cross-border integration: completing banking union is crucial to allow banks to compete internationally as euro area banks and not only as national champions. We need a single euro area regulatory approach that will facilitate cross-border mergers, acquisitions and investment, thereby enhancing diversification, risk-sharing and efficiency. Only by completing what we started can we reap the full benefits of banking union.

Changes are also likely needed from savings products frequently used in the past. I believe that the really important question to debate tonight is not quite the published title, but instead: what are the challenges for long-term saving products in the presence of a low natural rate.

Conclusion

Let me sum up. The ECB's unconventional policy measures over recent years have been necessary to react to the severe negative shock arising from the crisis. They differ from conventional policy measures taken before the crisis in part because of impairments to the transmission mechanism caused by the crisis. But in major part the measures are a result of the ECB adapting to the secular downward shift in equilibrium interest rates over the past three decades.

The measures have been successful in stabilizing output, helping to reduce unemployment and have begun to help steer inflation back towards our objective. We will keep the measures in place until output growth and inflation are back on sustainable paths. While some redistribution between households is inevitable with monetary policy actions, it is clear that to date there has not been an inequitable redistribution in the euro area. Indeed, the distributional consequences of policy inaction would have been worse.

The ECB will continue to use appropriate measures available in our mandate to achieve our inflation objective. This includes the temporary use of the unconventional measures introduced since the crisis until growth and inflation are once more self-sustaining. In enhancing macroeconomic stability and inhibiting the short-term effects of the crisis from weighing on long-term economic prospects, monetary policy is providing

its best possible support to long-run saving.

And it is important to view the contribution of monetary policy in the wider context of macroeconomic policy. Fiscal policy can play a greater role in stimulating demand, reducing the burden on monetary policy. Public investment as a share of GDP has declined for a number of years. It is vital that fiscal authorities re-balance towards more growth-friendly policies.

Furthermore, the secular decline in rates is not inevitable.

Structural reforms are needed to unleash the productive potential of the euro area economy. Such reforms fall beyond the remit of the ECB and are the responsibility of other national and European policymakers. Now is the perfect time for such reforms, since the current accommodative policy of the ECB can help offset any short-term adjustment costs of their implementation. This is a window of opportunity that needs to be seized. Doing so will raise future income in the euro area, supporting an increase in the natural rate and boosting the returns to saving.

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[1] See Orphanides, A and J. Williams, (2002), "Robust Monetary Policy Rules with Unknown Natural Rates", *Brookings Papers on Economic Activity*, Vol.2, 63-145, Laubach, T and J. Williams (2003), "Measuring the Natural Rate of Interest", *Review of Economics and Statistics 85*, No4, pp 1063-70, Laubach, T and J. Williams, (2015), "Measuring the real natural interest rate redux", *Federal Reserve Bank of San Francisco Working Paper*, No. 2015-16 and Taylor, J.B, and V. Wieland, (2016), "Finding the Equilibrium Real Interest Rate in a Fog of Policy Deviations", *Economics Working Papers 16109*, *Hoover Institution*, *Stanford University*.

[2] Notwithstanding the uncertainty over estimates of the natural rate, key drivers of long-term interest rate in a standard Solow growth model such as productivity and population growth have been slowing for decades in advanced economies, suggesting that the natural interest rate may have indeed declined. See Gordon, R.J., (2016), "The Rise and Fall of American Growth: The U.S. Standard of Living since the Civil War", *Princeton U.P.* and Goodhart C., P. Pardeshi and M. Pradhan, (2015), "Workers vs pensioners: the battle of our time", *Prospect Magazine*, *December*.

[3] Adam, K and J. Zhu, (2014), "Price level changes and the redistribution of nominal wealth across the euro area", *Journal of the European Economic Association*, 14: 871-906.

[4] Deutsche Bank Research, Focus Germany – Difficult times for German savers, 4 October 2016.

[5] Bundesbank monthly report October 2015.

[6] Rostagno M., Bindseil, U., Kamps, A., Lemke, W., Sugo, T. and T. Vlassopoulos, *Breaking through the zero line – The ECB's Negative Interest Rate Policy*, Brookings Institution, Washington DC, 6 June 2016.

[7] For a more detailed discussion of the challenges for euro area banks and the interlinkages with monetary policy see Praet, P. (2016), "Monetary policy and the euro area banking system", Speech at ECMI Annual Conference. Brussels, 9 November 2016.

Consequences of present Euro area monetary policy on savings and capital wealth formation

Jacques de Larosière
President of the Observatoire de l'Epargne Européenne

As we all know, the ECB has engaged in a very bold expansionary monetary policy, particularly since the beginning of 2015.

My purpose is not to discuss the QE policy of the ECB.

My mandate this evening is to try and understand the impact of this policy on savings and on investment.

Consequences of QE on European savings

A) The balance between savings and consumption.

Yields - very close to 0 or even lesser – on riskless investments should, normally, dissuade economic agents from saving and induce them into more consumption, which would support growth.

But, contrary to the hopes of many, "financial repression[1]", especially in Europe, does not always result into an increase in consumption.

Households savings in countries like France and Germany are structurally high (respectively 15% and 17% of incomes) and have remained stable. They ensure more than 80% of the financing of the European economies.

The financial part of those savings is mostly of a precautionary nature (to face life uncertainties, unemployment, old age …) and is also constituted for transmission purposes. The majority of such funds are placed in savings accounts, insurance and pension funds which are themselves invested in "safe" assets.

When the yields fall or, sometimes even disappear, as a result of monetary policy, it would be logical to see savings switch to equity instruments that can provide, over the longer term, more satisfactory returns, all the more so if investors believe in an upturn of the economy.

In fact, it is that process that took place in the US as a consequence of Quantitative Easing (QE) . With lower long term rates, equity markets rebounded exactly in line with the creation of liquidity by the Fed. That upturn in equity markets triggered a "wealth effect" which contributed to more consumption.

But in the Eurozone, as I will show later, this process doesn't seem to work : no shift to equities, no wealth-effect. Indeed European savers are not the same as those in the US. They are basically risk-averse, and are not inclined to buy shares (which

[1] Some banks in Germany are beginning to charge their household clients a negative rate on their current accounts (higher than 100,000 €). Some French banks are applying such rates on enterprises.

anyway would be, most often, penalized by the tax system).

Perhaps more worryingly, for policy makers, the shift of repressed financial savings to consumption doesn't seem to work either. Indeed, one observes that a significant number of savers are trying to offset lower returns by more savings.

B) Savings, consumption and low interest rates.

Let us look into this crucial issue in more detail[2].

- Gross household saving rate in the Eurozone has been hovering around the high level of 12,5% of disposable income for the last 5 years (**Graphs 1 and 2**) in spite of QE
- Germany's household savings ratio remains high and stable over the last 15 years : around 17% of disposable income. And this rate has not been materially influenced by the fall in German Bond yields which have tumbled (from 10% to 0,5%) over the period 1995-2015
- France's household savings also show much resilience at around the - very high - level of 15% of disposable income. There is little correlation between bond yields and household savings behavior
- Switzerland is an interesting case in point : households savings rate has increased dramatically from 21% in 1999 to 26% since 2015 during the years of monetary expansion and ultra low interest rates
- The corresponding figures mark an evolution of 5% to 19% in Sweden and 1% to 11% in Denmark over the same period
- In the United Kingdom, the household saving rate surged from 6% to 12% after the Bank of England dramatically lowered its intervention rate from 11% in 2007 to 0.5% in 2009
- Even in the US it now appears that lower interest rates are associated with higher savings (while it was not clear before QE)

I know that we should be careful not to jump from these figures to too simple conclusions.

Some saving behavior may indeed have been impacted (boosted) by the uncertainties stemming from the financial crisis.

One can add that in some countries higher financial and non-financial investment may be associated with larger borrowing, a combination that would not result in a fall in consumption.

Be it as it may, it remains that:

1. When studying the interest rate – savings behavior, we see that the "income" effect (which requires a higher level of savings to offset the consequences of lower or negative interest rates) has been manifest in most European countries,

[2] See: « ECB and Europe's oversaving problems » by Paul Jackson – *Les cahiers de l'OEE*, May 2016.

while the "substitution" effect (saving less to spend more) seems difficult to establish (except for the UK and Italy although the picture is unclear in the latter case) ;

2. This "income effect" is one of the factors that explains the resilience of household savings in Europe during the last years of low interest rates ;

3. The UK is the only significant case where the "substitution effect" dominates (more spending when rates fall), which also explains the current account deterioration of that country ;

4. This tendency for large Eurozone countries to maintain or even increase household savings is in line with the increase of the current account surplus of the region :

Eurozone current account surplus
(as a percentage of GDP)

	2013	2014	2015
Eurozone	+ 2,2%	+2,5%	+3,2%

Source: ECB

The interesting fact (but worrisome for monetary policy makers) is that the QE years in Europe have been globally accompanied by larger national savings and higher current account surpluses.

All in all, the European experience does not suggest that extremely low interest rates (or negative ones) are a recipe for economic growth and the revival of consumption, let alone of investment.

Consequences of QE on investment in Europe

A) The behavior of investment in the Eurozone is lackluster

The gross fixed capital formation trend has been disappointing in the Eurozone as compared with the whole group of advanced countries.

Annual average growth rates of Gross Fixed Capital formation from 2008 to 2017

All advanced countries	+ 0.4%
Eurozone	- 0.8%

Source: IMF – World Economic Outlook 2016

B) Productive investment (carried out by non financial enterprises) appears quite insensitive to changes in interest rates.

Recent studies[3] have found that only 8% of firms in a September 2012 survey declared that they would increase investment if borrowing costs declined significantly. By contrast, 68% did not expect that any decline of interest rates would lead to more investments. This is all the more striking that interest rates were much higher in 2012 than they are today. These observations are consistent with the more recent ECB surveys.

The determining factors cited by enterprises in business surveys regarding their decision to invest are always :

- Expected sales,
- Future growth,
- Confidence.

Interest rates changes are hardly mentioned in the list of significant factors.

[3] See Sharpe and Suarez (2014) referred to in William de Vijlder article in *Conjoncture* - BNP Paribas sept./oct. 2016: "What is driving corporate investment?".

C) Low interest rates do not seem to boost equity in the Eurozone

One of the assumed advantages of QE (which reduces long term interest rates) was to dissuade savers from investing in 0 yield riskless assets and to divert them into equity.

This does not seem to take place.
Since the ECB launched its bond purchase program in 2015, the MSCI-EMU Index actually has gone down by 15% which is in contrast with the US experience (see Graph 3). The reasons behind this bearish performance of Eurozone equities are not related to monetary policy, but to the weakness of expectations on economic growth and profitability of non financial corporations

It is clear that low interest rates, if anything, have not boosted the stock market in the Eurozone.

D) In a region where banks account for the overwhelming part of the financing of the economy, it is essential to keep the banking channel open and active. Extremely low interest rates compound the difficulties of that problem.

In the Eurozone, banks represent 70% of total financing of the economy (the reverse in the US where financial markets play the predominant role).
But banks in the Eurozone have been deleveraging over the past years.

- For 4 years (2012-2015) the outstanding amounts of bank credit to enterprises has been reduced by 2% to 3% per year.

There has been a revival of bank credit since 2015 (albeit only 1,8% increase). But Spain and Italy continue to be in negative territory.

- On top of demand driven factors that explain part of the dampening of bank credit, there has been a sharp increase in banking regulation constraints which limits the ability of European banks to expand their business ;

- The low interest rate environment of today compounds this evolution and contributes to erode the average profitability of banks (ROE : 4% in 2015 in EU against 9% in the US) ;

- The envisaged additional constraints on risk weighting (“Basel 4”) could amplify this phenomenon and make deleveraging a bigger threat.

While it would be logical - and essential - to preserve the transmission channel of Monetary Policy (i.e. banks ability to lend) we see a continuous move towards more and more procyclical regulatory rules on the banking sector.

Contrary to what is often pretended, the more monetary policy is well intended and increases its ease, the less investors seem to be tempted to take advantage of it. If “actualization” (discount) rates, as they are set by private investors today, are high and conservative in spite of the low interest rate environment, and if savings are resilient, it is perhaps because the “extreme” consequences of lasting monetary laxity are seen as additional factors increasing uncertainty as well as undermining confidence in future growth.

In such an environment, it is vital that central banks instill confidence and reinforce long term stability signals.

Conclusion

The risks incurred by too prolonged an accommodative monetary policy could be huge not only for the future of the economy but also for our society. Even if it's obvious that the "natural" equilibrium interest rate tends to diminish in an environment of weak growth and high savings, this does not mean that it must become negative.

The interest rate will always remain the price that savers are entitled to expect for having accepted, for a given period of time, to postpone their immediate consumption. To say that such a price should become negative goes against common sense (time would be abolished !) and could bear grave consequences for the future.

How could one calculate with negative rates the returns expected on an investment ?

What would be, in a market economy, the future of long term investment projects that would involve high fixed costs and high risks? who would finance them without adequate remuneration[4]?

Resource allocation tends to lose its efficiency when interest rates get very low. Indeed, the only projects that can be financed at current prevailing rates are the ones which are viable with very low rates. Less profitable and more risky investments (but perhaps socially more beneficial) could be left aside.

It is a fact that the present European monetary policy is hurting insurance companies and pension funds. These institutions have long term liabilities vis-à-vis their clients. But the yields produced by their assets are edging towards 0. How can those institutions solve this discrepancy[5]? Let's not forget that insurance companies and pension funds used to play an essential role in the buying and holding of long term investment securities as well as in ensuring market liquidity. To make things worse, this fundamental mismatch stemming from extremely low rates, is compounded by regulatory constraint (Basel, Solvency II).

The current preoccupation with the inflation goal should not overlook the dangers of asset bubbles. Negative nominal interest rates are hurting households, insurers and pension funds and are historically unprecedented. Let us not forget that a similar process was at work in the running to the credit crisis.

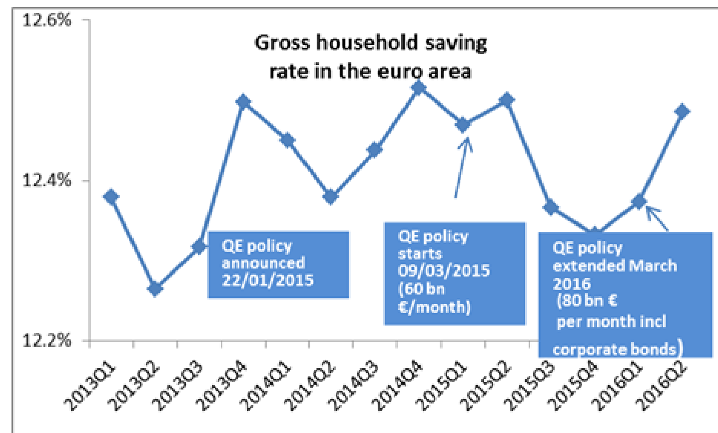
Truth is unfortunately simple:

It is not through lasting and massive liquidity creation - or even "monetary policy devaluations" - that growth issues can be tackled. Too much debt always leads to bubbles, to search for yield, to higher risks (insufficiently priced) and, ultimately, to crises.

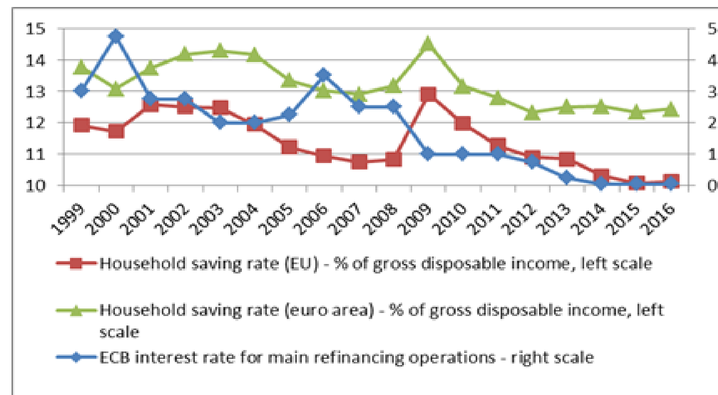
[4] More a project is risky and more its profitability is uncertain, more its discount rate (used to determine its present value) must be high, if private markets are to finance it.

[5] US defined benefits pension plans have moved from fully funded in 2000 to 74% funded (end 2015).

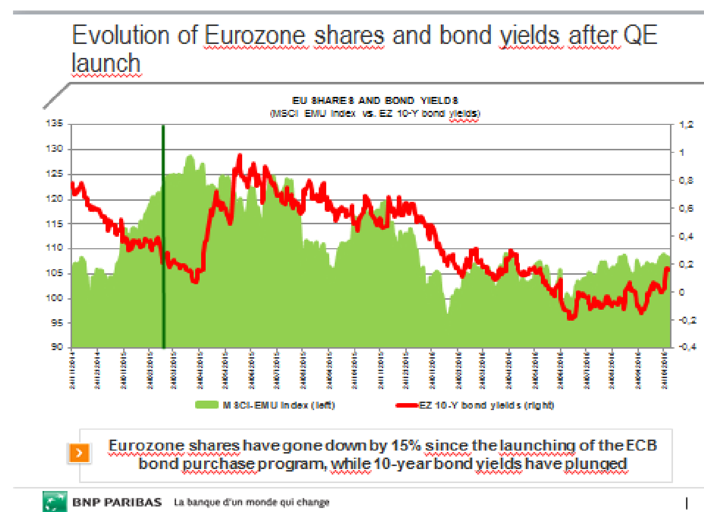
Graph 1



Graph 2



Graph 3



Effects on providers of long term savings and other players

Andreas J. Zehnder
Chairman of the Association of Private
Bausparkassen e. V.

Ladies and Gentlemen,

The first ECB President, the late Wim Duisenberg, once said: "It is normal for politicians to express their opinion from time to time on the interest rates policies. But it is equally normal for us not to listen."

In this context, I would like to thank Mr. Praet for taking the time today to join our event and have an exchange of views.

I am not a politician. I represent home loan banks called Bausparkassen, specialized credit institutions with over 40 million customers, who save and invest and who wish to trust their ECB. Just like the Germans in the pre-ECB era. Jacques Delors once said: "Not all Germans believe in God, but all of them believe in the Bundesbank."

The ECB is not any central bank. It is our central bank, catering to 340 million people of the Eurozone and to a large number of small and medium-sized financial institutions, not only big banks and investors. We have to live with each other.

This is why I truly appreciate your presence here today and your readiness to exchange points of view with us, thank you very much indeed for this.

To start with a positive remark, the ECB clearly deserves praise! During the financial crisis it took swift and resolute action.

When the interbank markets collapsed, the ECB did not hesitate to take over their function.
When the financial markets lost their nerves, the ECB regained the trust of investors.

When the financial crisis hit the real economy, triggering the worst global recession since the Great Depression, the ECB stabilized the economic cycle and provided incentives for growth.

However, the attempts to save Greece brought up tensions and disputes in the ECB. In the eyes of your predecessor Jürgen Stark the decision to go for OMT (outright monetary transactions) crossed the red line which leads to his resignation and another one sometime later.

Meanwhile the toolbox of the ECB is full of unconventional measures all of which have substantial side-effects; I shall come back to them later.

I don't want the ECB President to suffer the same fate as the former Chairman of the Federal Reserve Bank, Alan Greenspan. In 2000, US American senators praised him as "the best central banker we have ever had". And some years later he was blamed for the financial crisis.

And of course we are aware of the fact that the ECB is not the only one fixing low interest rates, it is not operating in a vacuum. The Chairman of the Fed, Mrs Yellen, sends her regards. And the same goes for Mark Carney of the Bank of England and Haruhiko Kuroda, Governor of the Bank of Japan.

I am convinced that the ECB, too, is watching the current developments with great concern as we are moving on unknown territory - but this is the real world and not a university lab or think tank.

Interest rates no longer indicate risks. They have lost their signal function for households, enterprises, banks and governments. Real estate and stock markets are showing first signs of price bubbles.

The ECB is trying to boost the business cycle in order to stimulate growth. This should entail a rise in the inflation rate.

But to achieve this objective the ECB needs others to play along. It can't do it on its own. It needs the real economy.

At the same time we observe that the Eurozone countries increased their debt massively. In 2009 their overall indebtedness amounted to 78 percent of GDP; in 2015 this figure reached almost 91 percent.

The idea behind the ECB's action was to buy time but unfortunately it was not used. The appetite for reform has gone whilst the risks in the financial system have grown, more particularly so in the ever increasing shadow banking system which is still not regulated.

The longer the unconventional monetary policy continues, the greater the risks from unintended consequences will be. The marginal benefit of the policies is also diminishing.

An exit strategy is getting increasingly difficult. Such unconventional monetary policy is like a mother-in-law who was planning to stay over the weekend but who is still around two months later.

The longer she stays the more difficult it gets to get rid of her and the more tensions rise at home.

I'd like now to express my concerns with a few questions:

First: If an alien, for example E.T, comes to earth and looks at the current monetary policy, what conclusions about the economic situation would E.T. draw?

Actually only one conclusion seems possible: We are in a crisis situation worse than the one of 1929.

But this is not the case. Take the US for instance: Growth 2 percent, inflation rate: 1.5 percent, unemployment rate: 5 percent. Do these figures justify the low interest rates of the Fed? No, of course not, the current rate is much too low, at least 2 percent would seem appropriate. In the Euro area the situation is not quite as good as in the US: less growth, higher unemployment, lower inflation rate.

The ECB says the low inflation rate is the reason for its accommodating monetary policy.

However, the main reasons for the low inflation rate so far are low commodity and oil prices. This becomes evident when looking at the core inflation rate which excludes food and energy prices; in the Eurozone it is 0.8 percent.

If today's oil price of about 50 US dollars rises to 60 US dollars where it was 18 months ago, inflation in the Euro area would rapidly approach the 2 percent mark again. The trend has already begun pointing upwards since the beginning of this year.

This takes me to my second question: What about the efficiency of the tools which are supposed to stimulate growth?

Unfortunately, there are no reliable studies or figures available on this subject. But some ECB internal figures have found their way to the public; according to them the growth effects in the Euro area are in the lower parts per thousand range! The figure is 0.1 percent. Such an effect is so small that it may be called negligible.

But let me return to the low interest rates and ask my third question:

Are the Germans the only ones having problems with low rates?

No. And it is not only the states in the North either. The savers in France, Italy, Spain und Belgium get also less and less interest on their deposits. This goes for both short term and longer term deposits.

And this is happening at a time when more private old-age provision is required because the demographic trend is pushing public pensions downwards.

For those who want to make provisions for the future, 'low risk' is the way to go. This is certainly the case for people in the middle or lower income segment. Since those who have little, have a lot to lose.
But without the compound interest effect there is nearly no room for more promising but also riskier types of investment.

Low interest means no interest income. It also leads to a runaway increase in asset prices - particularly for property and shares. So people who are reasonable enough to save up some equity before they purchase their own property are helpless and frustrated in the face of skyrocketing house prices.

You might object to this view by making the point that the zero interest policy is actually most beneficial to future home owners.

Leaving aside the fact that, all in all, more savers are losing more money than is gained by fewer debtors, these extremely

low interest rates for mortgages conceal a major danger, which is that debtors bite off more than they can chew over a longer period and find themselves in an interest rate trap when rates rise at a later stage. To avoid this, member states are now forced to pass laws which are to counter the hazards of the ECB policy.

Question 4: Some banks seem to cope quite well with the current situation whereas others don't. This is at least what the ECB President has recently stated in a speech to the German Parliament. But can we really afford to be indifferent about this divergence?

My answer is NO! Not if the dividing line runs between small and big banking institutions, between high risk and low risk business models.

And you, Mr. Praet, surely share my view that it can't be the objective of monetary policy to structure the banking sector and that collateral damage must be avoided.

Moreover, I wonder whether these assumptions are correct. Is the banking sector not suffering on a broad front? And isn't this the result of several causes?

One of the reasons is the non-performing loans as a result of the financial crisis, the sovereign debt crisis and a renewed slide into recession of some European countries.

Another reason is low interest rates: deposit based institutions, the most important partners of the real economy when it comes to the supply of loans, have to pay higher interest rates on older or long term deposits. At the same time, they have great difficulties to generate sufficient interest income from new lending.

Low interest rates severely affect bank balance sheets. They act as an slow poison. Higher banking fees are not a viable option in a highly competitive environment. Moreover, consumer organizations keep a close eye on banking fees.

The situation gets worse by the fact that small and medium-sized institutions are disproportionally affected by rising costs associated with regulation, and competition by unregulated FinTechs.

Unsurprisingly, profitability is shrinking across the banking industry. Some are, however, struck particularly hard: The smaller, deposit-based institutions, whose viability is linked to interest rates. We should not forget that these institutions have for decades lent stability to the financial system, not least during the financial crisis. They did not cause the financial crisis. They have never been involved in gambling activities on the financial markets. They did not rely on state aid when the banking sector was down.

Nonetheless they are supposed to pay the bill. The ECB cannot be indifferent about the fact that institutions with a sound underlying business model are facing problems. It would not be in line with its mandate.

This is why we also view with concern that the ECB focusses on purchasing

high-quality bonds. The market is drying out, whilst banks, insurance companies and other investors are forced to opt for higher-risk investments. With this policy the ECB might become a risk for financial stability - despite the fact that it acts as a banking supervisor itself.

Question 5: Is the reproach of creeping expropriation too polemical?

The ECB said that there is no right to positive real interest rates, and that savers always had to deal with negative real interest.

But if we take a closer look, we find that the phenomenon was by and large restricted to short-term deposits and investments. It does not apply to risk-averse savers who had opted for longer term investments as the latest Annual Report of the Bank for International Settlements confirms.

These savers - predominantly normal and low wage earners - have to be satisfied with considerably less real interest. They are the ones who suffer most from the zero interest rate policy and experience a gradual loss of wealth. Their willingness to make private provision for old age is undermined and the existing provisions are devalued.

In the 1970s, German savers could expect - on average - a real return of 2.2 per cent on savings certificates with a maturity of four years, in the 80s they even received 3.8 per cent and in the 90s 3.4 per cent.

I mentioned earlier that the low interest rates are not only a problem for German savers. In a recent study the ifo-institute proves that savers in France and Italy received higher real interest rates for safe long-term investments with a maturity of two years. In the 90ies, the real interest for savings certificates in Italy was on average 3.1 per cent and in France 4.6 per cent – even higher than in Germany. Today, you are not getting in these countries a return with a "1" in front of the decimal point. This marginalizes the compound interest effect for this savings product; incentives to save get lost.

Some argue that there are better investment alternatives, for example stocks.

Question 6: Is it not the savers' own fault if they take wrong decisions with regard to their old age provision?

Recommendations to savers to invest in risky assets such as from the stock market can't be a solution. Studies of the OEE show that not even subsidies can convince savers to opt for riskier investments. Stock market volatility has clearly increased since the start of the financial crisis. This deters security-oriented, risk averse savers.

Moreover, stock markets are not independent from interest rate changes. Once interest rates start rising again, share prices are bound to drop.

How sensitive stock markets react to even the smallest ECB signals can be observed time and again prior to decisive Governing Council meetings.

After all, I would like to come to a conclusion: With all the efforts the ECB

Undertakes, the side effects are getting worse. European citizen are starting to question the European idea. In this context, I greatly appreciate a recent statement by Yves Mersch, the ECB Director.

He said: “The longer we remain in this low interest rate environment, the stronger the side effects of our measures will be. So it has to be our shared goal to leave behind this special situation as soon as possible in order to minimize potential damage.”

The first years of the ECB were a success story, a symbol of the European idea which was met with confidence and enthusiasm.

If the ECB does not build on this tradition and changes its course, it should be honest and consider printing on the Euro banknotes a phrase found on U.S. coins and paper money: “In god we trust”.

Thank you for your attention!

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