Currency hierarchy and the financial periphery

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FMM 2022: POST-KEYNESIAN ECONOMICS AND GLOBAL CHALLENGES
20– 22 OCTOBER, Berlin

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Point of departure

Covid 19-shock: Record capital outflows from EMEs

- HI and UMI peripheral countries that enganged into financial globalization (FG) at the 1990s

Figure 1.a **Net portfolio flows, selected developing countries: Debt and equityPost-GFC and onset of COVID-19 crisis**

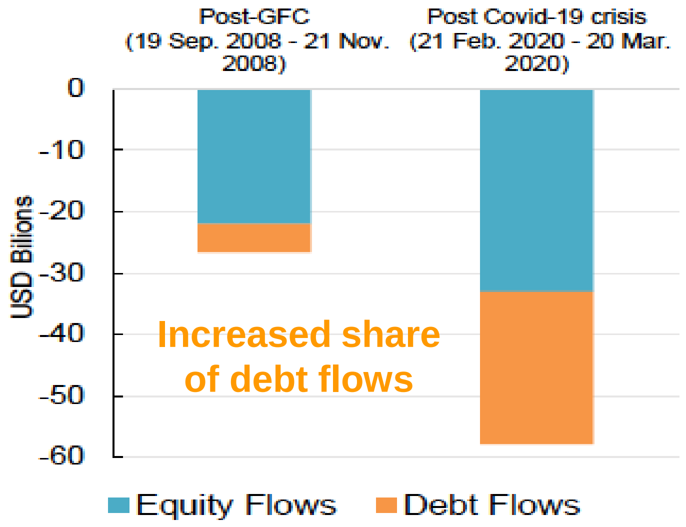
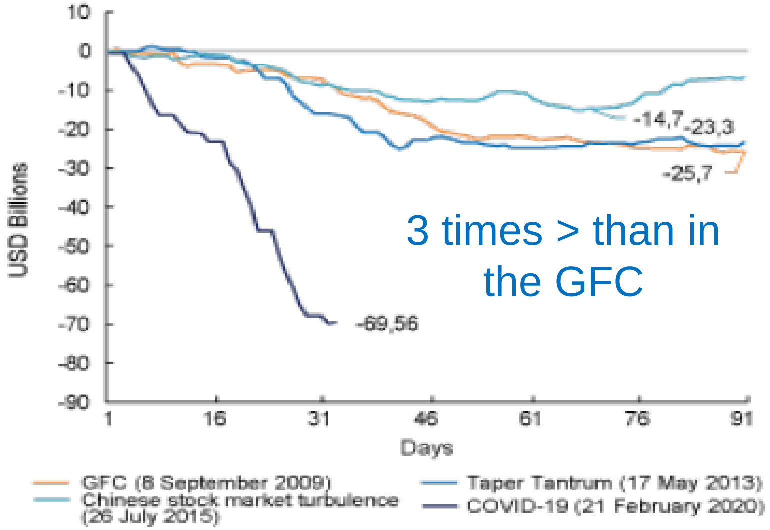


Figure 1.b **Net portfolio outflows from selected developing countries: Total flows after recent crisis**

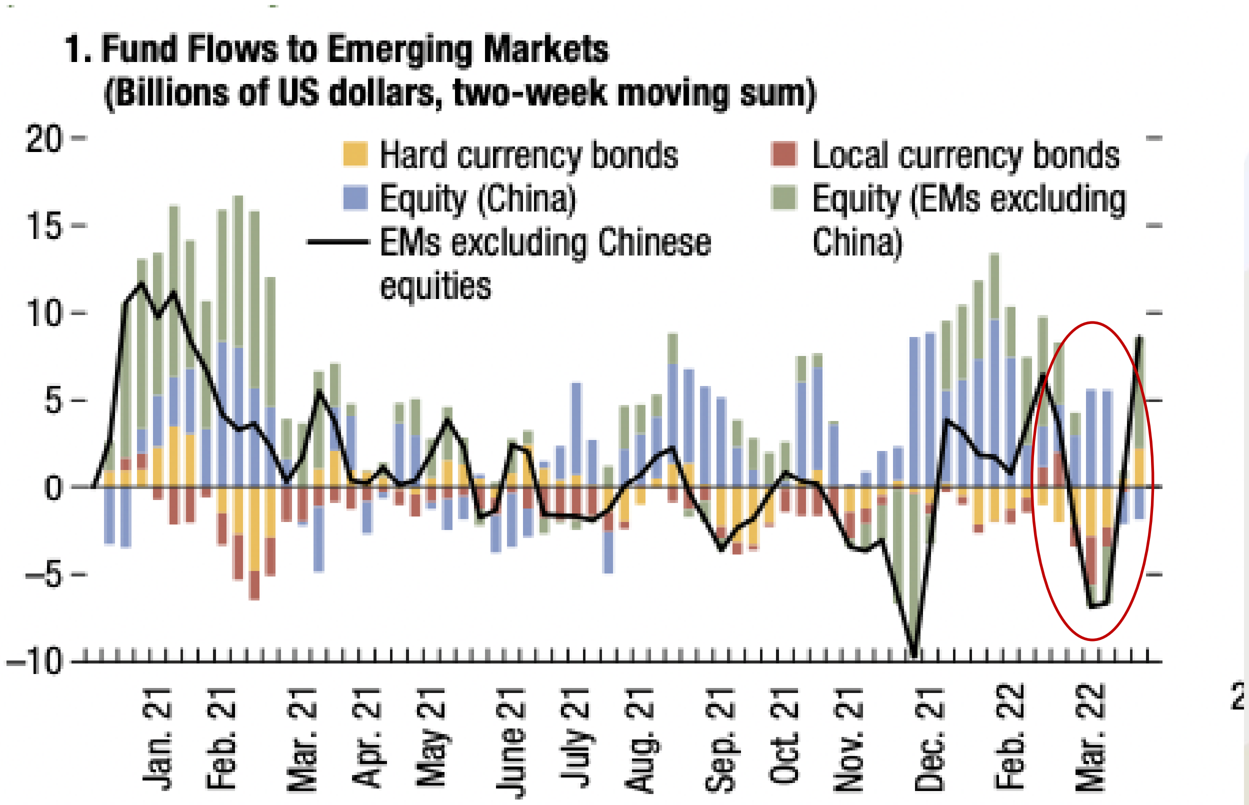


Source: UNCTAD secretariat calculations based on *IFF Daily Emerging Market Portfolio* database.
Note: Figure 1.a includes: Brazil, India, Indonesia, Philippines, Republic of Korea, South Africa, Thailand and Turkey for both data points. Figure 1.b also includes China, Mexico, Pakistan, Qatar, Saudi Arabia, Sri Lanka and Vietnam.

UNCTAD (2020) TDR Update, March

Point of departure

Ukrainian war-shock: similar pattern



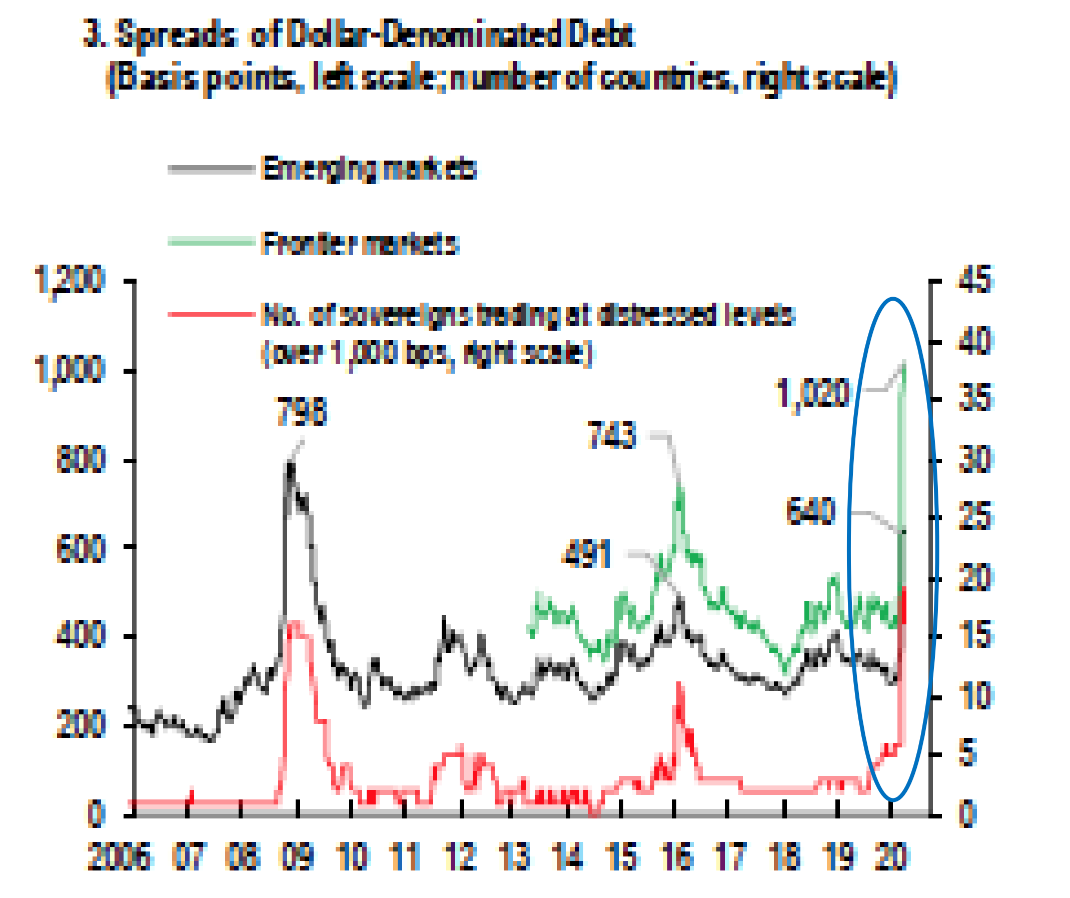
IMF/GFSR (2022), April

Point of departure

- Another group of peripheral countries were even more hit than EMEs in the international bond market

- Frontier-market economies (FMEs):
  - Peripheral LMICs and LICs that engaged into financial globalization after the GFC

Covid-19 shock



IMF/GFSR (2020), April

Point of departure

Who are the FMEs?

J.P. Morgan Frontier Index - EMBI NEXGEM (36 countries)

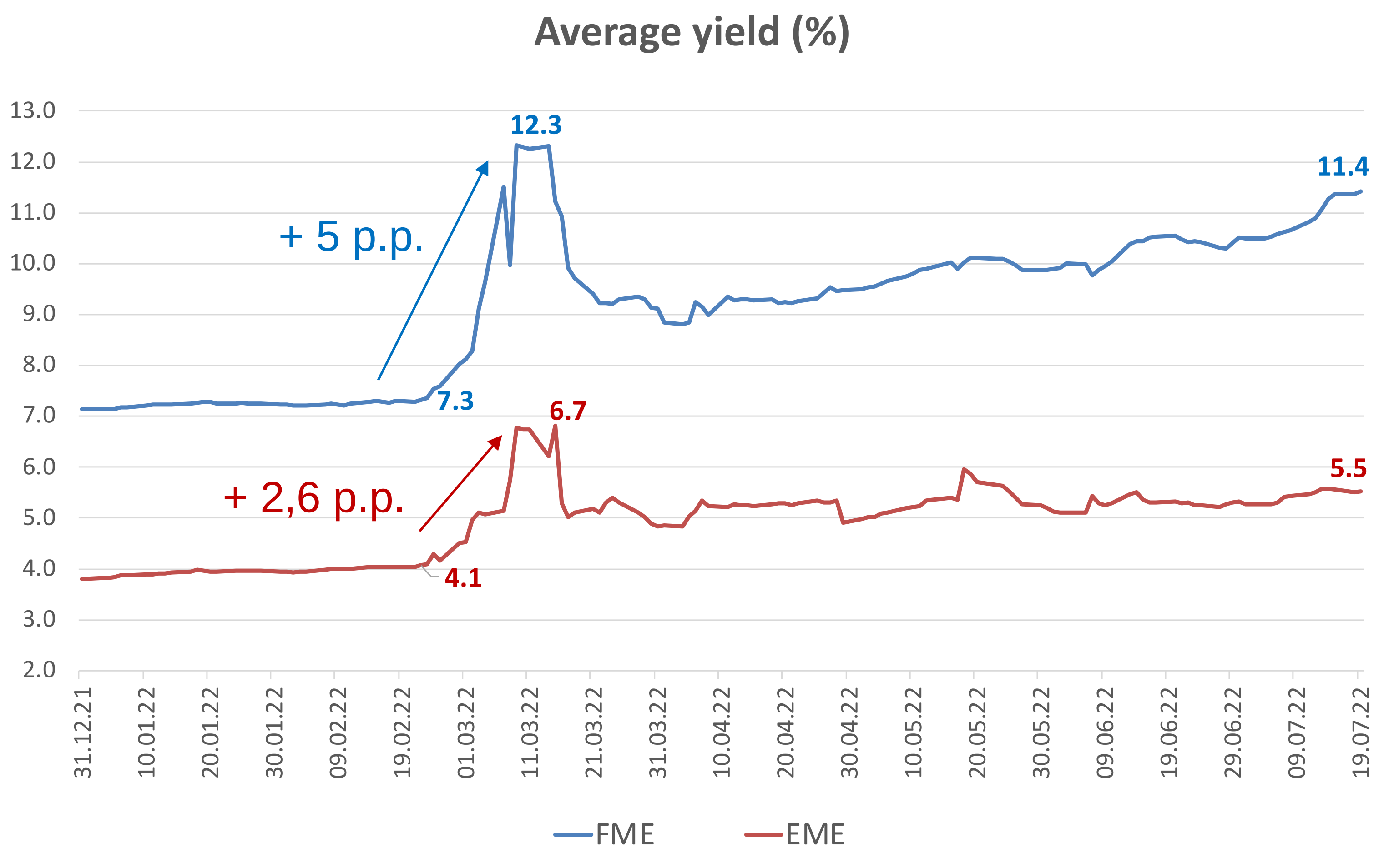
LAC (10)	SSA (13)	MENA (3)	SAS (3)	EAP (3)	CA (6)
Barbados	Angola	Iraq	Pakistan	Mongolia	Armenia
Belize	Cameroon	Jordan	Sri Lanka	Vietnam	Azerbaijan
Bolivia	Côte D'Ivoire	Tunisia	Maldivas	Papua New Guir	Belarus
Costa Rica	Ethiopia				Georgia
El Salvador	Gabon				Tajikistan
Guatemala	Ghana				Uzbekistan
Honduras	Kenya				
Jamaica	Mozambique				
Paraguay	Namibia				
Suriname	Nigeria				
	Rwanda				
	Senegal				
	Zambia				

J.P. Morgan EMEs Index - EMBI + (25 countries)

LAC (9)	SSA (1)	MENA (4)	SAS (1)	EAP (5)	ECA (6)
Argentina	South Africa	Egypt	India	China	Croatia
Brazil		Oman		Indonesia	Hungary
Chile		Qatar		Philippines	Romania
Colombia		Saudi Arabia		Malasia	Russia
Dominican Republic				Thailand	Turkey
Ecuador					Ukraine
Mexico					
Panama					
Uruguai					

Point of departure

Ukranian war shock

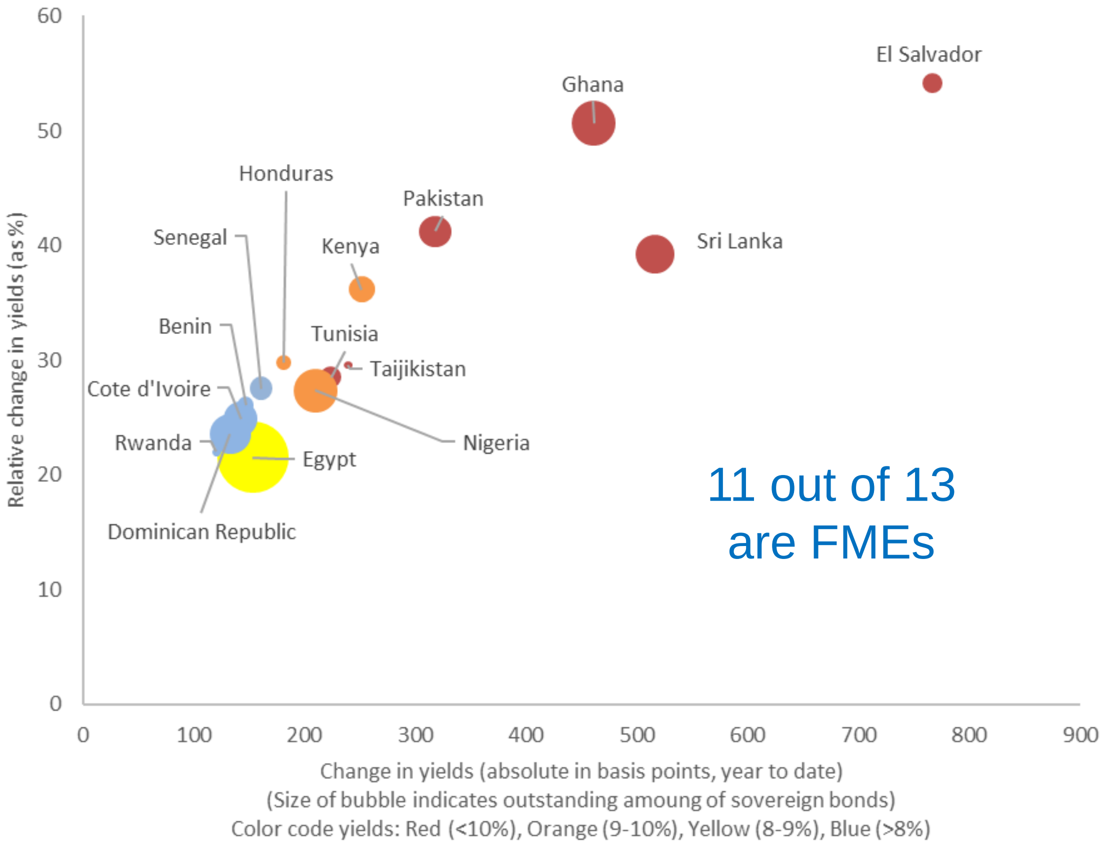


Source: UNCTAD secretariat calculations based on Refinitiv.

Point of departure

Ukranian war shock

Developing countries with the highest absolute increase in bond yields
(Absolute and relative changes YTD)



Source: UNCTAD Secretariat calculations based on Refinitiv.

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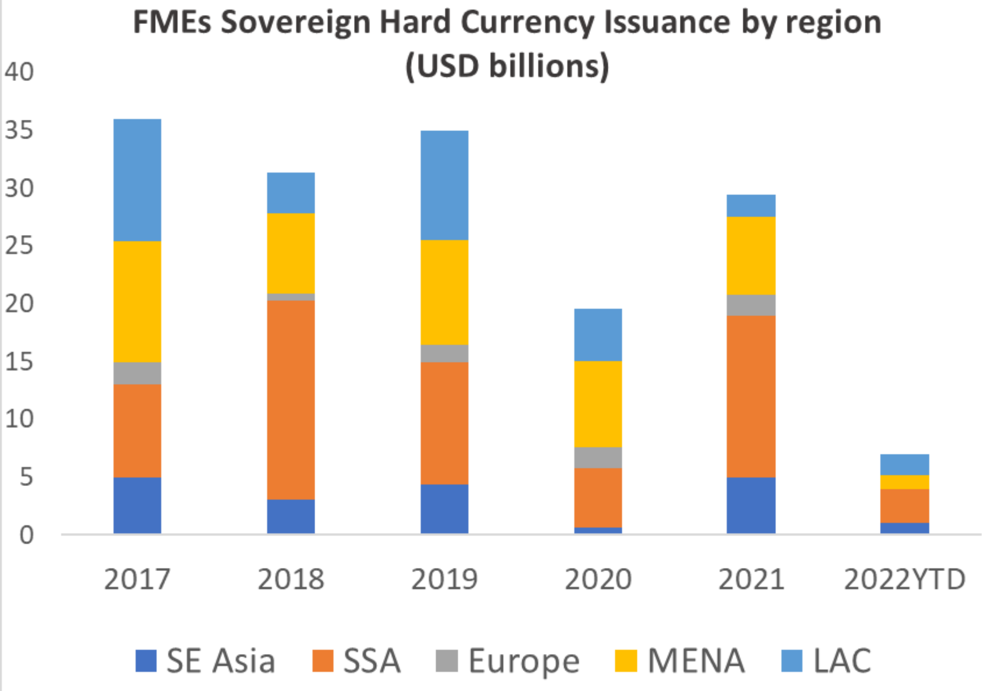
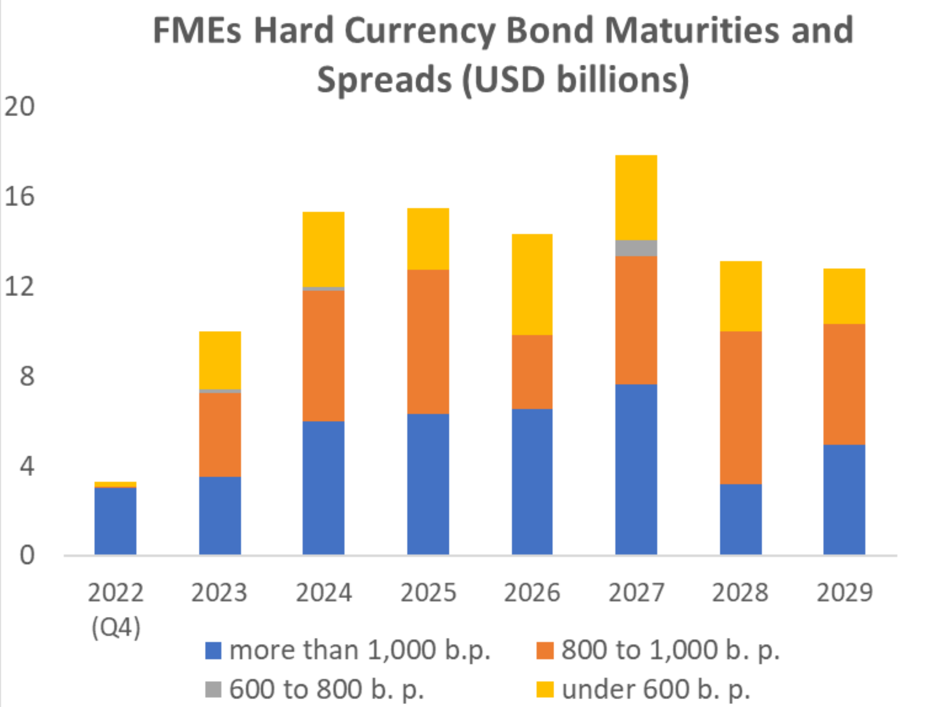
Point of departure

Current monetary tightening

Greater impact on FMEs: market access has dropped sharply and significant bond maturities with distressed spread



Source: UNCTAD secretariat elaboration based on IMF/GFSR



Source: UNCTAD secretariat elaboration based on IMF/GFSR Oct.22

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Main question and hypothesis

Recent external shocks place the new configurations of the external vulnerability of the periphery under the spotlight.

Research question: How has financial globalisation changed the nature of the external vulnerability of the periphery?

Keynesian-structuralist approach: Currency hierarchy (monetary asymmetry) + financial asymmetry/asymmetric financial integration/subordinated financial integration => unequal partners (Studart/Ocampo, Prates, Fritz. et al., Kalterbrunner and Painceira) **=>** focus on EMEs

Focus => financial periphery: EMEs and FMEs

Hypothesis:

- Centre-periphery dynamics of FG => changing pattern of the financial asymmetry over the K flows cycle
  - New channel of transmission of global financial conditions to EMEs: metamorphosis of external vulnerability => Paper co-authored with Barbara Fritz and Luiz Fernando de Paula: Currency hierarchy and financial globalization in emerging economies: how far does Riese's critique of growth by external debt still hold?, EJEEP, vol. 19, n. 2, 2022
  - **New partners: FMEs => Research at UNCTAD**
  - Financial asymmetry across the financial periphery
  - Besides CH, financial hierarchy

Structure

1. Post-GFC capital flow boom

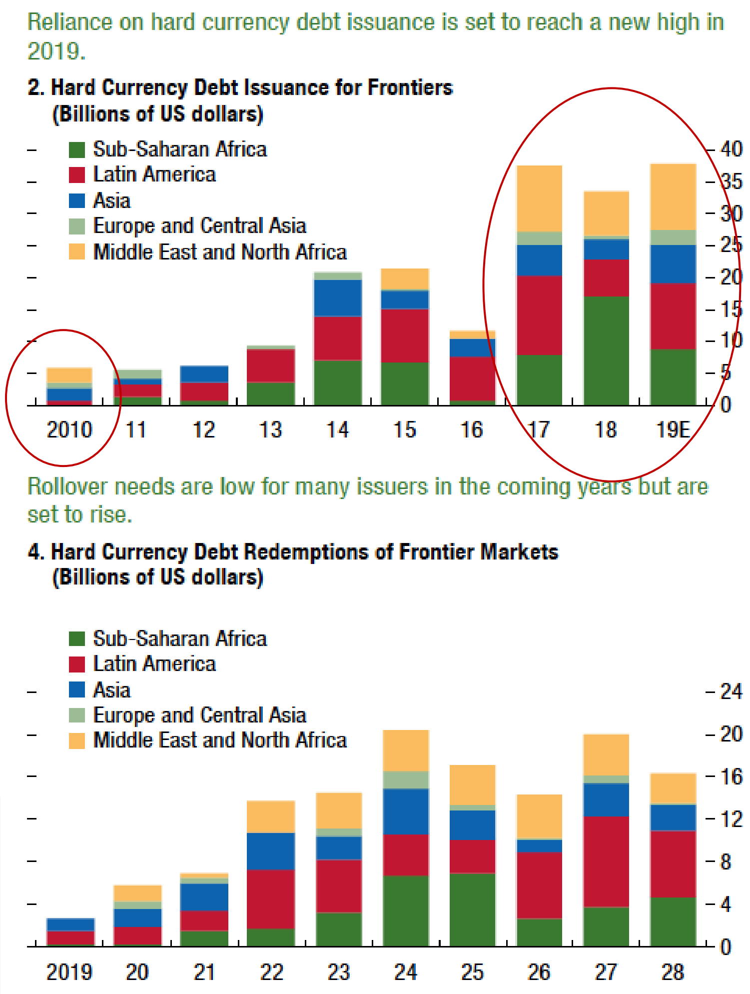
2. Centre-periphery dynamics of financial globalization

3. Currency hierarchy and financial hierarchy

4. Final remarks

1. The post-GFC capital flows boom: FMEs

- Global push factors: historically low-interest rates and quantitative easing policies in centre countries
- New target: FMEs' sovereigns bonds
  - Inclusion in Benchmark-indexes has increased the access of frontier issuers to the international capital market
  - J.P Morgan index for FMEs: EMBI NEXGEM
    - 17 in 2011 to 36 countries in 2022
- Pull factor: the "missing middle of development finance"

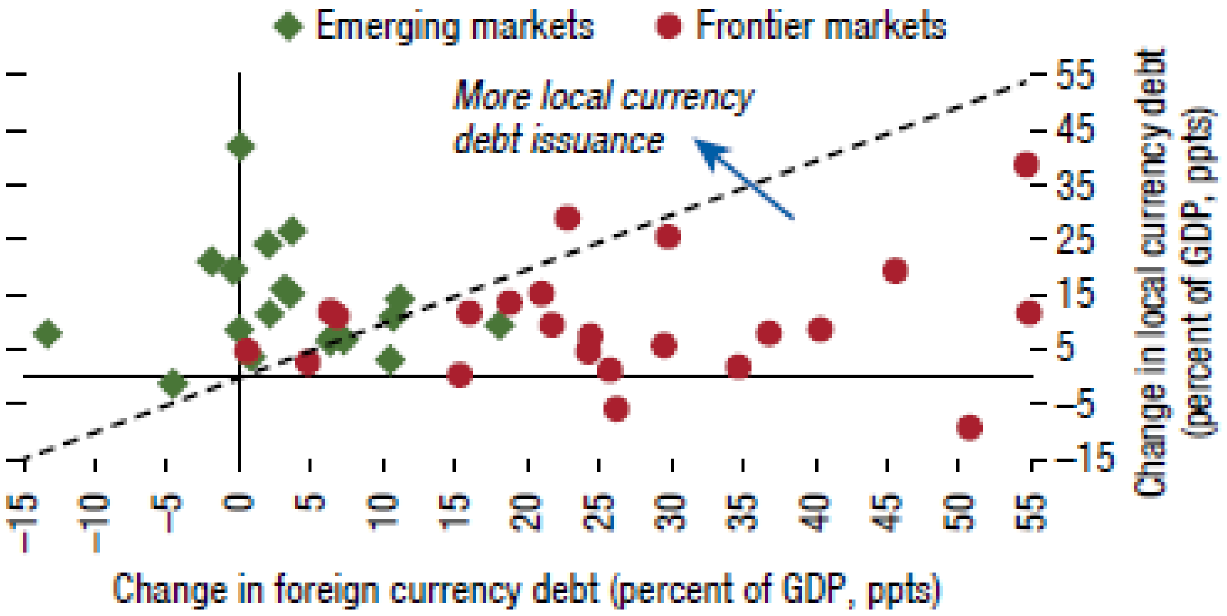


Global Financial Stability, Oct. 2019

2. The post-GFC capital flows boom: FMEs

- FMEs rely more on foreign borrowing => More directly susceptible to changes in global financial conditions
- **Transmission channel: original sin**

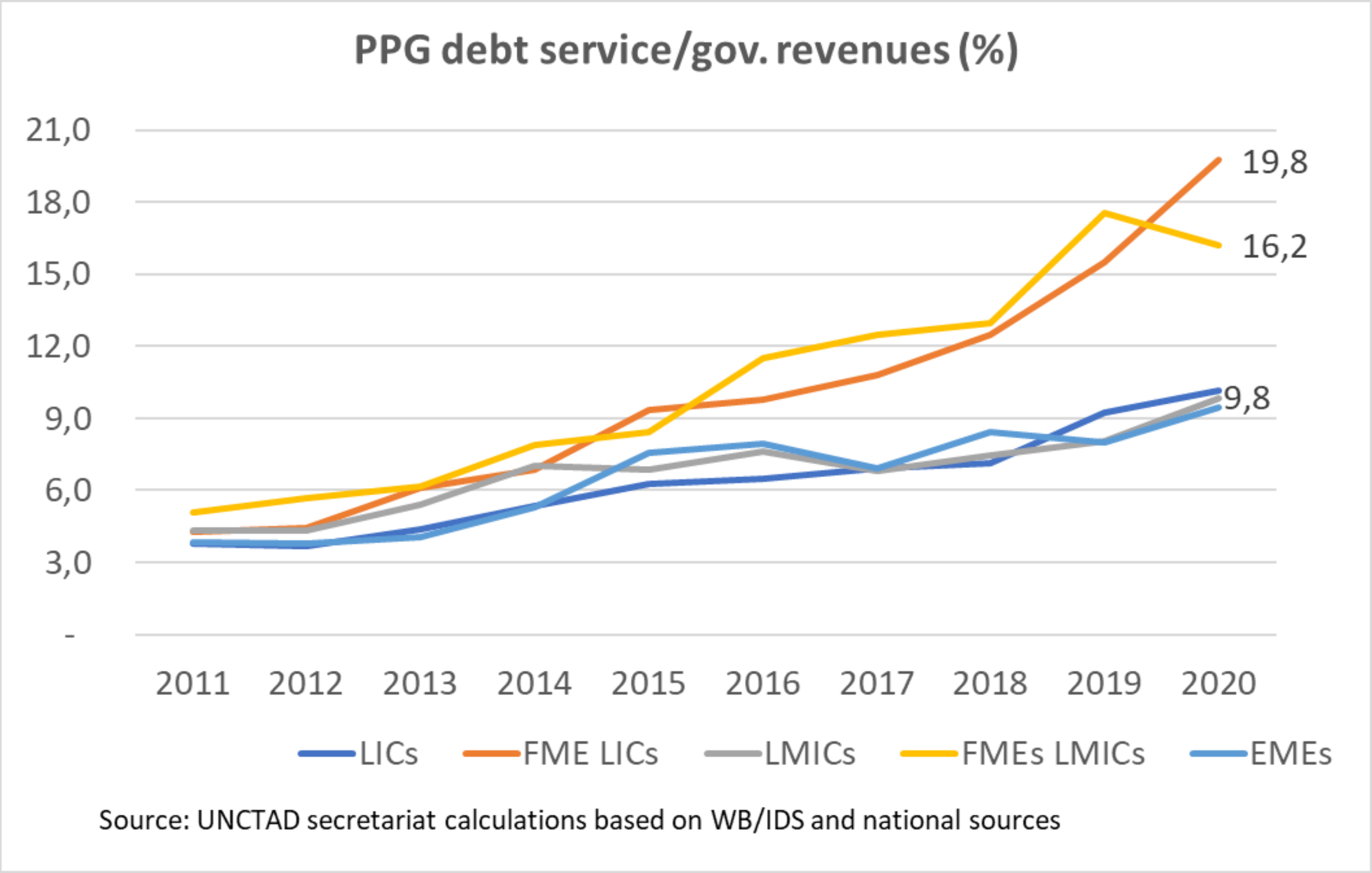
Change in public debt by currency (p.p. of GDP)



Source: IMF/GFSR, Oct. 22

2. The post-GFC capital flows boom: FMEs

- Higher external vulnerability of FMEs' sovereigns: currency mismatch in government's balance sheets



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1. The post-GFC capital flows boom: FMEs

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El Salvador	Gabon				Tajikistan
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Colombia		Saudi Arabia		Malasia	Russia
Dominican Republic				Thailand	Turkey
Ecuador					Ukraine
Mexico					
Panama					
Uruguai					

2. Centre-periphery dynamics of FG: the new partners

- Asymmetric financial integration -> changing over FG phases/the K flows cycle since the 1970s

- EMEs foreign bonds have become less profitable and volatile due to three trends:

  1. Higher share in global asset managers' portfolio, although still marginal, decrease in volatility

  2. Climb the rating scale of bonds issued abroad: vacuum in speculative segment

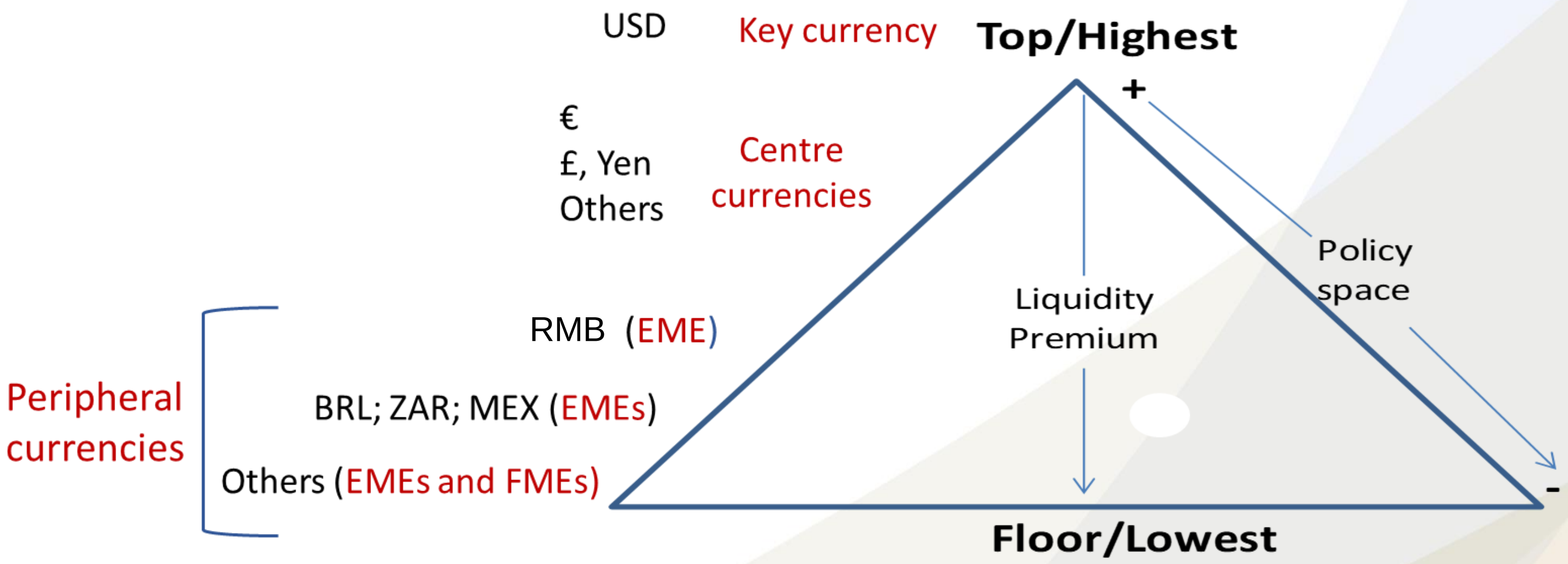
  3. Reduce the issuance of external bonds

- Search for new partners (FMEs)

3. Currency hierarchy and financial hierarchy

- Very few changes since the 1970s ⇔ IMS => static

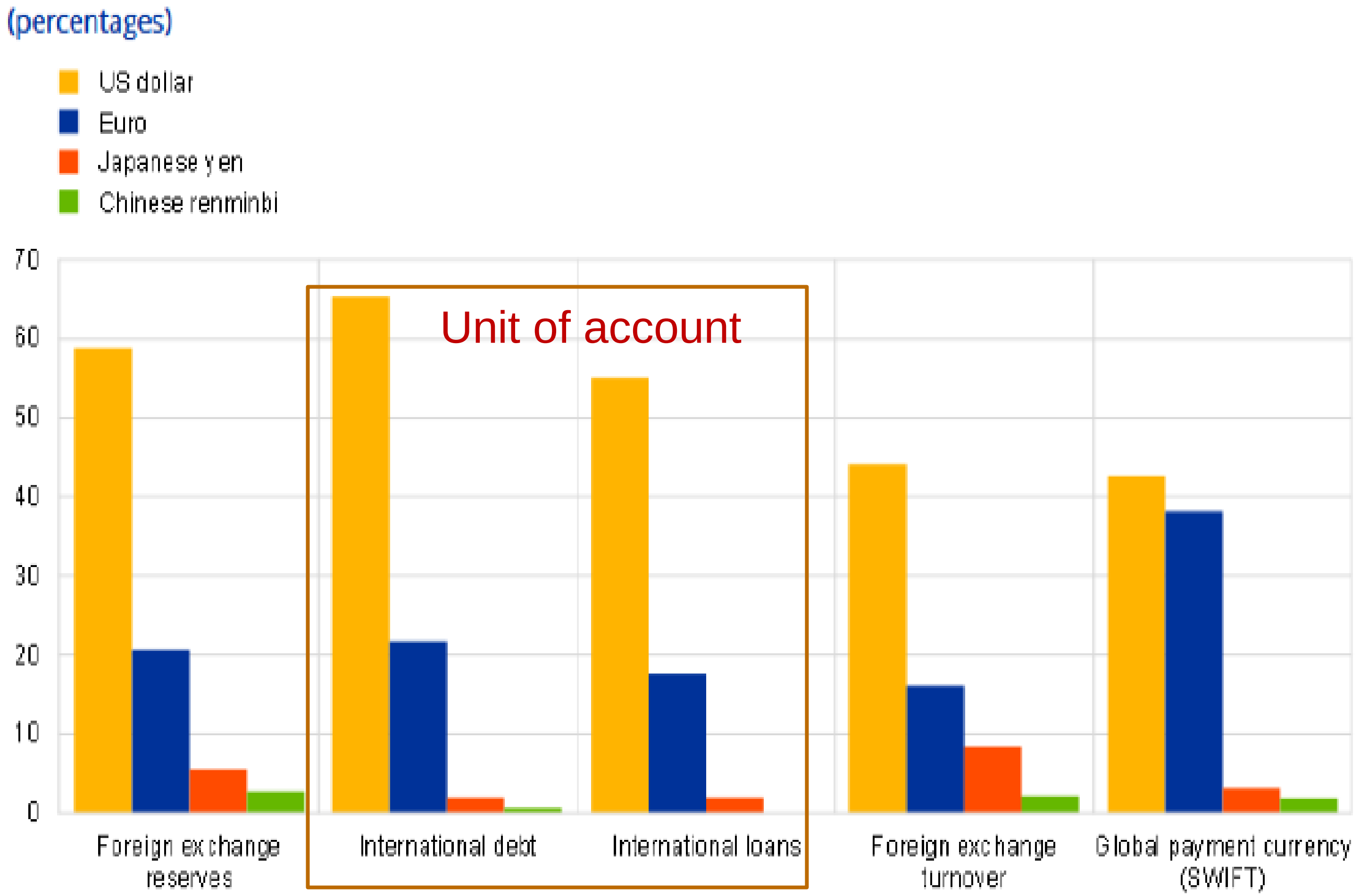
Currency hierarchy



Currency mismatch

3. Currency hierarchy and financial hierarchy

Snapshot of the IMS

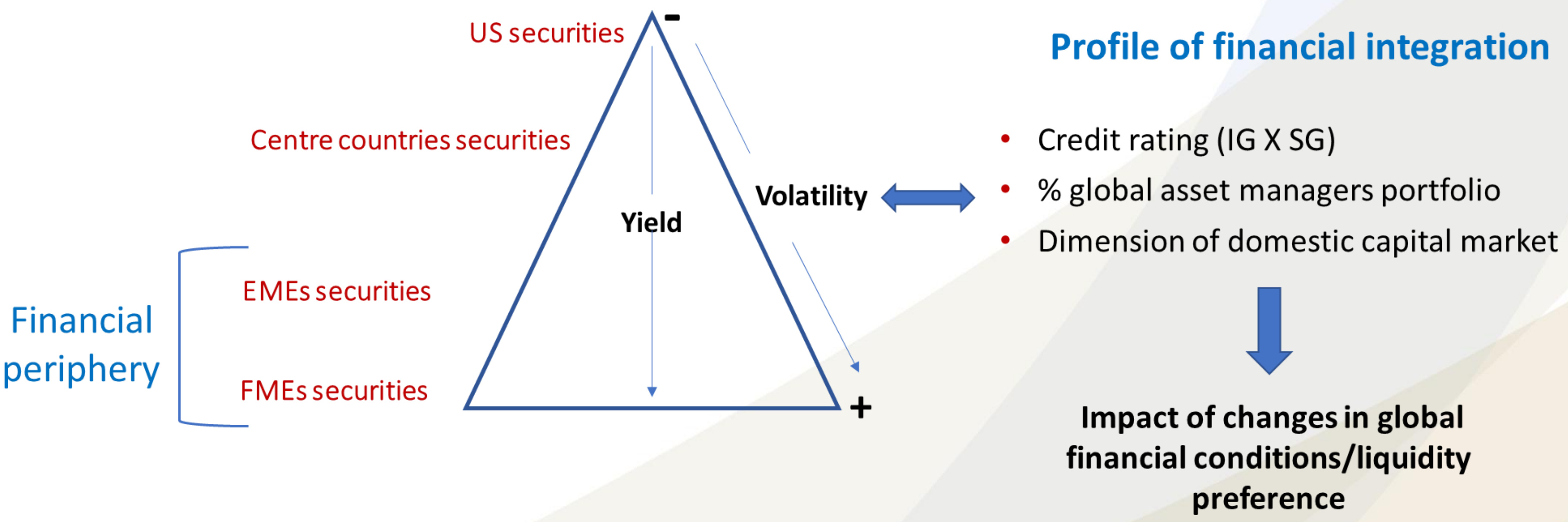


Source: ECB (2022)

3. Currency hierarchy and financial hierarchy

- Financial hierarchy: changes since the 1970s => dynamic
- FMEs: new partners => even greater marginal insertion/smaller pond

Financial hierarchy



4. Final remarks

- FMEs: new partners
    - Greater BOP constraints and development financing needs than EMEs in the 1990s and more vulnerable to the financial asymmetry of FG
    - Risk of cascading defaults, but more complex creditor base and the inexistence of multilateral legal framework for sovereign debt restructuring and relief => financial trap

- FMEs facing a new development paradox: external aid and financing to achieve climate-resilient structural transformation and reduce the dependence on external aid and financing

- Pull factor: not only private IFS is dysfunctional, but also public IFS, including graduation based on income level => reform of the IFA must encompass both systems.

- Otherwise, centre-periphery dynamics will lead to the inclusion of more LICs in FG

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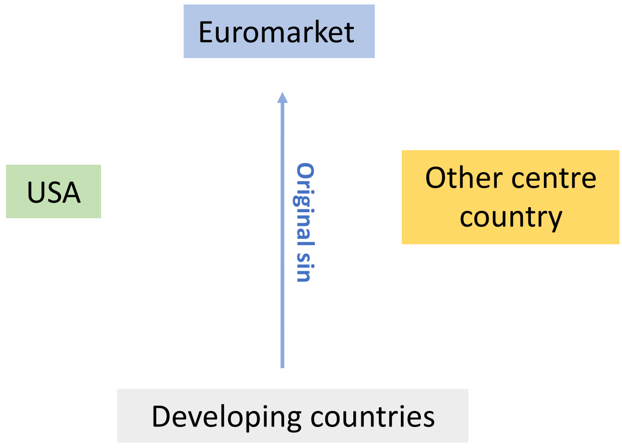
Annexe

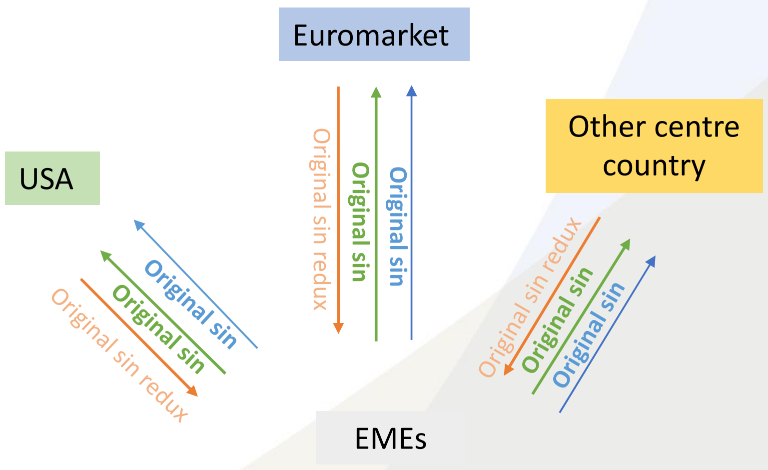
Centre-periphery dynamics of FG

Financial internationalization (1970s): 1a phase of FG (Chesnais, 1996)



External borrowing (bank loans) (C$)

Financial globalization (1990)



Non-resident PI Equity and sovereign bonds (P$)

EMEs' resident borrowing (bank loans) (C$)

EMEs' resident borrowing (securities) = non-resident PI (C$)

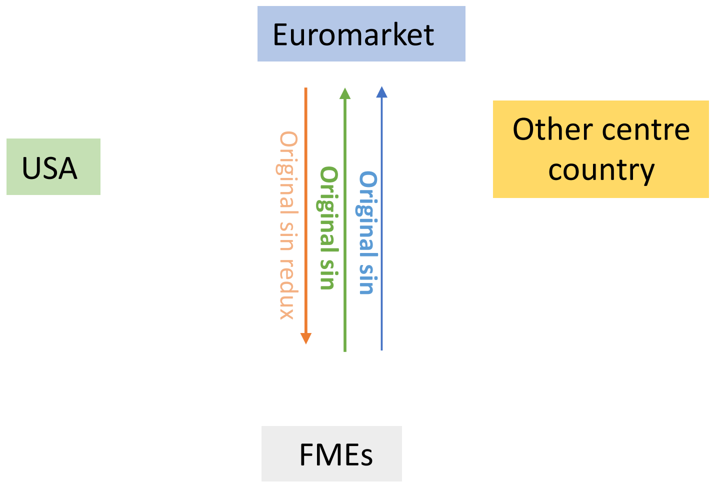
P$ = Peripheral currency

C$ = centre currency

PI = Portfolio investment

Centre-periphery dynamics of FG

Financial globalization (2022): FMEs

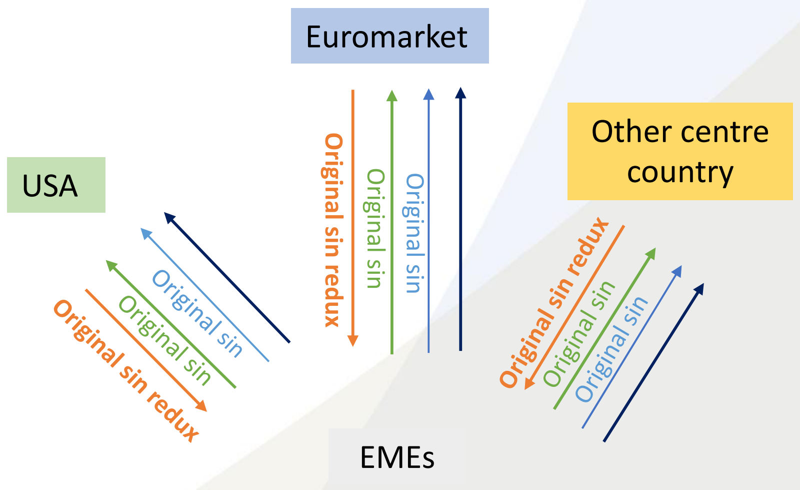


Non-resident PI Equity (P$)

FME's resident borrowing (bank loans) (C$)

FME's resident borrowing (securities) = non-resident PI (C$)

Financial globalization (2022): EMEs



EMEs' resident PI Equity and sovereign bonds (C$)

Non-resident PI Equity and Bonds (P$)

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PI = Portfolio investment

Transmission channels: EMEs/original sin redux

Original sin => currency mismatch in the balance sheet of the borrower: EMEs and FMEs

Original sin redux => currency mismatch in the balance sheet of centre country’s investor

Feedback loops between currency and bond markets