Roundtable discussion on “Addressing economic and financial challenges through **international policy cooperation**: Lessons from the past and prospects for the future”

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Takeaways

- Past
  - “Cooperation” has not always successful
  - Exchange rate coordination particularly was problematic
  - Cooperation for crisis prevention is difficult
  - Cooperation to manage a crisis is relatively successful
  - Lessons were learned from past crises to avert a future one
- Future
  - Regarding a crisis, debts (liabilities) are always a culprit
  - Global safety net is not adequate
  - Crisis warning:
    - Chinese corporation large debt and Over-indebtedness
    - Chinese shadow banking and local government
    - Chinese bilateral aid to developing countries

Past: Exchange Rate Coordination

- 1971. Smithsonian
- 1978. Dollar crisis
  - "Locomotive theory"
- 1985. Plaza Agreement
- 1987. Louvre Agreement
- 1992. ERM crisis: British Pound and Italian Lira
- 2006-07. Global Imbalances and currency "manipulation"

- Difficulties:
  - Equilibrium Exchange Rate is hard to be defined and estimated
  - Exchange rate coordination means monetary policy coordination
  - Central banks feel their domestic purposes are sacrificed, resulting in high inflation or a financial bubble

Past Crisis: Asian Financial Crisis

- Vulnerable macro and financial fundamentals
  - Large current account deficits
  - Overheating or a bubble
  - Double mismatch
    - Dollar denominated external liability
    - Local currency denominated assets
  - Impossible trinity
    - Fixed exchange rate
    - Autonomous monetary policy
    - Moving toward capital flow liberalization
- IMF mistakes and lack of "safety net"
- Lessons learned
  - Flexible exchange rate regime
  - Strong bank supervision
  - Capital Flow management
  - Regional safety net, CMI
  - Asian bond initiative (local currency denominated bonds)

Past Crisis: Global Financial Crisis

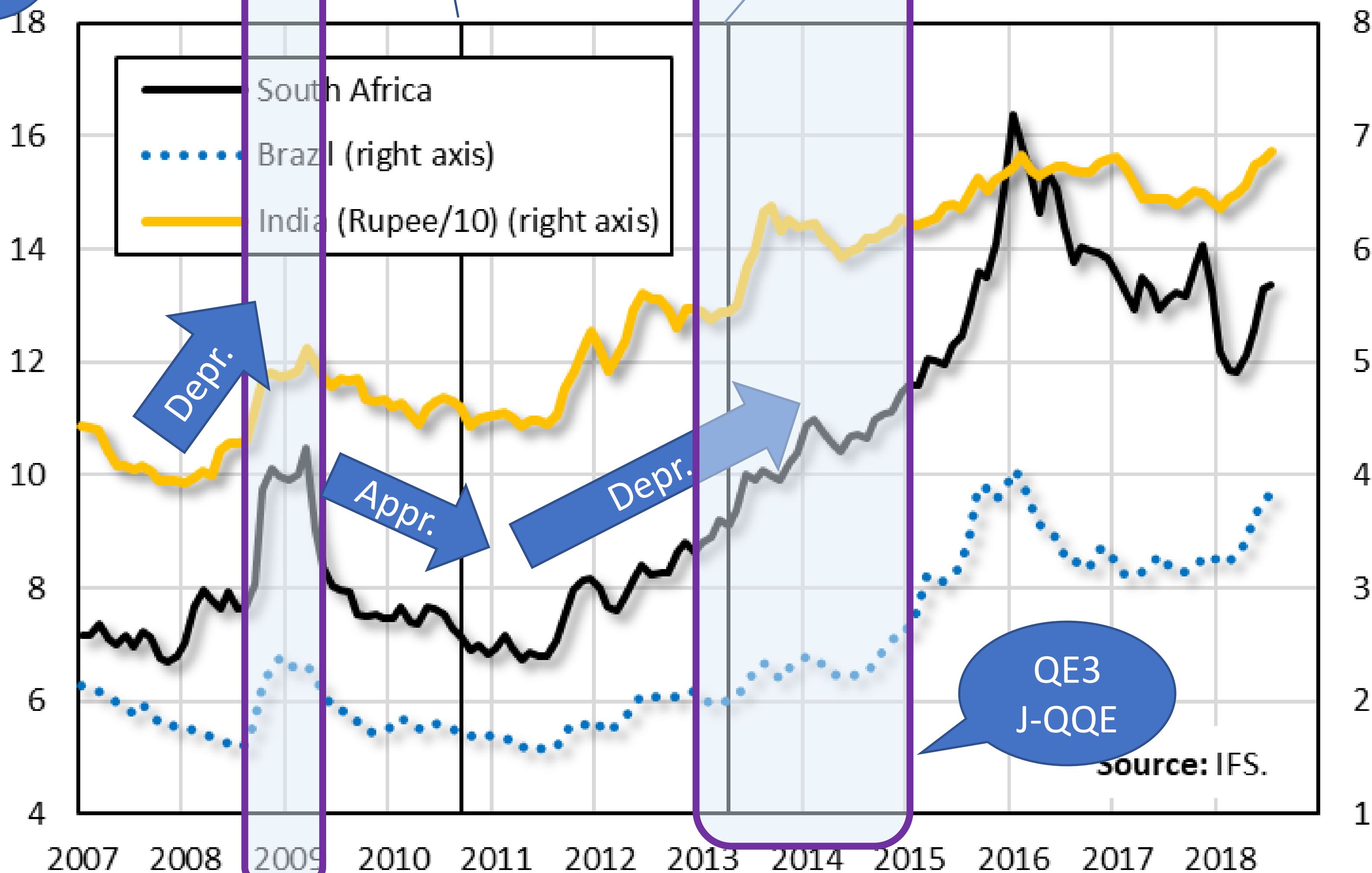
- Securitization
  - Moral hazard among originators
- CDO, CDO squared, and Credit rating
  - Moral hazard among credit rating agencies
- Inadequate supervision on (investment) banks
  - Basel II internal models for banks were inappropriate
  - Inadequate risk analysis for investment banks
- No capital injection or resolution authority
- Lessons learned
  - Basel III. Better and more capital (Loss absorbing capacity)
  - Expand “bank” category
  - Create (G-)SIB category

QE and Currency Wars

- Was QE (2009-2012) competitive devaluation?
  - “No” among advanced countries
  - But the Yen appreciated as BOJ stayed out of QE
  - EM with appreciation complained of currency war (mid 2010)
  - US argued that monetary policy is for domestic purposes; growth will benefit the world
- Taper tantrum (2013) and exit from QE
  - EMs with depreciation complained

- An “international currency war” has broken out, according to Guido Mantega, Brazil’s finance minister, as governments around the globe compete to lower their exchange rates to boost competitiveness. – Financial Times, Sept. 28, 2010

- “Does the currency depreciation that typically accompanies an easing of monetary policy unfairly disadvantage trading partners? The answer is generally no, for two reasons.” – Ben Bernanke, Polak Lecture, Nov. 5-6, 2015



"Currency War" Sept 2010
Taper Tantrum, May 2013
Domestic Currency per U.S. Dollar, Period Average
S. Africa, Brazil, and India
QE1
South Africa
Brazil (right axis)
India (Rupee/10) (right axis)
Depr.
Appr.
Depr.
QE3
J-QQE
Source: IFS.
18
16
14
12
10
8
6
4
8
7
6
5
4
3
2
1
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018

Why was QE criticized more than conventional monetary policy?

- With ZIRP, the currency channel became a primary transmission channel
  - Spillovers to other countries are greater
  - BOJ played a catch-up game with QQE in 2013
  - EM countries experienced capital inflows (and complain)

- Does US normalization (exit from QE and/or ZIRP) restore the equilibrium exchange rates?
  - EM countries experience capital outflows (and complain)

Bernanke defense

- Does the currency depreciation that typically accompanies an easing of monetary policy unfairly disadvantage trading partners? The answer is generally no, for two reasons.
- (1) "although monetary easing usually leads to a weaker currency and thus greater trade competitiveness, it also tends to increase domestic incomes, which in turn raises home demand for foreign goods and services."
- (2) "trading partners have the means to compensate for shifts in their international competitiveness through policy adjustments of their own"

Better alternative way?

- Internationally coordinated Fiscal policy? Yes, we did in 2009 (London G20 Summit)
  - Increased government spending in each country
  - Effective in mitigating aggregate demand decline
  - But, spending went to some not-so-useful projects in some countries
    - Chinese ghost towns with local government debts
- Internationally coordinated QE, possible?
  - Japan could have avoided a severe recession in 2009-10 if they adopted QE
  - EM could also adjust fiscal and monetary policy, temporarily
- EM countries can also adopt capital flows management
- A possible bubble can be managed with Macro-Pru

Future: (1) Safety net

- Can we identify a liquidity crisis?
  - No conditionality; Large amount; Quick disbursement
- Global Financial Safety Net
  - Unpopular FCL and PLL
  - IMF stigma
  - Failure of IMF SLS (Short-term Liquidity Swap)
- Regional
  - CMIM – NOT tested
- Central bank swaps
  - G10 central banks
  - Chinese PBOC-centered

Safety net: CMI-M vs. IMF SLS or else?

- CMI-M
    - Not-tested
    - 70% IMF-linkage
    - Surveillance and Trigger, unclear
- IMF SLS (Short-term Liquidity Swap)
    - Low commitment fee; pre-qualification
    - Was not approved (Asian opposition or US opposition)
- Stigma?
    - Asian countries are content with maintaining large forex reserves

Future: (2) Global Imbalances, again?

- Large current account surpluses
  - Germany
  - China
- US current account deficits – a problem?
- EM current account deficits – too big?
  - Argentina
  - Turkey
- Trump
  - Problem gets complicated as Trump sees bilateral deficits as a problem
  - Global trading system is about to be significantly damaged

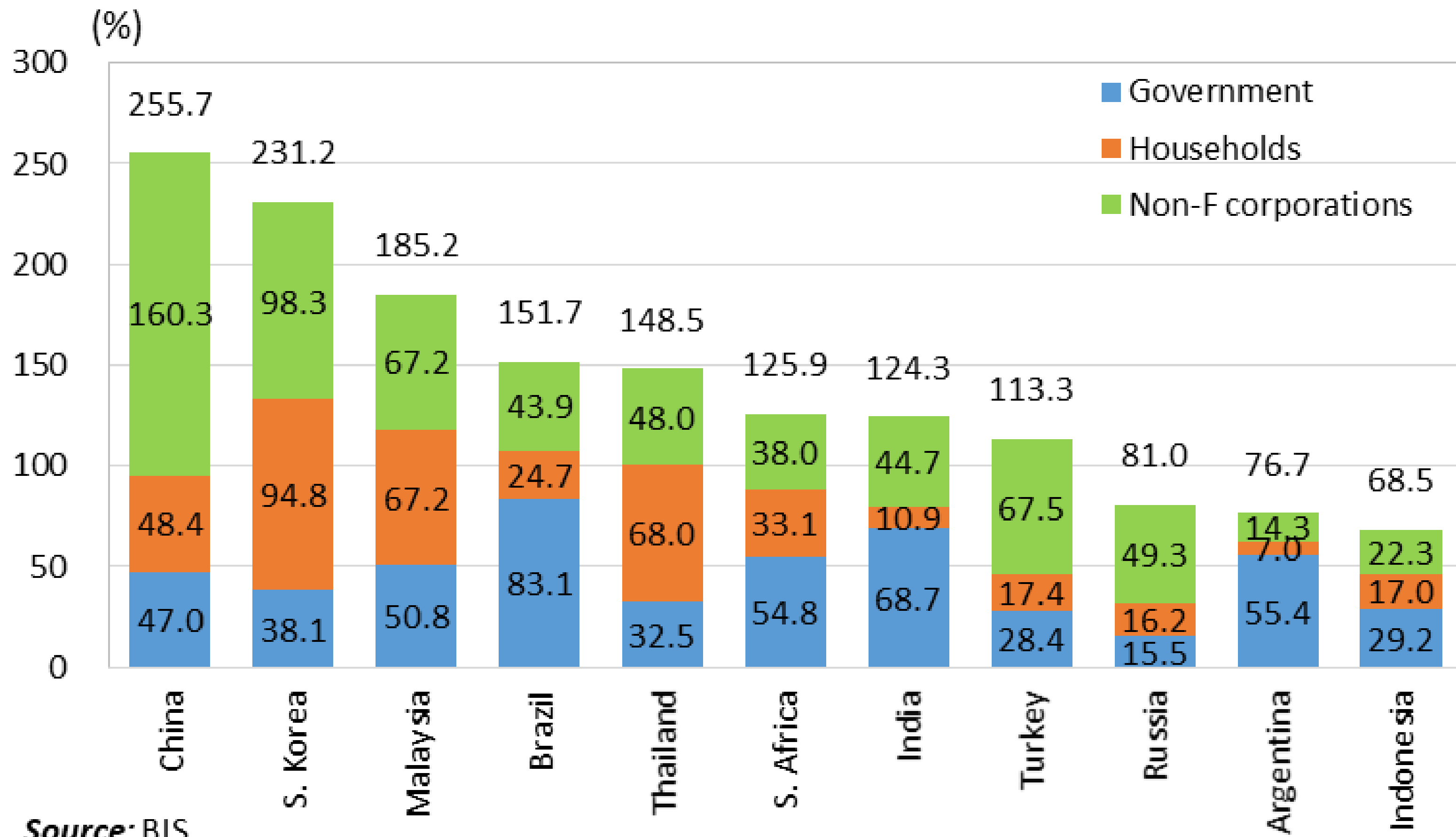
Future: (3) Next Crisis

- EM Unsustainable Debt
  - Latin America
- EM Liquidity Crisis
  - Lack of safety net
- Advanced/EM Bank and Nonbank Supervision
  - Basle III and Bank Supervision
  - Hedge Fund/Private Equity not included
- China
  - Corporate debt has risen fast
  - Local government debt
  - Bilateral aid to developing countries with large debts

Debt growth and crisis

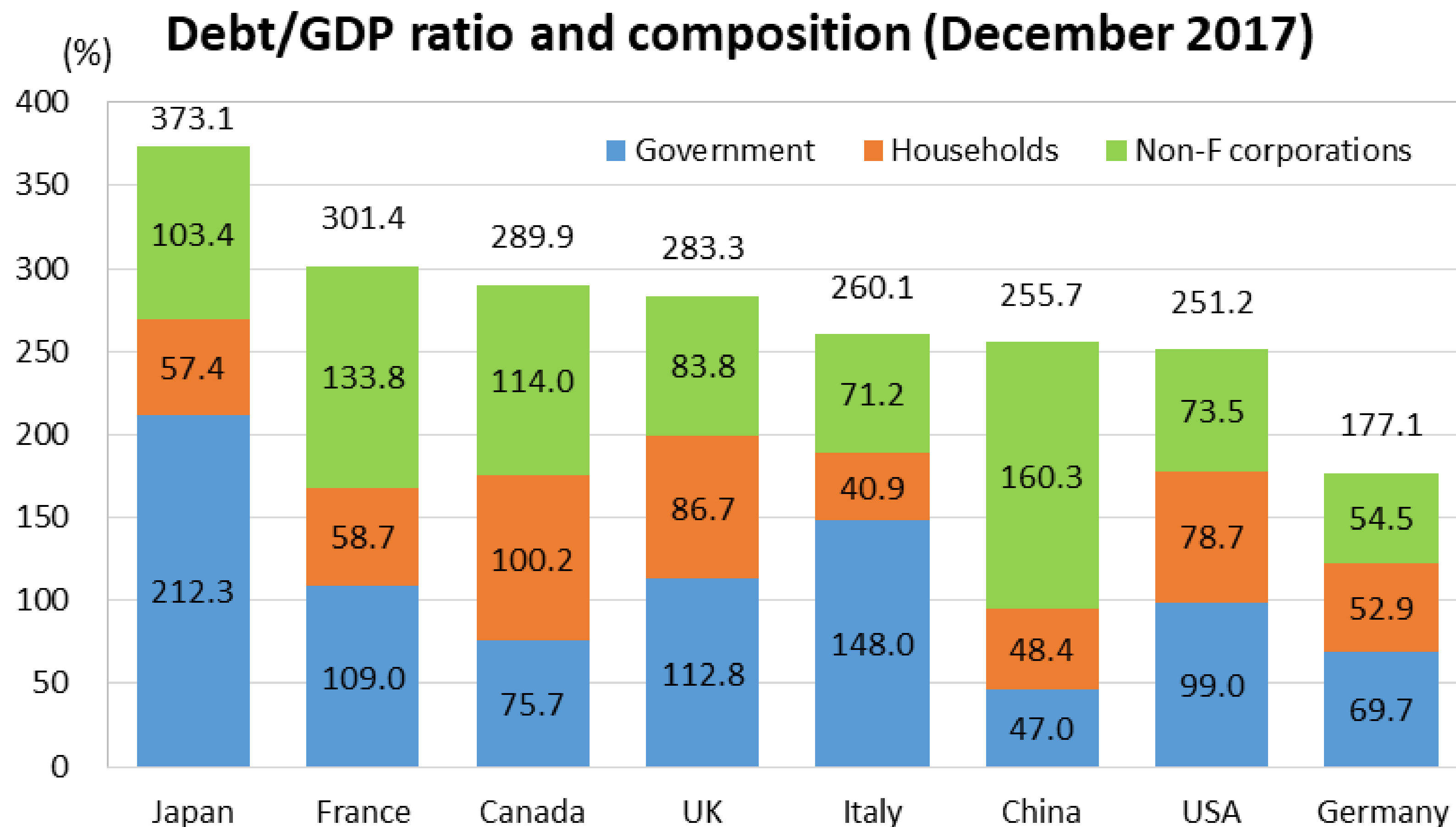
- Debt itself is not necessarily a sign of vulnerability
- Asset price increase is not necessarily a sign of vulnerability
- However, asset price increases supported by leveraged investment is a sign of vulnerability
  - Cases of Asian bubble, Japanese bubble, US subprime
- Where is next?

Emerging market countries & China



Source: BIS.

Advanced countries and China



Source: BIS.

China, time-series