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Securing the Future

THE HIGH-GROWTH MARKETS ECONOMISTS' ROUND TABLE

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St. Petersburg, Russia

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In cooperation with VTB Capital

Moderator:

Sergei Guriev, Rector, New Economic School

Panelists:

Cevdet Akçay, Chief Economist, Koç Financial Services and Yapı Kredi

Simeon Djankov, Deputy Prime Minister, Minister of Finance of Bulgaria

Alexei Kudrin, Dean, Faculty of Liberal Arts and Sciences, St. Petersburg State University

Yaroslav Lissovolik, Member of the Management Board, Chief Economist, Head of Company Research, Deutsche Bank in Russia

Jun Ma, Managing Director, Chief Economist, Deutsche Bank in China

Vladimir Mau, President, Russian Presidential Academy of National Economy and Public Administration

Alexey Moiseev, Head of Macroeconomy Analysis, VTB Capital

Roland Nash, Senior Partner, Chief Investment Strategist, Verno Capital

Peter Ong, Head of Civil Service Permanent Secretary, Ministry of Finance Permanent Secretary (Special Duties), Prime Minister's Office, Government of Singapore

Thomas Scott, Chief Economist, Development Bank of Southern Africa

Lúcio Vinhas de Souza, Sovereign Chief Economist, Moody's Investor Services

Oleg Viyugin, Chairman of the Board of Directors, MDM Bank

S. Guriev:

This is a round table of economists from high-growth markets. Situations change every day so sometimes high-growth economies become low-growth economies, but currently we have put together this panel with economists from many countries, mostly outside the developed world. We will talk about where the world is going and what challenges emerging markets are facing.

I will not introduce the panelists because we have so many distinguished panelists. In the programme we actually have profiles of the panelists and, to save time, we will give each panelist a few minutes to answer the most important questions. What is going to happen to Europe? What is going to happen to the US? What is going to happen to emerging markets? How will challenges in the developed world affect emerging markets and so on?

Before doing that, we will start with a vote. Please take your interactive voting devices. What we will do is we will run a vote, but we will not show the results. At the end of this session, we will run the vote again and then we will compare the results before and after, and see whether the panelists have made you more optimistic or less optimistic.

Before giving the floor, let us vote. Can we put the questions on?

What are the main risks for the global economy now? Europe, US, emerging markets, or there are no risks. Please press one of the four buttons. You cannot choose all of the above. You still have 10 seconds to choose.

OK. Let us put up the second question. Do you think in the next few years you should be optimistic or pessimistic? It is a yes or no question. As I said, we will not tell you the answers right now, but we will run the panelists' views and then see whether they make you more optimistic or less optimistic. OK.

Great. We took the temperature, now let us start talking. Once again, I will not introduce the panelists. I will just give the floor to Thomas Scott on my left. Thomas, what do you think is going to happen? What do you think we should be happy about or worried about?

T. Scott:

Thank you. There are some benefits for going first; hopefully, I will be able to get in a few interesting points. The first question was: will the crisis in the eurozone be resolved successfully or not? I think that in thinking about that, one must ask the question, what does one mean by successfully resolved and over what period?

My view is that the real roots of the problem and crises are structural. Those are not amenable to short-term solutions and short-term remediation. They will take time. In my view, Europe will not move off the inpatient board in the hospital for some time. If one, however, means success in management of the crisis and managing potential trigger events, and the beginnings of movements and reforms to address the basic problems and issues, I think progress is possible and there is a more realistic outlook. There is always adjustment to a crisis. It is just the scale of the costs and the period over which they are spread that varies. My view is that fear and enlightened self-interest will ultimately see enough being done in Europe to avoid an escalation to an implosion scenario. That does not mean that it will be without costs, and costs will be unevenly spread, I am pretty certain.

I think that one just does have to say in closing on the European question, that with as many variables moving at once as there are currently and such complex dynamics, there is an element of a chaotic system at work and a degree of indeterminacy in the outcomes. I think that is why it is so important to manage potential trigger events. In a way, the limits of union are being explored in real time at the moment.

The second question was around the United States: what will happen in the US? In my view, there is a slow rehabilitation taking place in the US economy, subject to setbacks, but if one looks at it in the longer term perhaps less vulnerable to setbacks than other parts of the world. A slowly recovering US in the coming years would be a supportive component in the global growth picture. Again, a significant number of the problems in the US are structural and, of course, the looming elephant in the room is the federal budget deficit.

In terms of the monetary accommodation and monetary policy, my question is really whether you can push your strength. The key is confidence in the

consumer and corporate sectors. Has the housing bust bottomed? Is employment beginning to rise? These are some of the key questions. Progress appears to be slow but perhaps surer than in some other parts of the world.

In terms of the emerging markets, what would the main risks be coming from an emerging market, as I do from South Africa? In my view, the core risk facing emerging markets is still contagion from the advanced countries feeding through the normal spoken about four channels of trade, credit, investment, and asset-based effects. Export volumes, commodity prices, capital flow, fixed investment, inflation, asset values, credit supply, currency values, and employment and incomes are the kind of factors that are impacted.

In that broad group of contagion issues, the first key risk is the worsening of the recession in Europe coinciding with an absence of traction in the US economy. One of the big concerns about that is that ultimately, the emerging markets are linked directly or indirectly to final demand in the advanced countries, and there are concerns that slow recovery or continued recession will accumulate in an emerging market's domestic sectors.

The second risk is, of course, the escalation of the sovereign debt crisis in Europe administering further shocks to the global financial system. The question is: can the emerging markets hold up as well as last time to buoy the global economy? I think the feeling I certainly have is that they are less well placed to do so.

Lastly, a third risk: possible changes that might be made to the Euro or eurozone structure would initially introduce opaqueness to financial markets, and risk aversion could quite likely be an immediate response, as the implications of any moves are explored and as a delegation might discriminate against some emerging markets.

Then the question on where I would put my personal money in terms of a global scenario, I would be looking for soft commodity prices and continued volatility in global financial markets as the eurozone dynamics play out. That scenario would present, in varying measure, a balance of payments, economic growth, and inflation risks to developing countries and some emerging markets.

The last question that was posed is taking a stab at the global growth outlook in the 2013–2014 period, and then 2015 to the end of the 20s. The current IMF GDP growth forecast average for 2013–2014 is around 4.2% for world growth, and 2015, 2016, and 2017 is 4.6%. That forecast, to me, is vulnerable. In my view, there is a likelihood of pulling back, a possibility of pulling back below the 4% level on average in 2013–2014. But if the current set of global structural problems, the debt issues in Europe and the US, are confronted and some progress made in addressing them, then the 2016–2020 period could see a synchronized rebound in global growth begin in that period, and that would quite possibly take the growth above the current forecast level.

S. Guriev:

Thank you very much, Thomas. Let us move on to Cevdet Akçay. What is your take on Europe, the US, and emerging markets?

C. Akçay:

I have to agree with most of what was said actually, but maybe I should be giving you some base objective views of mine about what is going on in the world from a more top-down view. I think the world was caught a bit off guard by the global crisis in the sense that we were reaping the benefits of globalization without really understanding what it meant. I think to understand what it means economically is very important, but it also has some political implications as well, which I think, going forward, will play some tricks on economies in the near future. But let me just concentrate on the economic interpretation of globalization. As far as I can see, as a macro-economist, I think globalization means, of the three channels that affect every economy, which are trade, finance, and expectations channels, the first two channels (trade and finance) move out of your control. In other words, you voluntarily give these two channels to the global system to be governed on your behalf by them. That leaves with you with only one channel to manage, which is the expectations channel, to reach a number of goals. This is the problem of number of tools versus number of objectives. Your tools are now much less but your objectives are still many, and they are there;

they are not disappearing. I think every administration, economic, political, et cetera, every country that is, has to be more skilled, more sophisticated, more knowledgeable, et cetera, in running this very different economic world: the global world. I think we were caught a bit off guard, so it is very important that we understand how we should be handling things from this point onwards.

As for the implications and repercussions of the crisis, I think the world has been turned upside down with the crisis, macro-economically speaking. I think for at least the next two decades – that is because I cannot see beyond two decades, not that I am able to see within two decades – two parameters that will govern countries and their performances will be the following: one, the health of your financial sector; and second, the sustainability of your debt dynamics. Now, these were two very common problems for emerging markets and it was not too much of a problem for the world overall, but when these become the problems of the developed world, then the repercussions are very different. These two parameters will also be affecting your growth performance going forward. If you have vulnerable debt dynamics and you have a messed up financial sector, your growth potential is going to be quite low. That is more or less what I think the big problem is in Europe now.

The US is also suffering from the same problem, you would say. I agree that the US is, at this moment, running a dangerous experiment. They are starting to actually succeed but they are trying to jump-start the engine, if you like, because there are huge liquidity expansions, loosening on the monetary side, and also fiscal stimuli accompanying these. Now, that is a very lethal combination. If it succeeds in jump-starting the engine, fine. But if it does not, the car is basically going downhill and it just crashes. It basically hits the wall. I think the US will manage to actually come up with some kind of a solution in the next three or four years, showing us that it is actually a sustainable situation, but I am bit more pessimistic about Europe because Europe's problems are manifold in the sense that they have a political union problem. They have a Euro problem in the sense of the optimal currency area. The EMU did not prove to be an optimal currency area as far as I can see. In retrospect, that is the second problem, and this has nothing to do with a lack of a fiscal union. It is part of the problem but not the

entire problem. Thirdly, the financial crisis leading to a banking crisis leading to an economic crisis is going full throttle in Europe, as far as I can see. The debt dynamics are worsening. Even if fiscal austerity is there, which is questionable, debt dynamics are still going to be worsening for Europe for the foreseeable future. Let us not ignore the last one: demographics. European demographics are horrible, and my take is that even if the financial crisis had not taken place, Europe would have had a fiscal crisis at some point in the future. Now, add on top of all these the financial crisis and it is a very, very challenging picture.

I am an eternal optimist. I do not think we will have an implosion but I think Europe is going to have a very, very tough two decades, and the problems are truly structural. The channel I talked about, the expectation channel, is very crucial in the following sense. The markets, I think, are committing the following mistake: they are confusing the long run versus the short-term solutions. Every time you come up with certain measures in Europe, markets are saying these are fine for the short-term but they do not solve the long-term problem. Well, Europe does not have that luxury. That is, this is time T and you cannot look at time $T+N$ and try to see the solutions for $T+N$. You do not have that luxury in Europe. You focus on $T+2$. So you say, can we handle it from T to $T+2$, and at the end of $T+2$, we will re-look at $T+N$ and see if it is more doable. If it is not, we will focus on $T+4$. That luxury does not exist and I think one very problematic case for Europe is markets are misperceiving the situation. They are trying to see all the solutions at once. That is nearly impossible. So that expectation channel is very, very crucial.

S. Guriev:

Thank you. If that is an optimist, I wonder what happens next, but let me ask you a philosophical question. You started with the channels and you said that many things have become global. Are you an optimist in terms of supranational coordination resolving the issues of trade and finance within the next 10 or 20 years, or beyond if you can see beyond?

C. Akçay:

That I would not say. I think that running the expectation channel is going to be more rational than it has been so far.

S. Guriev:

But these things are interacting, right?

C. Akçay:

They do, exactly. They are affected by the running of the expectation channel, obviously, but that problem you talked about cannot be resolved because it is more like a command economy, if you like, and it is not like that. As you said, it is a bit more chaotic than it looks on paper. That chaotic situation, I think, is going to be prevailing for some more time. That is unavoidable.

S. Guriev:

Thank you. Oleg, please, are you an optimist or a pessimist with regard to Europe, the US, and emerging markets? Where are you on this?

O. Viyugin:

If you do not mind, I will take this opportunity to speak Russian.

S. Guriev:

OK.

O. Viyugin:

With regard to the US, I believe the risk lies in the fact that its weak growth is untenable. We cannot expect that in the future, we will see growth or an improvement in the situation.

Regarding the eurozone: the institutional and structural problems facing the eurozone are so severe that it is difficult to say unequivocally that these problems will be solved without monetary expansion. The monetary expansion will come from the European Central Bank or from individual central banks with national currencies, which will begin to emerge in individual countries.

Regarding developing markets: here, the risk unambiguously lies in the fact that these markets have been up until now, and will continue to be for a long time to come, dependent on the developed markets. The risk of high volatility and reduced economic activity in this part of the world is very high; in effect, it is already playing out.

Why, in my opinion, is America's growth untenable? It is hard to believe that such a long history of low interest rates has resulted in the correct placement of investments. Americans are, most likely, still largely spending their future wealth. We are facing a global problem: right now, it is generally playing out as a debt issue. And the problem is not so much that the debt is too high, but that this debt was obviously created and used quite ineffectively. It is not completely clear to me how one can come up with useful forecasts and 'capture' future developments in an atmosphere of long-term low interest rates.

As far as Europe is concerned, I do not have much to add to what I have already said. These are very complex issues. In regard to whether I am a pessimist or an optimist, I believe that Europe will partly solve its national problems: it has the necessary political arena. But in some respects, it seems that Europe will also have to resort to monetary expansion. I guess this opinion lies somewhere between pessimism and optimism, but a bit closer to optimism, because I do think the institutional problem will be partially solved, step by step. It seems the political arena will allow this to happen. Developing markets are still following rather than leading. Unfortunately, analysts who think that developing markets can buoy up crashing developed markets due to growing domestic consumption are being proven wrong. These changes take a long time: before consumption can grow to match existing production levels, people's wealth must increase. And when people's wealth increases, it wipes out all margins created by low production costs, and the only way to salvage the situation is by pushing technology, quality, and so on to a whole new level, rather than by switching to the export-oriented model or the model of fast quantitative economic growth. This requires time. I am not saying that developing economies, such as China, are not capable of this, but it does require a lot of time, while the situation is growing worse by the minute. Thank you.

S. Guriev:

Thank you very much. Even you are saying that your outlook is partly optimistic, despite these forecasts. Alexei, do you consider yourself an optimist? In which part of the world do you find reasons for optimism?

A. Kudrin:

I agree with everything Oleg Viyugin has said, though I would consider myself a pessimist.

S. Guriev:

As compared to Oleg?

A. Kudrin:

Yes, as compared to Oleg. But I do want to add a few things to this picture.

I truly agree with many of these assessments. I will start with Europe. I believe that for the past six months, if not the past year, we have been standing on the precipice of a grave debt crisis. No measures have been taken to avoid it in the past year. Even now, when everyone considers Greece to be the first domino to have fallen, we see no solution to this problem. Greece must stick to the programme. We need to hear that it will stick to the programme. However, in its present condition, this programme cannot be implemented. Germany has announced that it will not budge on the parameters of the programme. But even if it concedes and softens the policy, this will not solve Greece's problems. Now the problem is engulfing other countries: Spain and Italy. This will mean a full-scale problem with the debt incurred by the financial sector in Spain and, I believe, in Italy.

In fact, this cannot be prevented: the time has come and gone; the process is already underway. Therefore, in the near future, Europe will have a most serious financial and economic crisis on its hands. It will be fully underway within a year: the financial expansion measures designed to soften it will partly delay it, but it will happen regardless. Today, companies, financial institutions, and banks are

developing strategies to prepare for this serious situation. They are deleveraging and selecting strategies based on the worst-case scenario, but these steps are only serving to strengthen the crisis. Currently, I see no political cohesion in Europe, first of all in terms of adequate evaluation of this situation, and secondly in terms of fast and adequately sweeping decisions.

Today, I would suggest that the only way we can step away from this precipice of debt crisis is by writing off or restructuring part of these problem countries' debts. Let me be frank: today, Spain and Italy must address this debt by partly writing it off. The financial sector will need help finding additional financing in cases in which shareholders will not be able to shoulder this themselves and will need help from the state. But this would be a much more calculated move than simply waiting for the situation to develop in the next few months. We are almost out of time. A large financial union will become a reality in the more distant future. But it cannot be created in the next two years, or rather, it will not solve the current situation. Even the creation of a financial union and the further consolidation of state powers in taxation and financial policies is not a simple process. This would require Germany to transfer some of its powers to some sort of union, and it would have no guarantees that it would have a majority vote. This process would be far from simple. At this time, I am sceptical about fast deployment, but strategically, it cannot be avoided. If Europe is to remain united and maintain the euro, at least within its boundaries, this process will be inevitable and will lead to a more formidable financial union.

In regard to the US, I agree that the country has three or four years to conduct its consolidation process. The current level of budget deficit cannot be tolerated. After the presidential election, a new team will have to offer solutions. I think they have two years, but these things usually get stretched out, so they probably have around three years to implement some measures. If the US does not implement consolidation measures (and these measures will not be made easy by the European crisis), then two to three years from now the world will lose much of its confidence in the dollar. These are lessons for developing markets. We are deeply involved in this process and highly dependent on it. Therefore, we cannot gamble on a successful, stable capital market. In regard to Russia, we have

probably not created certain necessary investment climate conditions or provided specific solutions for structural problems to increase stability. Now, on the eve of the deterioration of the general situation, we must accumulate additional reserves in order to meet the challenges facing Russia's economy and financial sector. Therefore, our strategy must be quite conservative. I believe it will be difficult to maintain Russia's current level of government spending in the face of the growing crisis. However, we do have certain opportunities, so it is crucial that we do not add to this spending and do not further our dependence on oil revenue. Obviously, for a period of time when the crisis expands, oil prices will fall much lower: to USD 70 or maybe even USD 60. Therefore, we need this safety net. I would even venture to say that today, we must borrow more while we still can, before lending market conditions deteriorate even further. This will allow us to build a certain bulwark to stave off the oncoming decline before our debt gets out of hand. Forecasts for Europe will be re-evaluated to account for a decline, both for this year and next year. In just two or three months, we will be receiving a range of new forecasts that will address the deterioration of these markets. Consequently, if the West experiences a decline, our Russian forecasts will also be re-evaluated to show lower growth rates depending on the severity and depth of the impending crisis for this year and next year. So, I would probably call myself a pessimist.

S. Guriev:

Thank you, Alexei. I did hear a hint of optimism in your remarks. You believe European banks can default and restructure. So far, it remains unclear where the European banks will get the capital, because the governments are broke too, are they not?

A. Kudrin:

Some estimates show that this will require 400 billion. In all likelihood, this amount is doable. But if it requires 700 to 800 billion, that could be a problem. And some estimates place this number considerably higher.

S. Guriev:

Here is my second question: when you were talking about other countries, you mentioned possible solutions, but also gave us your assessment of whether the solutions will be implemented. What do you see happening in Russia? Not what you think must be done, but what will be done.

A. Kudrin:

This morning at the Sberbank breakfast, I was disappointed to hear Shuvalov talk of increasing spending on modernization: that is a mistake.

S. Guriev:

OK, thank you.

A. Kudrin:

This does not mean modernization is not needed; it simply establishes a deliberately dishonest source and dishonest mechanism for it.

S. Guriev:

Following your logic, unnecessary assets must also be sold, correct? Before oil prices fall, we must privatize Russian assets, because later, in addition to being unable to borrow, we will be unable to sell anything.

A. Kudrin:

It is too late already. The prices are already significantly lower: they have fallen by 30% or more. But in the next three or four months, things will get even worse.

S. Guriev:

It will get even worse. I see.

S. Guriev:

Peter, are you an optimist or a pessimist on Europe, the US, and Asia?

P. Ong:

Thank you, Sergei. I guess I characterize myself as a pessimist in the short term. In the long term, I hope to be an optimist. I would like to cast my responses to your questions as a policymaker, which I am, and I would like to make two major points, two fundamental points. The first one is that for the first time since the global financial crisis we are seeing the prospect of a synchronous slowdown in all major regions of the global economy: the US, Europe, and major emerging markets. The second point is that the policy space is increasingly dwindling and the cost of ineffective action grows with each failed attempt.

Let me now elaborate on each of my two points. We are seeing that all throughout the global economy major regions are seeing slowdown. It was OK when Asia and the US were recovering from the global financial crisis, but what we see now is a synchronous slowdown. The US Fed just revised their forecast for the US economy this year. Its recovery from the global financial crisis was tentative, and now it has turned tepid. First quarter growth was 1.9% versus 3% a quarter ago. Even though the monthly data goes up and down, jobs growth has not been very encouraging. You would have heard the press conference from Chairman Bernanke last night. And so the slowdown is being felt in the US. Of course, all of us know that the big event at the end of the year, where we face the prospect of a fiscal cliff is something that worries all of us. If nothing is done, it could result in a negative shock of about USD 600 billion, which is about 4% of the US GDP. That is one key area.

The eurozone will probably see a mild recession this year; that is to be expected. Then in major emerging economies, in China, in India, and in Brazil, you are also seeing slowdown even though they have been recovering very strongly since the global financial crisis. Chinese manufacturing and Chinese data on electricity output show that moderation. Brazil, too, is seeing quite a rapid slowdown and our colleagues from India are experiencing the same phenomenon. So it is against this backdrop of the synchronous slowdown that we, policymakers, have to confront deep challenges in Europe.

That brings me to my second point, which is that the space for effective policy action gets reduced with time. We all know that the immediate cost of the

eurozone crisis is really a result of a project to form money for the union without a fiscal union. Basically, having a common currency but with no budget control. And this has led to fundamental imbalances across the entire eurozone, imbalances between the core and the periphery, imbalances that show themselves through public and private spending, trade imbalances, and underlying productivity and competitiveness imbalances that we will all have to move towards balancing over a period of time. But we know that any movement towards a fiscal union would also raise questions on the need for a political union, and with that also a social union. And by social union, I mean a convergence of social policies across different countries within the eurozone. We know that it is not easy to discuss issues relating to a political union, simply because countries will have to give up their sovereignty and it is hard to countenance having a bunch of bureaucrats in Brussels making decisions that impinge on national sovereignty. And in the area of convergence of social policies, which is needed if you are going to have a budget control within a fiscal union, a lot of these social policies within individual eurozone countries arose as a result of building up the social compact between government and its people over a period of time. Any movement towards social union really flies in the face of having to work against the grain of citizens with aspirations for a kind of lifestyle, the kind of quality of life they have come to expect over the decades. You have to work against issues of intertemporal distribution within countries, and now you have to think of those issues in the context of an entire region, because it is going to be very difficult for a worker in one country to work until 67 in order to finance the retirement benefits of someone who retires much earlier. These social policies have been built up over a period of time and it will take a long while before we can see harmonization and convergence of these policies in the short term.

Then we also see in the interplay of sovereign imbalances with the banking sector that has impacted financial stability within the eurozone. It has exposed the weaknesses of a lack of a banking union. Many of the issues that we see in the banking system, by the very nature that we have a very interrelated banking system within the eurozone, require the region to have supranational institutions

to deal with issues of supervision, banking regulation, and supranational bank deposit guarantees. Again, these are issues which are not easy.

So I have outlined five different unions: a monetary union, a fiscal union, a political union, a social union, and a banking union. Each of these pieces will all have to come together for there to be a comprehensive solution. Obviously, we have to balance between the short term and the long term. Not all issues can be dealt with in the short term, and I think it calls for wisdom on the part of the political leaders to understand which of these measures are to be front-loaded, carried upfront within maybe T+2, to use the parlance mentioned earlier, in order that you can ride through the immediate next one to two years and then, when you bring about a level of stability to then countenance a more full-blown union of sorts on all five different fronts. So we find policymakers today caught in the quandary over the five different unions and it would take quite a while to play themselves out over a long period of time, all with impact on the real economy.

Speaking as a policymaker from Asia, obviously all these will have a negative impact on emerging economies in Asia. Asia is highly dependent on trade. Europe is probably the largest, if not amongst one of the largest, trading partners of China and Singapore. And so through the trade mechanism you expect that it will impact on Asia. Through the banking sector, the loans that have been made by European banks to Asia, that will be another transmission mechanism. Asia is very open to exports and trade finance is a key part of the banking scene in Asia. European banks, in particular Spanish and French banks, account for some 40% of trade finance in Asia and as they go through a period of deleveraging, you expect that it will impact on trade financing and, therefore, trade for Asia. Also, there is the issue of financial contagion. Whenever you have contagion, there is always a flight to quality. That means an exit from emerging markets in Asia that would then put the squeeze on term loan financing by corporates, in particular the USD.

These are many of the reasons why I remain pessimistic in the short term. But as we contemplate beyond the short term into the medium to longer term, I think the cost of a very disorderly phenomenon happening in Europe is just too great, and I think it weighs in on policymakers. It is too dire for them not to do something,

and that is where I have some hope over the medium to longer term. That the political will of the leaders, who obviously know the dire consequences of continued ineffective policy measures, will get their act together for the region and for the world. Thank you.

S. Guriev:

Thank you very much, Peter. Roland, are you more optimistic? It is hard to be less optimistic. Are you more optimistic for Europe, for the world? What is your take, for example, on the IMF forecast? Are you more optimistic than the IMF? Are you less optimistic in the short term or the long term?

R. Nash:

Peter answered that question as a policymaker. I am going to try to answer the same question as a financier. In the interest of time, I am going to do it, if I can, by redefining Sergei's questions down into one. I think the answer to that question will go a long way to answering all the others, but before I do that, I just want to lay the scene a little bit.

If you look at the world economic outlook, the latest IMF world economic outlook, the IMF split the world into advancing economies, which is Europe, the US, Japan, some Asian countries now like Singapore and Korea, and then the rest of the world. In 2012, for the first time, the advanced economies and the so-called emerging and developed economies have exactly the same GDP by PPP: USD 41 trillion on both sides. If you listen to what we have been saying here, if you read the newspapers, if you take part in conferences, then it is very clear that all of the world's problems to do with growth are in the part of the world defined as developed, and all of the world's opportunities in terms of economic growth are coming out of parts of the world that are defined as developing and emerging.

Here is my question: why is it that global savings still go from the parts of the world where the opportunity is into the parts of the world where the problems lie, i.e. the developed world? That is clearly happening. You can see that in many ways. If you look at the world's institutions, at the world's pension funds and insurances funds, 90% of assets are still held in the so-called developed part of

the world. Look at the amount of money that America is still borrowing. Before 2008 and 2007, America was borrowing from the rest of the world roughly USD 700 billion a year, and that was part of the cause of the financial bubbles that emerged and the subsequent collapse. Today, after the collapse that started and was caused in America, America is still borrowing USD 500 billion a year and at lower interest rates. Finally, sort of anecdotally, I was in a hedge fund conference yesterday in Monaco with some of the world's most powerful hedge fund managers, all terrified. The conference was focusing on these questions and it was very clear. Everybody said all the problems are in the EU, they are in the US, and the conclusion from that was to sell emerging market assets and buy developed assets. Why is that the case? The answer that is generally given is that there are such huge macro issues globally today that the only safe thing to do is to run into safe havens, and the safe havens are all in the developed world. We just heard from Peter that people sell emerging market assets and they go into the developed world: the flight to quality.

Let us go back to IMF's split between advanced and developing countries. The developing countries have 50% of the world's GDP. They have 60% of the world's savings. They are generating 75% of the world's growth. They have 80% of the world's people. They have very little debt, generally speaking, and they have extremely cheap valuations on most assets. So to me the idea that the safe haven is in the developed world – just listen to what this panel is saying – it does not seem to make too much choice. So what is the reason? What is the actual reason for money to continue to flow?

I think, partly, it is actually just market inefficiency. I think there is at least one key market inefficiency which is quite easy to spot, and that is that the institutions globally that are capable of absorbing the world's savings are all in the developed world. Who can intermediate these huge flows of savings? These are global investment banks. Where are the global investment banks based? They are all based in Europe and the US. They know how to intermediate money into those regions. Which are the markets that are capable of absorbing those kinds of flows? They are all in Europe and the US. The US treasury market has the liquidity to be able to absorb all of those savings. It is very difficult, actually, for a

Chinese saver to effectively lend money to an Indian household or a Russian household, even though there is huge spreads in terms of borrowing and lending costs across there. So I think that some portion of the reason why money continues to flow into Europe and the US is because the institutions do not exist to funnel the savings in the other direction. The global financial markets are not capable of doing that.

To get back to the original point that Sergei asked, am I optimistic or pessimistic? I think that there is an enormous opportunity in that arbitrage, in arbitraging the money in the opposite direction, getting money going into emerging markets and out of developed markets. When eventually that happens, because in the end the economics will come through, then you will have money actually going to the places where it can work hardest and that can actually sponsor faster economic growth than we had in the past when the money was going in the wrong direction. There is a big transition cost associated with building that market infrastructure, and one way of defining it is that it is kind of what we are living through right now, but in the end, I think the opportunity is great. In that sense, I remain a long-term optimist.

S. Guriev:

Thank you, Roland. I actually came here from a session where I interviewed Lloyd Blankfein, the CEO of Goldman Sachs, and we discussed exactly this issue. He remained confident that Goldman Sachs will be an international firm but said that we will not see a non-American CEO in the foreseeable future. That will be in the next generation, he said. Yaroslav, do you have anything optimistic to say, before everybody is scared?

Y. Lissovolik:

As I did last year.

S. Guriev:

Yes.

Y. Lissovolik:

Last year during the same session, I was in the camp of optimists and I have mixed feelings about that because, obviously, the good thing is that we did not have a fully-fledged second wave of crisis accompanied by major recession globally. That is good. On the other hand, clearly risks have intensified since then and are squarely focused on Europe. Personally, I think that there is a division of labour of some sort that is in order in the global economy between developing countries and developed countries, in terms of how they should adjust to current circumstances. In terms of emerging markets, I think clearly there is scope for emerging markets to be the key drivers of growth, globally to contribute more and more to growth. The responsibility and the tasks for the developed markets are to provide the foundation for sustainable growth in the global economy and to forge ahead with greater macroeconomic stability, which would be the basis for more sustainable growth rates.

If developed countries are to still contribute to global growth while forging ahead with macroeconomic stability, what is the key recipe here? What is the key factor? Clearly, I think this is labour productivity and I think for all of us, this is probably one of the main indicators with which we should judge the quality of the adjustment of the global economy of individual countries to the current crisis circumstances. I think productivity growth would be absolutely crucial in the adjustment of the global economy to the ongoing deceleration on growth in the advanced countries, and the possible, the likely deceleration on growth in emerging markets later on as diminishing returns kick in from the use of capital and labour inputs.

I think, in terms of how countries grow, there are essentially two ways that economists assess growth. One is increase in capital inputs. This is capital and labour factor inputs. This is what economists call perspiration. Then, there is productivity growth, which is inspiration. Of course, for some of the European economies in the midst of this depressing debt crisis, it may be quite difficult to be too inspired and to forge ahead with substantial productivity gains, but we have some rays of optimism, some rays of hope.

For one such successful example, I would point to Ireland. Ireland is actually one of the very few countries in the debt-ridden eurozone area in the very epicentre of the crisis which may come up with positive growth rates. It is actually the country with the highest productivity growth in the past three years of all of the OECD countries. Here is one example of a country that is in the midst of the crisis but through a mix of fiscal and structural adjustment is managing still to, at least, aspire to some growth. Actually, the track record of Ireland previously back in the 1980s attests to the capability of countries, while facing these challenges of the need to forge ahead with macroeconomic stability, to still forge ahead with growth.

More generally, the thing that I am concerned about is the quality of growth, not so much even the quantity, and this has been mentioned by some of the speakers. It does seem that some of the growth that we are seeing coming from the developed world is not well entrenched. It is sputtering and we see it most recently with the US. The authorities there are reducing growth projections for this year. Obviously, significant growth strains in Europe despite all of the rounds of stimuli. It seems like these rounds of stimuli are hitting diminishing returns somewhat alike to what we see in Russia with the effect of high oil prices.

How do we perceive, how do we see signs of a qualitative, systemic, fundamental change in the system and in the economic system globally? What do we have to look for? I think at the enterprise and sectoral level, this is productivity growth. At the global level, I think it is the reduction in global imbalances. And at the country level, I think this is greater adherence to rules versus discretion. I think there are some positive signs in recent years of the reduction in global imbalances, but at the same time, I think discretion versus rules is an issue for a lot of the countries.

One last optimistic note on Russia in terms of rules versus discretion: we see more rules emerging in Russia and in the structural sphere, this is WTO accession. In the fiscal sphere, this is the possibility of a return to the rules of the Stabilization Fund; hopefully, this will take place. And the monetary sphere, this is greater exchange rate flexibility and inflation targeting.

S. Guriev:

I agree, but despite your optimism, Ireland is very small. So give me a yes or no on Italian reform in its labour market, and France committing to credible pension reform.

Y. Lissovolik:

I am an optimist, so...

S. Guriev:

Yes or no?

Y. Lissovolik:

Yes.

S. Guriev:

OK. Simeon, where do you stand?

S. Djankov:

As the Finance Minister of Bulgaria, my comparative advantage is to share views on Europe. The other speakers have already spoken about many of the other issues and I will sum up my views as follows. I am quite pessimistic on Western Europe, Southern Europe, and the European Union as a set of institutions but I am quite optimistic about Eastern Europe. So I will talk about these two issues.

First, the pessimistic part. Since I became Finance Minister about three years ago, I have seen two types of decisions in the European Union, slow decisions and bad decisions, and I will give you examples of both types. For slow decisions, I became Finance Minister in July of 2009 and I was very excited to go to my first Ecofin meeting of finance ministers, but that did not happen until late September of 2009. When it happened, I asked why we did not meet in August or early September, and the Chair very seriously said it would interfere with our summer vacations and that is why we did not have a meeting in August. Well, this is an anecdote that tells you why some very slow decisions have taken

place. Mr. Kudrin already mentioned one of them: how the EU has dealt with Greece, which has been a prolonged, painful set of meetings and very obvious decisions have not been taken, meeting after meeting after meeting. By the time that a decision is taken, it is already too late. You should have already taken another decision after that. There are many examples that can be shown of this slow decision-making. In part, it is because of the institutions of the European Union. By definition, to some extent, they are underdeveloped and that makes for slow decision-making, but also the inability to switch to a higher gear and realize this is a big crisis and not business as usual. You need to move a lot faster.

Second, bad decisions. A number of bad decisions have been taken in the last three years that not only prolong the crisis, but also do not give a longer-term perspective of where exactly Europe is going. One such decision, after two years of various meetings and discussions, is the decision on the so-called adherence to the golden rules that was held as of this March; if you like, the saving decision on the stability of the Economic and Monetary Union. It is not a short-term solution. It is not clear that it is a long-term solution, but if you look at the numbers you realize that it actually does not inspire any confidence.

Why? Well, the European Central Bank just came up two days ago with numbers on adherence to the Maastricht criteria. The golden rules are basically two obvious criteria, debt and deficit, and by and large, it says only six countries of the 27 European Union countries meet the debt and deficit criteria, and several of them are not even in the eurozone. Like Bulgaria is one of these countries, Denmark and Sweden. Actually, exactly half of the six countries are not members of the eurozone. Only three countries currently meet these criteria. And if you ask the larger question, which is how many countries meet the Maastricht criteria which every country that has joined the eurozone is supposed to meet, the answer is quite startling actually. None of the 17 eurozone countries currently meet the Maastricht criteria. There are only three countries in the whole EU that meet the criteria, which are Bulgaria, Denmark, and Sweden. None of them is in the eurozone.

If you have established rules, you clearly do not meet them. You spend two years and then you establish a rule that basically is a subset of the previous rules

and again nobody meets them or hardly anybody meets them, there is no way that you build confidence in this way.

Similarly, one more example has been the discussion of tax harmonization. Every economist can tell that it is an idiotic idea and it certainly has nothing to do with resolving a fiscal, budgetary, monetary, or whatever crisis. But some countries that have high taxes like France like the idea of everybody else also having high taxes. Hence, for the last year, year and a half, a number of countries like Bulgaria have had to spend enormous efforts to convince people that this is not a point we are discussing, since it is completely tangential to the issues at stake. It is actually going to hurt cohesion in the European Union.

I will finish with the topic of a common Eurobond. Similarly, a very bad idea but nevertheless we have been discussing it ad nauseam over the last nearly a year and it displaces discussions of, I think, many other much more worthy issues. I will finish on an optimistic note about Eastern Europe. Why is this crisis actually bringing in more short-term and long-term optimism in Eastern European economies? First, because these economies actually have a lot better public finances than either Southern or Western European countries. All of our countries already went through a similar crisis during the transition from central planning to a market economy, and if you compare our public finances to basically Western or Southern Europe, we are a lot more stable. There are a couple of countries like Hungary and Romania that are going through some transitions, but even they are doing the types of reforms that others in Southern Europe are not. This is the first reason.

The second reason is political decision-making, something that clearly by and large is missing in the European Union. Eastern Europe is already used to making these decisions, even at the cost of losing elections, because we understand that this game that we need to follow, which is raising our wealth standards, does require some pain and people are used to it. Even most politicians in Eastern Europe are used to this and we follow it. One example is the previous local government which, at the expense of basically falling out of power, made a difficult decision. We have not seen this anywhere in either Western or Southern Europe.

I will finish with a final note that was already mentioned by a previous speaker, which is that, of course, I am not happy as the Finance Minister of Bulgaria that next door Greece is having a terrible time. I would much prefer to have a very strong economy next door. But if people ask me, how exactly are you hurting from this? The statistics are actually very positive in what they show. In the last year and a half, about 3,000 Greek firms have moved from the Greek side of the border to the Bulgarian side of the border and they are now producing in Bulgaria. We have had a few tens of thousands of Greek retirees and pensioners who actually have moved to live on our side of the border and spend their money in Bulgaria. We have had a significant increase in deposits coming from the Greek side of the border, since they see stability in the Bulgarian banking system. So what we see is a micro example of what can be a transfer. Somebody mentioned that it is time to go to the high value-added and high productivity economies of the so-called developing or emerging economies. We see this actually just across the Greek–Bulgarian border. We also see some transfer of such investments coming from Belgium, from the Netherlands, precisely from the countries that are having some troubles.

I see this also happening in some other Eastern European economies, which is why I will conclude that with Eastern Europe I am quite optimistic. It is time that we look not just towards Western Europe, which has been the pattern in the last 15 years but towards some of the markets that we sort of forgot like Russia, like the Middle East, like Asia. And this is happening if you look at the trade patterns. A lot of the growth in Bulgaria and the region as a whole over the last two or three years during the crisis has come from trade, from some of our somewhat forgotten partners in Asia, in the Middle East, and in Russia. Thank you.

S. Guriev:

Thank you very much, Simeon. As long as you resist tax harmonization, you will probably have a flow of rich people from France as well. The current president wants to impose a 75% marginal tax rate, but then one of the presidential candidates who got 10% of the vote said that that is too low. So he would prefer 100% marginal income tax rates. So you will probably have a lot of French

pensioners moving to you. Jun, please, I would like to ask the remaining speakers, even though it is very unfair, to be briefer. It is your turn.

Jun Ma:

Sure. Thank you very much. Now, before getting to the question of the eurozone and emerging markets, I would like to follow up on the comment made earlier on why emerging markets are investing so much in developed markets. I think this situation will continue for a long, long time for a fundamental reason, which is that emerging markets have very cheap labour. Because of cheap labour, they have export competitiveness, they generate a lot of trade surplus and they have to accumulate reserves. And the reserves are invested mainly in US and European bonds because the US and European financial markets, especially bond markets, are most liquid and sizeable. So this is a fundamental reason which will not go away despite all the change in institutions and all that. But one refinement I think the emerging market should make, at least on the China part, is to open up its capital accounts. I have been talking to a lot of large global investing organizations – including the Sovereign Wealth Fund Institute, which runs like a few hundred billion US dollars – in terms of how much you want to invest in China, and one of them was telling me that they have a quota which is very small right now and that they want it to be 10 times bigger than that. This shows that, at least marginally, what China can do is to open up the capital accounts much more quickly, allowing those who want to invest in China, especially in the Chinese bond market, to come in and help in addressing part of this imbalance problem.

Now going back to other issues that the host has been raising; one is our views on the eurozone and other being emerging markets and investment opportunity. I do not want to pretend to be a specialist on the eurozone because I really focus on the Chinese economy, but, very briefly, I think there is no quick fix to the eurozone crisis. But on a long-term basis, I am hopeful that the unions that Peter mentioned will probably be seeing some material progress on the horizon over the next three to five years, maybe the banking union first, followed by some material progress towards the fiscal union. But in the interim period over the next

couple of years, there will still be a lot of volatility which will have an impact on the rest of the world, including the emerging markets.

In terms of emerging markets, I am very confident that the long-term growth will be much, much stronger than the developed markets. I think for BRIC we should be looking for something like 5–6% annual average GDP growth in the coming 10 years, and I think China can deliver 7% in the coming decade. The fundamental reasons for that are the following. Firstly, we still have a very low per capita GDP level away from the production frontier, so the catch effect will be there for a decade or a few decades. Secondly, urbanization is still a process. We will probably be completing that process in the coming two or three decades, and that in itself will create both demand and supply in the economy. Thirdly, for emerging markets as a whole, demographics are much more favourable to growth than in the developed markets.

In terms of risks, there are a couple of things I think are very country specific that I want to mention. For example, in China there is a short-term problem of dealing with what I call excessive regulation against bank lending to long-term and medium-term projects, and that problem is being addressed. So I think with some policy adjustments, China may be able to stabilize growth in the coming one or two quarters and begin to see a recovery in the next six to nine months. For India, it is more of the macro stability problem with very high inflation and fiscal deficit. That is an ongoing concern that needs to be addressed. For Brazil, I think it is too much volatility of its exchange rate, and Russia probably needs to address the problem of over-reliance on the oil sector.

In terms of where to invest, personally I think China is a very promising emerging market destination. I think the Chinese fixed income market will be very interesting for lots of global investors when China opens up the capital account, increasing QFII quota and so on. The fixed income market offers 4–5% average yields and I think after the short-term volatility, we will begin to see the RMB appreciating again against the USD, probably at a pace of 2–3% per year in the coming few years. So that will give you sort of an accumulated return of 6–7% in USD terms. That is going to be very attractive for a lot of investors in USD. The second thing I think investors should be looking at is the Chinese service industry. I was doing

some surveys recently in China meeting a whole bunch of entrepreneurs. The manufacturing guys and exporters are doing worse, but there are three very interesting examples. One company is doing car rental and is growing 200% year on year in terms of revenue. The other guy is doing CCTV surveillance, which is a security device, and it is growing at 100% per year. And the last guy is doing a leasing business, ship leasing and aircraft leasing, growing at 40% per year. So these all represent very strong new growth engines in the economy, which I think deserve some attention from investors.

S. Guriev:

Thank you very much. Vladimir, optimist or pessimist? Yes or no?

V. Mau:

I will expand on this subject in Russian. First of all, you know I am somewhat of an optimist, though I am rather a historical optimist. The source of my optimism lies in the history of economics. We know that every crisis eventually ends. We know this is a structural crisis, and it has been clear from the beginning that it would last approximately ten years. When we discuss the possibility of a second wave or a second crisis, we know full well that we will have to go through several waves of the crisis. This is a turbulent period: a period of unstable growth rates; a period of currency volatility; a period of the restructuring of economic strategies, balances of power, and currencies. In this regard, I am an optimist: things are going exactly as they should. In terms of history, this is definitely encouraging. Finally, we all know that countries usually – but not always – emerge from a crisis more powerful.

Secondly, let us look at Europe. When we talk about this crisis, we must understand that the structural character of this crisis lies in the fact (and I am absolutely sure of this) that it is a crisis of the traditional welfare state. We will not be able to come out of this crisis and save the welfare state, which is what a significant number of European countries are still trying to do. Europe is quintessential in this regard. We must admit that Europe's demographics, competitive strength, and budget policies cannot coexist. With the existing

demographics, the existing budget spending structure cannot be supported while saying that Europe is still the best because it is the oldest, with the oldest culture and history. Europe requires reform on a level for which, I think, it is not yet prepared. Take Ireland, for example (and I would also add the Baltic countries and to some extent Poland): they were ready and willing to implement these reforms. By the way, the success of the United States and China and the relative optimism in regard to these countries is based on the fact that they are not welfare states. They do not have to break out of the welfare state model that has proven so hard to cast off in Europe and that we had so much trouble getting rid of at the cusp of the 1980s–1990s. In this regard, I believe Europe must accept several truths. The first is that a fiscal union is necessary. This is obvious: a currency union must be augmented by a fiscal union. The second is that differences in Europe's growth rates are unavoidable, even within the eurozone. But we are not talking about this. What I am going to say will be completely politically incorrect: it is not that the centre of Europe has to move faster toward a union than the outlying countries, but the other way around. The countries that need a bailout and want to remain in the European Union must surrender themselves to the German treasury, in the same way that to transition to the euro, all central banks had to surrender to the Bundesbank. However politically incorrect it might be to say this, it is the case. In this respect, the Bundesbank must be augmented by the German treasury.

S. Guriev:

Based on Simeon's remarks, we have to surrender to the Bulgarian treasury.

V. Mau:

Because the Bulgarian treasury has already surrendered to Germany.

S. Guriev:

No, Germany has much bigger debt and deficit problems than Bulgaria.

V. Mau:

Of course, but this is a welfare state problem. It is related to the fact that Germany is a welfare state.

Finally, before we get too bogged down in this subject, I think that a considerable risk facing Europe, which we never discuss, is the risk of stagflation. In these macroeconomic conditions, I cannot see how Europe would not fall into the trap of stagflation. We have growing inflation, no, worse than that: recession during inflation. From the perspective of theory of economics, this is even more eyebrow-raising than the traditional stagflation of the 1970s. By the way, from this perspective, I completely understand the situation in Europe, and especially in Greece: Russia experienced the same thing in the late 1980s–early 1990s, only with no hope of bailouts. Greece has hope that it might be bailed out, but Russia did not. In this regard, I disagree with my colleagues' opinion that the problem is that Europe takes a long time to make decisions. Of course it takes a long time. Between 1986 and 1991, we also took a long time to make decisions, because we did not want to deal with them. Greece is currently at a juncture at which it understands pretty much everything, but it does not want to make a decision because it has Germany, which might make concessions and do something useful for the outlying countries.

When it comes to the US, I must say that there is certain optimism in the country's outlook. I shall outline the reasons for this position. One is the history of reserve currencies: after all, the dollar has a rich tradition of being used as a reserve currency. In this sense, the American money printing press is more effective. Another is the fact that the US is not a welfare state. I think the US was lucky that healthcare reform has been failing and dragging its feet for the last twenty years. For a country with a full-scale healthcare system or, God forbid, a state pension system, the crisis would have been a complete catastrophe. This obviously makes the US somewhat more competitive. If you ask me where I expect to see growth, it will likely be in the US.

A few words about emerging markets. I feel that we have virtually stopped talking about the issue of decoupling. We can see that globalization makes this impossible; that the growth rates are equalizing; that qualitatively, a considerable decrease in China's growth rate presents as much danger as a recession and

Europe's negative growth rates. Only recently, emerging markets have seemed poised to become the engine that drives the world. I do not believe this will happen, simply due to the geo-economic balance and the existing structure.

I am happy to say that pretty much nobody has answered your last question about growth rates. I consider forecasts of growth rates for the next few decades to be completely pointless, because we understand that most likely...

S. Guriev:

That is the International Monetary Fund's problem.

V. Mau:

Because this is the only way they can justify their existence. Thank you.

S. Guriev:

Thank you.

S. Guriev:

Lúcio, a part of your job is also to look into the future, right?

Dr. L. de Souza:

I presume that that was a question.

S. Guriev:

Yes.

Dr. L. de Souza:

Thanks for that and thanks again for the invitation to be on this unusually large panel of chief economists.

S. Guriev:

It is more than unusually large. It is unusually, unusually large.

Dr. L. de Souza:

OK. I will try to be very brief on the euro area and on the United States, and concentrate on emerging markets, which are and will remain a locomotive of global growth. In terms of the euro area, our consistent position has been that there is a significant disconnect between what the member states seem willing and capable of actually committing to and delivering; and what markets expect in practical terms. Member states seem to believe that you have an extension of what is standard business as part of a situation which is just a 'minor cyclical problem', while markets have been consistently expressing the view that what is necessary for the euro area to survive is the significant overhaul of what we could call its management structure from an economic union to banking union. As long as we see no clear commitment in the capacity of member states to deliver on those fronts, I do not think that we have reason to expect significant positive evolutions of the euro area situation.

The United States is a relatively different situation. Let me elaborate a little first on what the people somewhat obscurely define as being a fiscal cliff. What is behind this expression is the notion that from the beginning of next year, a series of tax cuts will elapse at the same time in which we are going to have a series of revenue sequestrations that is supposed to deliver a very negative shock to the US GDP. It should be pointed out that the perception behind that is that the current structure is optimal, which obviously is not the case. We believe that there is a margin for a significant overhaul, a feasible overhaul for the current fiscal policy in the United States, which a judicious combination of limited tax cuts and a certain expansion in other areas would deliver within the next 10 years a GDP growth to the United States that is actually 20% above what is currently expected. That is a significant difference from the United States, together with the fact that compared to other developed economies they have a very different demographic situation; namely, the United States, in terms of population, has one of the main sources of economic growth: more people producing stuff. They are going to continue growing in terms of population. No other developed economy has this sort of profile.

Now, concerning the economic motor of global growth, developing economies, just thinking about a limited subset of developing economies of what we may call BRICS, and I extend it to BRICS with a capital S to include South Africa. In the past 11 years, they have been responsible for over 50% of global growth. Those four countries are responsible for 40%, and one single country, the People's Republic of China, for over 30%. The significant question that we have now, which I think markets have not adequately priced, is not to the euro area. It is the almost simultaneous reduction of growth that we have among those large emerging markets. They are differentiated in the sense that what we observe in India and in Brazil is a reduction of growth which is due to the constraints that they have in terms of infrastructure, in terms of human capital. It is therefore a reflection of what they have in terms of those constraints with limited fiscal space to counteract those.

The deceleration that we have in China, which is in any case the major source of global growth, is different because, first, it is priced in terms of markets. What you have been observing is exactly what markets have forecasted and what the Chinese government has been conveying. The deceleration is exactly what they have been telling us was going to happen. And secondly, they have a fiscal space, a policy space to counteract that which is absent from almost any other economy in the world. So in the short term, you have this deceleration in terms of emerging markets, but for a subset of them you have policy tools to cushion it. Long term is a different matter. Contrary to what the people think, China does not have a positive demographic profile. Quite to the contrary, China is going to be observing a reduction of its labour force, which is precipitous and will happen very soon. As soon as 2015, the People's Republic of China will start observing a reduction of its labour force. This has significant implications for the medium-term growth in China and, therefore, for the medium-term growth of the global economy. Think about this in these terms. Ten years from now, China will have an over-the-age-of-60 population that is larger than the population of the United States is now. Over 350 million people in China will be over the age 60. This has obvious implications in terms of what they are going to be producing or not producing, and what they are going to be consuming. That will create a cap in

terms of the sustainable, long-term (a generation from now) growth rate of the global economy. Take China out of the equation, which is natural, right? At the end of the day, no country that has become richer can continually grow by 7% a year, let alone 10%. This normalization of China, both in terms of the average GDP per capita and of the demographic situation that we have in other countries around the world, is going to put a cap on global growth in ways that I do not think is fully priced by markets now. And these are not only related to China. Everybody is going to be over the demographic dividend very soon. Not only China, but India at some point, Brazil will be 5–10 years from now, and therefore, global growth will be conditioned by essentially total factor productivity; technical progress that creates a long-term constraint in terms of global growth that we, as policymakers and markets, should realize.

S. Guriev:

Thank you very much, Lúcio. At least you are optimistic on the twelfth year.

Dr. L. de Souza:

I have to stress that we are always unbiased and realists. That is our job.

S. Guriev:

So, at least we have some optimism on China. Alexey, please.

A. Moiseev:

Thank you, Sergei, I will try to spend no more than one minute with a couple of bullet points. I think it is obvious that all the issues which were raised now are completely systemic issues. I think that the future generations' wealth is not going to be spent; I think that is already spent. I think that in many cases, people are actually paying for the excess of previous periods, as evidenced by the deleveraging of the households in many of the developed economies and deleveraging of the corporations which has already taken place in many places. So essentially, I think that we are already beyond that point and the adjustment has already started taking place.

The question is whether this adjustment takes place through deflationary measures, or basically shock therapy and this is something which we are seeing in Greece, which is internal devaluation and something that we have seen in Ireland, and something which arguably the most successful countries (Bulgaria, Sweden, and Denmark), as mentioned by Minister Djankov, which were happy enough to tackle this crisis early enough and conduct their internal deleveraging early enough. But others are far less lucky and, therefore, I think that it is realistic to assume that there will be a global shock therapy session. So, I think there will be inflation readjustment and that will, as Mr. Viyugin mentioned earlier, probably most likely take the shape of massive monetary expansion.

I think particularly now that the Bank of England, which has been ideologically one of the leaders of quantitative easing, yesterday almost voted for new quantitative easing spending with four votes in favour. Now to me, this is major. The Bank of England has been doing quantitative easing for five years and they want to do more of it, right? So, I think that there will be more of it from Bank of England, from the Bank of Japan, from the Federal Reserve, from the European Central Bank, and so on and so on. No matter how much people try to pretend they will not do it, I think they will have to do it.

Now, the consequence of this I think is going to be that there will be a very high degree of monetization of prices of what countries like Russia produce, such as commodities which are limited in terms of the physical volumes of their production versus a virtually unlimited supply of new cash. But it is going to be very volatile and we will see periods of commodity price going very much up and then periods of commodity price going very much down. So, I think that we definitely have to be very conservative, and every time the total price goes to 500 we should not think that is going to last for 10 years. But I think that going forward, going back to your last question about growth, I think that we will see no growth for years to come. I think that we will see...

S. Guriev:

In the global economy.

A. Moiseev:

In the global economy. I think that the global policies, given the current technological set up, are basically bankrupt. I think it will take the private sector to actually come up with a new model of growth and to deliver growth in places we do not know, in technologies we do not know, and in countries that we cannot foresee being countries of growth. I think that given that there is global economy, given that the G20 promises to not impose the new protectionism, I think that there is going to be a competition of investment climates and that the private sector will deliver growth at some point in the future, hopefully in the not so distant future, but in a country where the investment climate is best. So, I think that is really the key. If countries want to grow, they have to enter this competition of investment climates.

S. Guriev:

Thank you very much, Alexey. I would like to run another vote as at the beginning. Please put the question up. We have the very same question. I do not know to what extent your views have changed having listened to 13 excellent speakers. Let us vote whether the risks are coming from US, Europe, emerging markets, or none of the above. We have not seen a person who tried to convince us of the fourth answer, I guess, but at least some people said Europe was scarier than the US, the US is scarier than emerging markets, we heard pessimism on emerging markets, but we also heard some reasonable optimism. Let us now vote on the second question. Are you an optimist or a pessimist? Yes or no? OK.

Thank you very much. Now we are counting the votes. In Russia, whenever we have electronic technology it takes some time to count the votes in the right way, but we also have a short clip for you from Bloomberg on the state of the global economy which we will show now during the vote counting and that will take a couple of minutes.

Bloomberg presentation:

As Europe's debt crisis remains far from resolved, emerging economies, which count about half of the world, advocate continued growth at a steady rate. Brazil, Russia, India, China, and South Africa – the BRICS – continue to largely outperform developed economies. It is all important. In 2011, India grew 6.1%, China 8.9%, and Russia 4.3% – faster than initially forecast. Brazil lacked behind with a 1.4% growth rate. Still, significant when compared to the eurozone where investment declined the most in two years and both exports and consumer spending dropped. South Africa continues to grow at a pace of over 3%, thanks to its strong manufacturing and mining industries. International companies from BMW to Mercedes to Ford are all expanding their South African production and exports are booming.

The BRICS are certainly not immune to the economic swings in the advanced economies, but analysts are convinced they can continue to outperform over time. This is thanks to low debt GDP levels, high foreign reserves, and a young working population. Trade and financial transactions between emerging markets are also poised to grow. Chinese investment in Africa is surging. Russian companies, such as Rusal, have chosen Hong Kong for their IPOs. Brazilian banks are increasingly tapping debt markets abroad. Flagship Indian companies, such as Reliance Communications, are borrowing from Chinese banks, and South Africa is benefiting from the new Pan-African Free Trade Agreement designed to boost African development.

That is not to say that the emerging economies face no challenges. Reforms are needed especially to spur employment, build innovative capabilities and tackle income inequality. These in turn will bring stronger political stability and a much needed boost in domestic consumption. But how will the emerging economies be able to tackle these issues effectively and how critical are the emerging markets to maintaining global growth? Let the conversation begin.

S. Guriev:

We are working in the opposite direction and I think there was a reason for that as you saw from the conversation. So, let us put the vote results on. Probably the counting will still not provide the right outcome.

From the floor:

Were they informed how to calculate correctly?

S. Guriev:

Yes. Well, that is a good question. Yes.

From the floor:

Was it an old structure?

S. Guriev:

No. Maybe the people who did the counting also listened to you too much, so they want to massage the data to have it consistent with your forecast. OK. Then you know in this awkward situation we have time for one question. I am sorry for keeping you this long. Do we have any quick questions?

From the floor:

I will be very quick.

A. Sotnichenko:

Alexander Sotnichenko, St. Petersburg State University. I have a specific question for Cevdet Akçay. Here it is: Turkey is currently one of the global and European leaders in economic growth. How do you think the Arab Spring revolutions will impact Turkey's economic growth, and what predictions can you give us for this year? How much will Turkey's economic growth increase, or will it decrease; and if so, then how much? And how will the Arab Spring revolutions impact this trend? Thank you.

S. Guriev:

Quick answer. Simple question.

C. Akçay:

The economy is not going to go down. As we suggested, there is a slowing down process going on everywhere and Turkey is going to be having her share of this slow down process. The question would be difficult to answer in the sense that I think the so-called Arab Spring actually has a lot to do with what I mentioned as an implication of globalization, politically speaking. So, in the longer run, I think there are huge benefits to be reaped in the region because the region finally, I think, is 'normalizing' politically and that would be to Turkey's advantage because Turkey was a very strange country in the sense that about 15–16% of our trade was with our border partners. Now, that is an anomaly and that situation is going to be changing. There was some kind of a halt with the Libya thing and trade suddenly stopped, but the latest trade numbers are showing huge increases with the countries in the region. So, I think it is going to be for the benefit of Turkey, not in the very short run, but definitely so in the medium to long run.

S. Guriev:

Thank you. Now, we have the vote results coming up. So, you see people are much more pessimistic about Europe now and much more optimistic about emerging markets, even though we heard enough concerns about emerging markets as well, and we lost optimists altogether. There were 4% optimists but none are still sitting in this room. Maybe the people left, maybe the people changed their mind. Let us look at the second slide.

Generally the situation did not change, but some people think that there will be positive dynamics, like Alexey, but there are many people who are not happy about the current world. So, I hope that was informative. I myself learned a lot. I am sorry for failing to stick to the schedule. I would like to ask for a round of applause for the speakers. Thank you very much.