

# Financial Globalisation and the Crisis

BIS Annual Conference

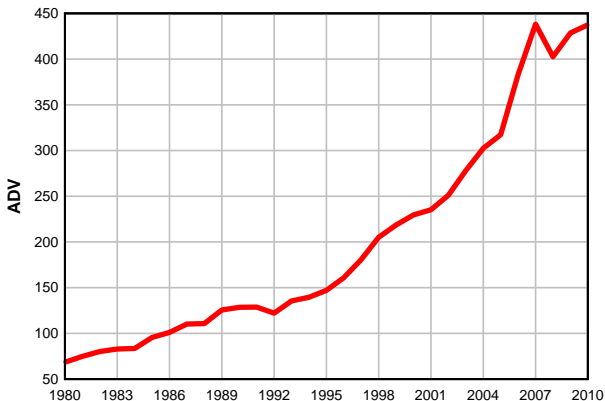
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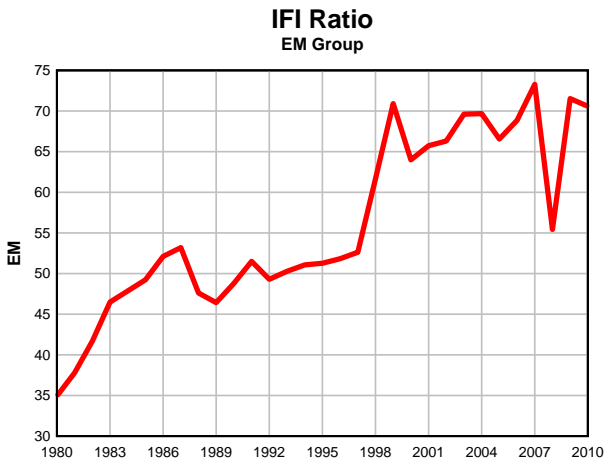
- Financial Globalisation: Pre-Crisis (1999-2007)
  - Advanced economies: boom in cross-border asset trade (especially 2003-2007)
  - Emerging economies: cautious approach
  - Research/Policy Literature: parallel Advanced/Emerging split
- 2008+ Crisis
  - Financial Globalisation and Crisis Origins?
  - Financial Globalisation and Crisis Dynamics (Amplifiers/Buffers)
  - Financial Globalisation and Crisis Management
- Financial Globalisation After the Crisis: Policy Reforms

- Boom among advanced economies
  - Financial liberalisation; financial innovation; Europe; euro
  - Central role of international banking system
  - “Short debt, long equity”
- Limited, asymmetric strategy among emerging economies
  - Improvement in NIIP; shift from FC debt to equity-type liabilities; Official reserve assets (liquid)
  - Tighter regulation of banks
  - “Long debt, short equity”

## IFI Ratio Advanced Group

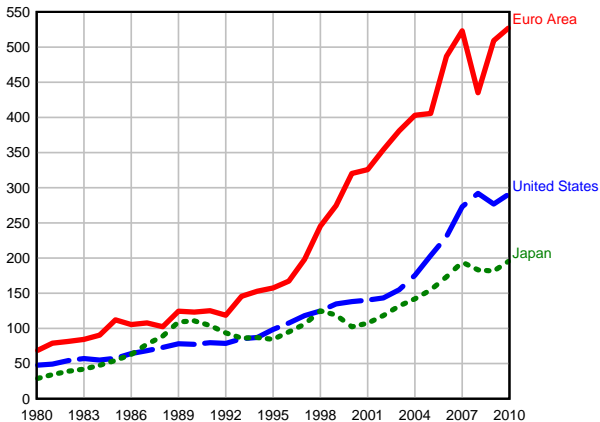


**Figure:** IFI Ratio: Advanced Economies. Source: Author's calculations, based on updated version of dataset developed by Lane and Milesi-Ferretti (2007).



**Figure:** IFI Ratio: Emerging Economies. Source: Author's calculations, based on updated version of dataset developed by Lane and Milesi-Ferretti (2007).

## IFI Ratios



**Figure:** IFI Ratios (Euro Area, United States, Japan). Note: Euro Area is sum of cross-border positions of individual member countries. Source: Author's calculations, based on updated version of dataset reported in Lane and Milesi-Ferretti (2007).

## Cross-Border Capital Flows, 2002-2010

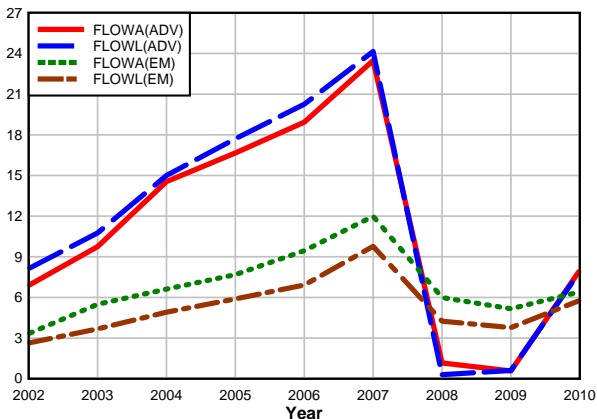


Figure: Gross International Financial Flows, 2002-2010. Source: Author's calculations, based on IMF BOPS data.

## Financial Account Liberalisation Index (Chinn-Ito Index)

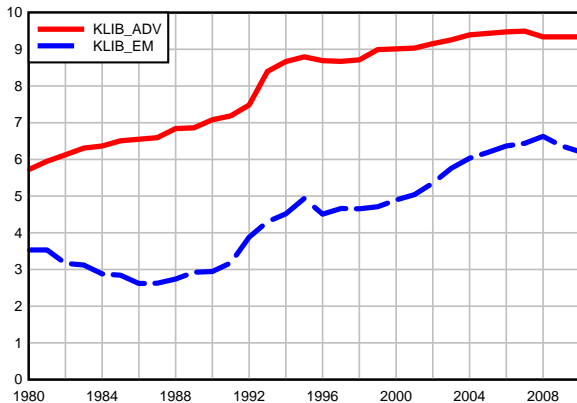
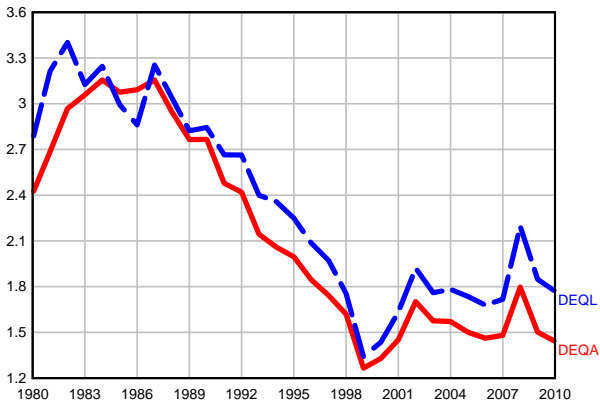


Figure: Financial Account Liberalisation Index. Note: Chinn-Ito index, rescaled.

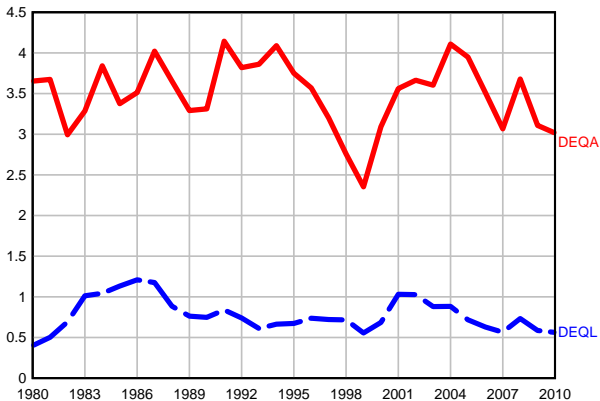


## International Debt-Equity Ratios (Advanced Economies)



**Figure:** International Debt-Equity Ratios (Advanced Economies). Note: DEQA is ratio of foreign debt assets to foreign equity assets; DEQL is ratio of foreign debt liabilities to foreign equity liabilities. Source: Author's calculations based on updated version of dataset reported in Lane and Milesi-Ferretti (2007).

## International Debt-Equity Ratios (Emerging Economies)



**Figure:** International Debt-Equity Ratios (Emerging Economies). Note: DEQA is ratio of foreign debt assets to foreign equity assets; DEQL is ratio of foreign debt liabilities to foreign equity liabilities. Source: Author's calculations based on updated version of dataset reported in Lane and Milesi-Ferretti (2007).

- Financial Globalisation and Crisis Origins?
- Financial Globalisation and Crisis Dynamics (Amplifiers/Buffers)
- Financial Globalisation and Crisis Management

- Foreign investors and expansion of ABS markets in the US (esp. European banks)
  - Acharya/Schnabl (2009), Bernanke et al (2011), Shin (2012)
- Balance sheet expansion in banking systems
  - Global banks (CGFS 2010)
  - Local banks and international wholesale funding
- General-equilibrium impact of rising demand for safe assets by EM official investors

- Financial Globalisation and Domestic Credit Growth
- Financial Globalisation and External Imbalances
- Domestic Credit Growth and External Imbalances key correlates of severity of crisis
  - Lane and Milesi-Ferretti (2011, 2012); Lane and McQuade (2012); Lane and Pels (2012)
- Counterfactual - financial autarky / limited financial integration

## Domestic Credit Growth and International Capital Flows

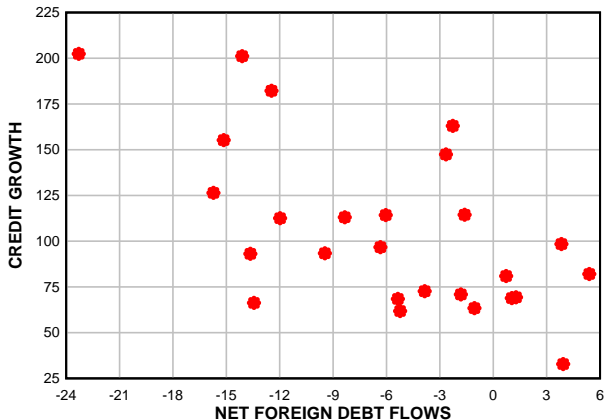


Figure: Domestic Credit Growth and International Debt Flows, 2003-2008.  
Source: Based on Lane and McQuade (2012).

## Cross-Country Standard Deviation of Current Account Balances

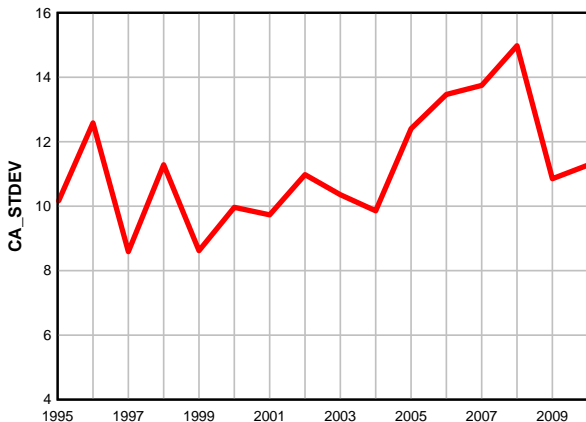


Figure: Cross-Country Standard Deviation of Current Account Balances, 1995-2010. Source: Author's calculations based on WEO data.

- Mechanisms: crisis amplifiers versus crisis buffers
- Dynamics of international capital flows
- “International Balance Sheet” channels



- Great retrenchment
  - Procyclicality/volatility of international capital flows
  - Inter-bank flows
    - cross-border liquidity issues
    - multiple equilibria (?)
  - Not uniform - gravity factors (De Haas and Van Horen 2011, Galstyan and Lane 2011)
- Asset price adjustment and capital inflows
  - Less force for non-portfolio positions
  - Banks: asymmetric information and regulatory problems
- Repatriation of foreign assets
  - Diversification versus concentration
  - Regulatory pressures

- Valuation channel - size of gross positions
  - Stabilising or destabilising?
  - Quantification issues
- Global decline in equity markets in 2008: ADV group losers
- Losses in ABS markets: ADV group losers
- Exchange rate movements: US loses in 2008; EM group gains; UK/AUS/NZ also gain
- Interest rate movements: ADV group gains; EM group loses; (Euro periphery)
- Debt writedowns
  - Greek sovereign debt; Iceland; Ireland: bank subordinated debt
  - More to come!

- Scale of cross-border financial positions much greater than in previous crisis episodes
- Financial Stability
- Fiscal Stability
- Macroeconomic Stability
- Domestic versus International Targets
- (Europe as a case study)

- Banking - global banks (G-SIFIs); European banks
- Home-Host tensions in regulation/resolution of multi-country banks
- Liquidity provision
  - Dollar shortage (central bank currency swaps)
  - Cross-border within euro area

- Bank Deleveraging
  - “Fire sale” risks
  - Domestic assets; foreign assets
    - core versus non-core (CGFS 2010)
  - Multiple regulators in common markets
- Recapitalisation
  - New private equity (domestic, foreign)
  - Subordinated debt (domestic, foreign)
  - Senior bonds (domestic, foreign)
  - Taxpayers (domestic, foreign)
  - International externalities

- Europe: case study of high level of international financial integration
  - bank/sovereign 'diabolic' loop
  - European-level bank regulation/resolution
  - European-level fiscal union (*degree?*)
    - banking backstop; unified bond market (ESBies, Eurobonds); European-level revenues and expenditures
  - 'Excessive' imbalances (*prevention?; correction?*)
  - Common Currency: buffer or amplifier?

## ● International Reforms

- Regulation of international banking system (*data; models*)
- International bank resolution regimes
- Stronger international safety nets (global/regional)
- International bankruptcy court?

## ● Domestic Reforms

- Safe level of public debt
- Broader concept of counter-cyclical fiscal policy (*output cycle; financial cycle*)
- International liquidity
- Gradualist approach to financial liberalisation (but trade off remains)
- Debt/equity balance
- International externalities

- Financial globalisation: amplifies costs of policy and regulatory failures
  - crisis prevention; crisis dynamics; crisis management
- Divergent experiences of Advanced and Emerging economies
- Lessons from European experience with cross-border financial integration
- International banking system and international financial system
- Required: institutional reforms at domestic, regional and global levels
- Prospects?