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EUROSYSTEM

Ten Years After – Capital Flows and the Global Monetary Order

“10 Years after the Crash: What Have We Learned?”

22nd Conference of the Forum for Macroeconomics and Macroeconomic Policies

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Expectations in autumn 2008

1. Deleveraging of the private sector and leveraging up of the public sector
2. Shadow banks to be brought into regulatory regimes
3. End of hyperglobalisation in finance
4. End of ,Too Big To Fail‘
5. New Global Monetary Order

Structure

Outcomes versus expectations – Ten years after

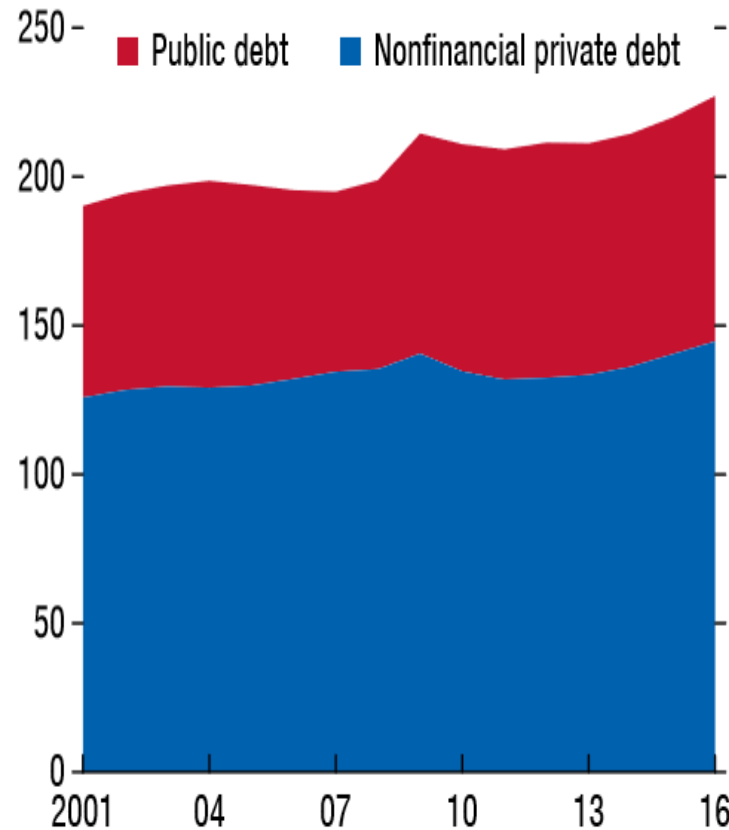
Current Global Monetary Order – Characteristics

Reform Proposals of the global monetary order

Outcomes ten years after – Deleveraging?

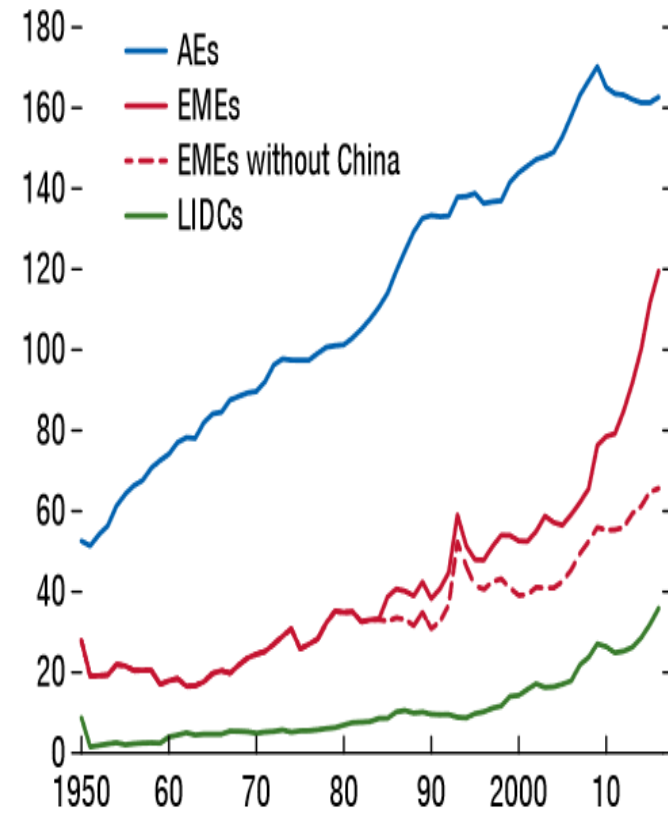
Global Debt

Weighted average percent of GDP



Nonfinancial Private Debt

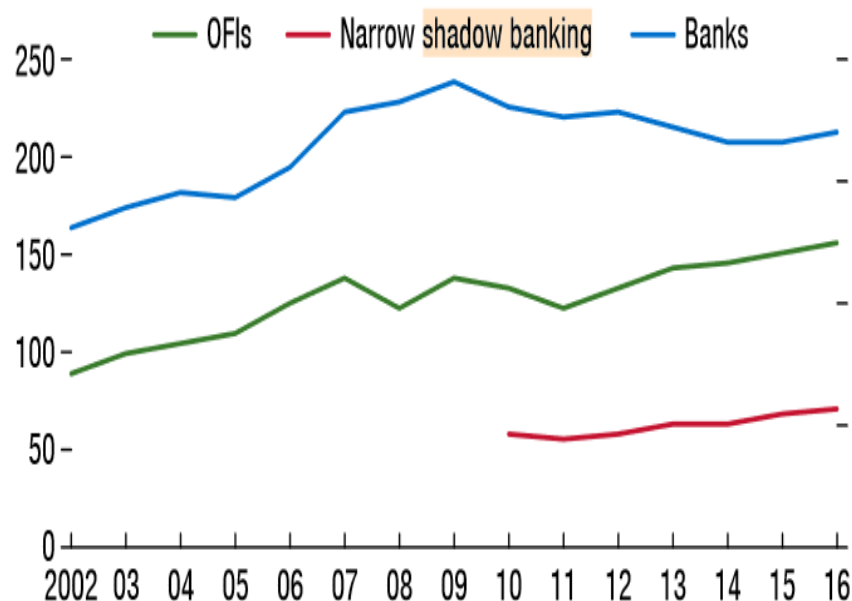
Weighted average percent of GDP



Source: IMF, Fiscal Monitor, April 2018

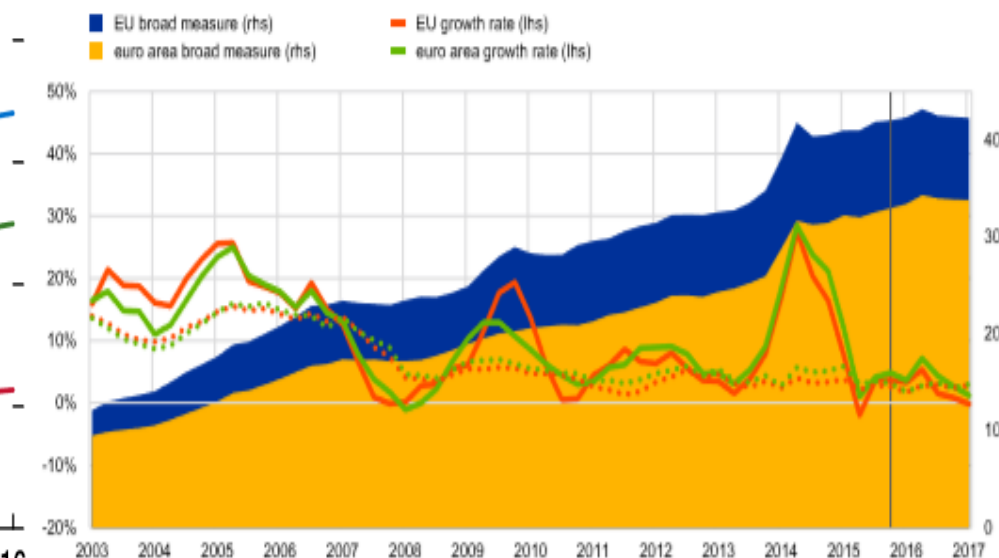
Outcomes ten years after – Regulation of Shadow Banks?

Shadow Banking in S29 Countries Percent of GDP



Source: Global Financial Stability Report, IMF, October 2018

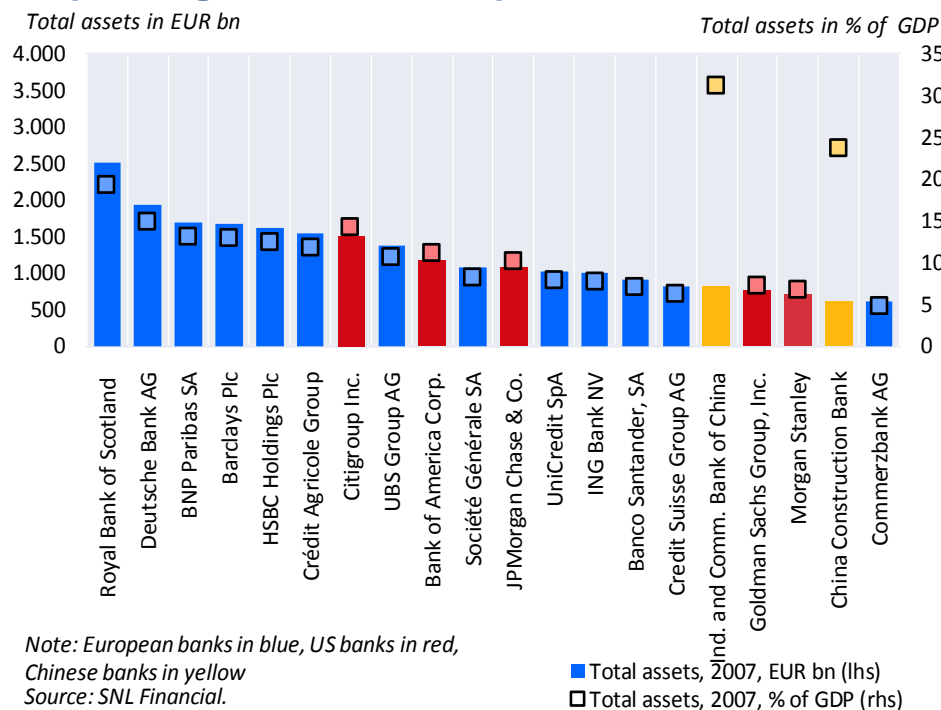
Size of EU and euro area shadow banking system Annual growth rates and EUR tn (rhs),



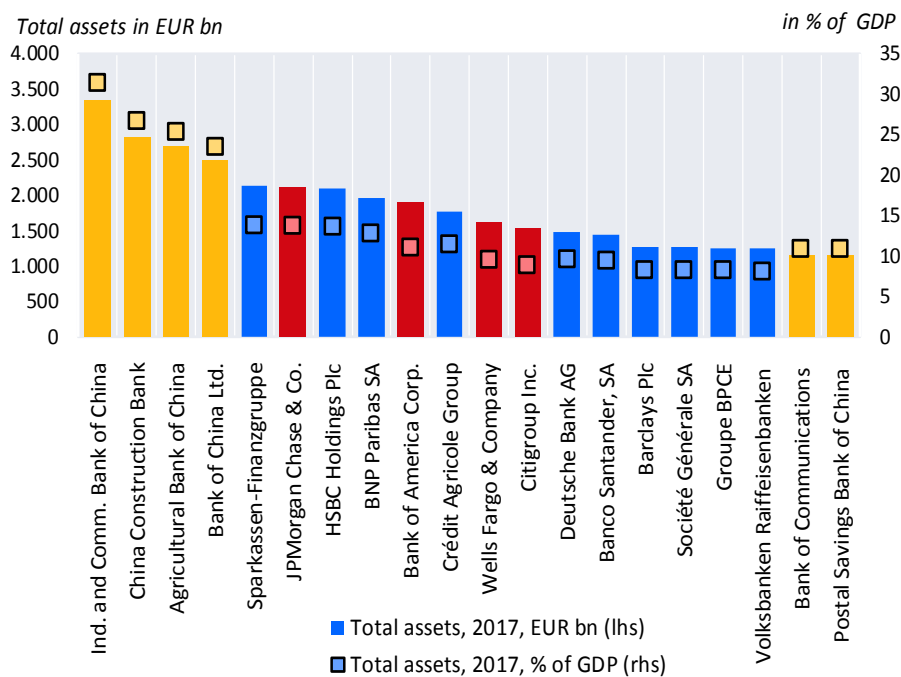
Source: EU Shado Banking Monitor, ESRB, September 2018

Outcomes ten years after – End of ,Too Big To Fail‘?

Top 20 largest banks in Europe, USA and China, 2007



Top 20 largest banks in Europe, USA and China, 2017

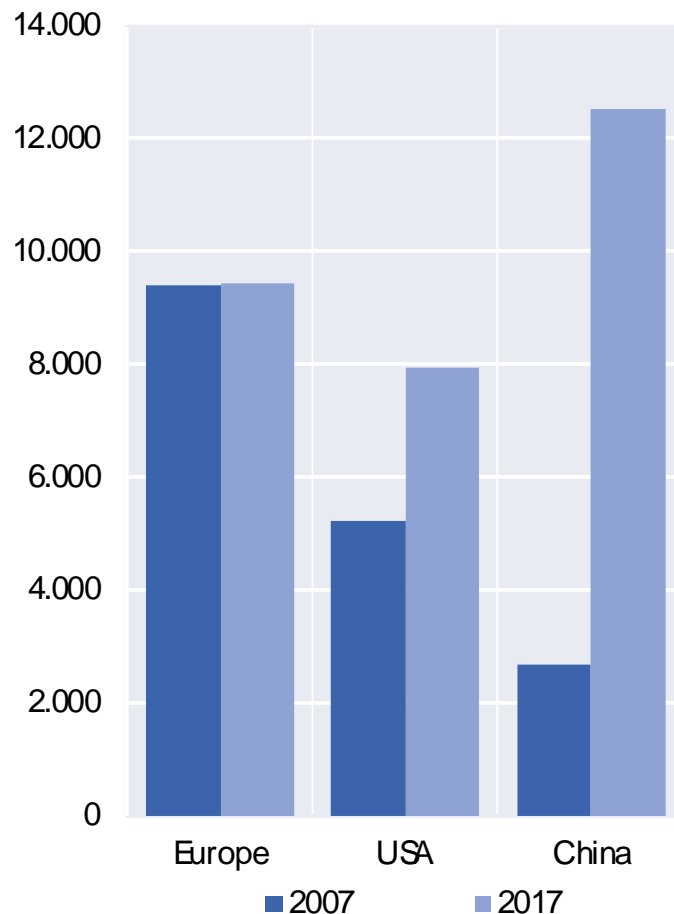


Source: SNL Financial. Note: European banks in blue, US banks in red, Chinese banks in yellow

Outcomes ten years after – End of ,Too Big To Fail‘

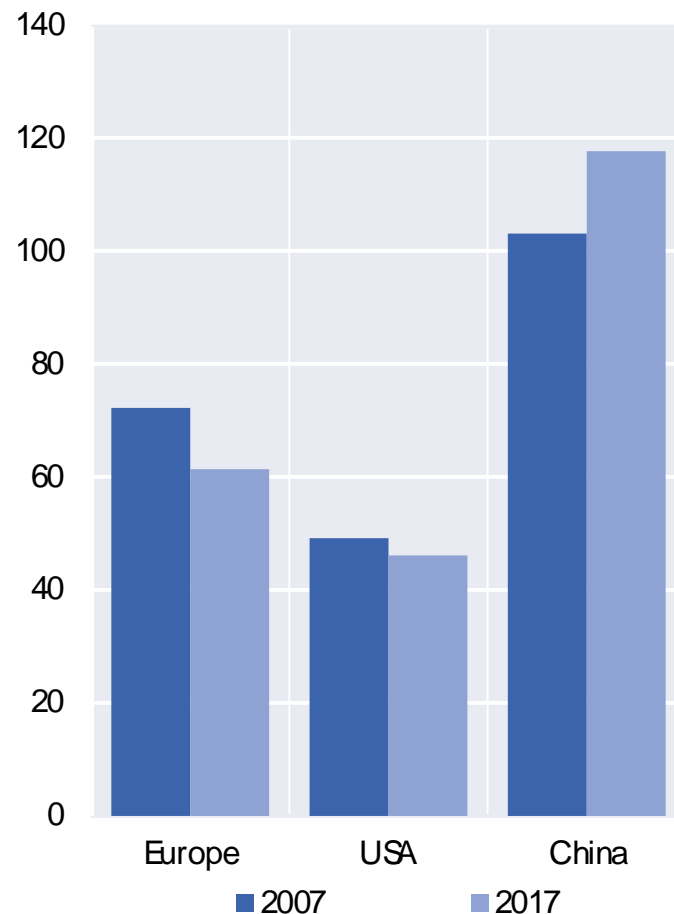
Top 5 biggest banks

in EURbn



Top 5 biggest banks

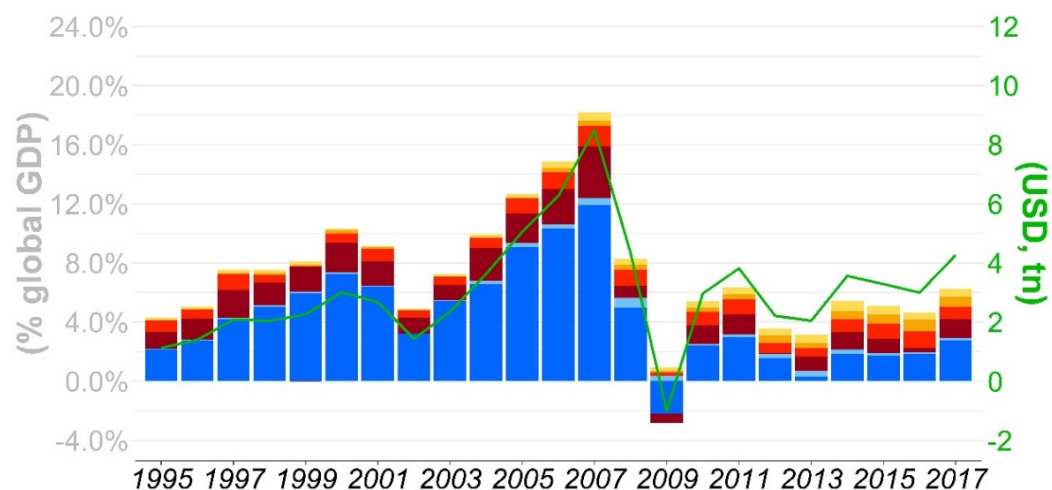
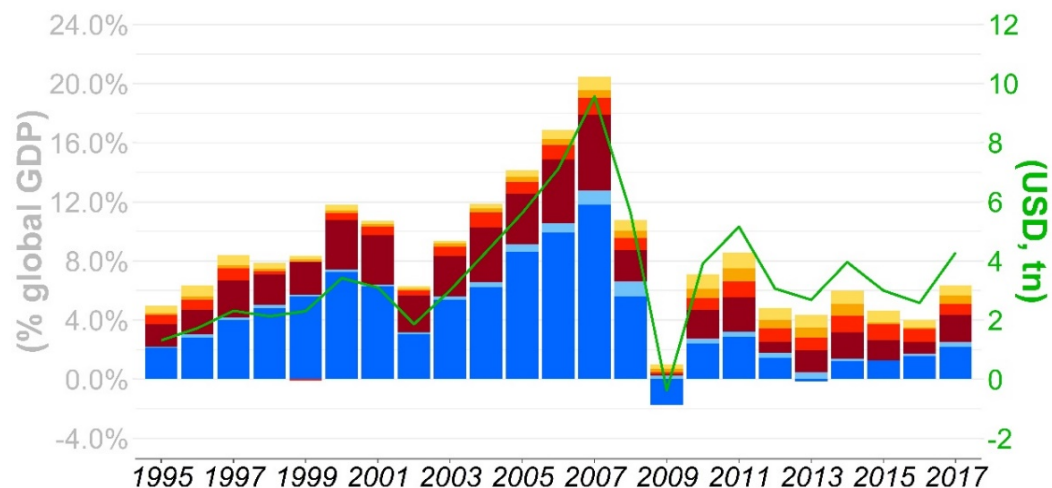
in percentage of GDP



Source: SNL Financial.

Outcomes ten years after – End of ,Hyper-Globalisation‘?

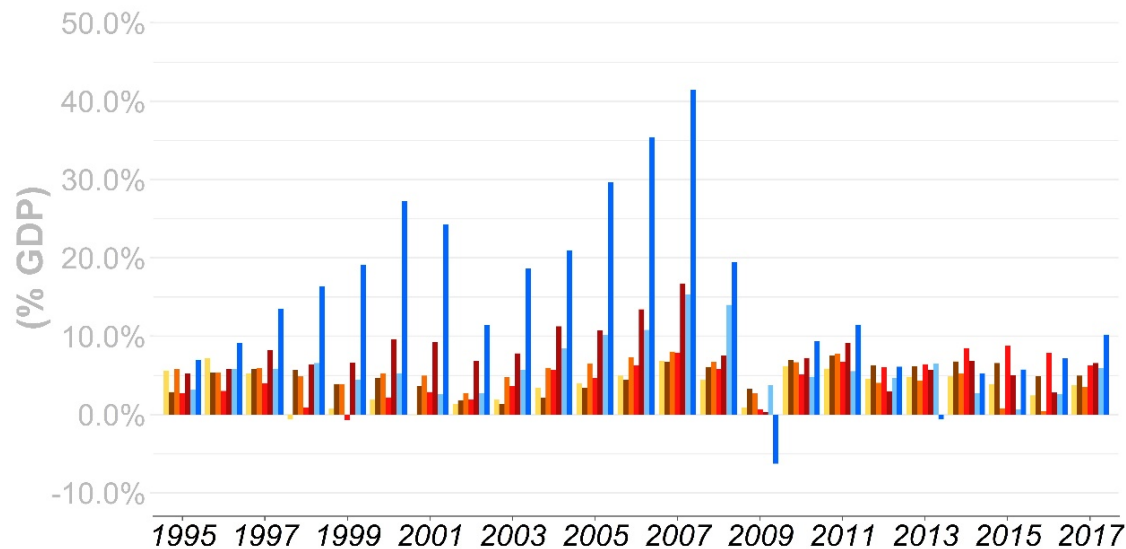
Gross capital flows by country group



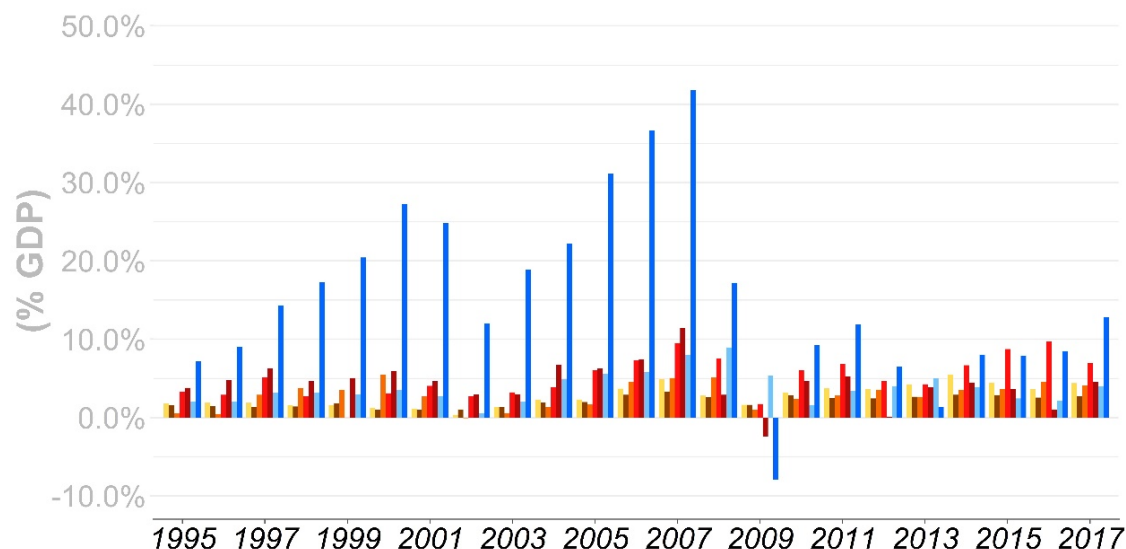
EM: Asia, Latin America & South Africa; DM: Japan, Kanada, Australia & New Zealand; global coverage of approx. 87%

Source: BIS, own calculations

Outcomes ten years after – End of ,Hyper-Globalisation‘?



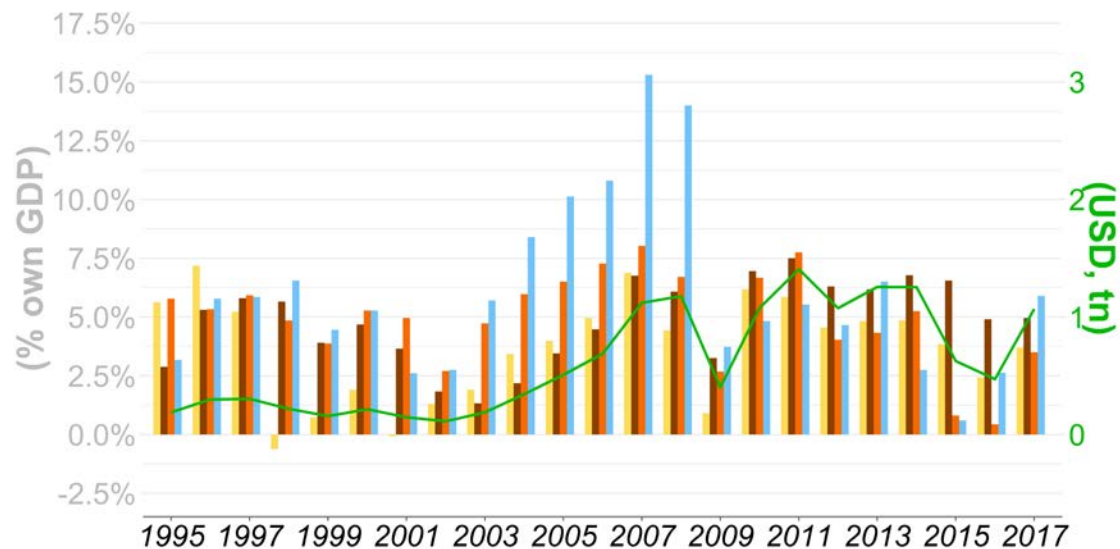
Gross capital **inflows** in percent of own GDP



Gross capital **outflows** in % of own GDP

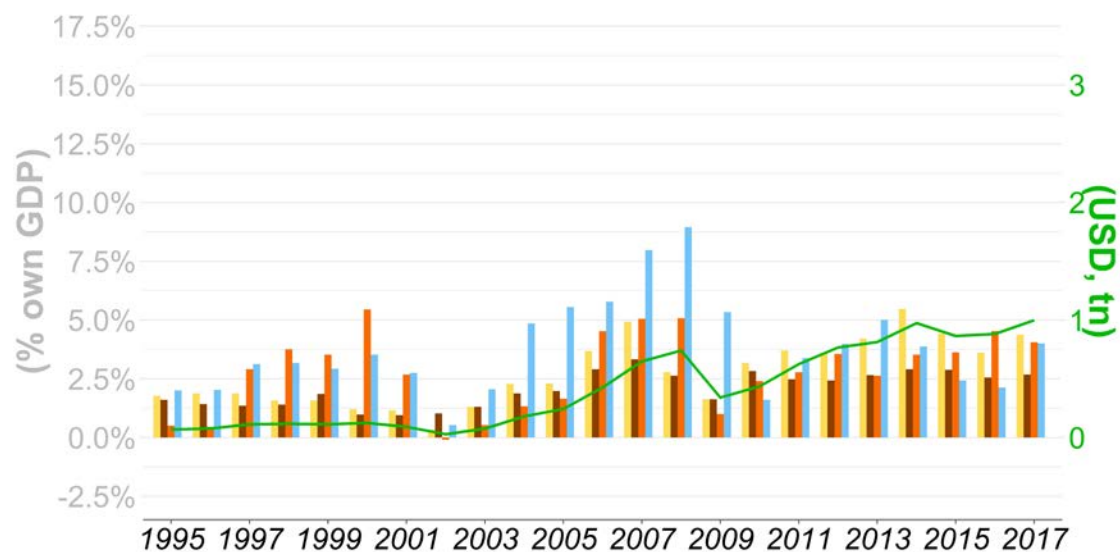
Source: BIS, own calculations

Outcomes ten years after – End of ,Hyper-Globalisation‘?



Gross capital **inflows** in percent of own GDP

- Asia (excluding China)
- Latin America
- China
- CESEE
- EM (rhs scale)

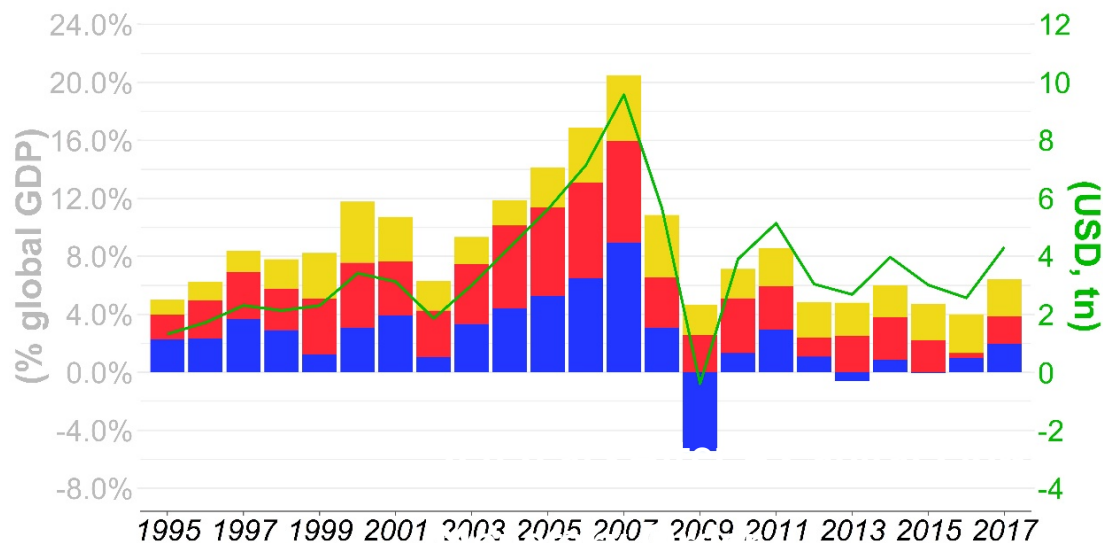


Gross capital **outflows** in % of own GDP

Source: BIS, own calculations

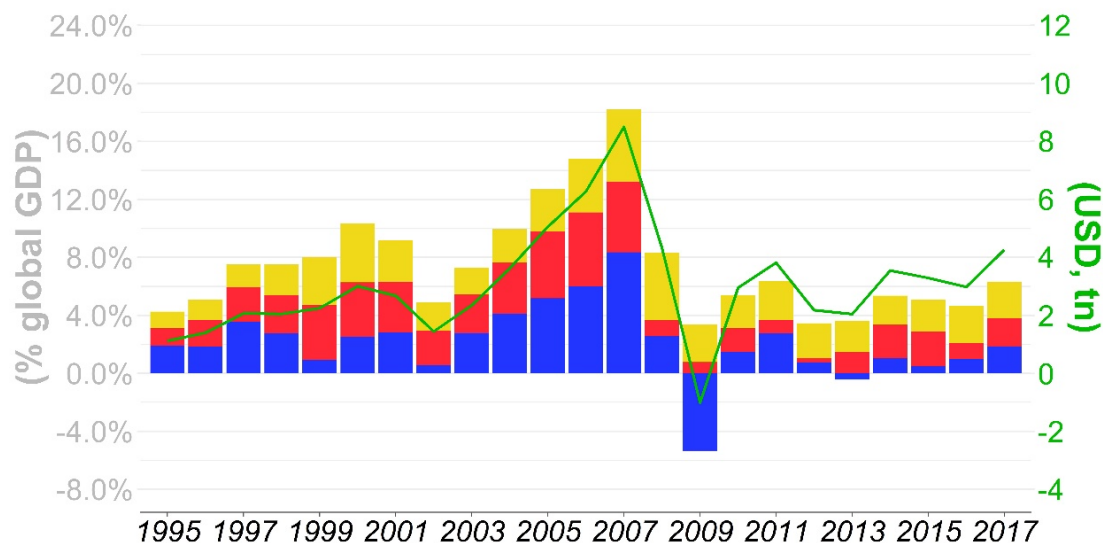
Outcomes ten years after – End of ,Hyper-Globalisation‘?

Gross capital flows by capital flow category



Global gross capital **inflows** in % of global GDP

- FDI
- Portfolio investment
- other investment
- total in-/outflows (rhs scale)



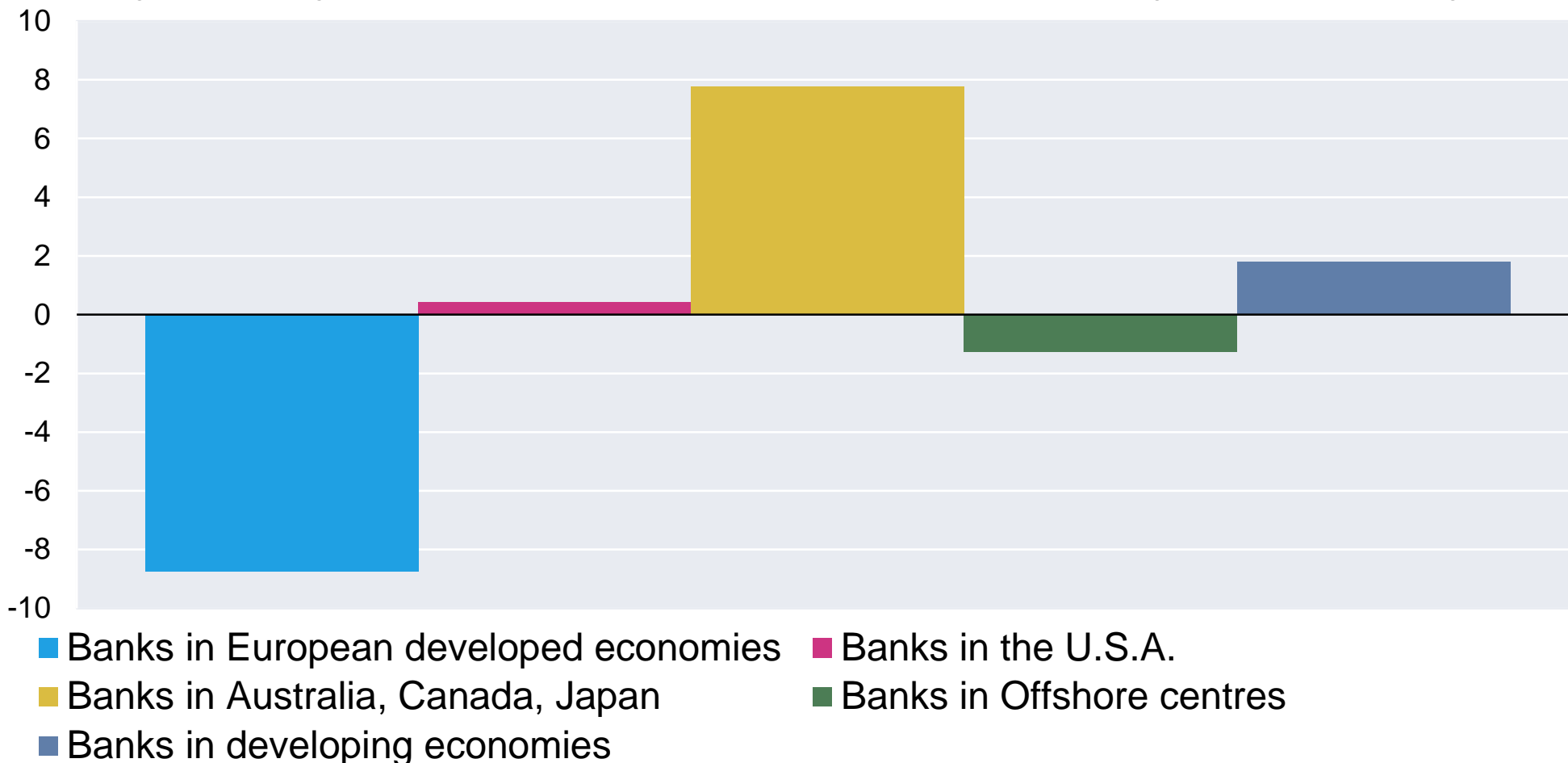
Global gross capital **outflows** in % of global GDP

Source: BIS, own calculations

Banks in Europe drove the decline of global cross-border claims ...

Cross-border claims of banks by region of bank location: change 2007 to 2017
(as cross-border claims of all banks reporting to the BIS declined by 10%)

Percentage point change of the share in total cross-border claims of all banks reporting to BIS, 2017 exchange rates

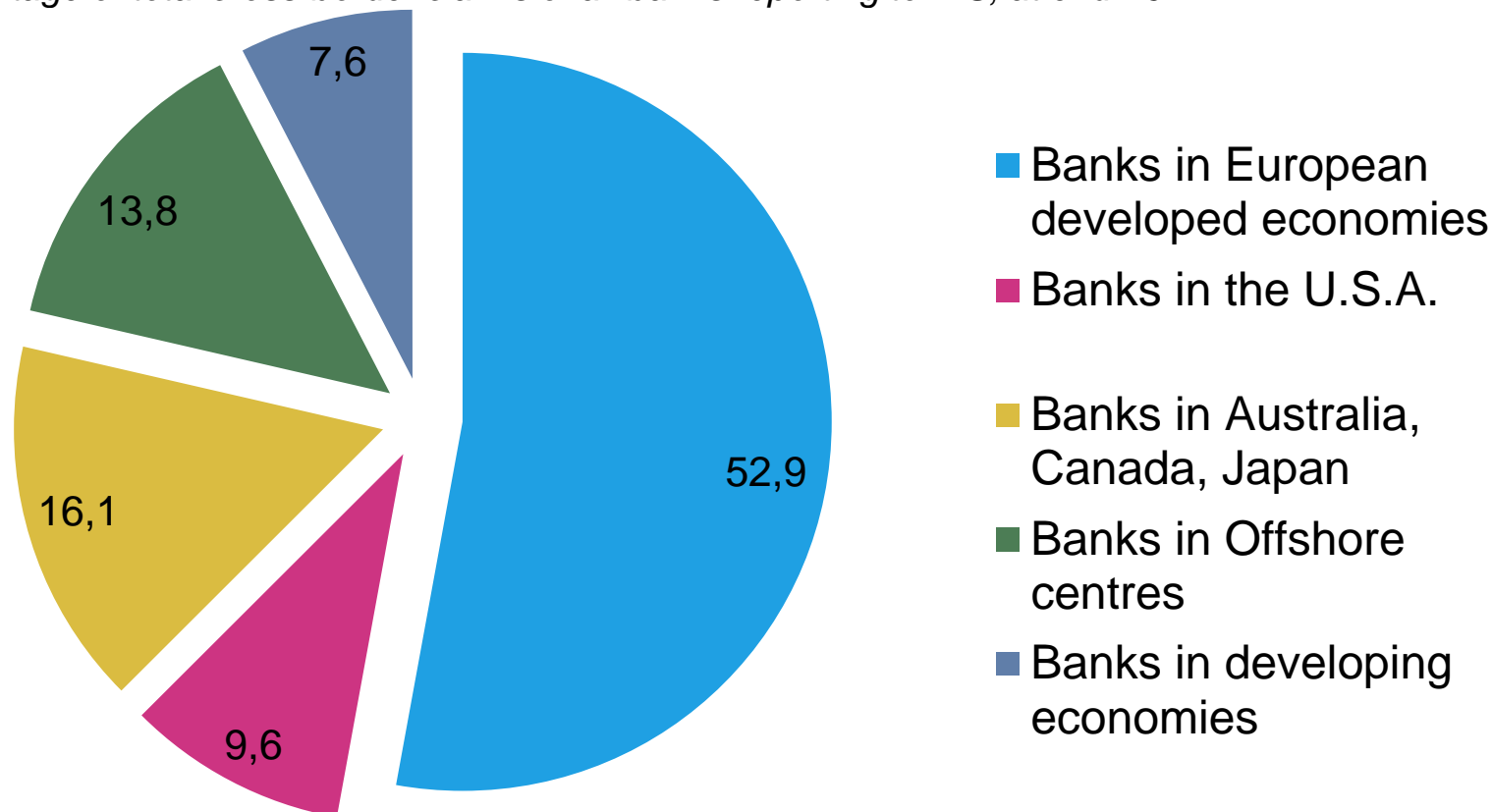


Source: Own estimations, based on data provided by BIS.

... but banks in Europe still hold most global cross-border claims

Cross-border claims of banks by region of bank location, at end-2017

As a percentage of total cross-border claims of all banks reporting to BIS, at end-2017

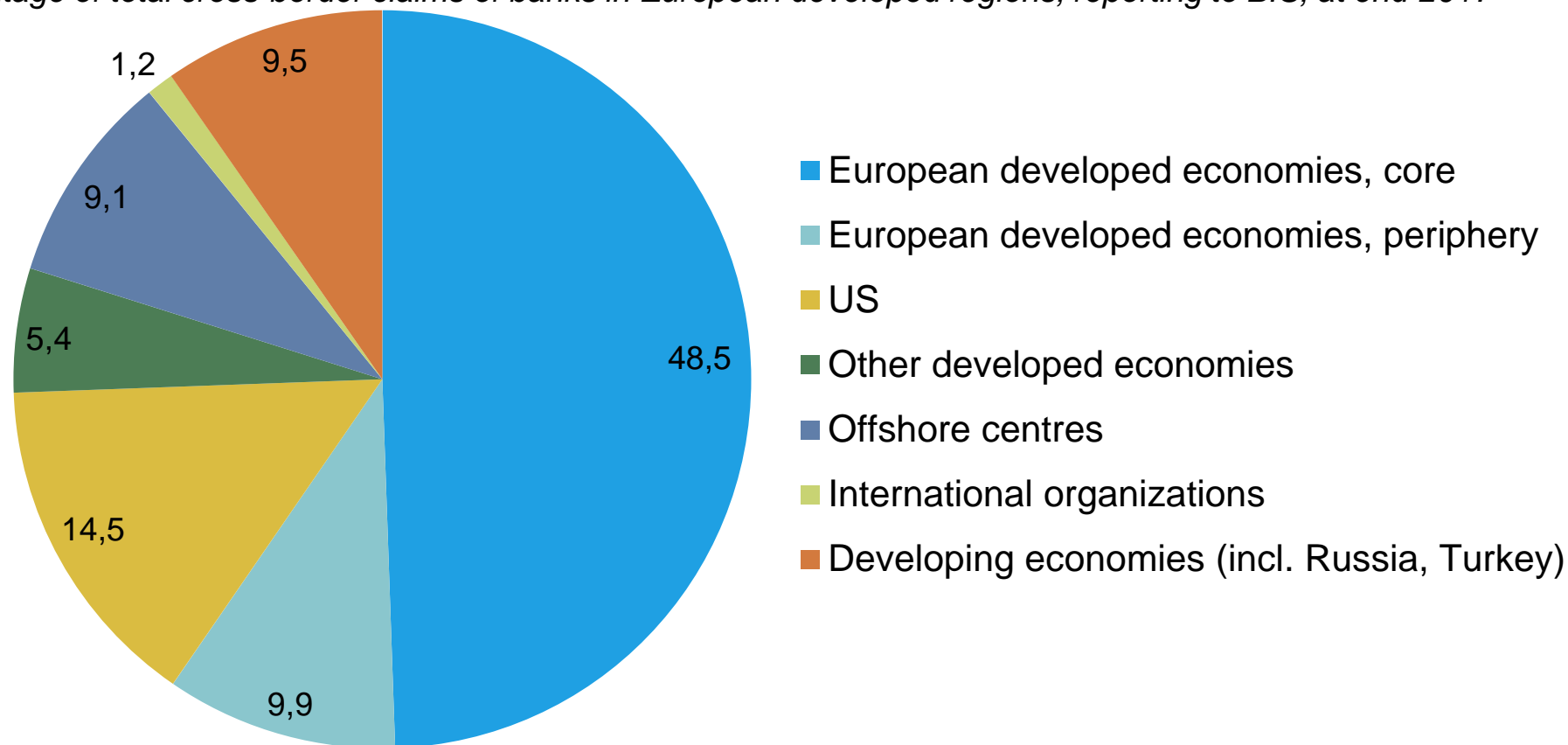


Source: Own estimations. based on data provided by BIS.

Banks in Europe hold their cross-border claims mainly against Europe itself, then against the US ...

Cross-border claims of banks in European developed economies, by counterparty region (all sectors as debtors in other countries), at end-2017

As a percentage of total cross-border claims of banks in European developed regions, reporting to BIS, at end-2017

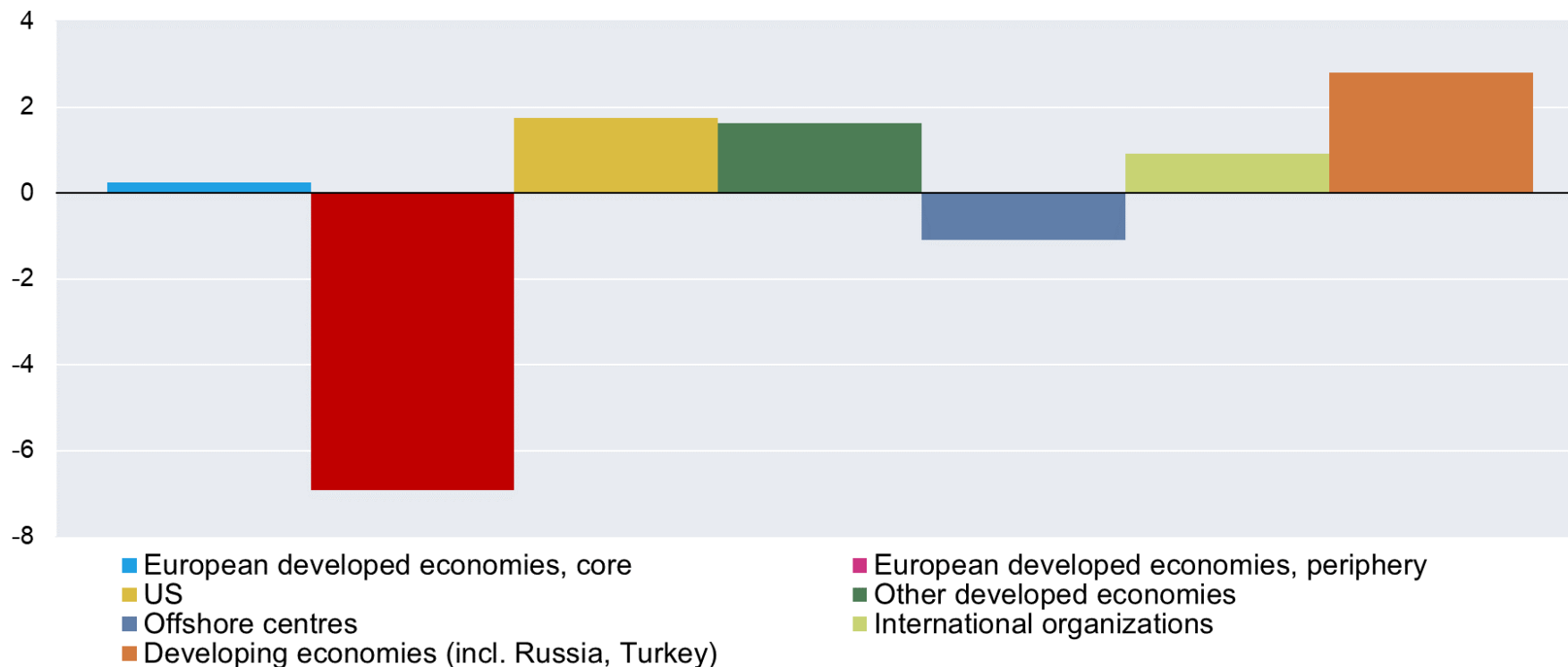


Source: Own estimations, based on data provided by BIS.

Within total claims of banks in Europe: EA periphery & Offshore c. had above-average declines

Cross-border claims of banks in European developed economies, by counterparty, 2007 to 2017 (as cross-border claims against all counterparties declined by about 20%)

Percentage point change of the share of the counterparty region in total cross-border claims of banks in European developed economies, at exchange rates end-2017, without break in sample

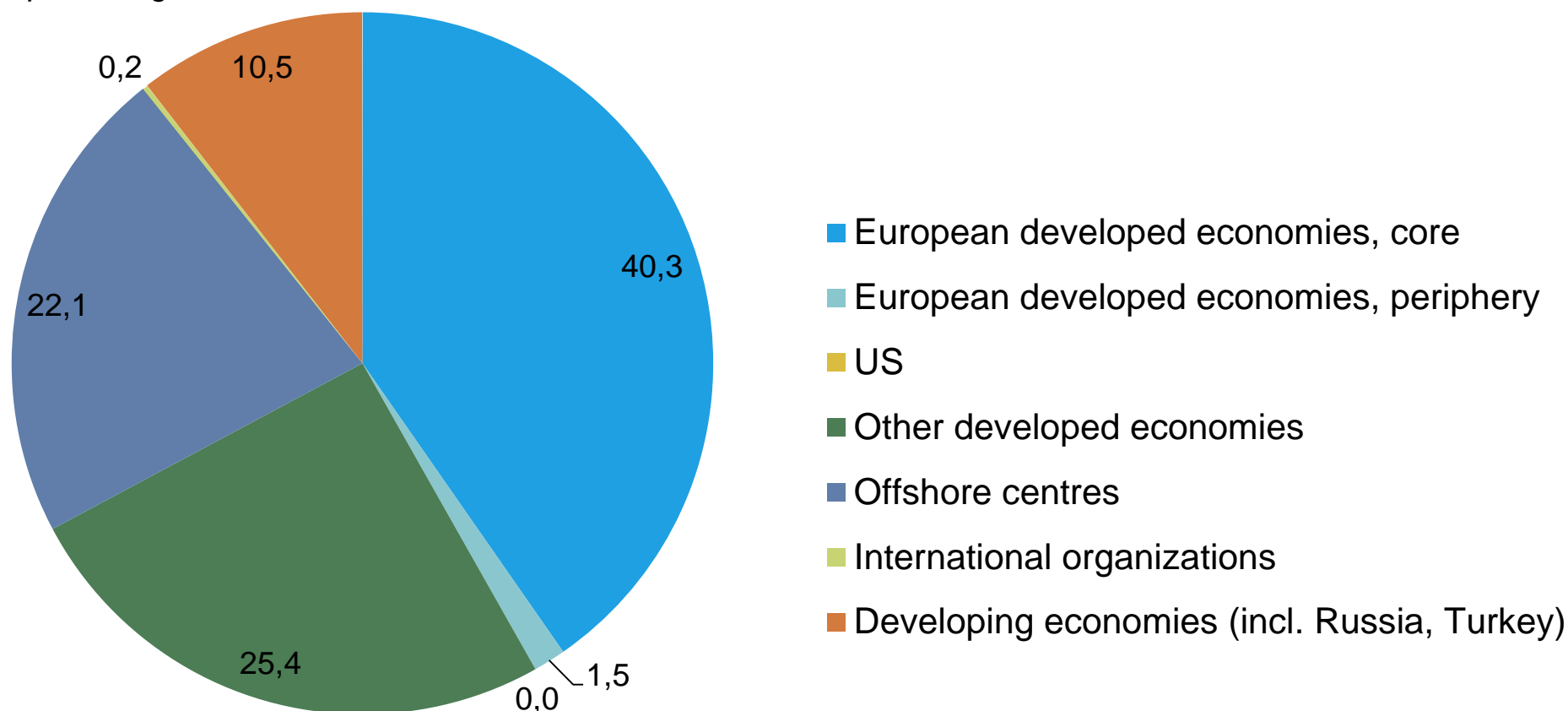


Source: Own estimations, based on data provided by BIS.

Banks in the US hold their cross-border claims less on Europe, more on Other developed economies & Offshore centres

Cross-border claims of banks in the US, by counterparty region, end-2017

As a percentage of total cross-border claims of banks in the US

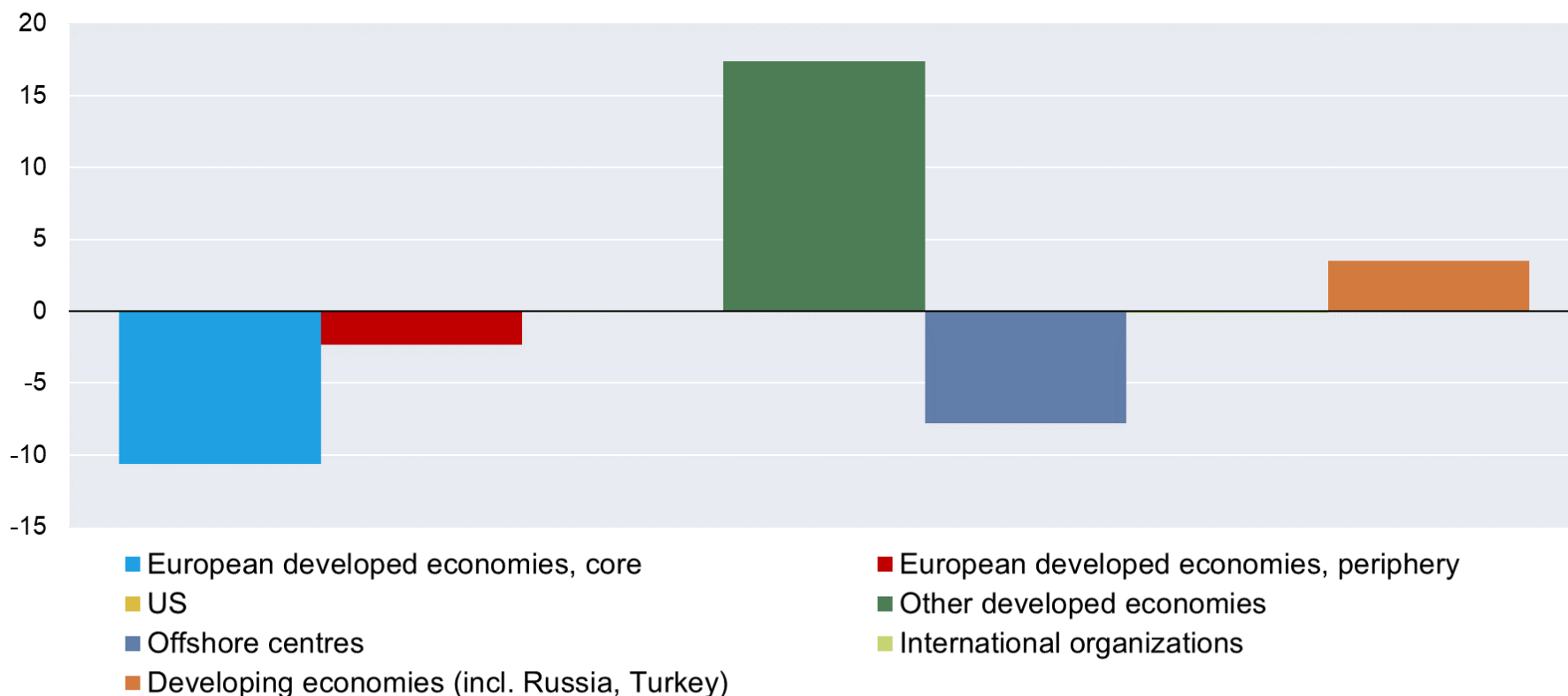


Source: Own estimations, based on data provided by BIS.

Within total claims of banks in the US: the EA and Offshore centres had above-average declines, while Other developed economies rose

Cross-border claims of banks in the US, by counterparty, 2007 to 2017
(as cross-border claims against all counterparties declined by about 5%)

Percentage point change of the share of the counterparty region in total cross-border claims of banks in the US, at exchange rates end-2017, without break in sample



Source: Own estimations, based on data provided by BIS.

Outcomes ten years after – New Global Monetary Order“?

“We must **rethink the financial system from scratch**, as at **Bretton Woods**.“

Nicolas Sarkozy, September 2008

We need a new Bretton Woods. We can't have, on the one hand, a multipolar world and, on the other, **a single benchmark currency across the globe**.

Nicolas Sarkozy, September 2008

"Democratic governments worldwide must establish **a new global financial architecture, as bold in its own way as Bretton Woods**, as bold as the creation of the European Community and European Monetary Union. And we need it fast."

Georgios Papandrea, March 2010

Outcomes ten years after – New Global Monetary Order‘?

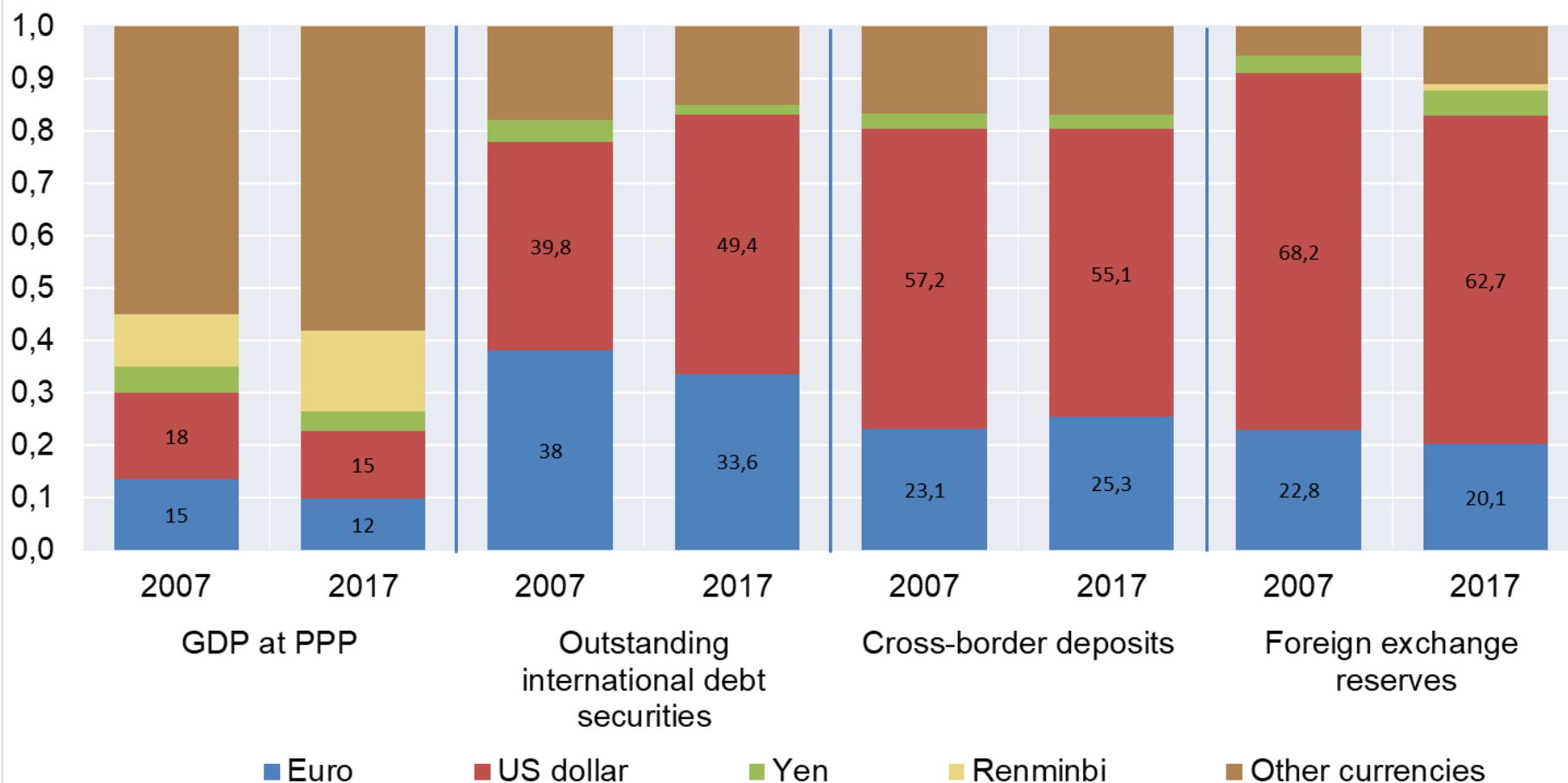
„The acceptance of credit-based national currencies as major international reserve currencies, as is the case in the current system, is a rare special case in history. The crisis again calls for creative reform of the existing international monetary system towards an **international reserve currency** with a stable value, rule based issuance and manageable supply, so as to achieve the objective of safeguarding global economic and financial stability.

Zhou Xiaochuan, March 2009

Outcomes ten years after – New Global Monetary Order‘?

The international role of the USD

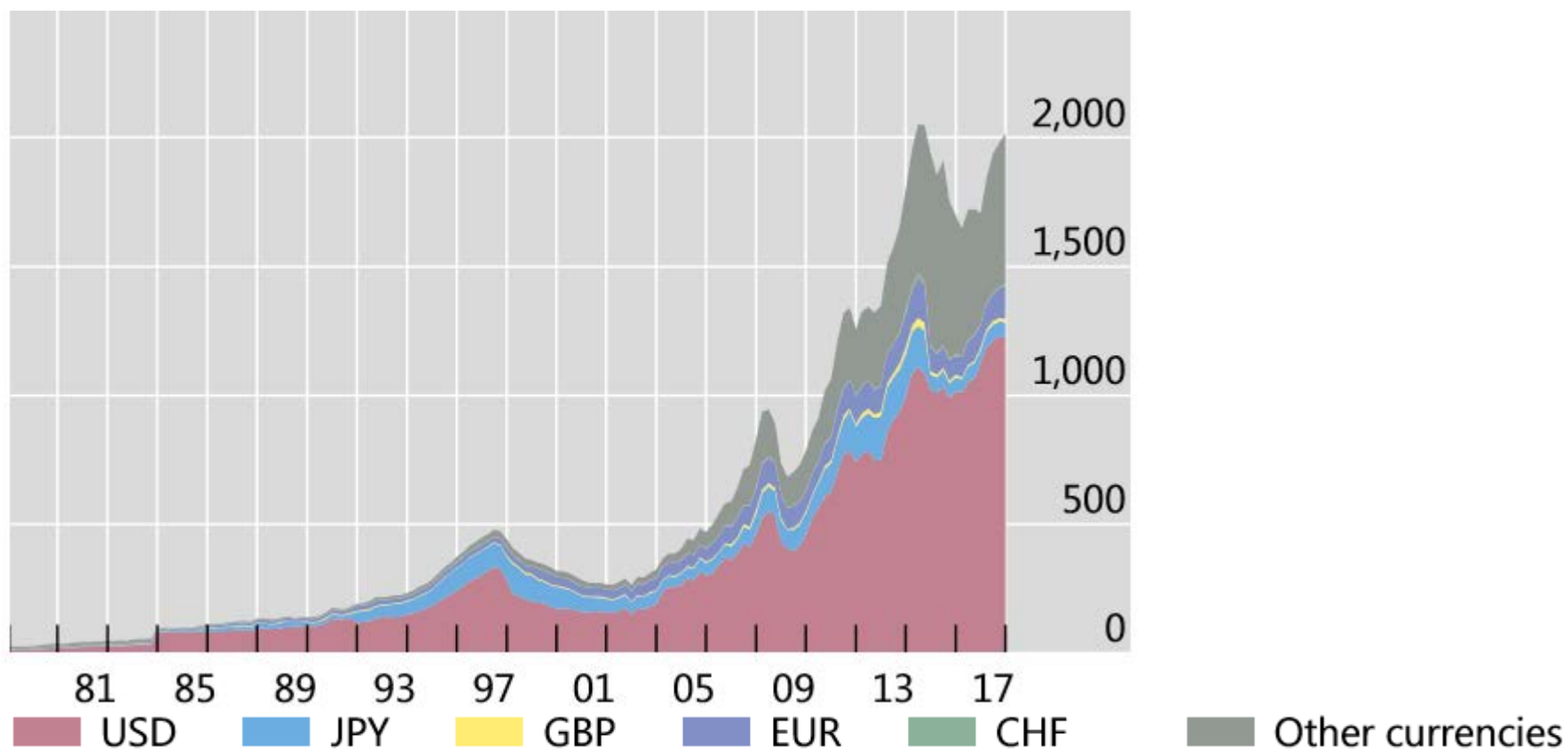
2007 and 2017 values, in % of world volume



Source: ECB.

Outcomes ten years after – New Global Monetary Order‘?

Cross border claims of BIS reporting banks on Emerging Asia, currency breakdowns, in bln of US dollars



Source: BIS locational banking statistics

Avdjiev et al. (2018), Gauging procyclicality and financial vulnerability in Asia through the BIS banking and financial statistics, BIS Working Papers No 735.

Structure

Outcomes versus expectations – ten years after

Current Global Monetary Order – Characteristics

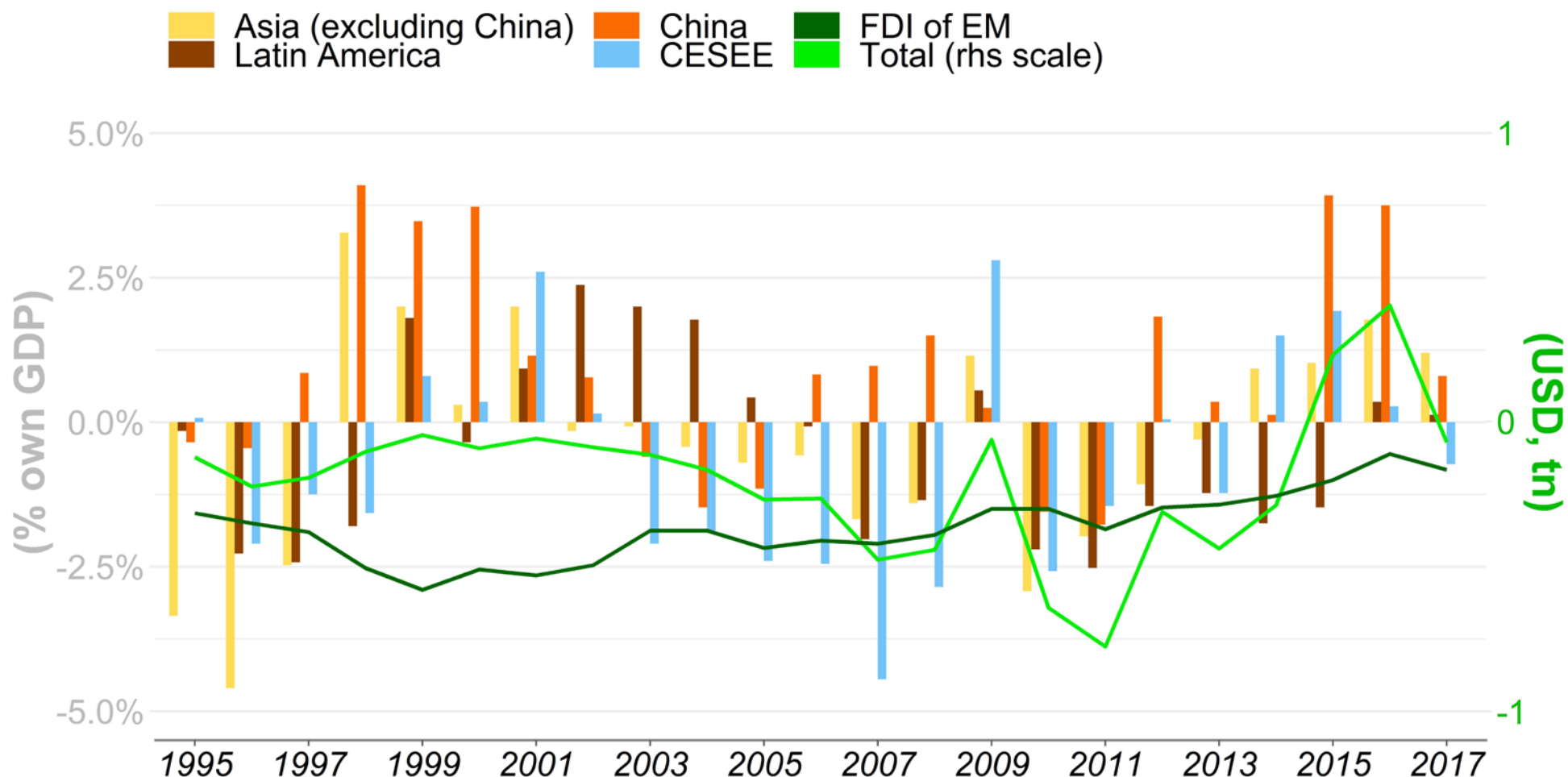
Reform Proposals of the global monetary order

Current Global Monetary Order – Characteristics

- Capital flow volatility and abrupt reversal of private capital flows
- Absence of systematic mechanisms to allow for sufficient and coordinated supply of liquidity - Excessive accumulation of foreign reserves by emerging
- Asymmetry in the adjustment mechanisms between borrowing and lending countries
- Asymmetry between the US and the rest of the world – **Monetary centre drives the global financial cycle**

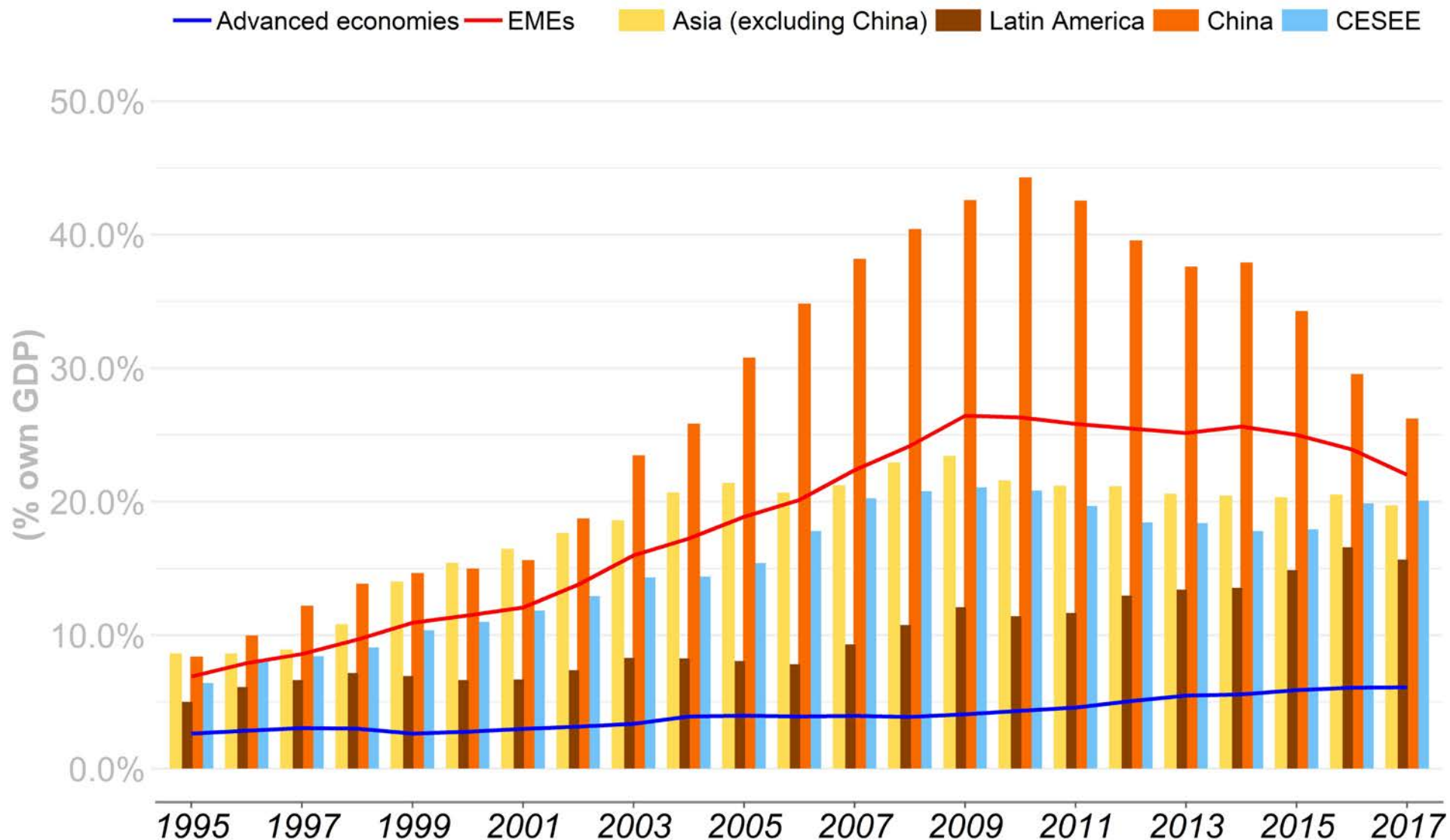
Capital flow volatility and abrupt reversals of capital flows

Net capital flows in % of own GDP, portfolio and banking flows, EMEs



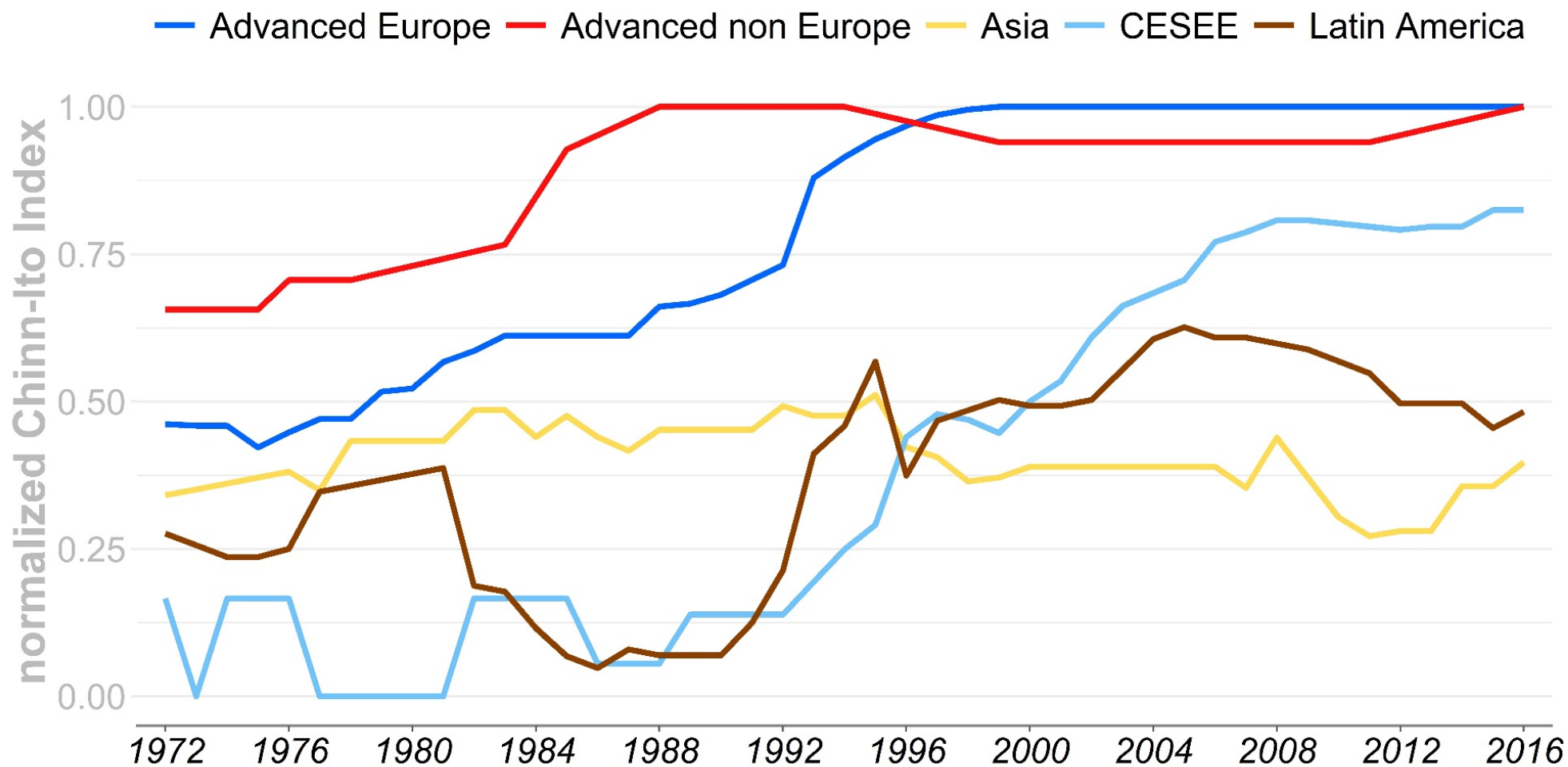
Source: BIS, own calculations

Excessive accumulation of foreign exchange reserves



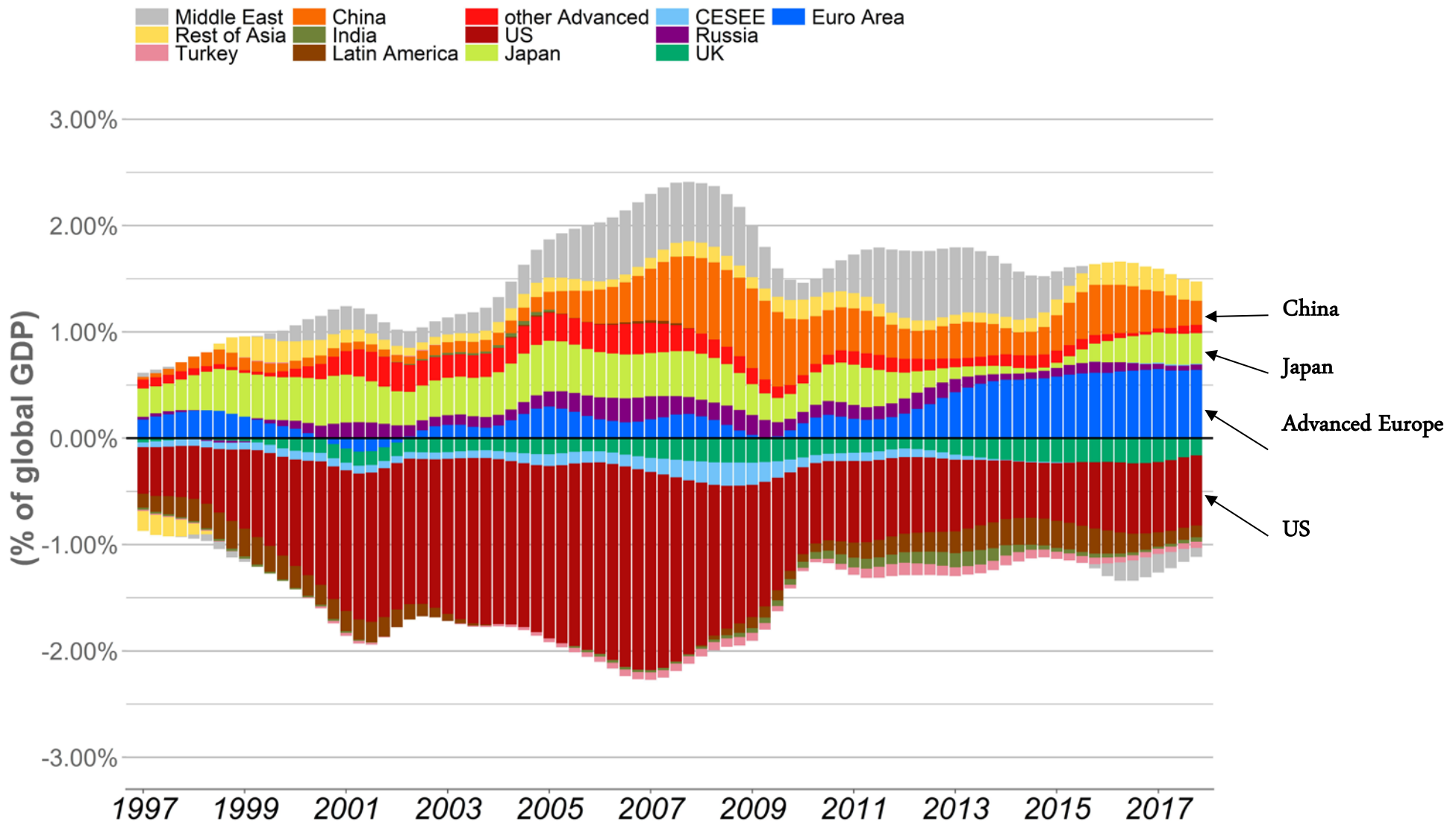
Source: BIS, own calculations

Capital flow volatility and abrupt reversals of capital flows



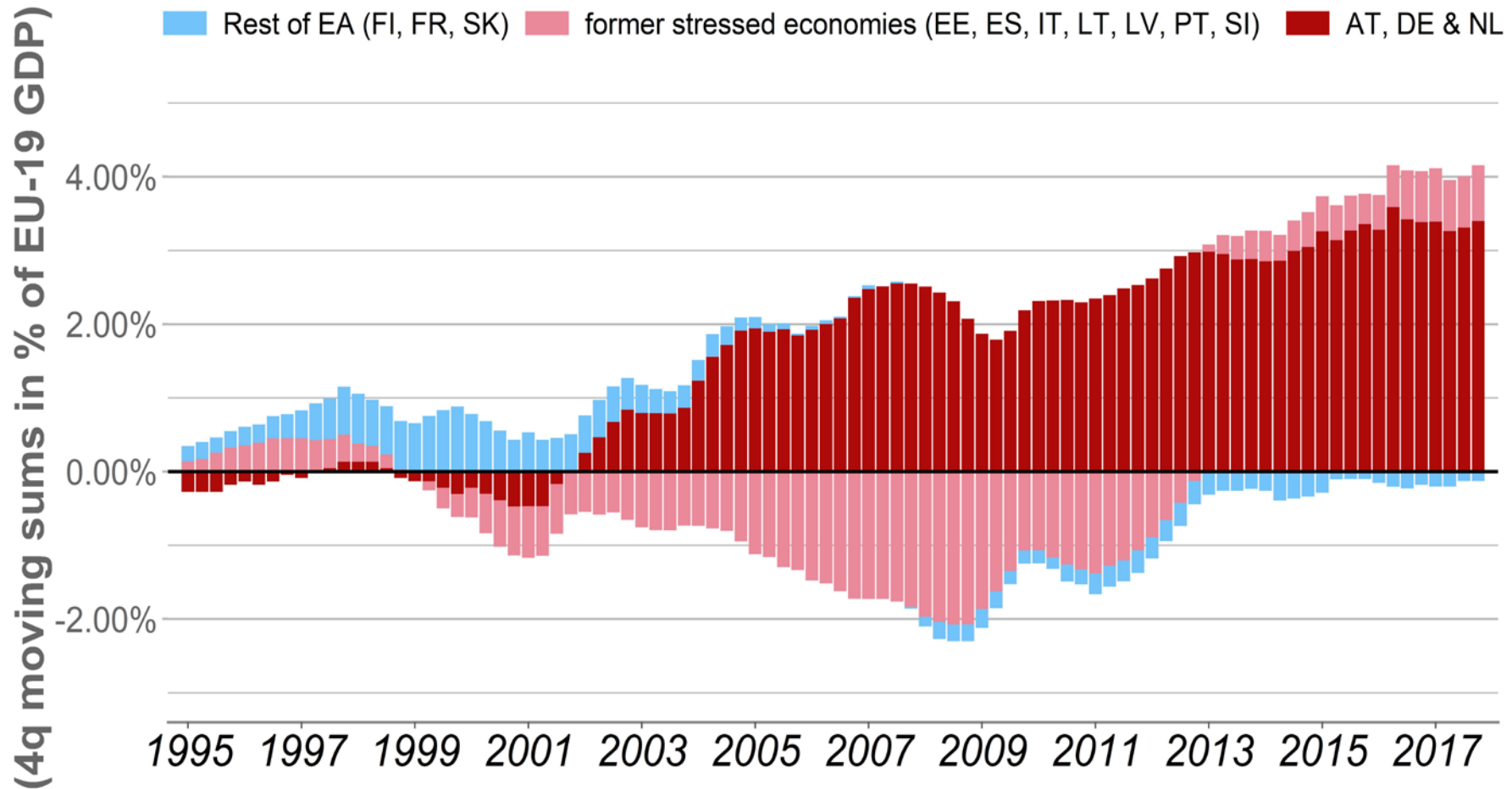
Source: Chinn, Menzie D. and Hiro Ito. 2006. "What Matters for Financial Development? Capital Controls, Institutions, and Interactions," *Journal of Development Economics*, Volume 81, Issue 1, Pages 163-192 (October).

Asymmetry in the adjustment mechanisms – CA world



Source: BIS, IMF, own calculations

Asymmetry in the adjustment mechanisms – CA EA



EU-19 excluding Belgium, Cyprus, Greece, Ireland Luxembourg and Malta

Source: BIS, own calculations

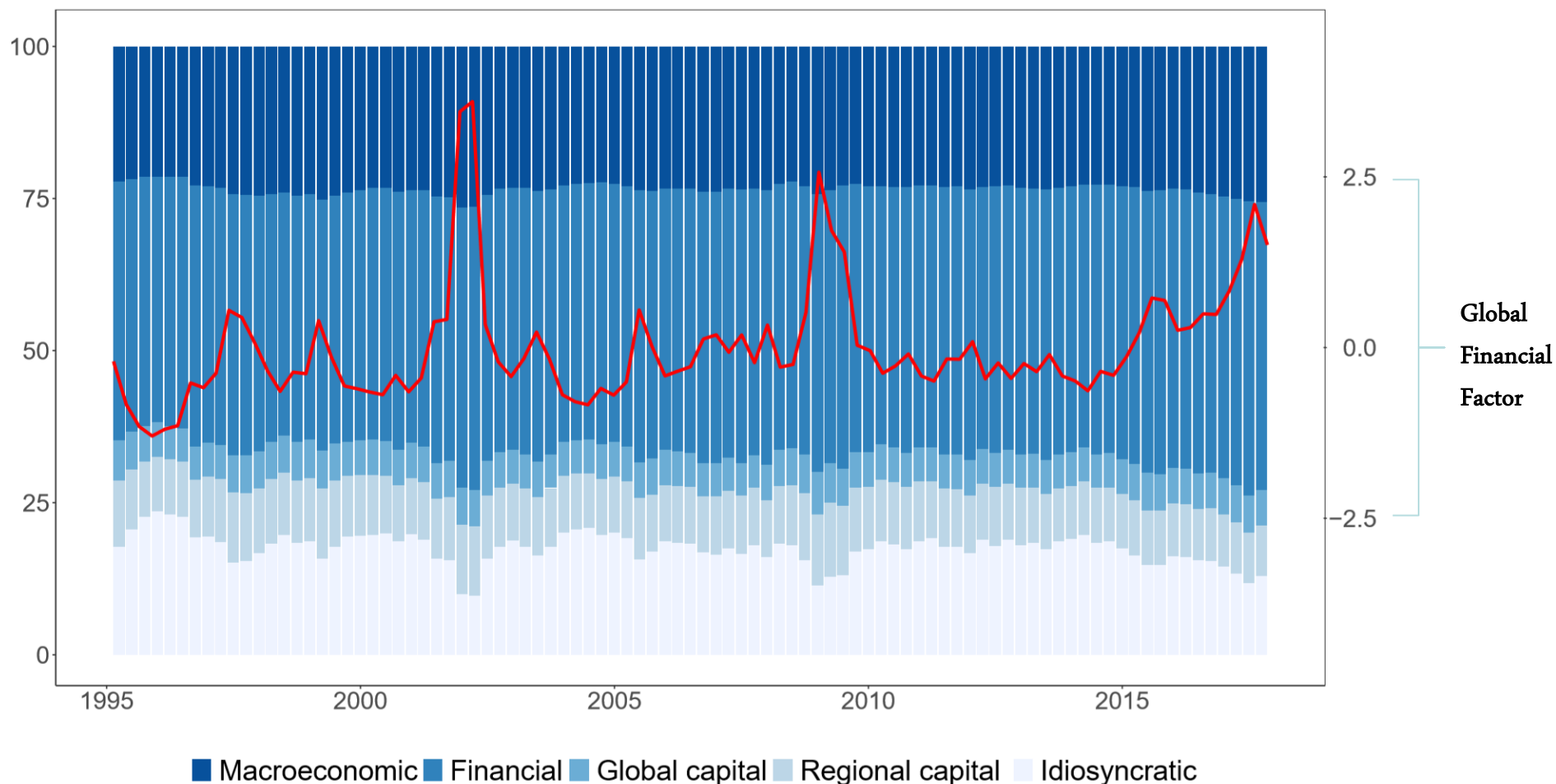
Capital Flows and the Global Financial Cycle

Monetary centre drives the global financial credit cycle

- Connection between the surge of gross capital inflows and financial boom-bust cycles
- **Push factors** (US monetary policy, supply of global liquidity (especially in USD) versus domestic **pull factors** in capital flows (*Calvo 1993, Rey 2013*))
- Strong empirical evidence of predominance of common push factors over domestic push factors
- Large global banks expand and contract their cross-border claims in part in response to global liquidity and monetary policy in advanced countries (*Shin 2015*) – crucial role of cross-border flows via global banks that transmit financial conditions from the center across the globe. (*Bruno and Shin 2015*)
- **Mundell’s “trilemma”** may have morphed into a **“dilemma”** where **autonomous monetary policy is no longer effective, irrespective of the exchange rate regime** (*Rey 2013*)

Capital Flows and the Global Financial Cycle

Variance decomposition of gross capital inflows over time, in percent (lhs)
Standardized volatility (red line), (rhs)



Source: Eller/Huber/Schuberth (2018)

Capital Flows and the Global Financial Cycle

Three (different) types of policy implications discussed in literature

Increase country's resilience to procyclicality in capital flows

- Better fundamentals
- Foreign exchange reserves
- Deepness of financial markets
- Financial regulation and prudential oversight
- More flexible exchange rates
- etc.

Temporary Capital Flow Management Measures (CFMM) (IMF 2011) and Macroprudential Measures (MPM)

- Association between opening up capital accounts and financial crisis (in poor and rich countries)
- CFMM are now a „legitimate part of the policy toolkit“ (Ostry et al. 2010)

Restriction of Capital Flows on a more permanent nature

Revival of literature on economic cost-benefit analysis since the GFC

- Association between capital account convertibility and growth is weak (Rodrik 1998)
- Capital flow liberalisation episodes have reduced the labour share of income and increased overall inequality (Furceri et al. 2017)
- Capital mobility shifts the burden of economic shocks to labour (Rodrik 1997) and taxation from capital to labour (Onaran and Boesch 2014)

Structure

Outcomes versus expectations – ten years after

Current Global Monetary Order – Characteristics

Reform proposals for the global monetary order

Reform proposals for the global monetary order

Incremental approach

Incremental transition towards a more multipolar systems

- Provision of international liquidity by expanding the Global Financial Safety Nets (GFSN), should
 - reduce excessive reserves
 - reduce capital flow volatility
 - reallocate country's assets to productive uses
 - partly resolve the Triffin dilemma
- Development of alternatives to US Treasuries – European Safe Asset (SBBSs)

More far-reaching approach

- Reimposition of capital controls on a permanent nature
- A new Bretton Woods Agreement – cooperation of central banks to stabilise exchange rates
- Replacement of USD as the leading international currency by a transnational unit



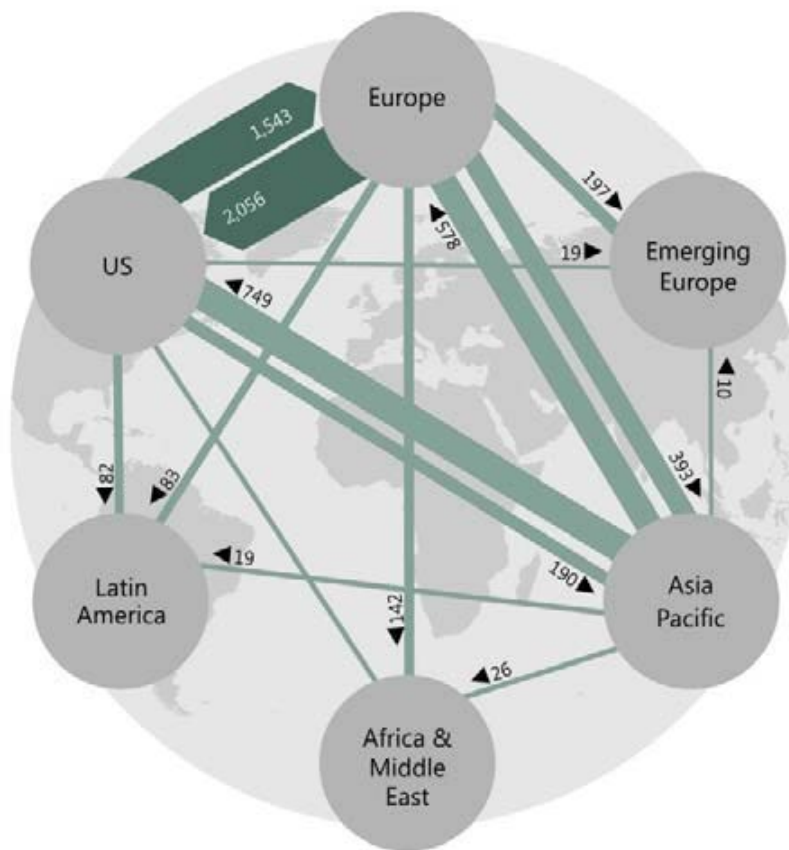
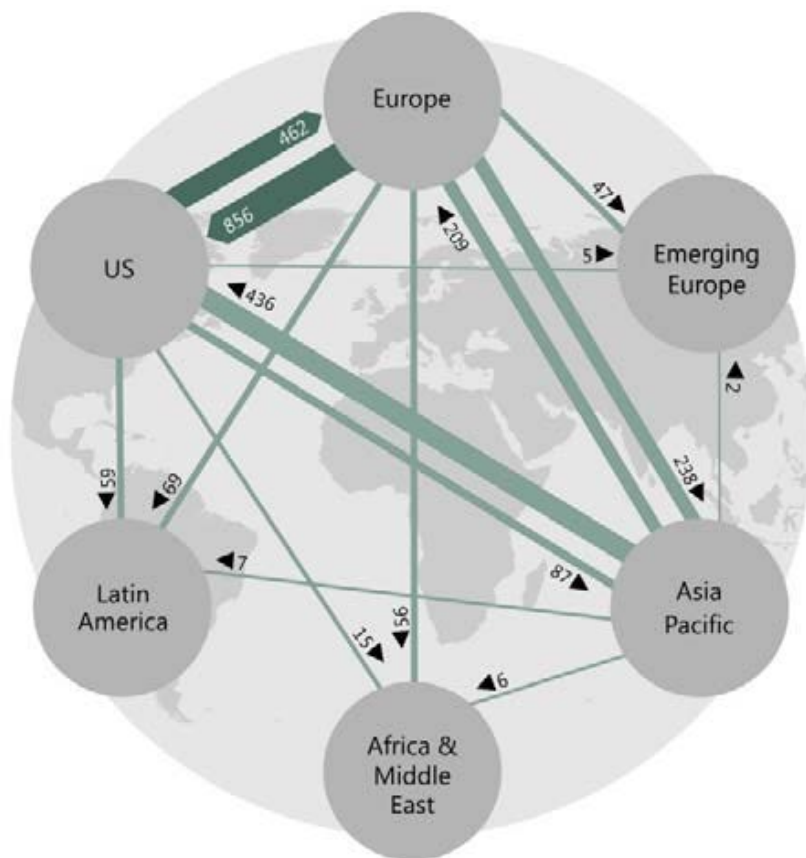
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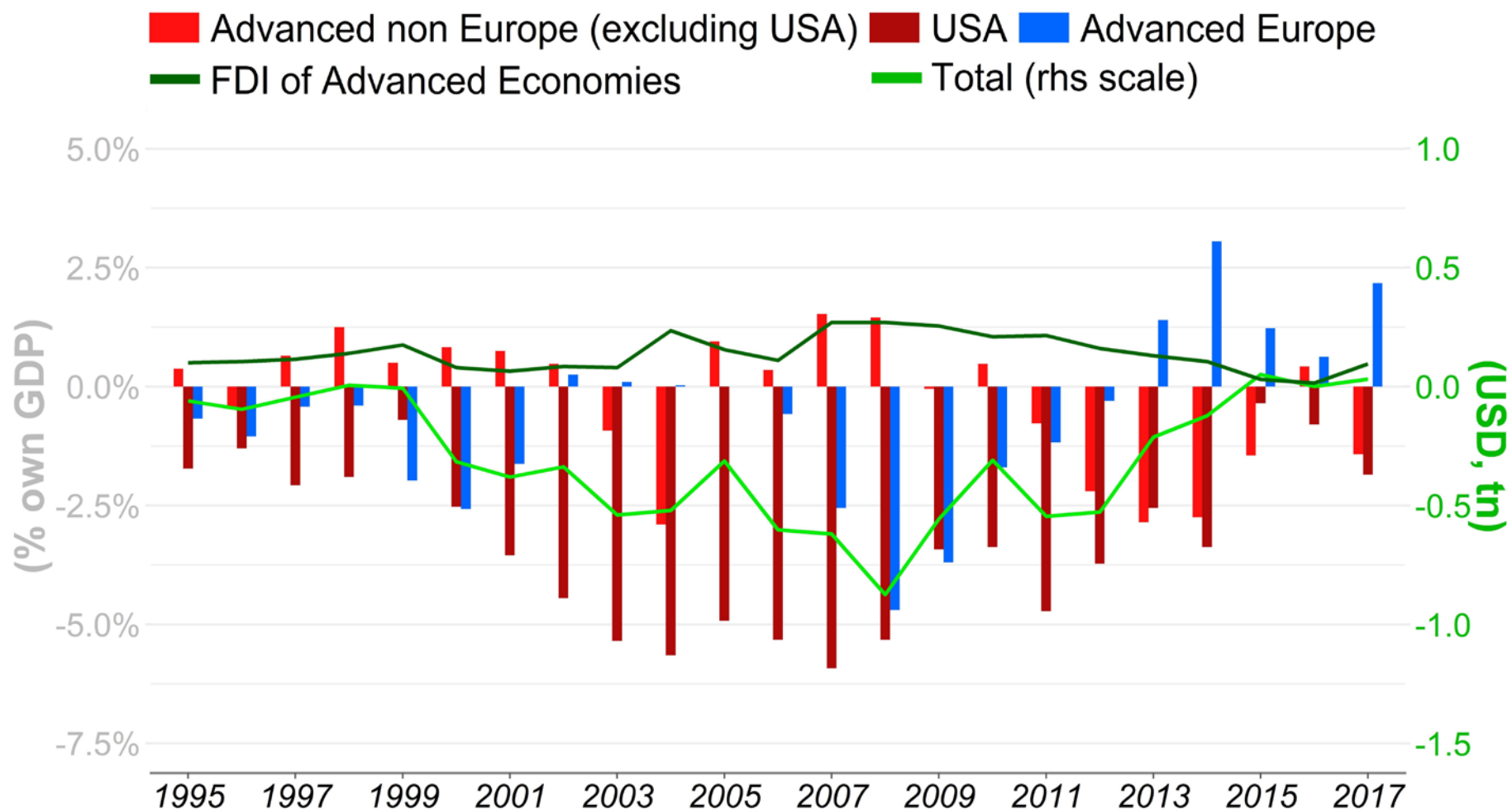


Outcomes ten years after – End of ,Hyper-Globalisation“?



Capital flow volatility and abrupt reversals of capital flows

Net capital flows in % of own GDP, portfolio and banking flows, advanced economies

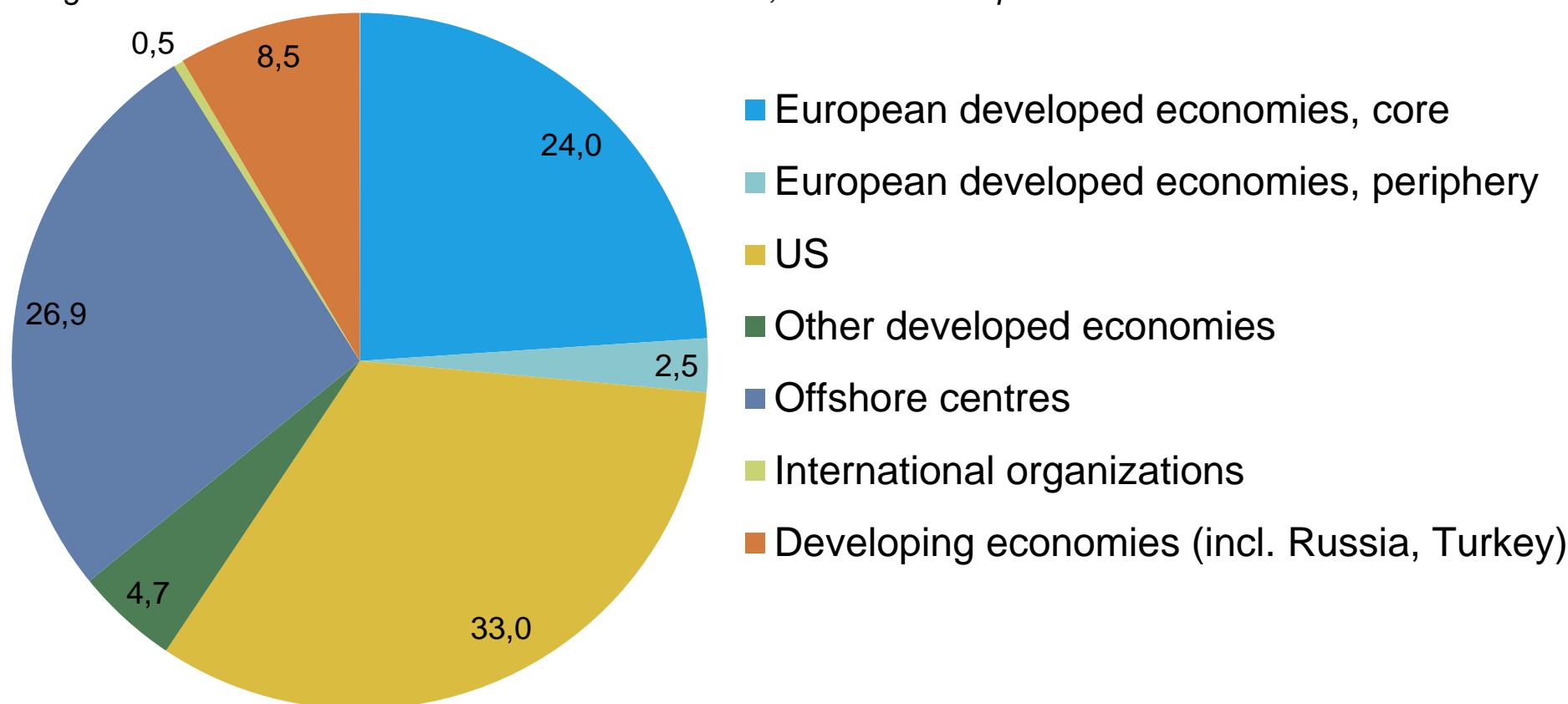


Source: BIS, own calculations

Banks in Canada and Japan hold their cross-border claims more on the US and on Offshore centres than on Europe

Cross-border claims of banks in Canada & Japan, by counterparty, at end-2017

As a percentage of total cross-border claims of banks in Australia, Canada and Japan

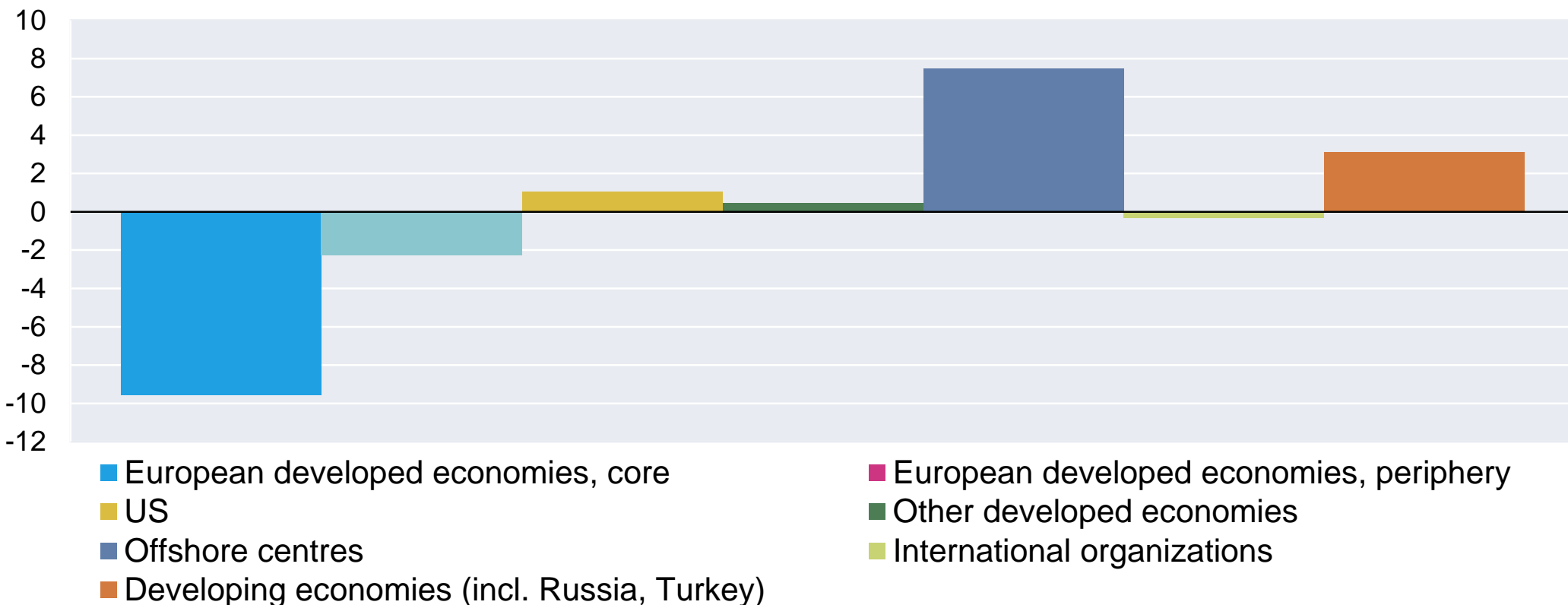


Source: Own estimations, based on data provided by BIS.

Within total claims of banks in Canada and Japan: the share of EA fell, while that of Offshore centres rose markedly

Cross-border claims of banks in Canada & Japan, by counterparty, 2007 to 2017
(as their cross-border claims against all counterparties increased by about 70%)

Percentage point change of the share of the counterparty in total cross-border claims of banks in Australia, Canada & Japan



Source: Own estimations, based on data provided by BIS.