



INSTITUTE OF WORLD ECONOMICS
Centre for Economic and Regional Studies
Hungarian Academy of Sciences

THE RETURN OF THE FINANCIAL REPRESSION AND THE RISE OF FINANCIAL INNOVATIONS

Conference theme:
2nd annual Research Capacity Building
4-lateral Meeting

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Institute of Economic Sciences, 1
2 Zmaj Jovina st. 3rd floor, room S3

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Introduction

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- Junior research fellow
 - Institute of World Economics
 - Member of the Research Group on European Integration
- Fields of research
 - Economics of innovation,
 - Financial Technology,
 - Comparative economics,
 - Economic and financial consequences of the crisis in the European integration,
 - Role of the European Union in the world trade
- Research assistant to Janos Kornai

Content of the presentation

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- The return of the financial repression
 - ▣ Definition Central bank-led financial repression – the case of Hungary
- The rise of financial innovations
 - ▣ Digital is the new normal
 - ▣ Banking is changing also
 - ▣ Definition of fintechs
 - ▣ The rise and scope of fintechs
- Conclusion

The return of the financial repression (FR)

Definition and history of the term

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- FR comprises a range of policies that the financial sector exercises to **redirect savings to the government** at an **artificially low cost**.
 - After the World War II **governments imposed rate ceilings** for government bonds to **avoid an explicit default**.
 - 1970s first appearance of the term Shaw (1973) and McKinnon (1973). “A **pejorative term** akin to **political repression**” (McKinnon, 2012)
 - The downside is that this applies to the savings of the people.
 - When the **inflation rate is higher than the interest rates** paid on the markets, the **debts shrink as if by magic**.

Theoretical background

The concept of financial repression (FR)

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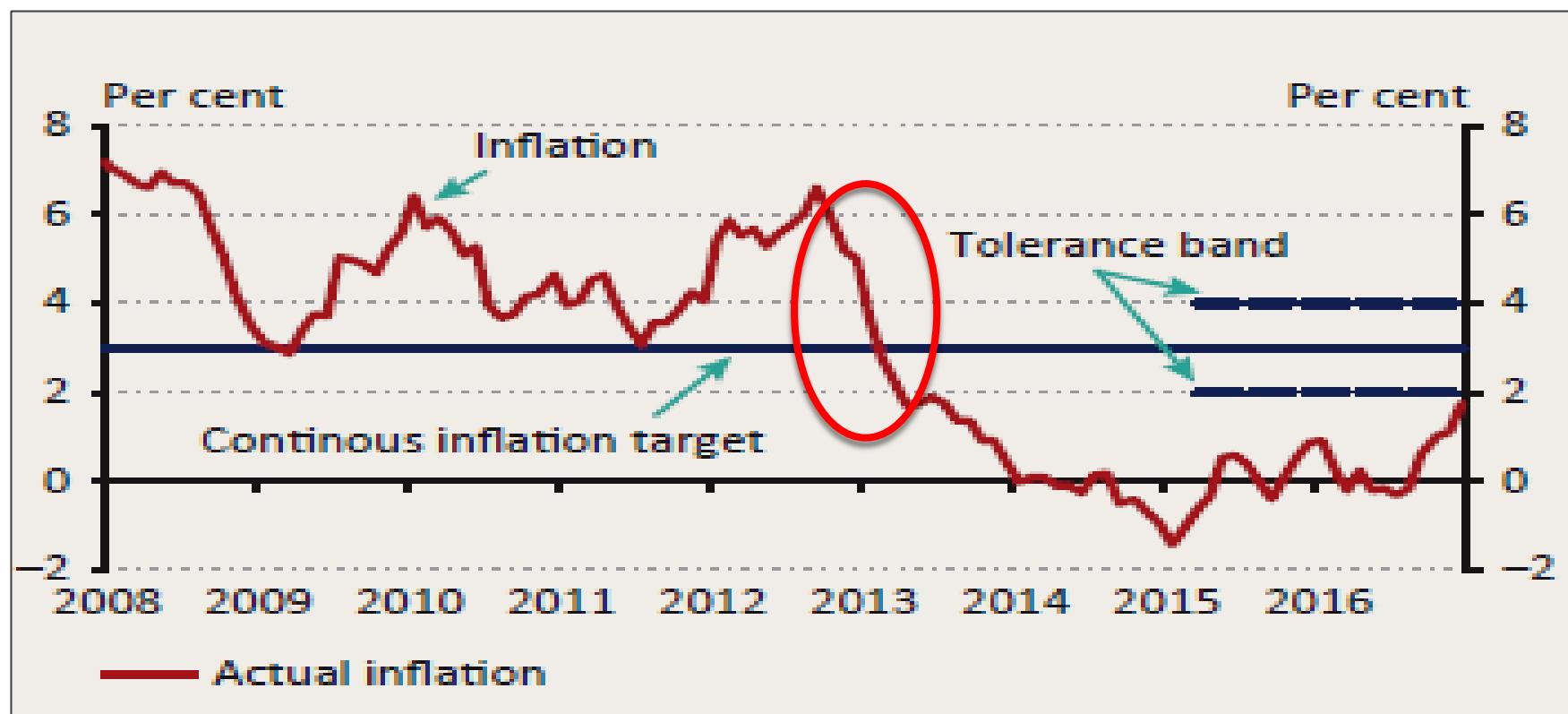
- „Nowdays there are **more sophisticated means**. (...)
- ... **Monetary policy is doing the job**. (..)
- ...With **low inflation** that doesn't even look suspicious. (...)
- ... Only when inflation picks up, which is ultimately going to happen, will it become obvious that **central banks have become subservient to governments**”.

Inflation developments in IT regime in Hungary

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MNB's primary task of achieving and maintaining price stability

MNB kept inflation low too – also implemented populist programs like utility price cuts



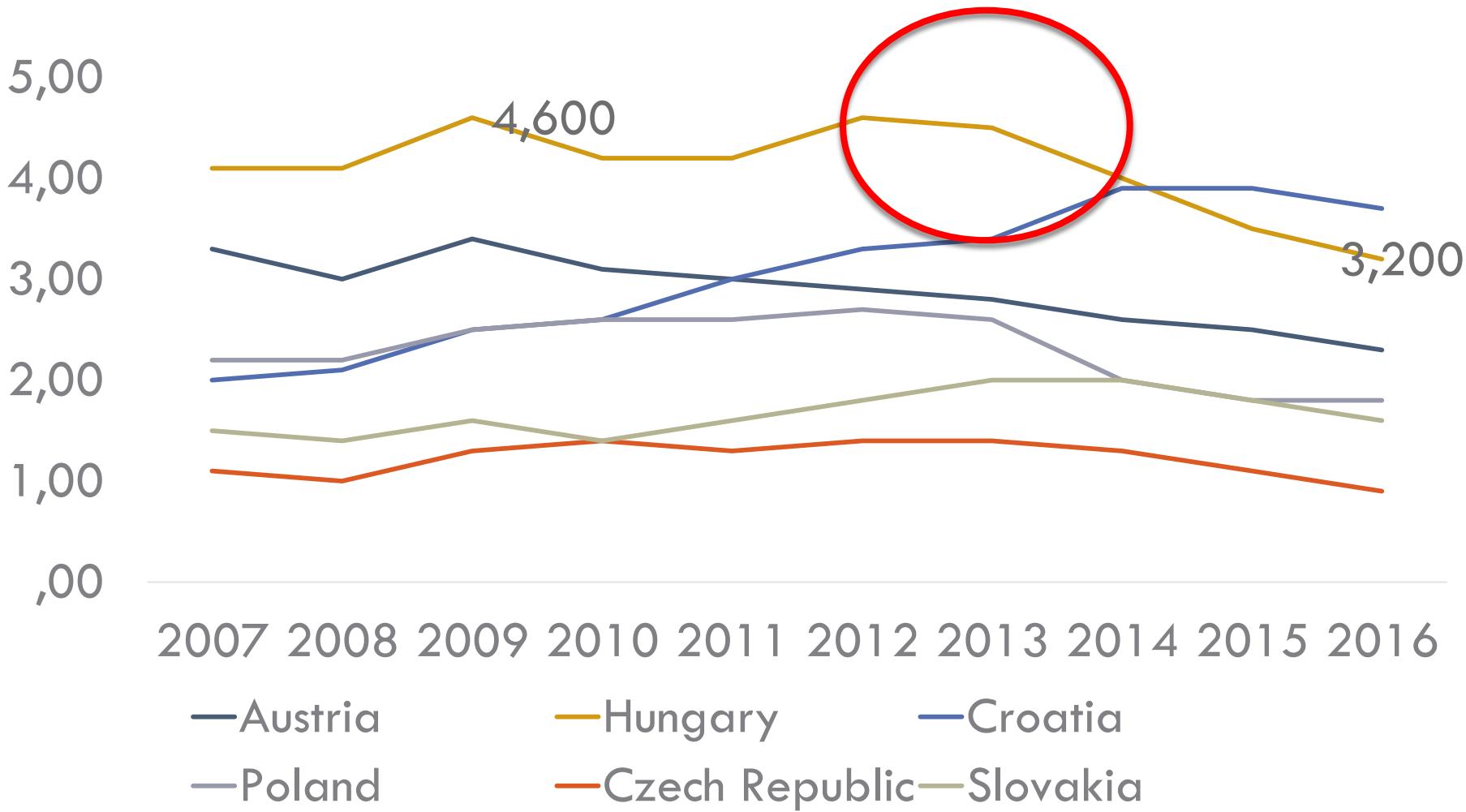
Record low base rate in Hungary → reducing 10 Year bond yields, even below United States 10-Year Bond Yield

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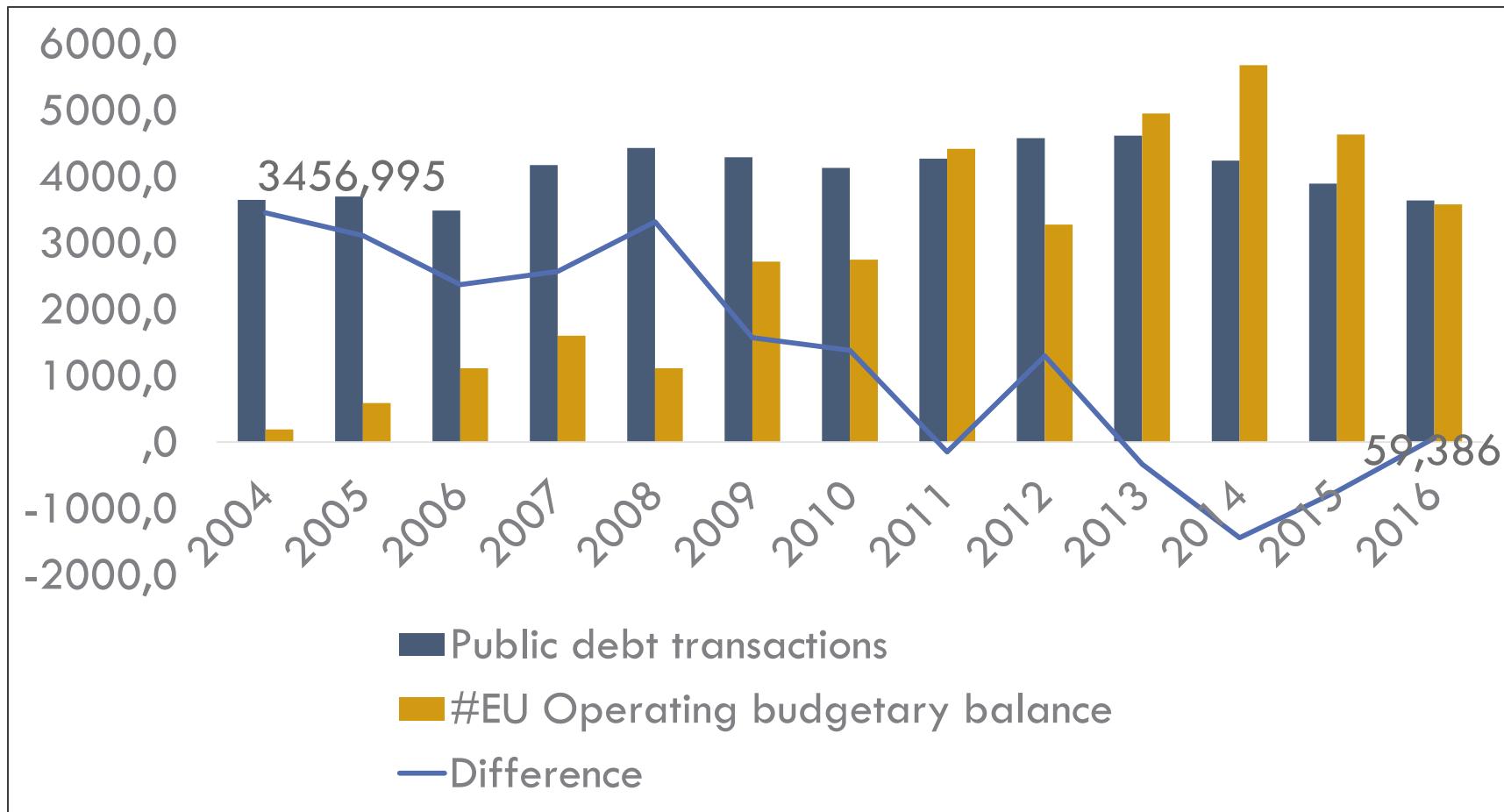
Lower interest rates
Some beneficial effects →
Reduced public debt transaction (in %GDP)

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Lower interest rates
Some beneficial effects →
Reduced public debt transaction (in Million EUR)

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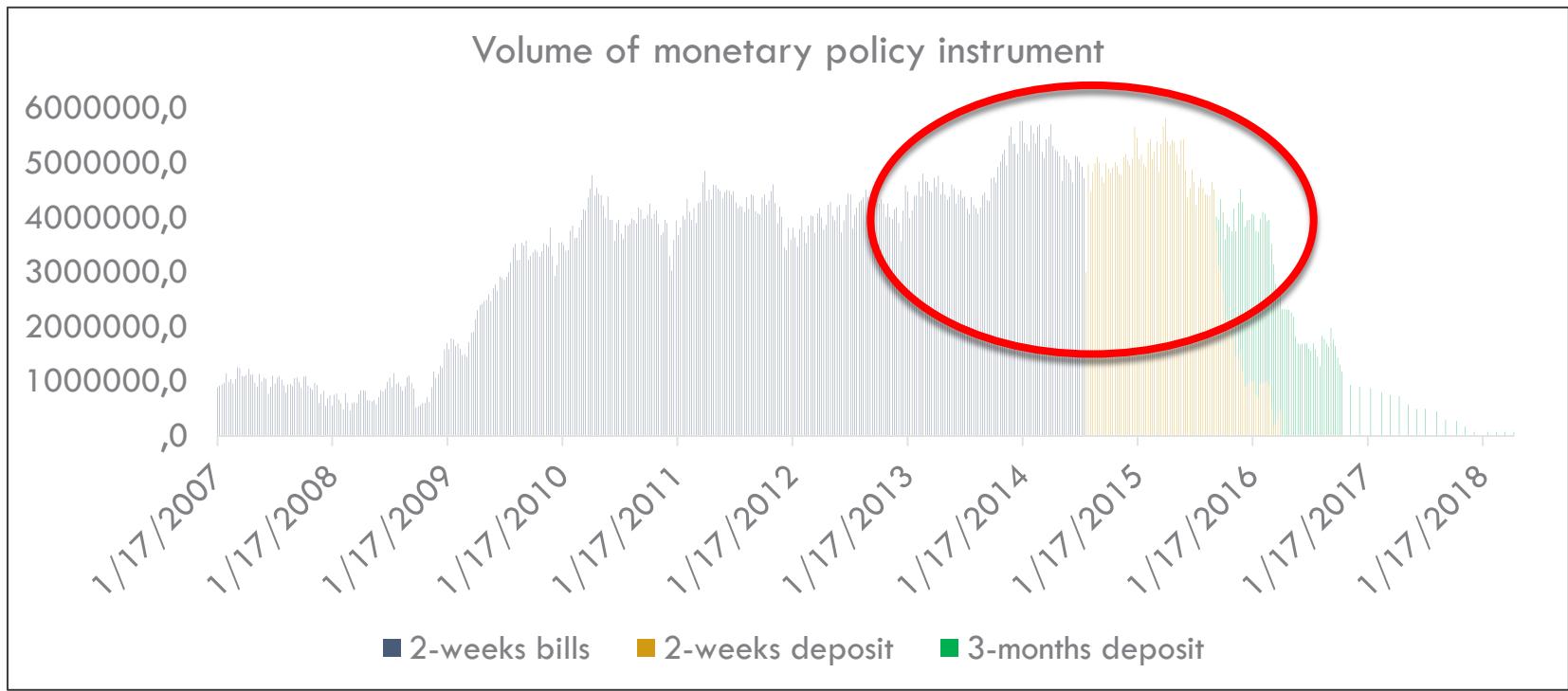
Sources: Eurostat, EC

Central bank-led financial repression

The case of Hungary

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Restructuring the 2-week bonds into 2-week deposits
later to 3-month deposit



The elements of FR

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- Explicit or indirect caps or ceilings on interest rates
- Exchange controls
- Capital account restrictions
- Regulatory requirements in order to that financial institutions, households prefer government debts in their portfolios
- Transaction taxes on equities or on payments
- Direct/national ownership of banks and other financial institutions
- Prohibitions on gold transactions
- Restrictions of entry to the financial industry
- Directing credit to certain industries or to sectors (SMEs).

The rise of financial innovations

Digital is the new normal banking is changing

Challenge of bigtech companies

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In the future **ICT** (information technology communication) and **social** behemoths **GAFAA** (Google, Apple, Facebook, Amazon, Alibaba) might take **leader** role in the **financial** industry

Bill Gates said that **banking** is **necessary**, **banks** are **not**

The emergence of financial innovation (fintech-phenomenon)

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	Macroeconomic environment	Monetary policy Regulatory arbitrage Prudential issues
Supply side	Technological developments	Mobile penetration & digitalization Big data Crowd solutions, Open platforms Machine learning Decreasing cost of computing Artificial intelligence Blockchain
Demand side	Changing consumer needs	New generations (Digital natives) Extreme impatience Experience focus Sense of „specialness”
		Trust-decrease towards banks



Decreasing cost of computing

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BBC
NEWS

Mobile banking is saving us 'billions' in charges



Mobile banking has changed the way we manage our money for good, and is saving us billions in bank charges

Typical characteristics of computers in 1967, 2004 and 2015

Indicator and unit	Computer used by MIT		Laptop	Smartphone
	1967	2004	2015	
Processor speed (unit: MIPS)	0,25	1 000	18 200	
Memory (unit: KByte)	144	256 000	16 777 216	
Retail price (unit: USD in 2003)	\$ 11 000 000	\$ 2 000	\$ 399	



Source: Background material of Kornai (2016): So What Is Capital in the Twenty-First Century?
Some Notes on Piketty's Book http://www.kornai-janos.hu/Kornai2015_background.pdf

The emergence of fintech-phenomenon

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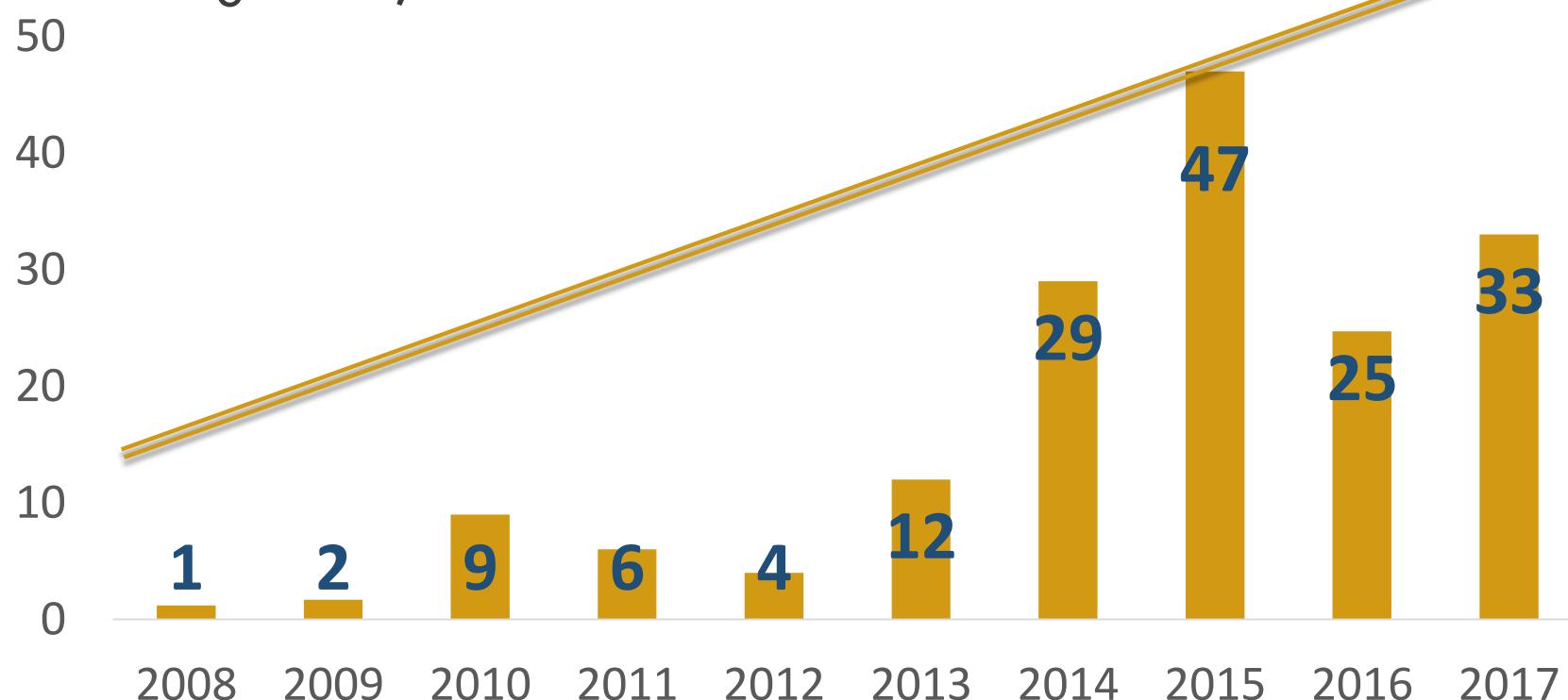
- ‘FinTech’ is defined as ‘**technologically enabled financial innovation that could result in new business models, applications, processes or products** with an associated **material effect** on **financial markets and institutions** and the provision of financial services’.
- The fintech **services and products diffuse across the financial industry’s market segments and along its value chain**.

The level of FinTech financing is booming

Investments in FinTechs 2008-2017

Funding is ballooning.

Since 2008 **\$B 165** has been invested in FinTech companies throughout 7,500 deals



Total global investment in FinTech companies - USD billions

Source: KPMG, 2018, PitchBook, 2018

Expanding scope

Where once companies focused on payment applications, lending, and money transfers, the industry's reach has extended into **more than 30 areas**.

- SoFi, began by offering financial products to students expanded to provide career coaching and networking services.
- Holvi **began by offering banking services to SMEs and expanded to provide bookkeeping services.**

Conclusion

- **The financial repression has returned**
 - ▣ Despite IT regime inflation rate is becoming higher than the interest rates paid on the markets the debts shrink
 - ▣ Hungarian Central Bank has become subservient to government
- **The financial innovations are rising**
 - ▣ **Banks are investing heavily** in order to fend off the FinTech newcomers and keep the all-important customer relationship, or **cooperate** with them.
 - ▣ **The most forward-looking banks** will not just survive the wave of digital disruption, but **will thrive**, as these FinTech-driven challengers gain momentum.
 - ▣ **Banks and Fintech firms have more business interests in common than issues that divide them.**

Thank you for your kind attention!

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