

Franco German Council of Economic Analysis, November 12-13 meeting

The Franco German Council of Economic Analysis has met in Berlin, on November 12-13, 2007, parallel to the Franco German governmental summit held in Berlin on November 12.

In its previous meetings, the Council created in 2002 and acting in an advisory, non-official function for both governments, addressed a variety of issues such as fiscal and budgetary developments, energy, structural reforms and their implementation.

In view of the on-going worldwide financial crisis and its potential adverse effects on growth and employment in Europe, the Council devoted, this time its full meeting to this issue.

*
* *

The crisis on world capital markets, reflecting the diffusion of the US subprime mortgage market crisis, through notably the impact of instruments associated with recent financial innovations (securitization, structured products, hedge funds), shares some features with past crises (from excessive confidence to excessive retrenchment), but it has been also characterized by specific developments: a liquidity crisis on the interbank market; an interruption of LBOs and to a large extent of other equity related operations, such as M&As; and a possible forthcoming extension to consumer finance as a whole.

In view of its potential impact on global financial stability and economic growth in the world, the current financial crisis has been legitimately a major topic in the discussions of the G7 and other venues in Washington in conjunction with the IMF/IBRD meetings in October. From these meetings and from the analyses produced notably by the IMF and the Bank of England, have emerged the main subjects that the Financial Stability Forum would have to address in a report to be established during the first quarter of 2008, in advance of the next G7 ministerial meeting in April 2008: transparency; information; risk analysis; capital adequacy; role of rating agencies; liquidity issues; diffusion of risks; crisis management.

Some members of the council thought in addition that lessons have also to be drawn from the crisis in the field of monetary policy, notably with regard to asset prices and their developments.

Since the German and French governments have been in contact during the crisis to develop joint positions, it appeared that the Franco German Council for Economic Analysis could contribute to these discussions and elaborate, in the coming weeks, detailed proposals, as a background for the solutions to be advocated by the French and German Governments, in a common approach.

*
* *

From a first preliminary review in its November 12 meeting, the Council took the view that the crisis called for remedies to be used by financial actors through financial instruments to deal with the crisis, but also for new ways of supervision. Under these two headings might, in particular, be analysed the following items:

- financial actors and financial instruments: risk analysis and transparency; diffusion of risks with special emphasis on the role of rating agencies and on the responsibility of primary banks who should keep a participation in the initial risks subjacent to the securitisation

process; a differentiated treatment of illiquid and depreciated assets; and a better protection against liquidity risks;

- supervision: risks weighting and capital adequacy requirements under BASEL II; accounting and managing rules to be applied to off-balance sheet vehicles, hedge funds and other non-bank financial entities; and liquidity requirements. The goals, possibilities and limits of regulation should be addressed on a national, European and international level. At the same time developments in the real economy, related to the diffusion of the financial crisis, with its potential impact, notably on housing and productive investment, should remain under permanent review.

*

* *

The Council has set up a working group which will conduct deeper analyses and produce in January a full report. With regard to all these subjects, the Council would appreciate some guidance from both governments and notably their ministers for Economy and/or Finance, to focus the attention on the subjects that appear the most likely to be addressed by the two governments, in a coordinated way including a joint document, in the framework of the G7/FSF process which has been initiated in Washington.
