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.

Households and non-profit organisations
Non-financial corporate business
Securities brokers and dealers

Securities brokers and dealers
Cross-currency basis against the US dollar

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

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<td>Short run</td>
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<td>REER</td>
<td>–0.103***</td>
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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

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