Global Imbalances and International Monetary Order

Matthieu Bussière
(Banque de France)

Croissance et déséquilibres mondiaux. Approches chinoises et européennes
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The views expressed in this presentation do not necessarily reflect those of the Banque de France or the Eurosystem

Aim of the presentation

- Some personal reflections on global imbalances and the international monetary order

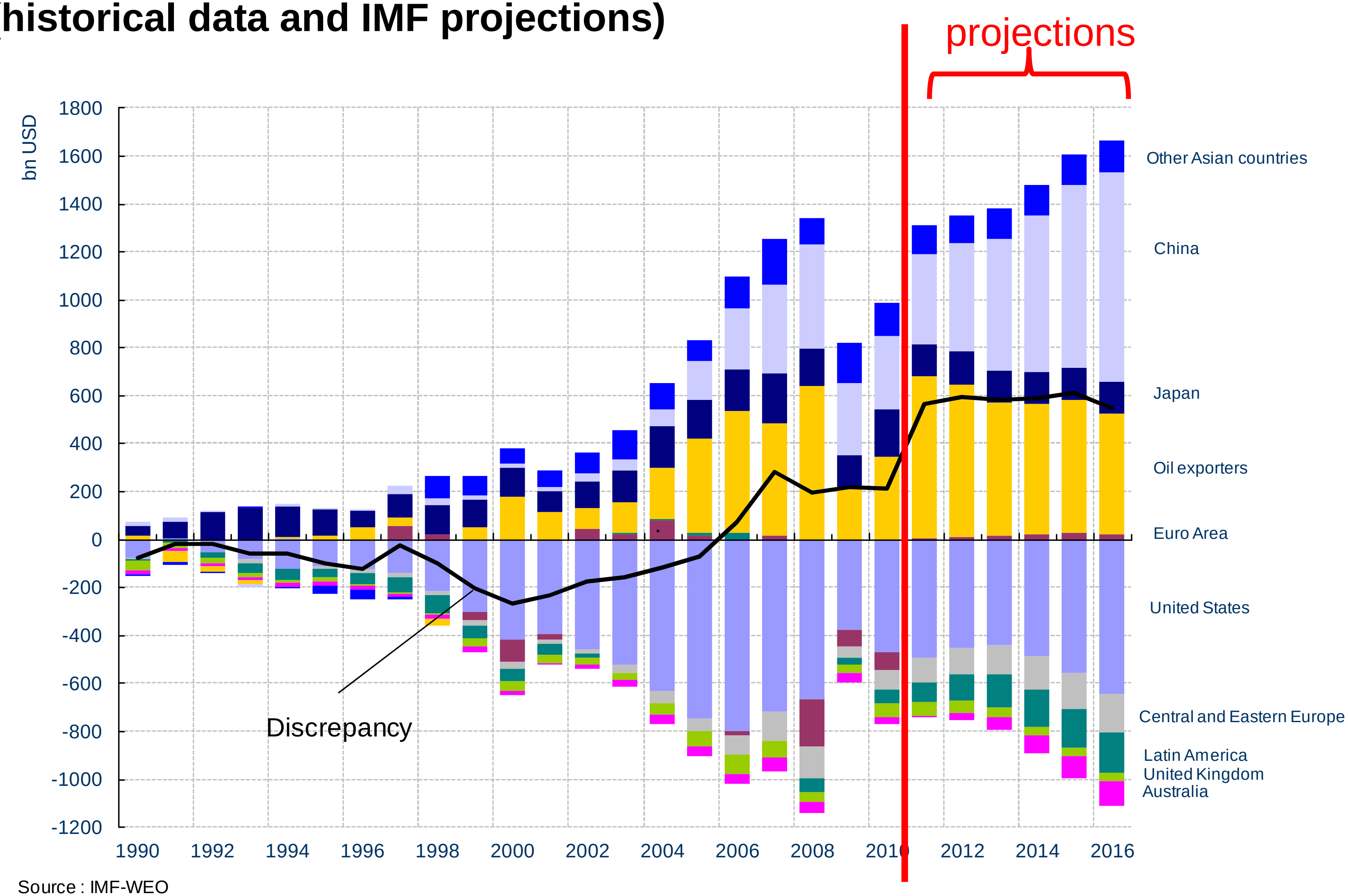
- Based on recent/ongoing research

- Specifically:
  1. Is global rebalancing needed? (review of the arguments)
  2. (Global) imbalances, crises and reserve accumulation
  3. How to proceed: the role of policy coordination

Is global rebalancing needed?

Growing external imbalances

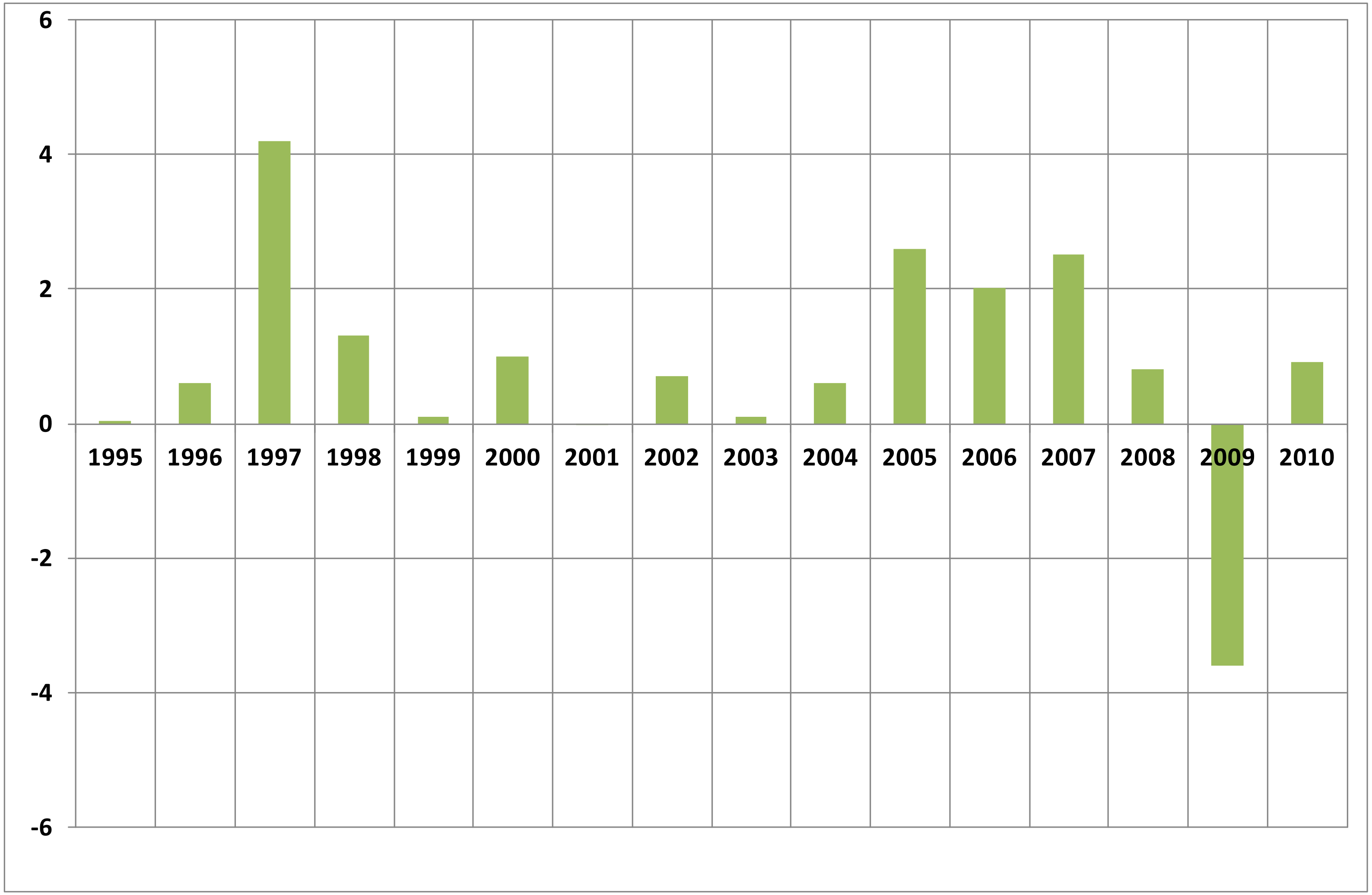
Current account position in selected countries and regions *(USD bn)*
(historical data and IMF projections)



Source : IMF-WEO

The role of international trade

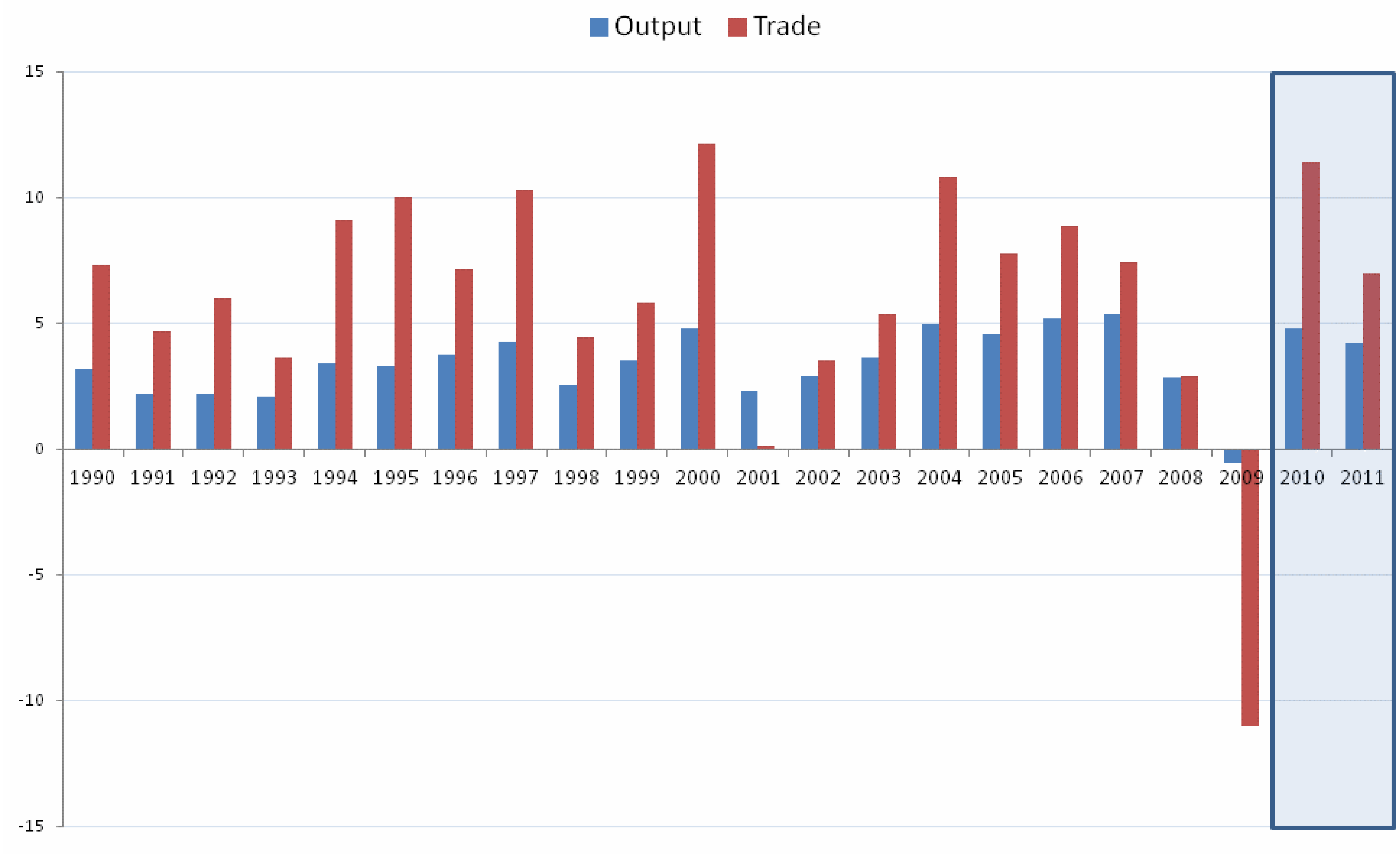
China: Net trade contributions to growth (p.p.)



Source: IMF WEO.

The Great Trade Collapse

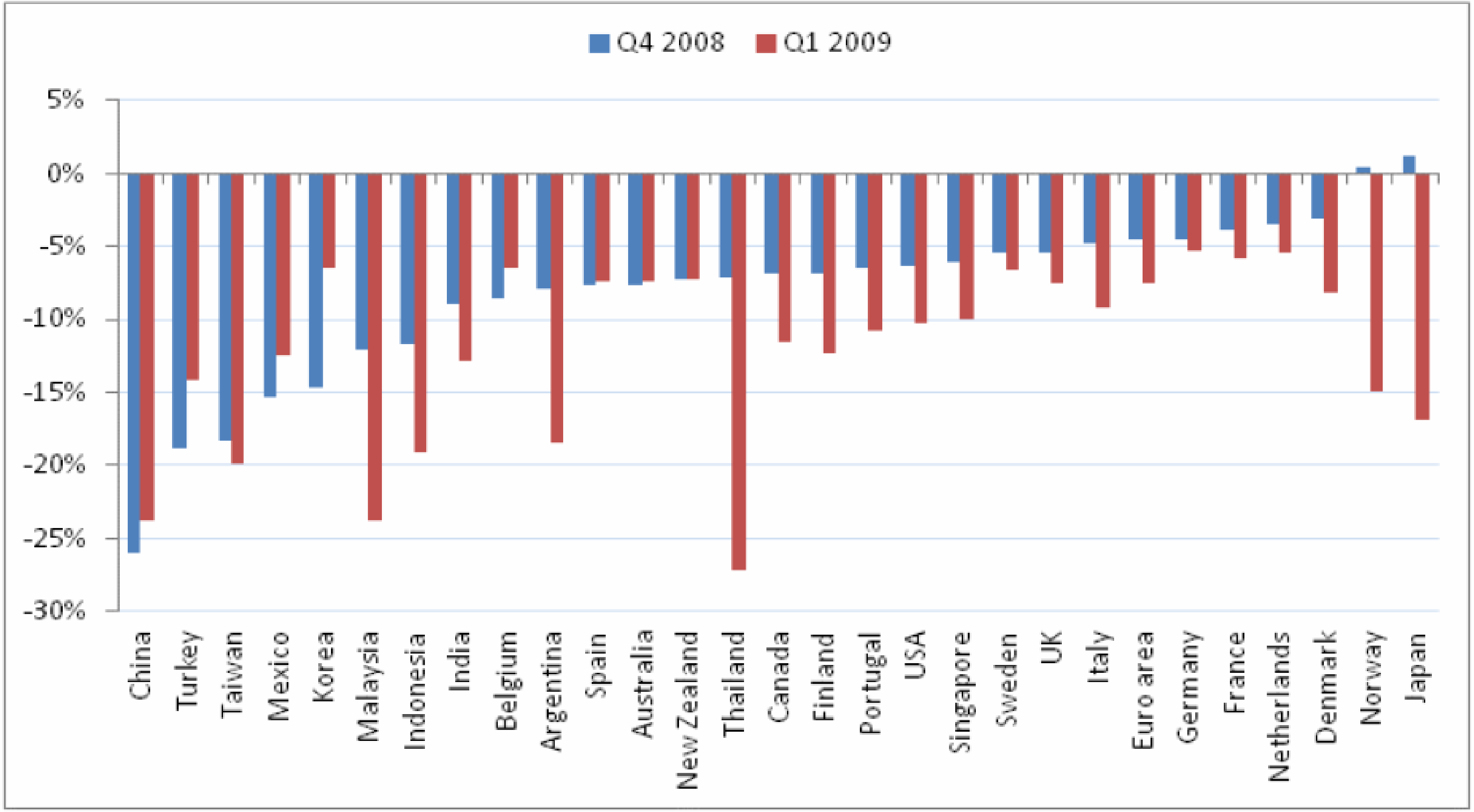
YoY growth rate of world trade and output (p.c.)



Source: IMF WEO.

The Great Trade Collapse

Figure 2: Growth rate of real imports in 2008Q4 and 2009Q1, q-o-q growth rates



Source: Bussière, Callegari, Ghironi, Sestieri and Yamano, 2011.

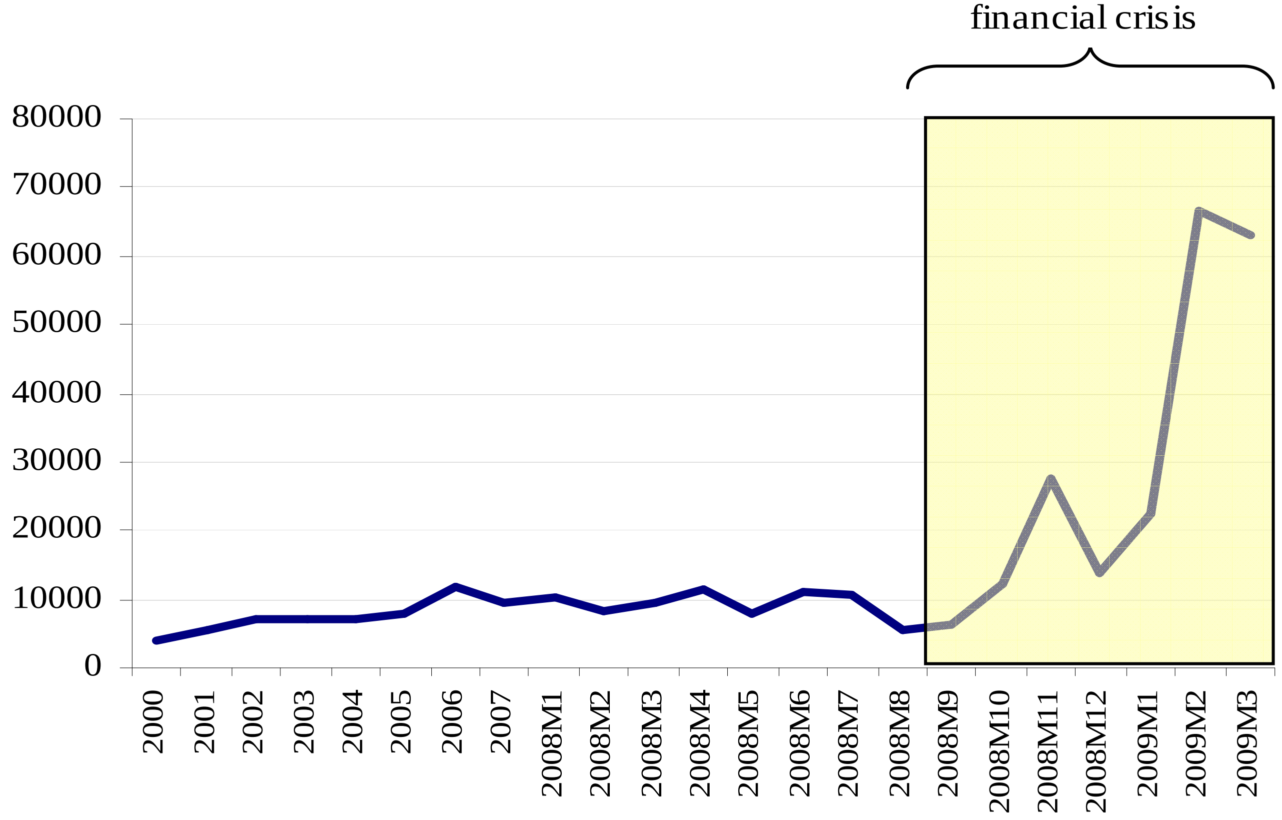
Why is global rebalancing needed?

Reasons to believe it is the case:

- Risk of global deflationary pressures + risk of protectionism
- Current account reversals are costly
  - ➢ Clear for deficit countries (EME crises of the 1980s & 90s)
  - ➢ Also for surplus countries, esp. if reinforced by internal imbalances (investment/lending boom)
  - ➢ Global repercussions may be larger due to the internationalization of production chains
- Optimality issue (Lucas paradox)
- Global imbalances and the financial crisis

The protectionist threat

Importance of the word "Protectionism" in the news.
(number of articles including the word "protectionism"; annual frequency between 2000 and 2007, annualised monthly frequency since January 2008)



Source: Dow Jones/Factiva and Bussière, Perez, Straub and Taglioni 2011.

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(Global) imbalances, crises and reserve accumulation

Crisis indicators:

Bussière & Mulder (1999): short-term debt to reserves (Greenspan-Guidotti rule); Bussière & Fratzscher (2006); Bussière (2007), Bussière & Mulder (2011)

Kaminsky & Reinhart (1999): reserves; M2/reserves

Sachs-Tornell-Velasco (1996): M2/reserves

Rose, Eichengren & Wyplosz (1995): growth rate of reserves and of M1/reserves ratio

→Reserve accumulation for insurance motive

→Note that CA deficit also a usual indicator

Lessons from the 2008 crisis

- Growing empirical literature: Aizenman & Hutchison (2010), Aizenman & Sun (2010), Rose and Spiegel (2010), Frankel and Saravelos (2010), Bussière and Mulder (2011), etc.
- Blanchard, Faruqee & Klyuev (2009)
  - Weak evidence of a link between reserves and the extent of the crisis across countries
  - New IMF instruments could serve as better insurance
    - New SDR allocation
    - New programs (Flexible Credit Line)

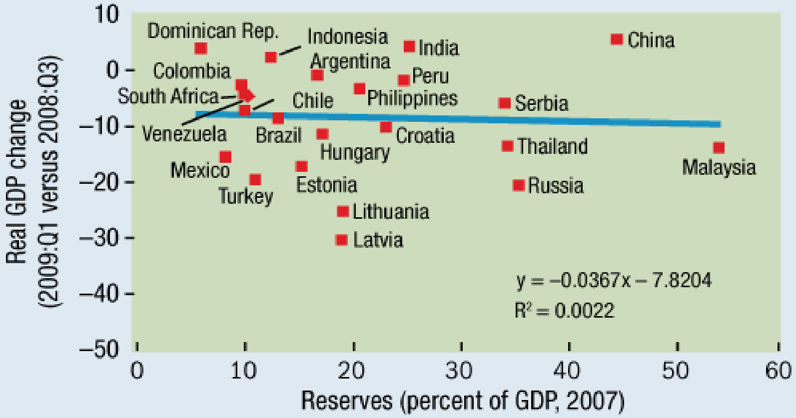
Reserves and the crisis

Chart 2

How much cushion?

Larger reserves did not lead to lower declines in economic activity at the peak of the crisis.

(selected emerging countries, in percent)



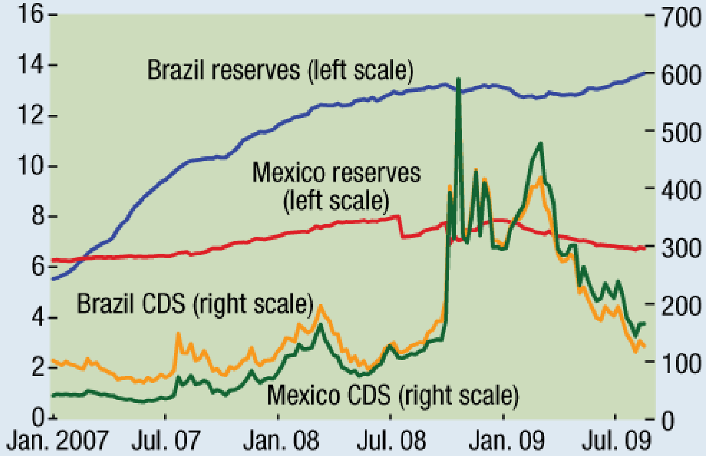
Sources: IMF, Global Data Source database and staff estimates.

Chart 3

Market perceptions

As the evolution of credit default swap spreads indicates, markets did not see Mexico as more vulnerable than Brazil despite lower reserves.

(percent of 2008 GDP) (basis points)



Sources: IMF, *World Economic Outlook* database; and Bloomberg L.P.

Reserves as insurance instrument

Why it might fail:

- "fear of losing reserves" (Aizenman & Hutchison, 2010, Aizenman & Sun, 2010)
- The "Machlup problem" (no clear benchmark → infinite accumulation)
- Cross-country benchmarks (same implication)
- An important coordination problem (if all reserves are used at the same time)

The role of policy coordination

Importance of the Twin Deficit relation

Table 1: A Synthetic Summary of the Literature, Effect of a 1% Increase in the Budget Balance on the Current Account

Paper (see References)	Sample and Methodology[1]	Result
Empirical Contributions		
Summers, 1986	US, 1950-1985, single equations	0.25
Bernheim, 1988	US, UK, Canada, Germany, single equations	0.33 for the US
Roubini, 1988	18 OECD countries, 1961-85, single equations	0.14 (Canada) to 0.60 (US)
Dewald and Ulan, 1990	Same as Roubini 1988 for the US	0
Miller and Russek, 1989	US, Q data, 1971-87, OLS and cointegration	1 or 0 depending on methodology
Enders and Lee, 1990	US, Q data 1947-87, VAR	0
Evans, 1990	G7, Q and annual data, 1973-1988 and other time samples	0
Normandin, 1994	US and Canada, Q data 1970-1993	• Between 0 and 1 for Canada • 0 for the US
Chinn and Prasad, 2000	18 industrial countries, 1971-1995, Panel regressions	0.34, 0.13, 0.14, and 0.08 depending on specification
Piersanti, 2000	17 OECD countries, 1970-1997, GMM	• 0.16 for average of G7 countries • 0.25 for the US
Kim and Roubini, 2003	US, Q data, 1973-2002, VAR	<0
Kennedy and Slok, 2005	13 OECD countries, 1982-2003, panel regressions	0.08 to 0.33
Theoretical Contributions with Simulations		
Baxter, 1995	RBC	0.5
Kollman, 1998	RBC	0
Erceg, Guerrieri and Gust, 2005	DSGE	0.2

1/ Annual data except where indicated (Q for quarterly data).

Source Bussière, Fratzscher and Mueller, 2010

"Global" liquidity

Discussion on how to measure global liquidity not tackled here

Instead: why concept of "global" liquidity? (BIS):

- Significant share of domestic currency held abroad
- Credit booms and financial inflows
- Issue of currency mismatch

Conclusions

There is a case for global rebalancing and policy cooperation → a multilateral issue

The G20 agenda under the French Presidency:

- Rebalancing issues tackled in the Framework WG on Strong, Sustainable & Balanced Growth
- Issues related to the International Monetary System are tackled in the IMS WG, with:
  - A SWG on capital flows
  - A SWG on global liquidity