BANK FOR INTERNATIONAL SETTLEMENTS

Liquidity, leverage and macro risk

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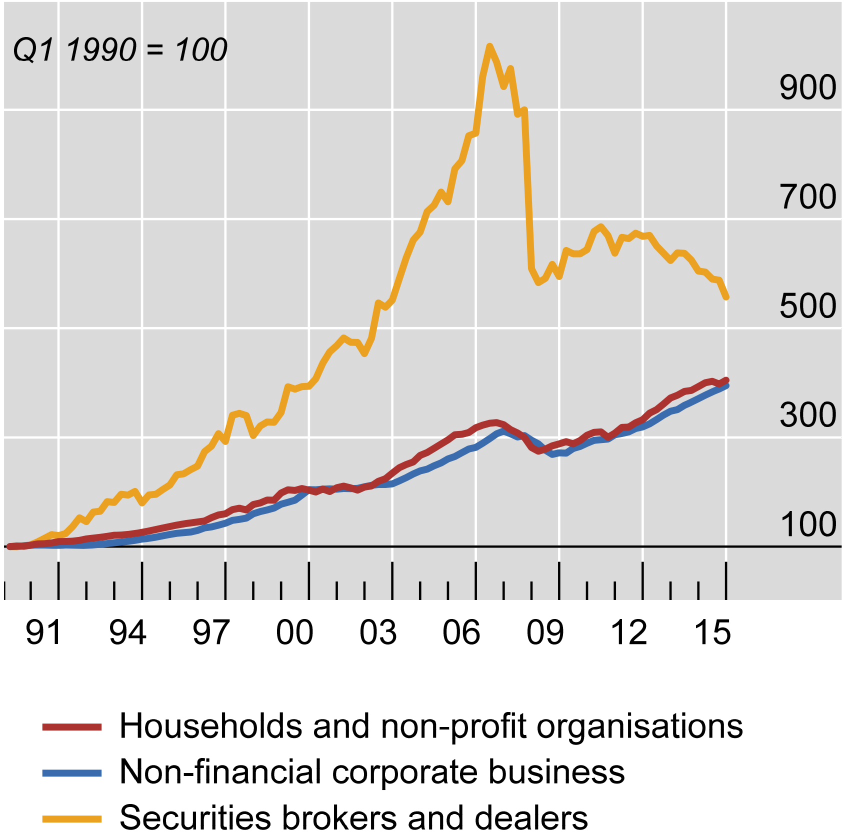
Realignment of the global economy

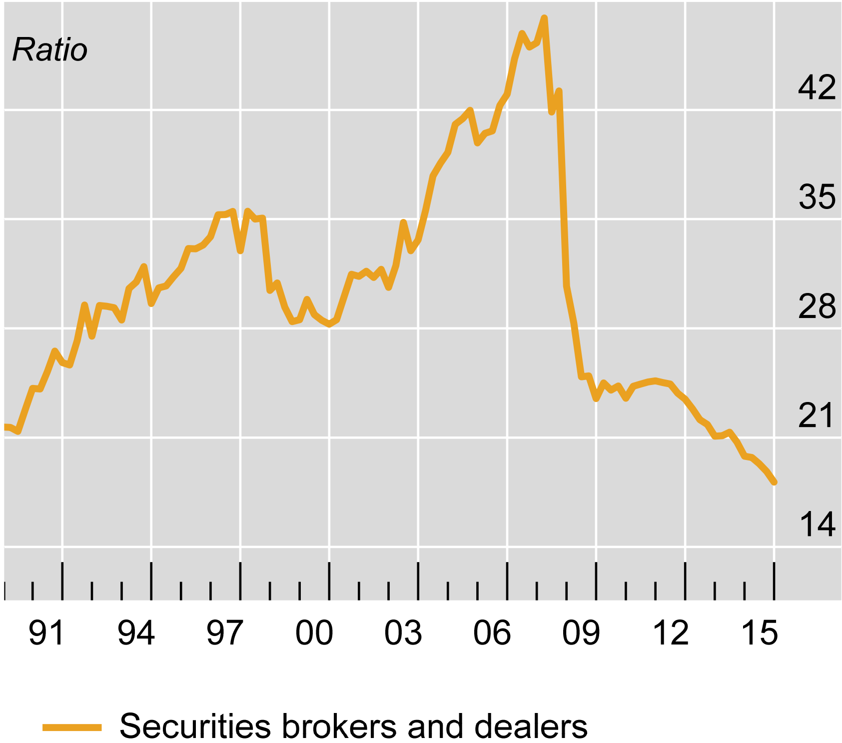
- Exchange rate and commodity price adjustments
- Shocks are accentuated by accumulated stocks
- Same forces that impact emerging economies also bear on:
  - Currency market anomalies
  - Impaired market liquidity

Total assets and leverage of the US securities broker-dealer sector

Total assets



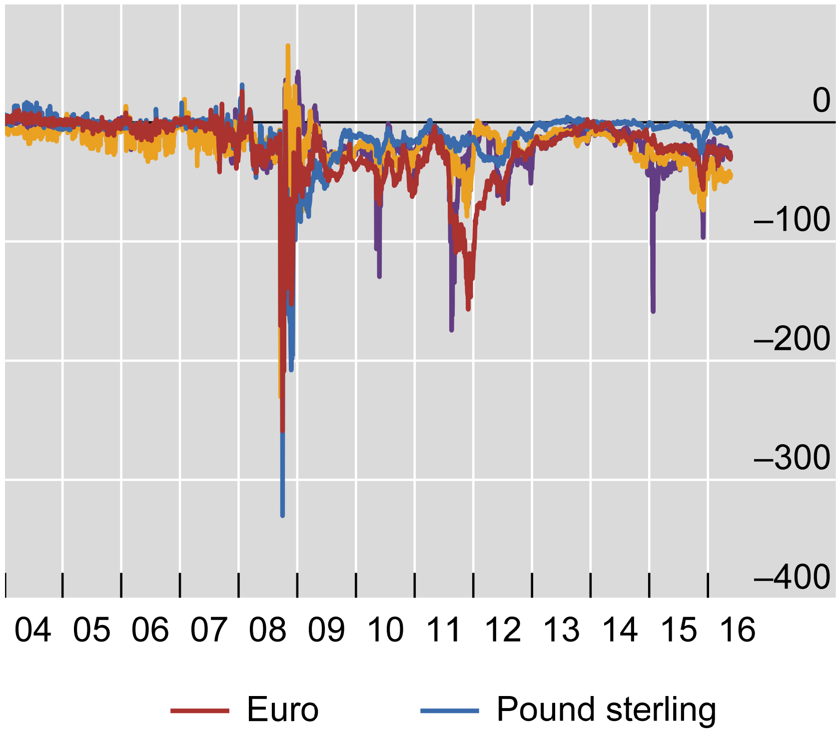
Leverage (total assets/equity)



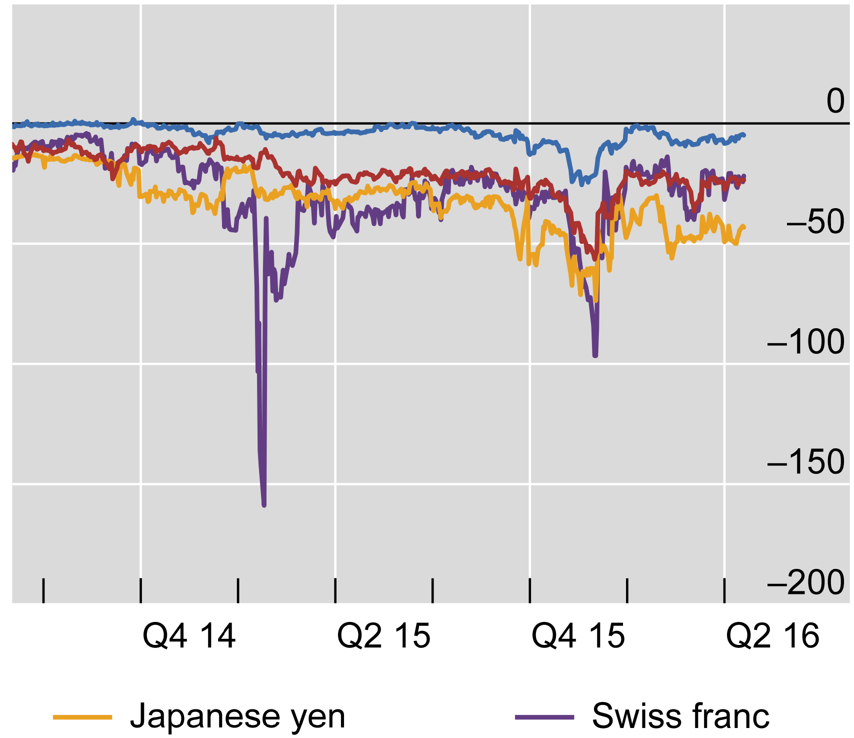
Sources: Federal Reserve, *Flow of Funds*; BIS calculations.

Cross-currency basis against the US dollar [1]

Historical

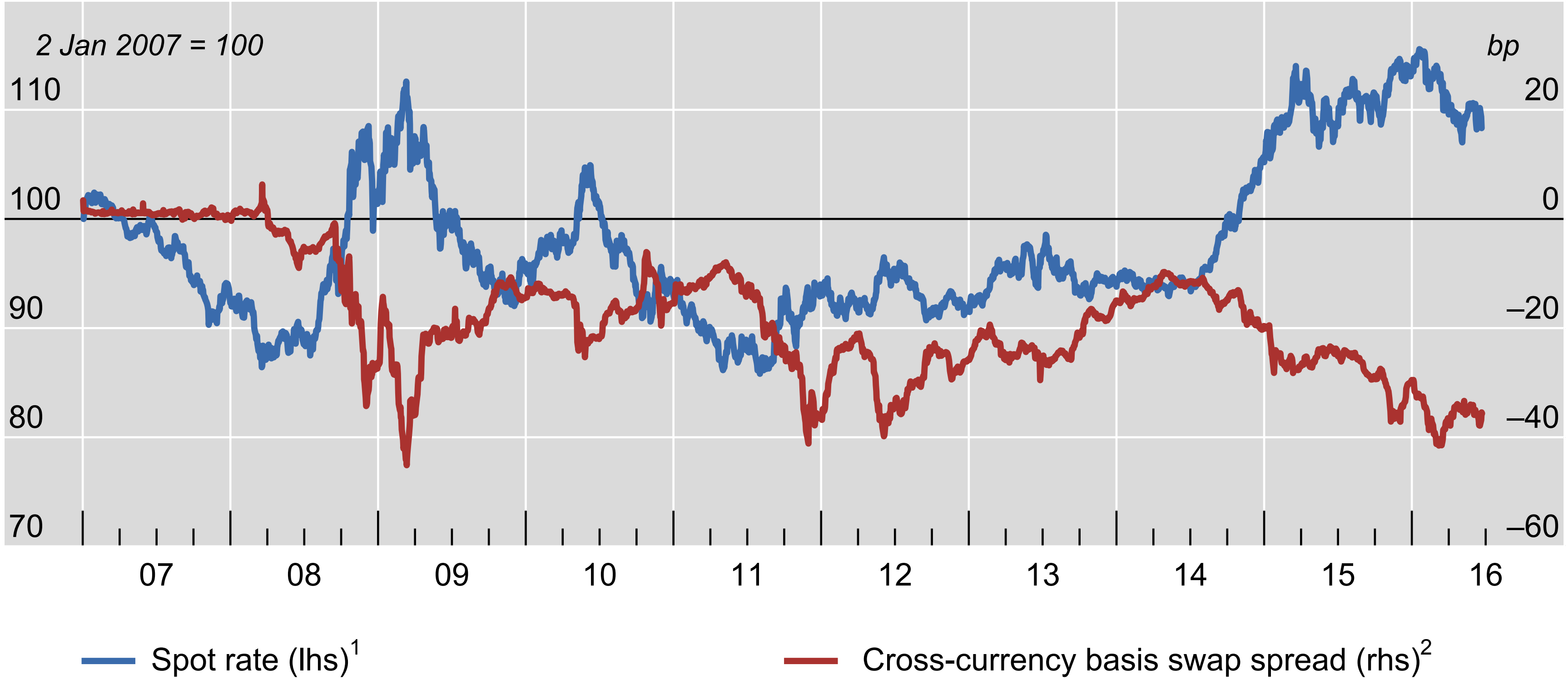


Recent



[1] Spread between three-month US dollar Libor and three-month dollar rate implied by FX swaps.
Sources: Bloomberg; Datastream; BIS calculations.

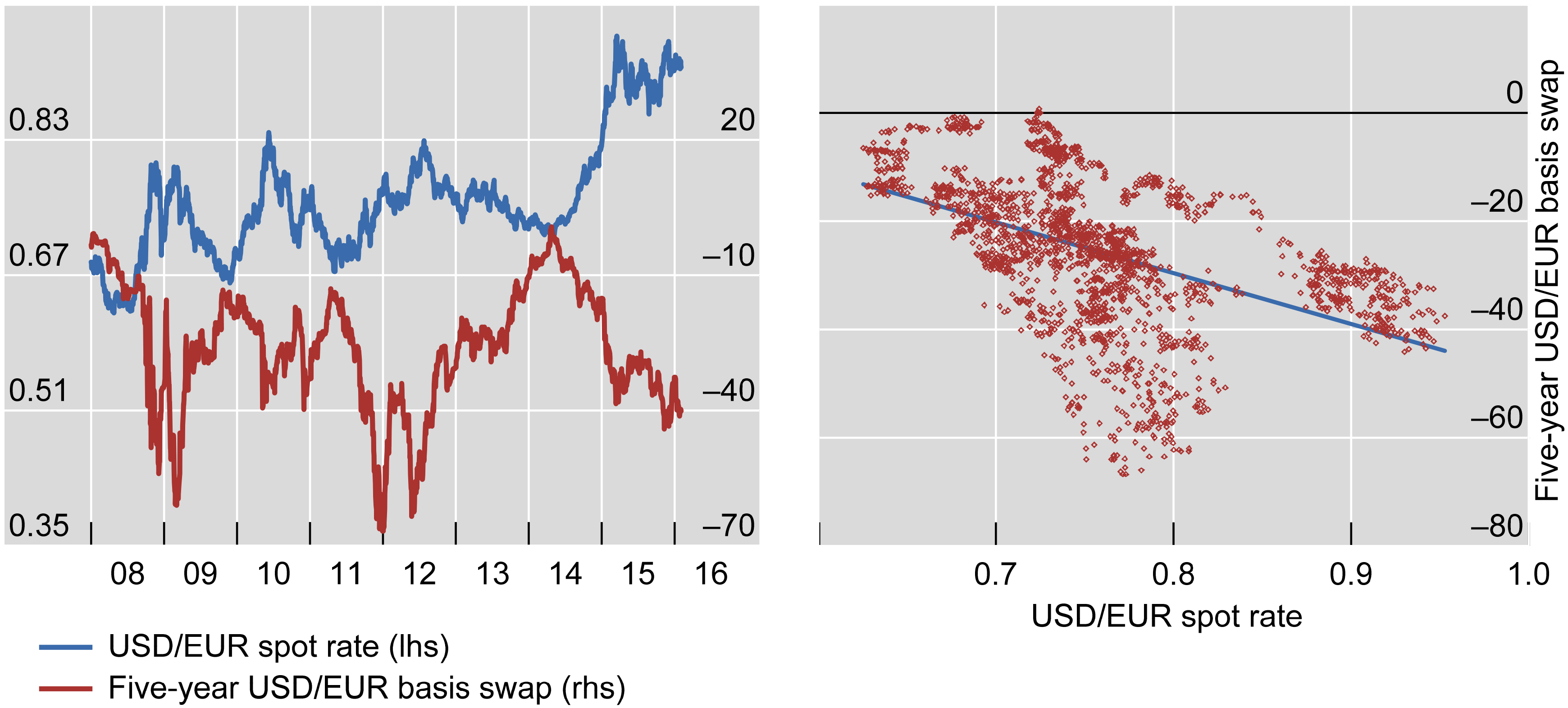
US dollar exchange rate and the cross-currency basis



[1] Simple average of the bilateral exchange rate of the US dollar against CAD, CHF, EUR, JPY, GBP and SEK. Higher values indicate a stronger US dollar. [2] Simple average of five-year cross-currency basis swaps against CAD, CHF, EUR, JPY, GBP and SEK vis-à-vis the US dollar.

Sources: S Avdjiev, W Du, C Koch and H Shin (forthcoming); Bloomberg; BIS calculations.

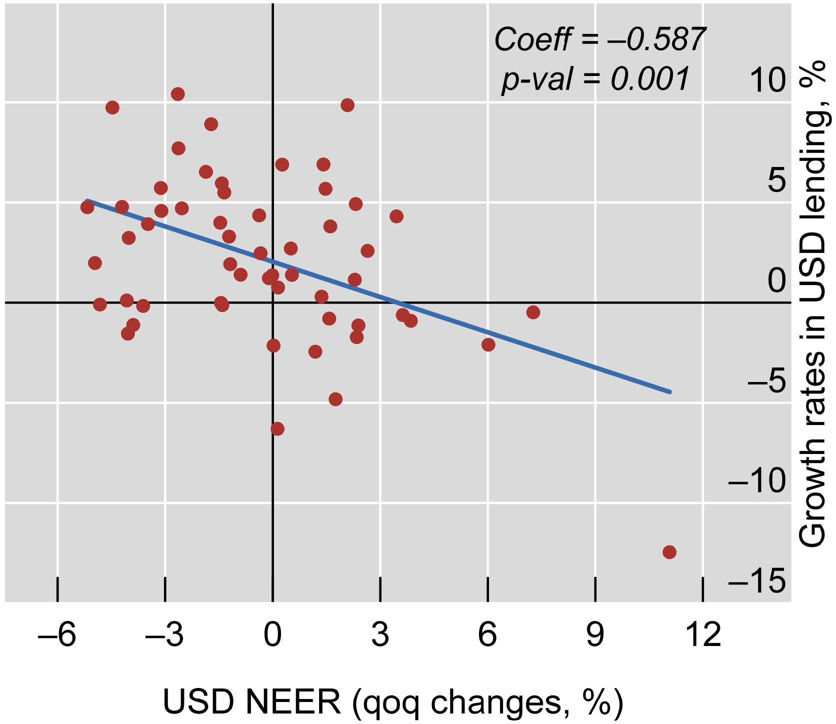
Cross-currency basis of the euro against the US dollar



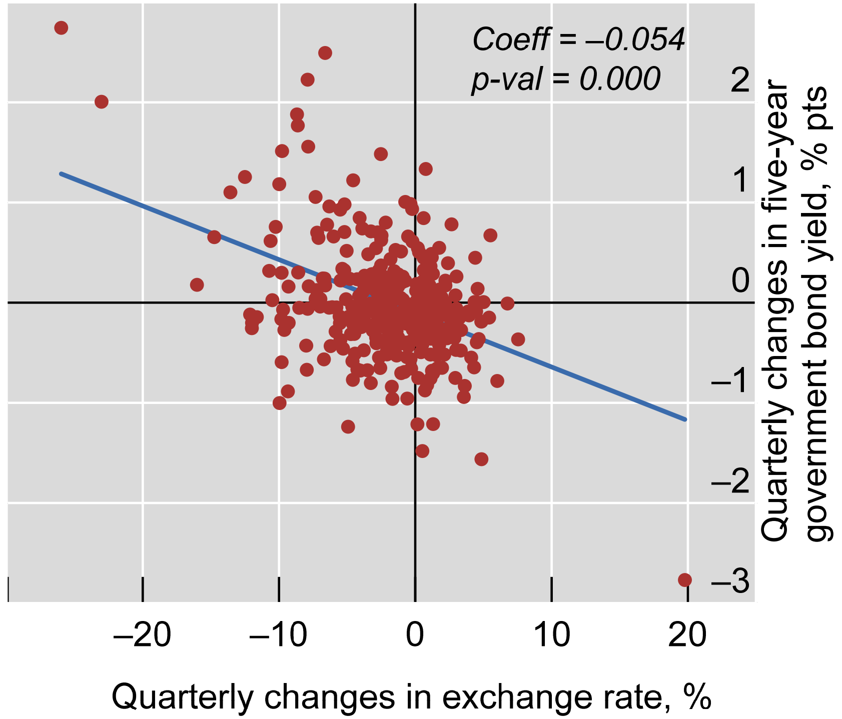
Source: Bloomberg.

Risk-taking channel of exchange rates

Cross-border bank credit to EMEs, all sectors



Changes in EME local currency sovereign yields



Source: BIS, *86th Annual Report*, Graph III.5.

Elasticity of GDP growth with respect to real effective (REER) and debt-weighted (DWER) exchange rates

	EMEs			Advanced economies		
	Short run	Long run	Ratio: Short run to long run	Short run	Long run	Ratio: Short run to long run
REER	–0.103*** (0.017)	–0.1217*** (0.040)	0.85	–0.058 (0.034)	–0.0104*** (0.044)	0.56
DWER	0.1233*** (0.025)	0.105*** (0.033)	1.26	0.026 (0.027)	0.032 (0.033)	
Observations		1055			1072	
R^2		0.92			0.32	

Robust standard errors (clustered by country) in parentheses; ***/**/* denotes results significant at the 1/5/10% level.

Source: BIS, *86th Annual Report*, Table III.B.

Elasticity of GDP growth with respect to real effective (REER) and debt-weighted (DWER) exchange rates

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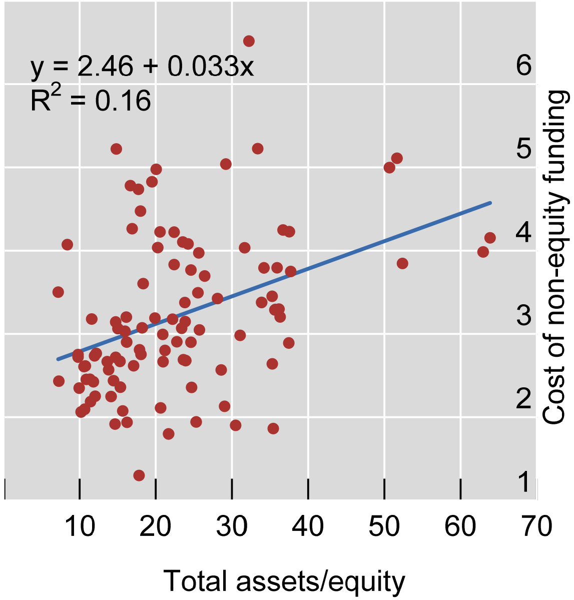
Source: BIS, *86th Annual Report,* Table III.B.

Total assets = equity x leverage

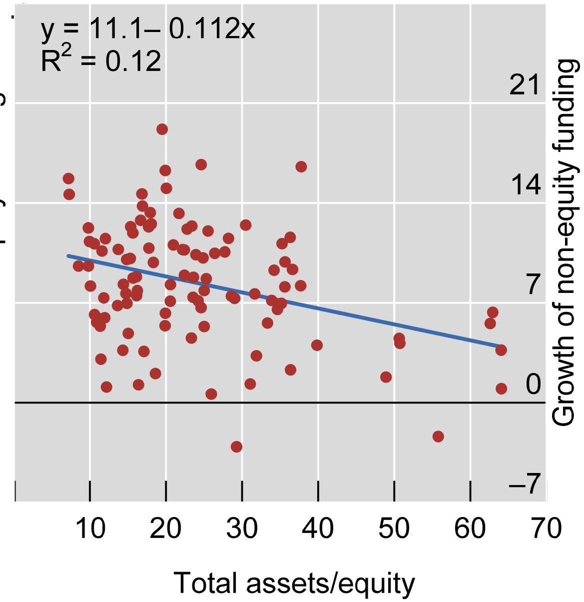
- Equity → foundation of the building
- Leverage → height of the building
  - Leverage is affected by regulation, but also by market risk factors
  - Insufficient risk-taking capacity is like a building that is too small to accommodate needs
  - Broader foundations for the building can make up for limits on market risk factors

Sound banks lend more

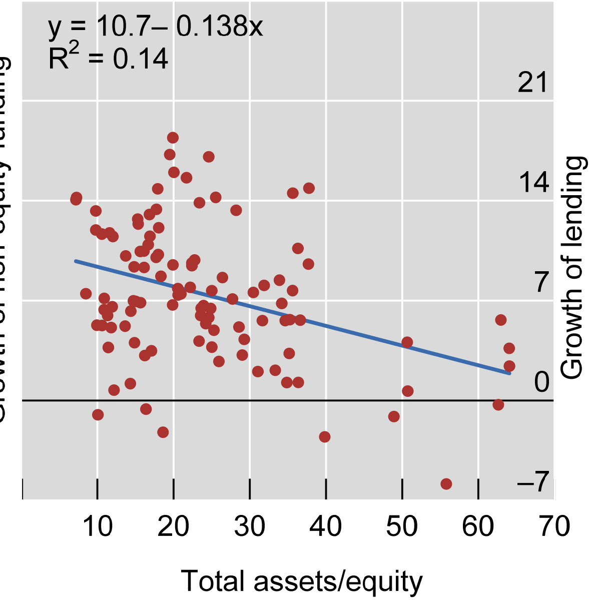
Cost of funding



Non-equity



Lending



Source: Based on BIS, *86th Annual Report*, Graph VI.A.

Connecting the dots

- Stock of dollar-denominated debt as common thread:
  - Market liquidity
  - Currency market anomalies
  - Risk-taking capacity of financial intermediaries

- Better capitalised financial sector conducive to:
  - Greater resilience, but also to:
  - More liquid financial markets
  - Better macro outcomes