

Institute of  
Global Affairs

# **How to make the global financial system work – for emerging economies**

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# How to make the global system work - for emerging economies?

- Policy considerations in advanced economies
- Reforms in emerging economies
- Reforms in the global financial institutions

# Emerging economies and the global system

- Crisis response driven by interests of advanced economies
  - Regulatory responses (Basel 3 etc.) – differential impact
  - Deleveraging of international banks, particularly in emerging economies
  - Unconventional monetary policies in AEs – spillovers/“spillbacks” in EEs
- Challenged hard-fought policy regimes in emerging economies

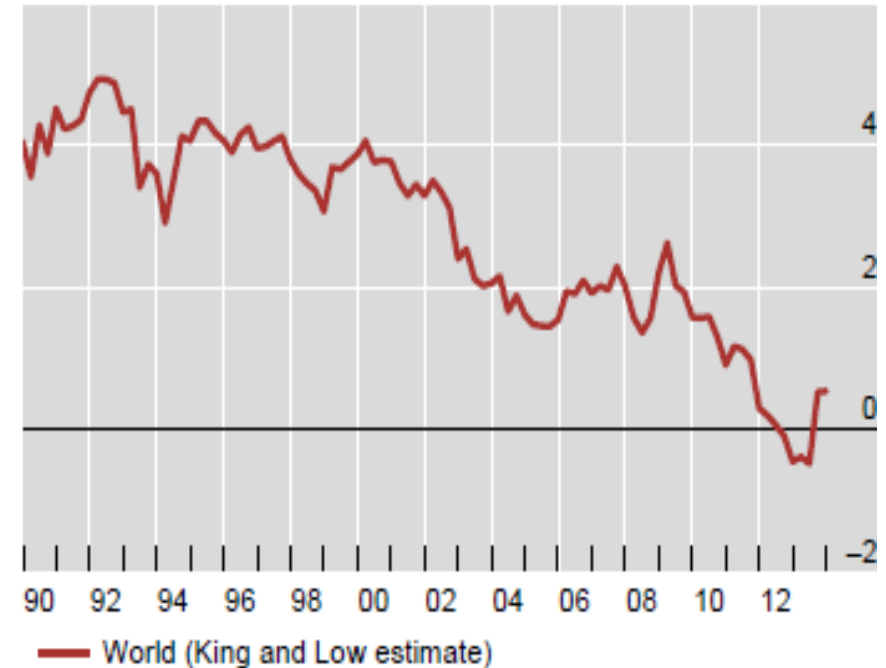
# Global liquidity injection

- Three strong and mutually reinforcing elements (Turner, 2016):
  - **C**redit expansion, international and domestic
  - **C**ommodity price upswing
  - **C**urrency appreciation
- Boosted growth...but created vulnerabilities
- How should EEs cope with reversal? Lessons for global finance?

# Is this time different?

- Unlike in previous episodes of US monetary tightening, key EEs are now significant economic powers
- Significant spillback to AEs (a first):
  - Exchange rate
  - Growth
  - EE savings behaviour => global interest rates
- Interest on both sides to collaborate

A. World real long-term interest rate



# AD-EE central bank collaboration: towards a new framework

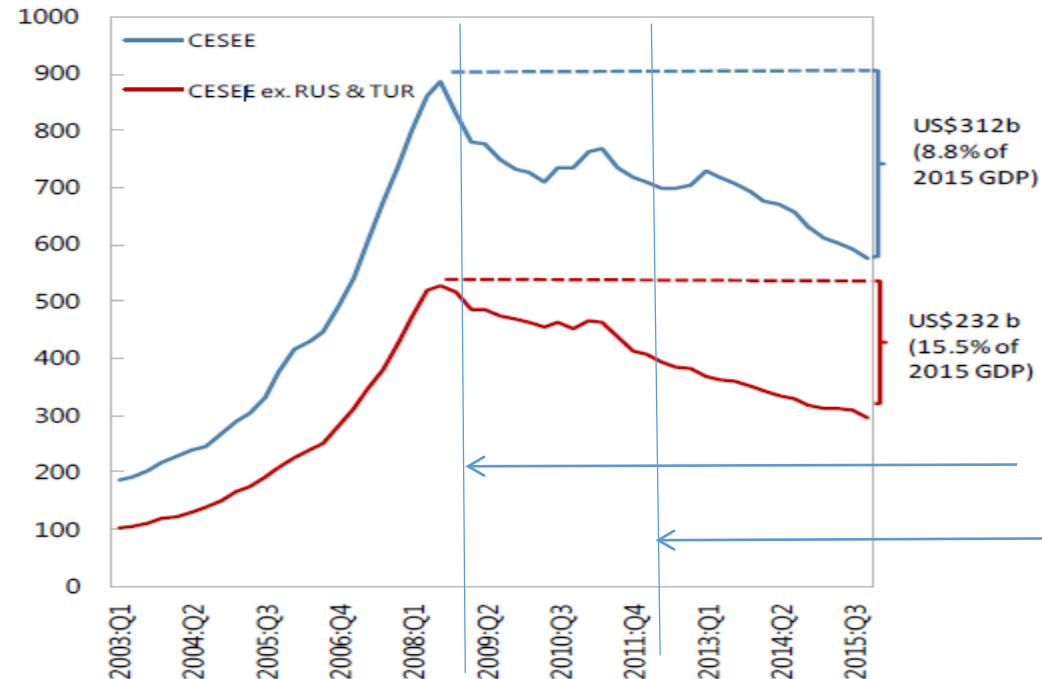
- Monitor ... Assess ... Adjust ... Collaborate?
- Rajan-Mishra “traffic light” proposal (2016)
- Is this naïve? Or have there been examples?

# Vienna Initiative coordination platform

- Material interest in managing volatile capital flows
- Process:
  - **Monitor** – data needs: BIS
  - **Assess** - “Objective referees”: IFIs
  - **Rare policy interventions** because observation and joint assessments helped giving rise to acceptable behaviour
  - **Soft powers dominantly**
- Must for volatile periods (Vienna 1.0: global crisis 2008/9; Vienna 2.0: Eurozone crisis 2011/12)

**Figure 2. CESEE: External Position of BIS-reporting Banks, 2003:Q1–2015:Q4**

(Billions of US dollars, exchange-rate adjusted, vis-à-vis all sectors)



Sources: BIS, Locational Banking Statistics; IMF, World Economic Outlook database; and IMF staff calculations

# Research needed

- Data-mining (what types beyond bank flows)
- Separating impact of global and domestic monetary policy and understand regional variations within (large) emerging economies
- Going beyond studying *outcomes* (bond yields, exchange rates) to look at cross-border spillovers from *national policies*
- Understanding financial stability risks of spillovers in underdeveloped and distorted financial systems
- Understanding international economic and financial integration/ liberalization with underdeveloped and distorted financial systems



# Action needed for light-touch platform

- **Monitor...Assess... Adjust...[Collaborate]**
  - Data compilation
    - Cooperation on data among central banks? BIS+? With private sector players?
  - Trusted referees
    - Academia (RR-PM proposal) – “Shadow Monetary Policy Committee on Spillovers”
    - IFIs?
  - Publication
- **No formal rules** but soft powers of public assessments.