

# Global liquidity and financial contagion: *Impact and Policy Challenges for EMEs*

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# Overview

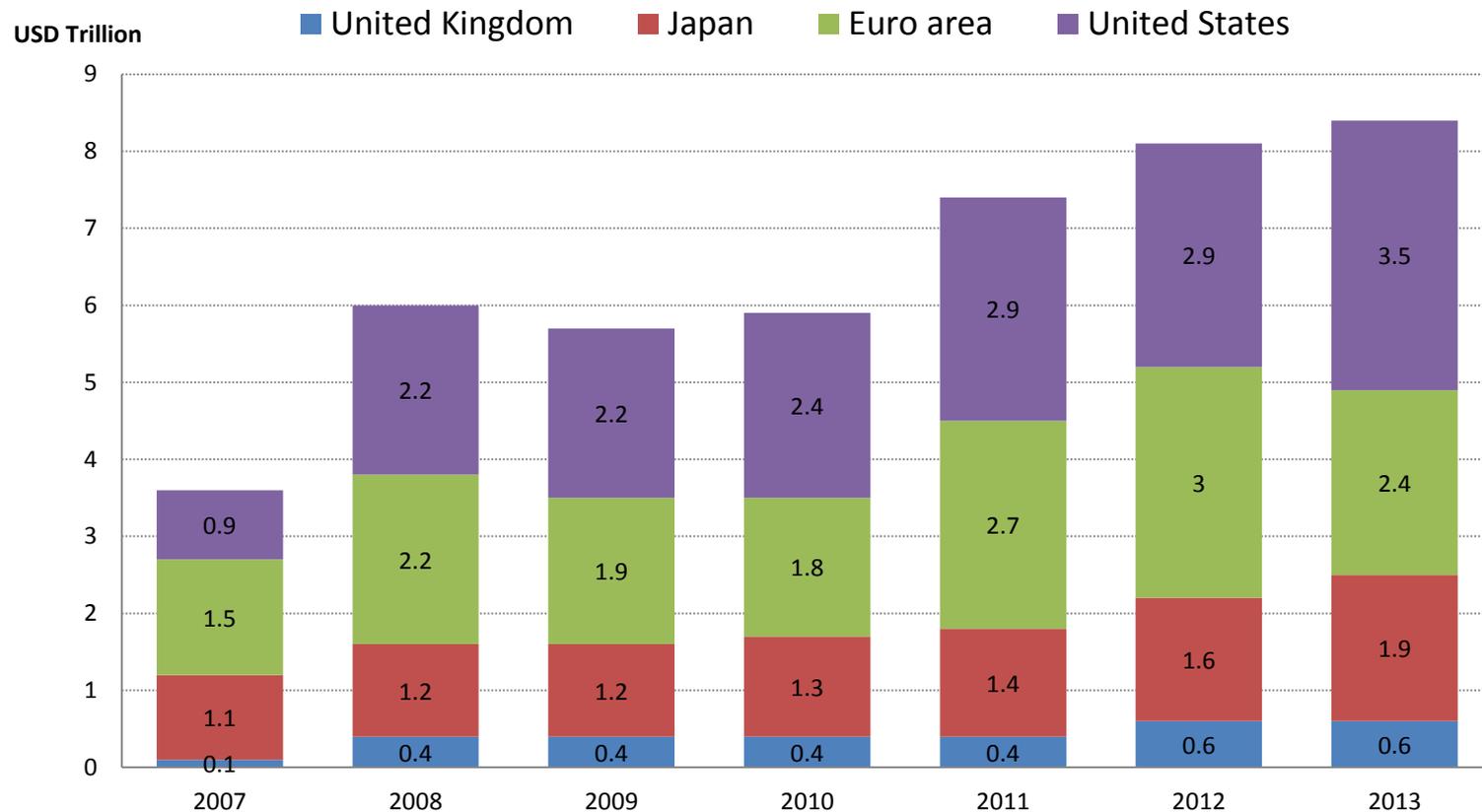
1. Global liquidity, capital flows and financial instability
2. Policy responses and challenges for EMEs
3. Strengthening the global financial safety net for EMEs

# Overview

- 1. Global liquidity, capital flows and financial instability**
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# Official liquidity has expanded significantly since the financial crisis, spurred by the expansion in the balance sheets of the major central banks

## Total assets of major central banks



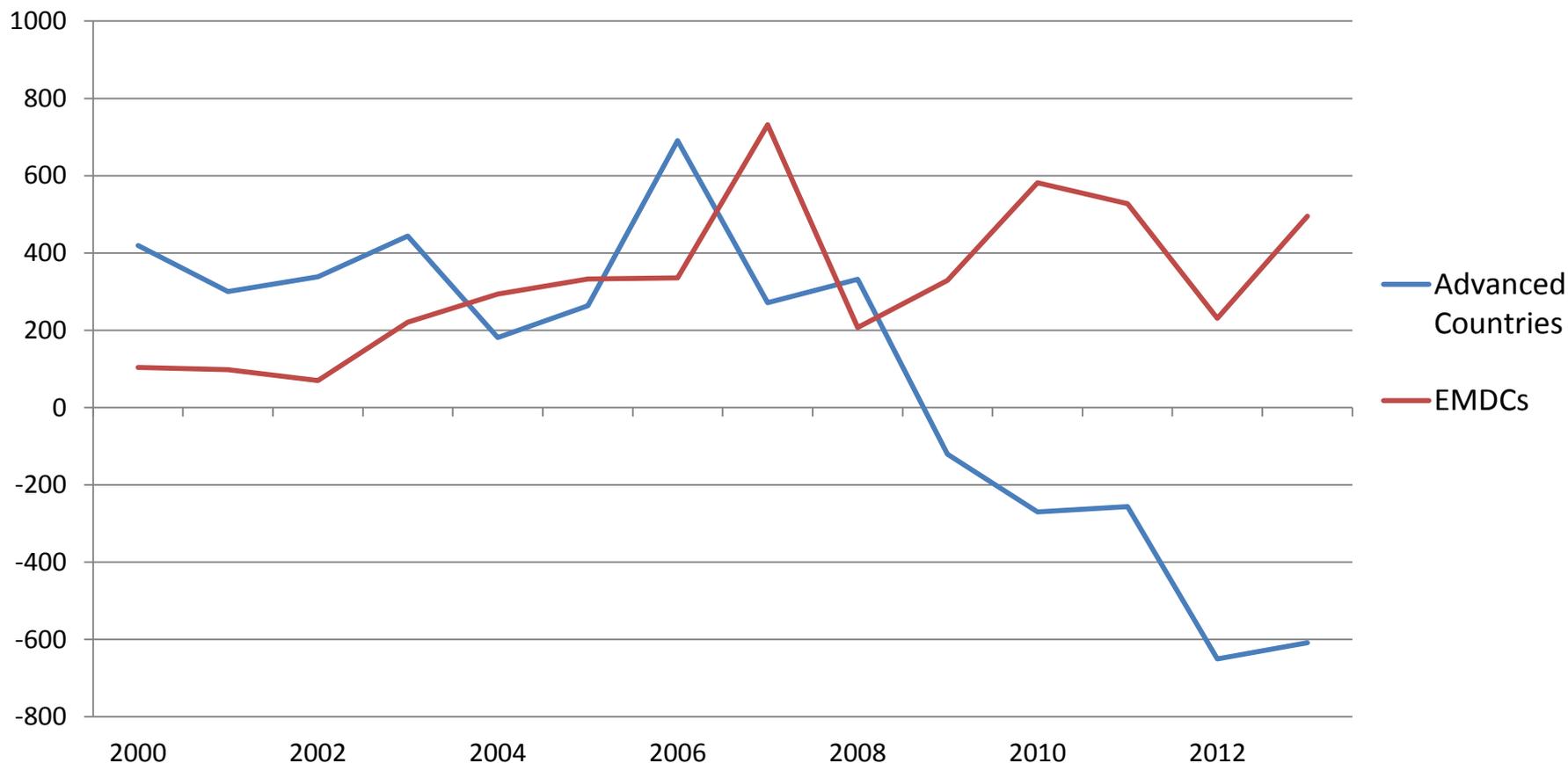
**Private liquidity (especially cross-border flows) contracted significantly, and has never fully recovered because of the decline in flows to AEs due to a sharp drop in bank lending**

**G20 inflows over previous four quarters (\$tn)**



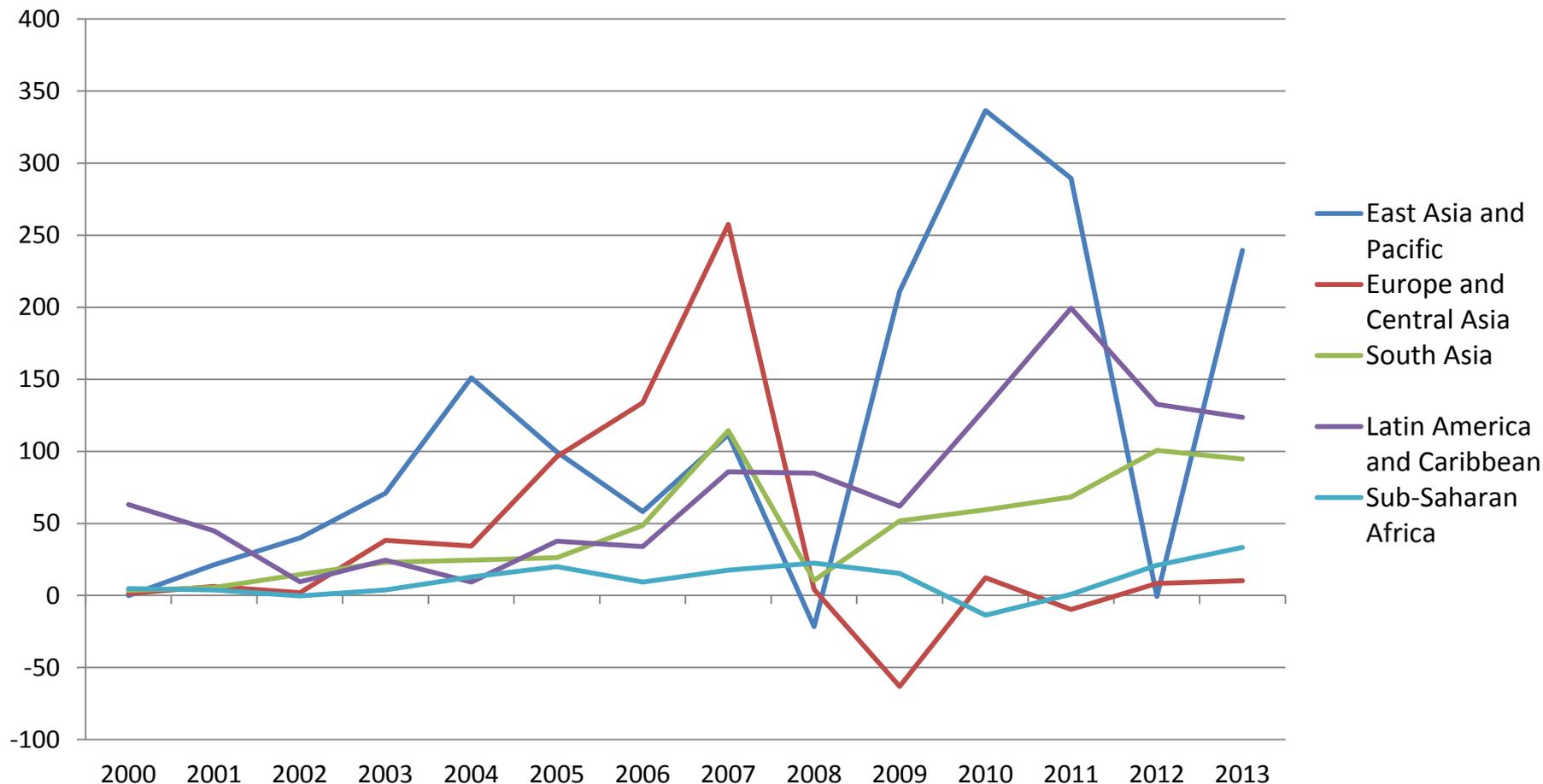
# Flows to EMEs, though volatile, have continued to increase, with differentiation by type of flow and across regions

## Net private capital flows: advanced countries & EMDCs (USD Billion)



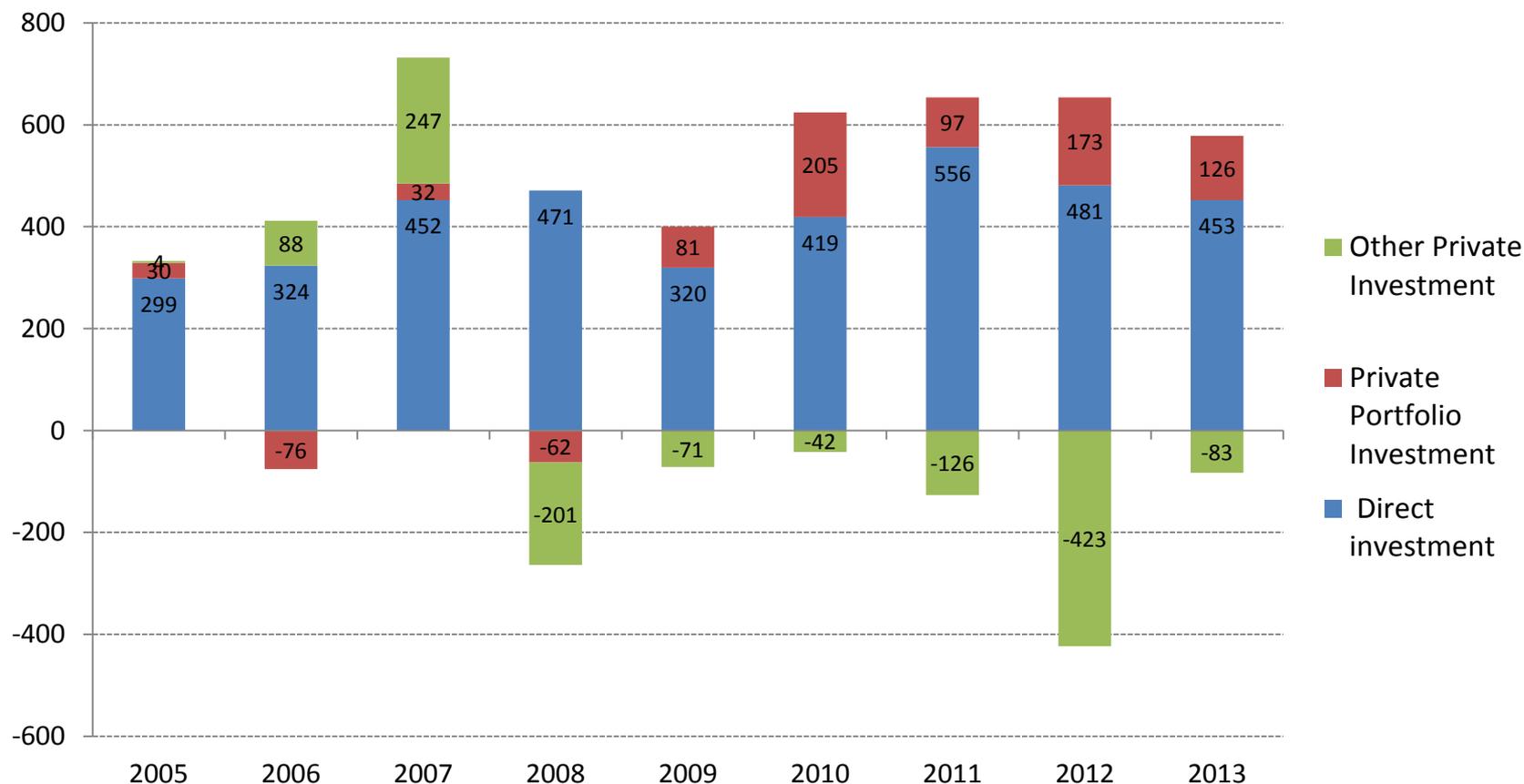
# Flows to EMEs, though volatile, have continued to increase, with differentiation by type of flow and across regions

## Net private capital flows by region (USD Billion)



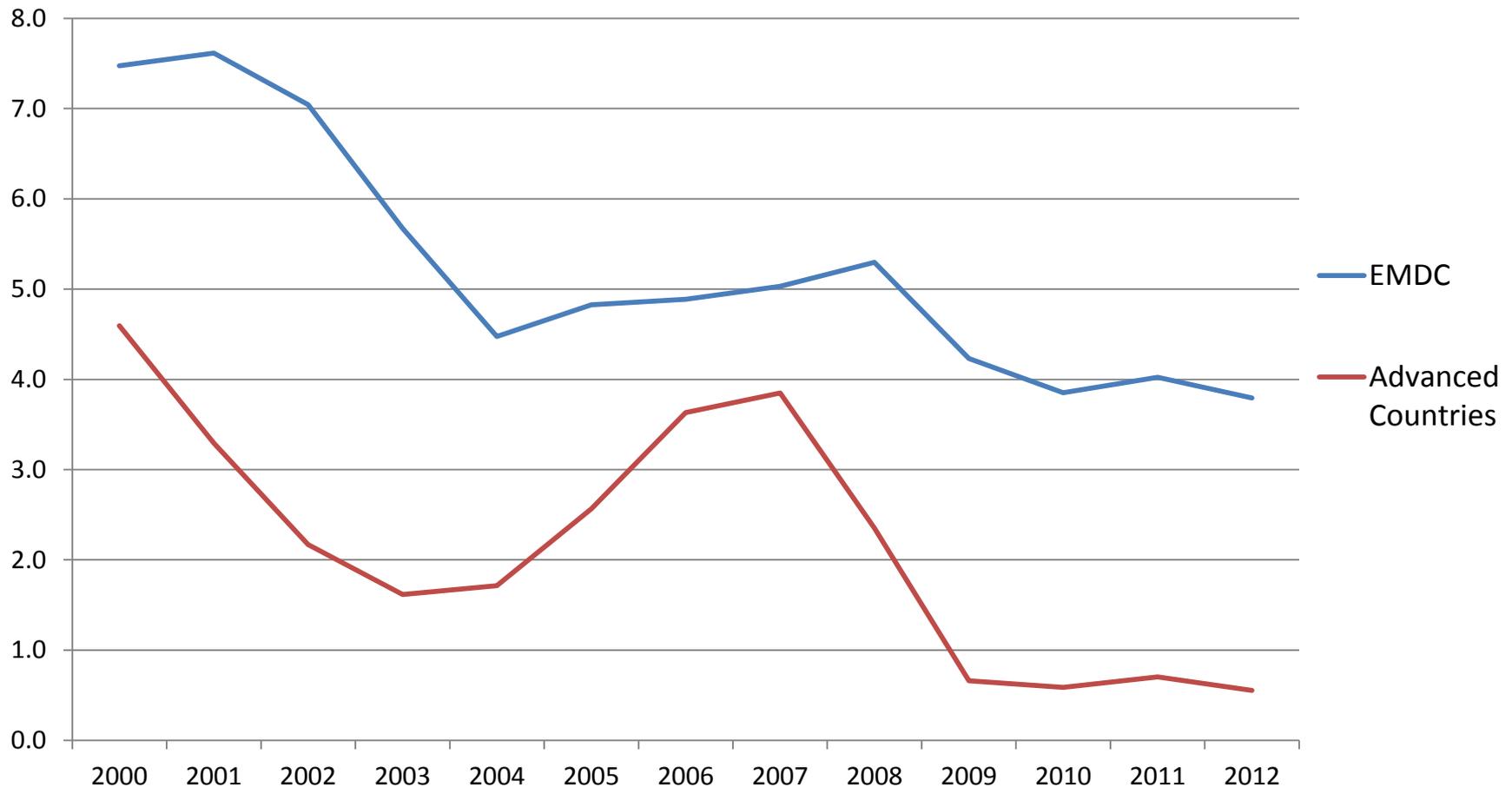
# Flows to EMEs, though volatile, have continued to increase, with differentiation by type of flow and across regions

## Net private capital flows to EMDCs by component (USD Billion)



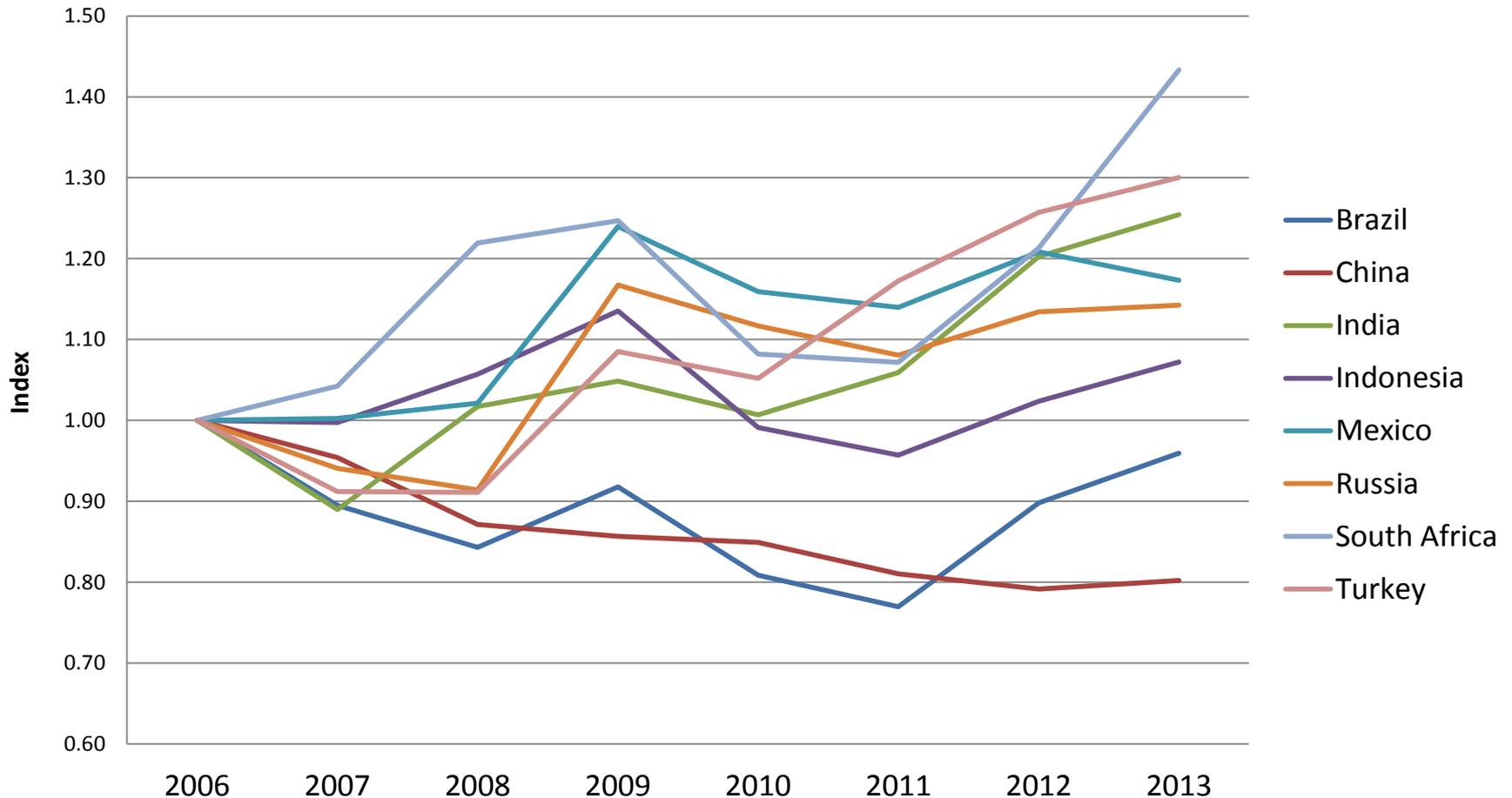
# The differential in interest rates between AEs and EMEs has been an important driver of capital flows to EMEs

## Short term interest rate: advanced countries and EMDCs

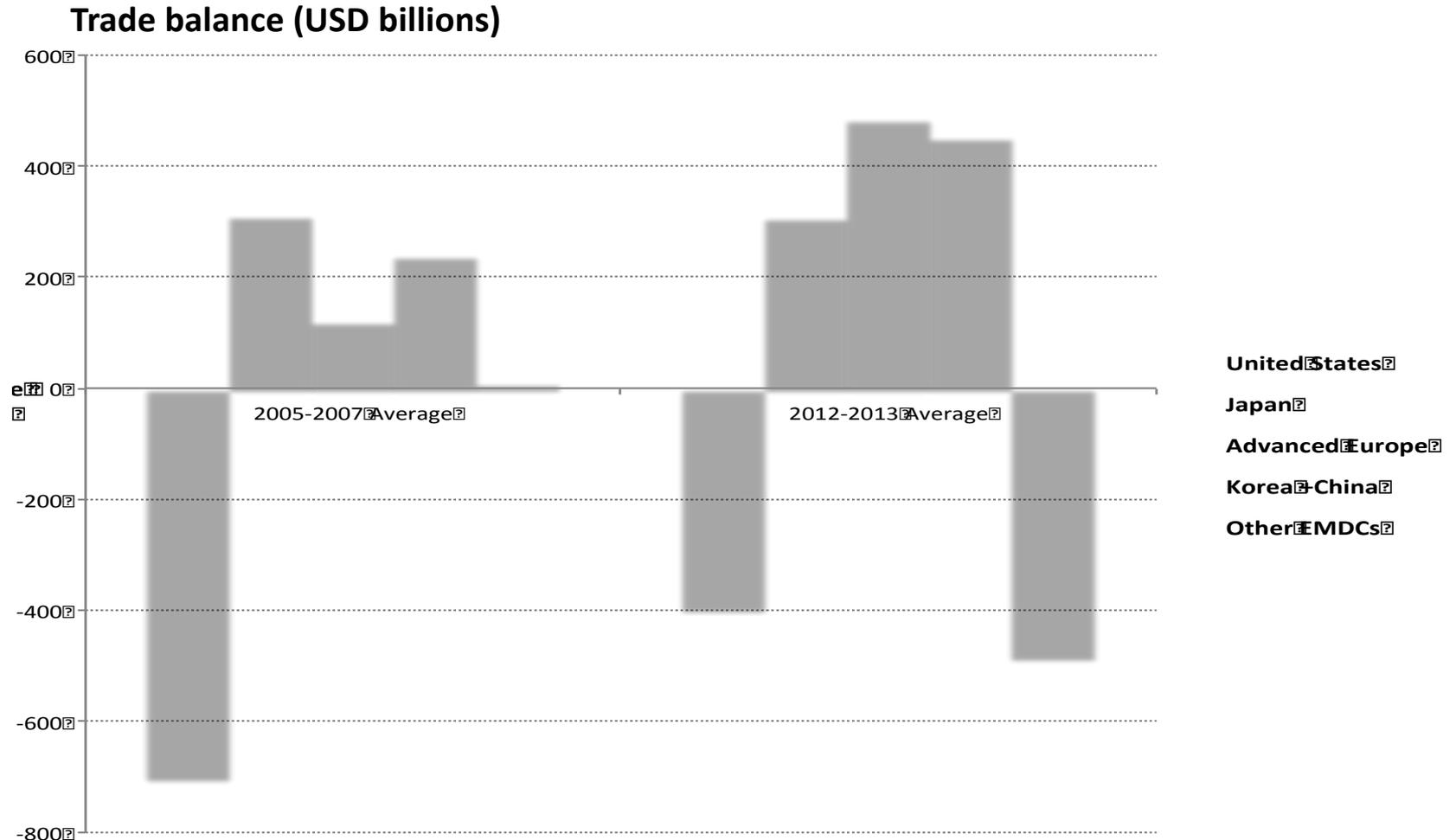


# Capital flow volatility has led to significant exchange rate volatility

## Exchange rates in select EMs (indexed to 2006)

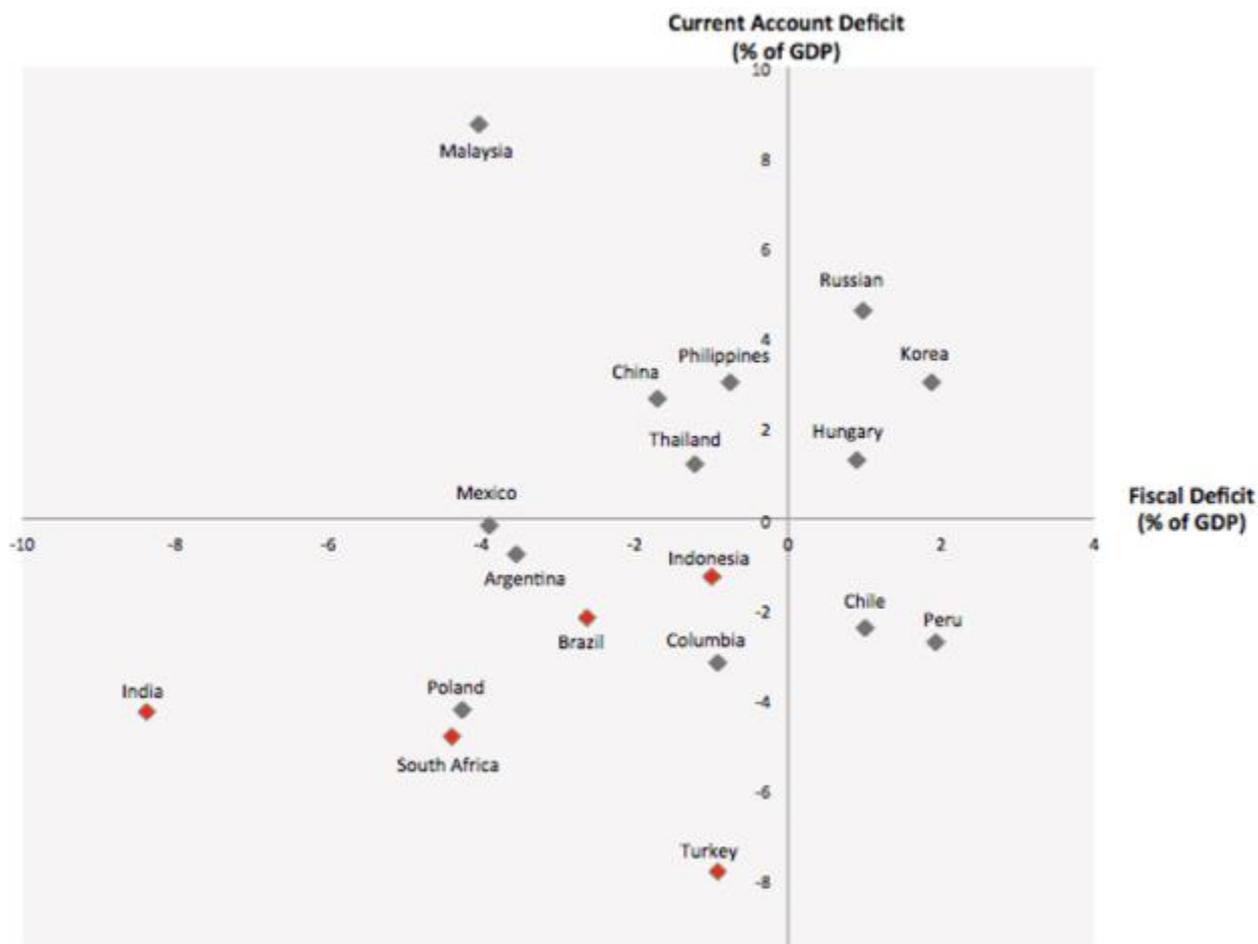


# Abundant capital flows have helped to finance increased trade and current account deficits



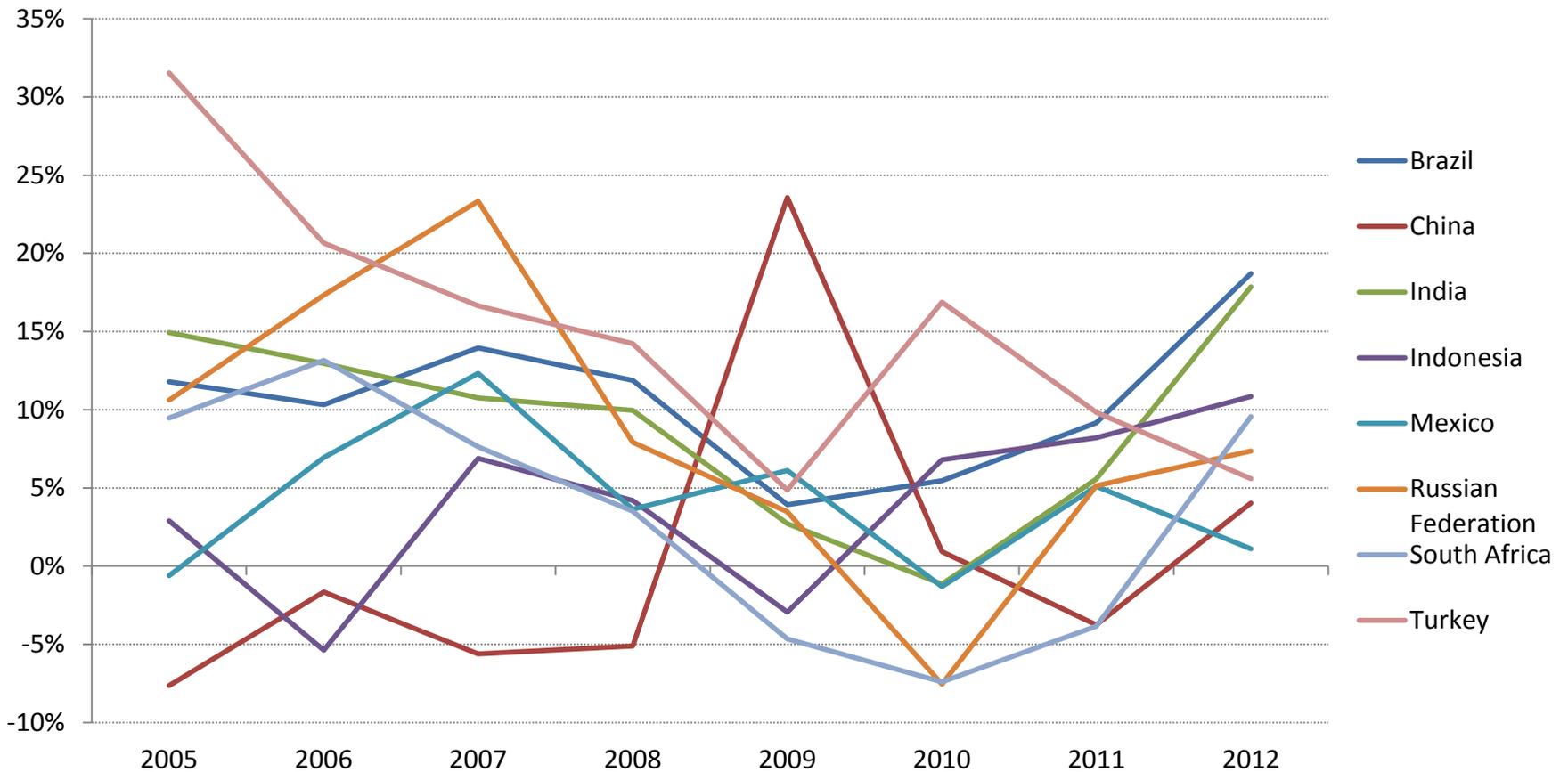
# ...but have also resulted in increased macro vulnerability

Current Account and Fiscal Balance (average of 2011-2012)



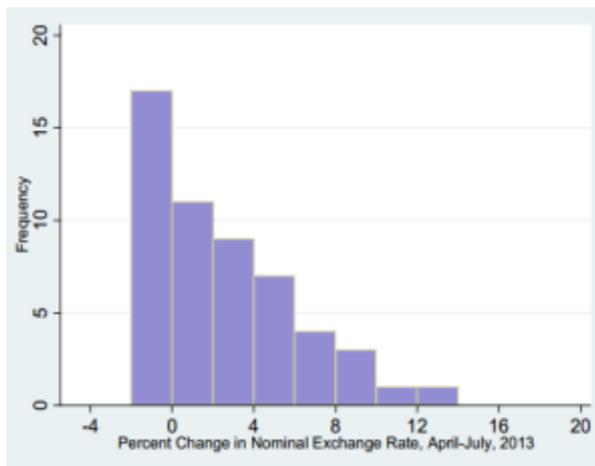
# ...and have contributed to some acceleration in credit growth

**Credit growth for major emerging markets  
(growth rate of outstanding loans from commercial banks, % change)**

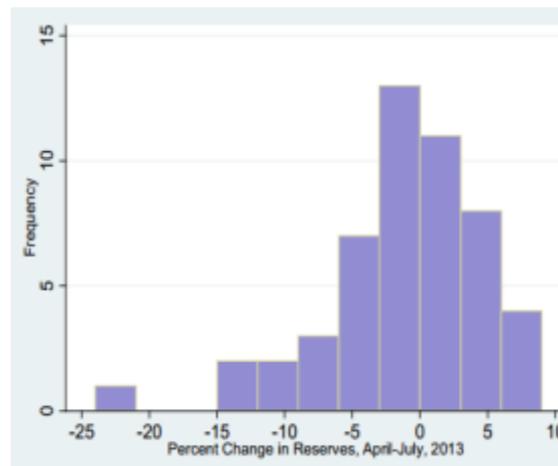


# The impact of Fed tapering on EMEs has been significant

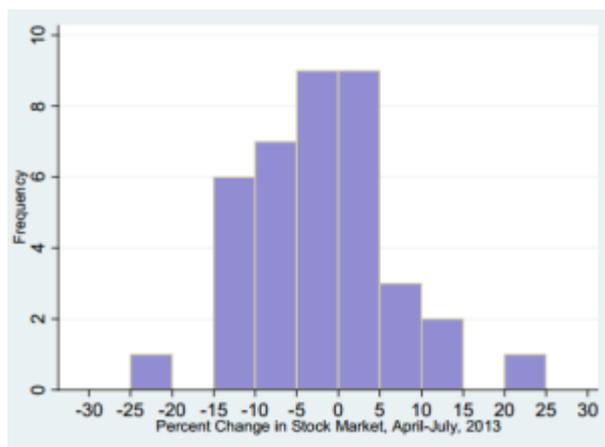
**Cumulative effect on exchange rate  
(April-July 2013, % change)**



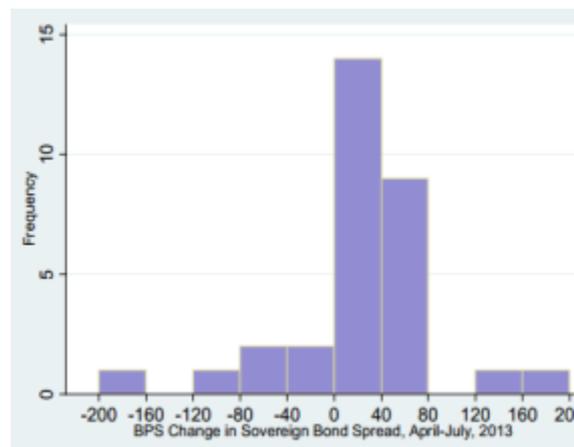
**Cumulative effect on external reserves  
(April-July 2013, % change)**



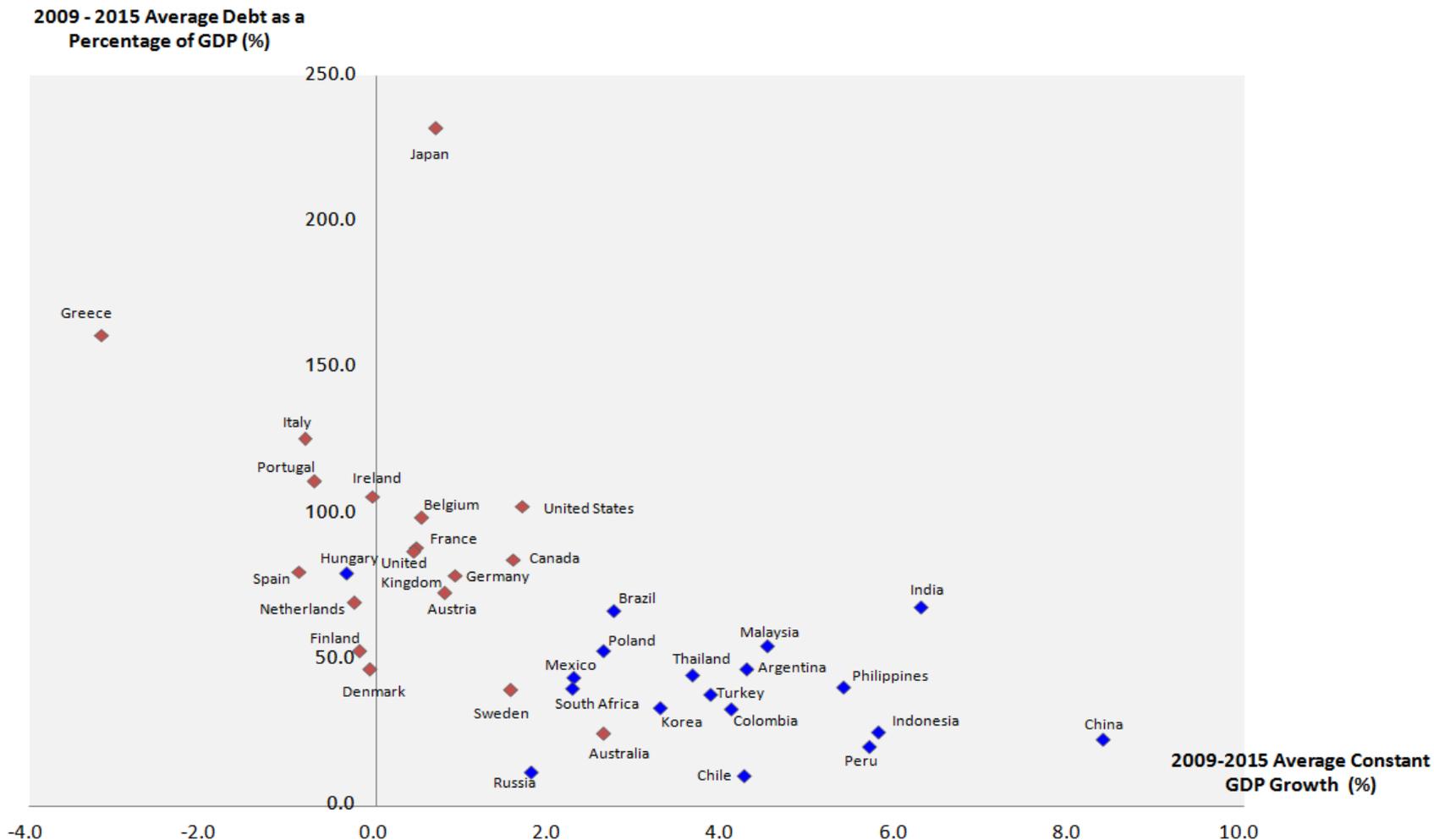
**Cumulative effect on stock market index  
(April-July 2013, % change)**



**Cumulative effect on sovereign bond spreads  
(April-July 2013, % change)**

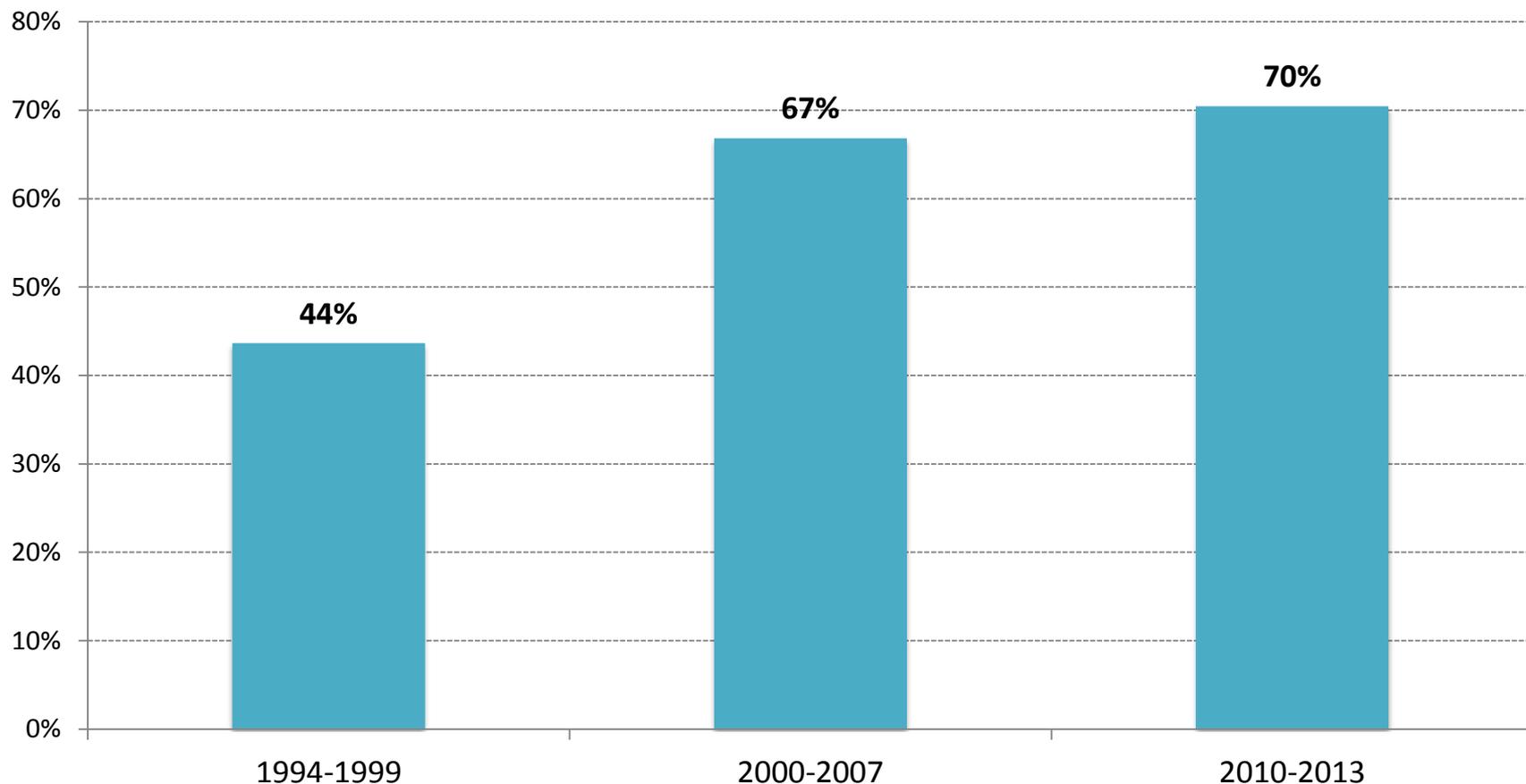


# Large current account and fiscal deficits have been seen as potential sources of vulnerability...but the underlying fundamentals remain strong



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**EMDCs' Contribution to World GDP Growth (PPP Terms)**



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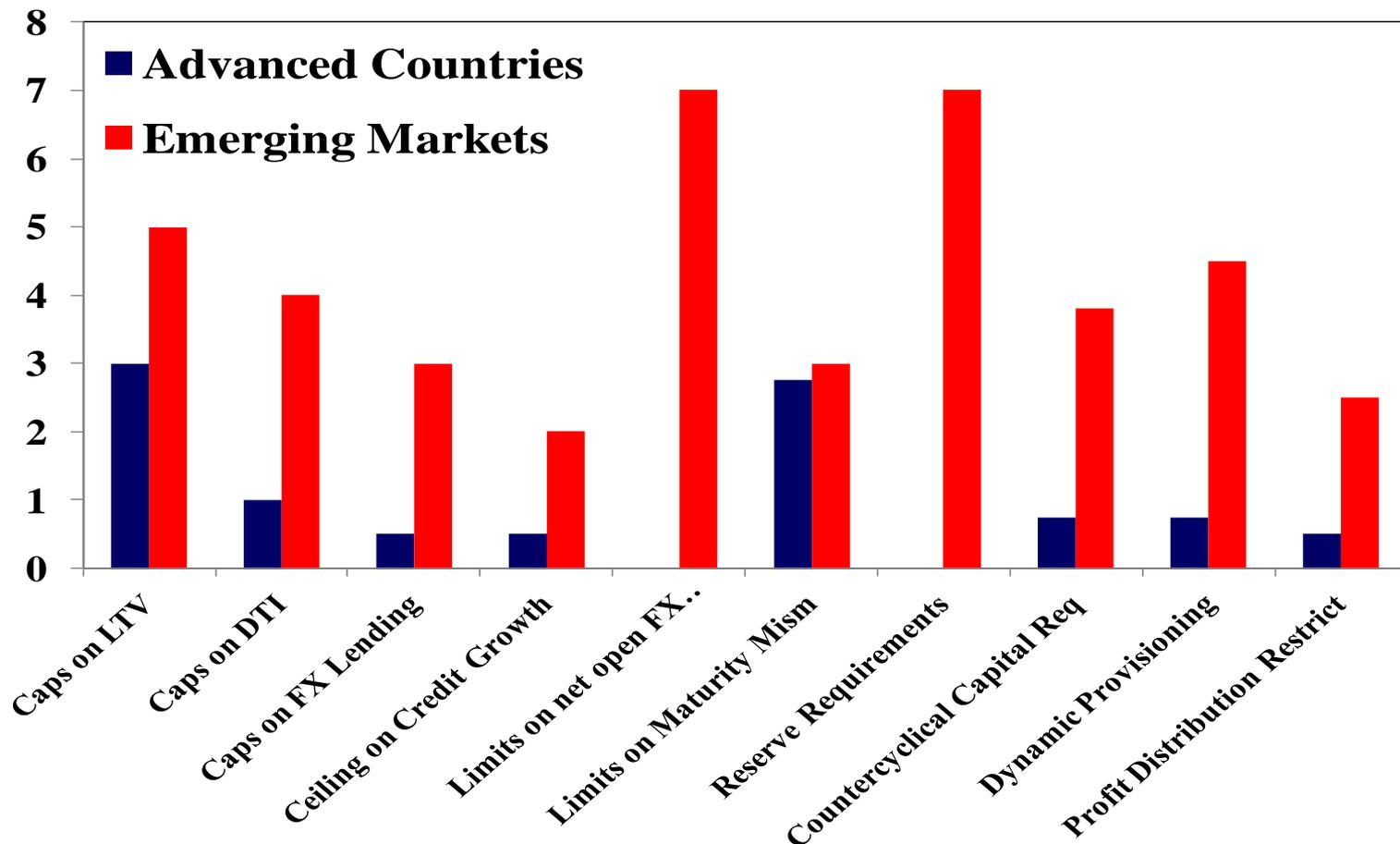
# Many EMEs have instituted macroprudential measures to curb flows and strengthen resilience of financial sectors

## Policy responses to capital flow volatility in select EMEs

Country	Policy responses			
	<i>Fx flexibility</i>	<i>Fx intervention</i>	<i>Macroprudential measures</i>	<i>Capital flow management</i>
<b>Brazil</b>	Yes	Yes	Yes	Yes
<b>Colombia</b>	Yes	Yes	Yes	No
<b>India</b>	Yes	Yes	Yes	No
<b>Indonesia</b>	Yes	Yes	Yes	Yes
<b>Korea</b>	Yes	Yes	Yes	No
<b>Mexico</b>	Yes	Yes	Yes	No
<b>Russia</b>	Yes	Yes	No	No
<b>South Africa</b>	Yes	Yes	Yes	Yes

# Many EMEs have instituted macroprudential measures to curb flows and strengthen resilience of financial sectors

Percent of countries using MaPP instrument



Source: Claessens, S. & Ghosh, S. (2013) 'Capital Flow Volatility and Systemic Risk in Emerging Markets: The Policy Toolkit', in Canuto & Ghosh (ed) (2013) *Dealing with the Challenges of Macro Financial Linkages in Emerging Markets*, World Bank Study; based on IMF internal country economist survey for 48 countries (both ACs and EMs)

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# Towards a multi-layered global financial safety net

## ➤ Lessons from the crisis

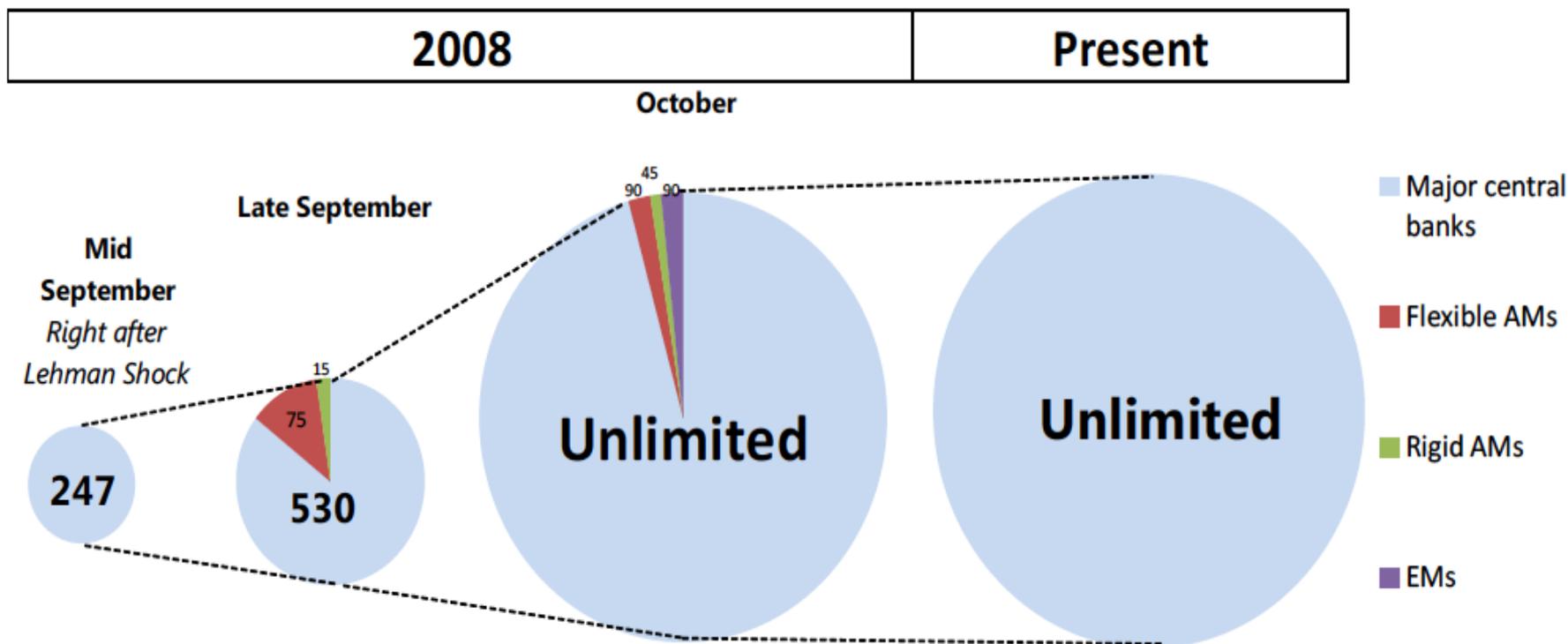
- Need for strong firewalls
- Importance of early action

## ➤ Since the crisis, there has been progress on multiple fronts

- Central bank swap arrangements
- Regional financing arrangements (RFAs)
- Build-up of international reserves
- Augmentation of IMF instruments and resources

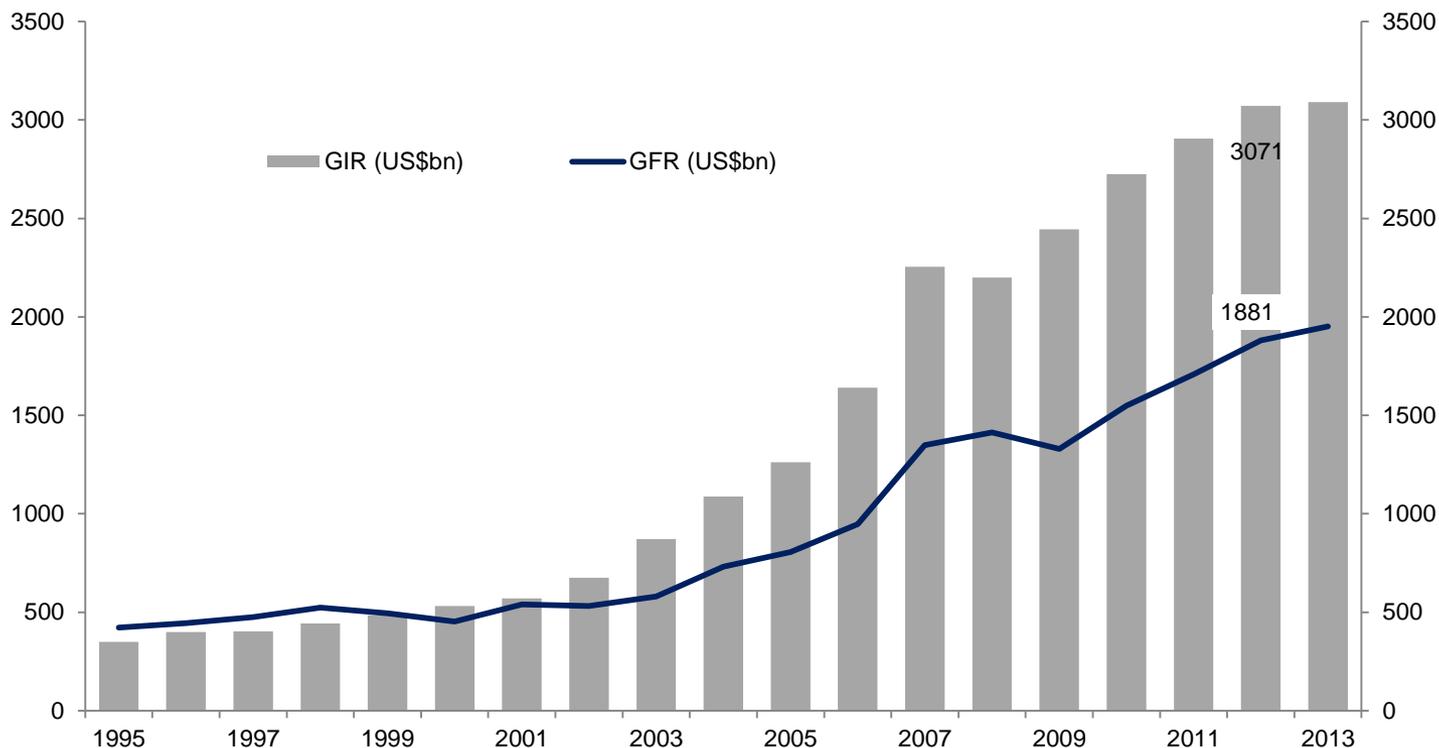
# Swaps amongst major central banks have been greatly strengthened, but EMEs have not felt the benefits

## Allocation and Access in U.S. Dollar Swap Lines (USD Billion)



# There has been a significant build up of reserves in EMs...

## Selected EMs ( excl China) plus Korea: GFR and GIR, 1995-2013



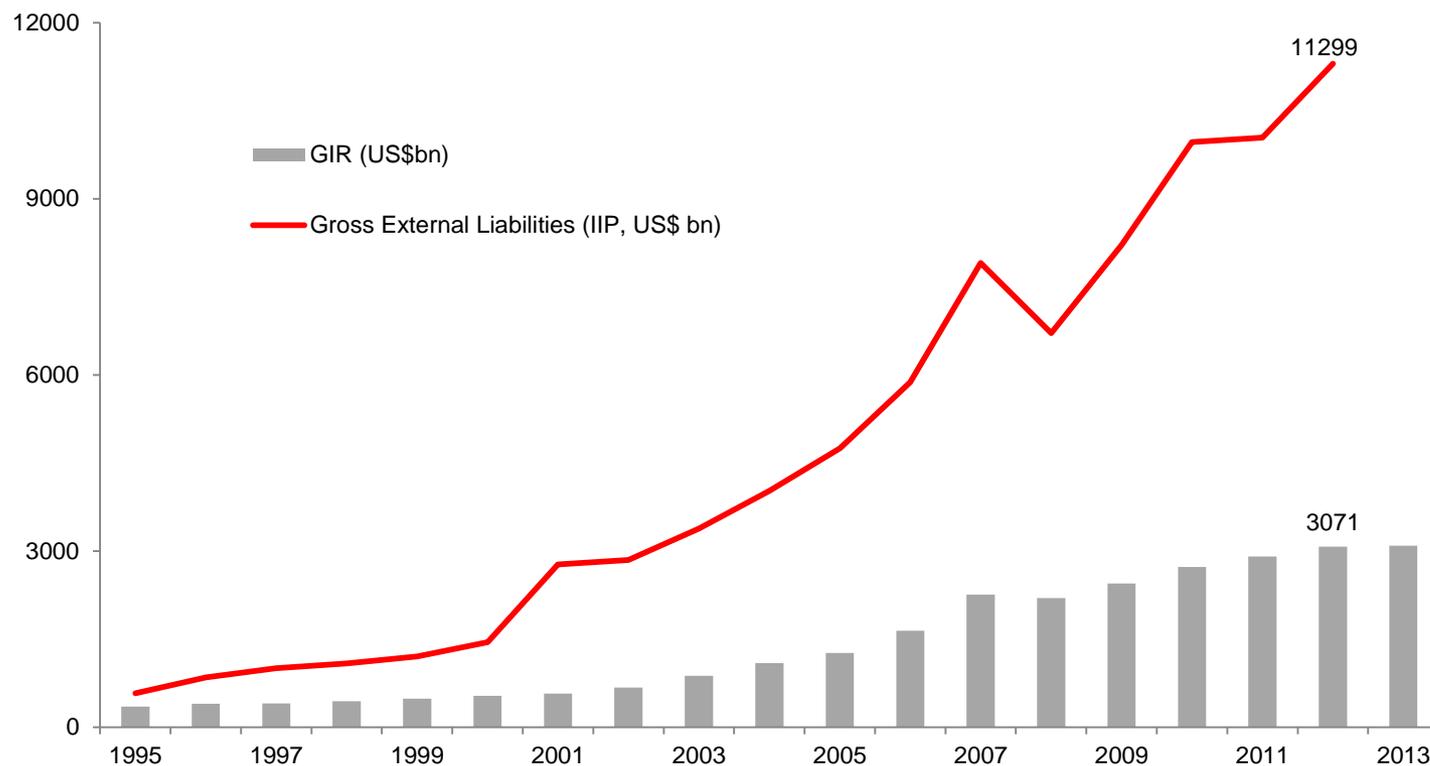
Source: IMF staff calculations based on WEO and IFS (2013)

1/ Gross financing requirement (GFR) equals current account deficit plus STdebt on a remaining maturity basis.

2/ Countries include: Turkey, Argentina, Indonesia, Ukraine, South Africa, Mexico, Malaysia, Lebanon, Hungary, Poland, Romania, Belarus, Croatia, Panama, Latvia, Venezuela, Lithuania, Chile, Pakistan, Bulgaria, Morocco, Sri Lanka, Tunisia, Jamaica, Georgia, El Salvador, Macedonia, Bosnia-Herzegovina, Guatemala, Dominican Republic, Ecuador, Costa Rica, Brazil, Colombia, Egypt, India, Peru, Russia, Thailand, Albania, Algeria, Jordan, Kazakhstan, Serbia, Uruguay, Vietnam. and Korea

# ...but these are still modest compared to the increase in external liabilities

## Selected EMs (excl China) plus Korea: Gross IIP and GIR, 1995-2013



Source: IMF staff calculations based on WEO and IFS (2013)

1/ Gross External Liabilities based on BPM 6 definition for data after 2004 .

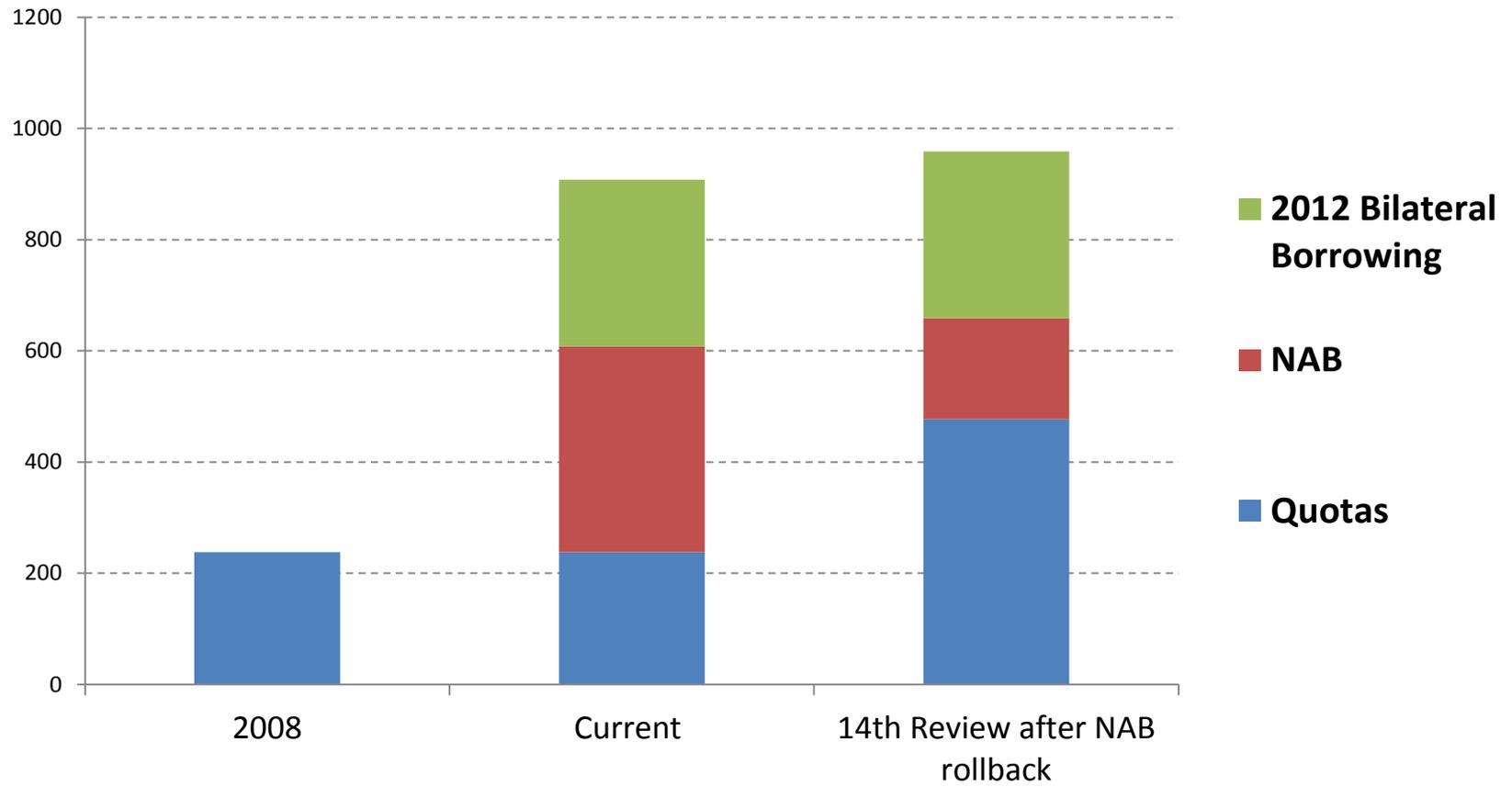
2/ Countries include: Turkey, Argentina, Indonesia, Ukraine, South Africa, Mexico, Malaysia, Lebanon, Hungary, Poland, Romania, Belarus, Croatia, Panama, Latvia, Venezuela, Lithuania, Chile, Pakistan, Bulgaria, Morocco, Sri Lanka, Tunisia, Jamaica, Georgia, El Salvador, Macedonia, Bosnia-Herzegovina, Guatemala, Dominican Republic, Ecuador, Costa Rica, Brazil, Colombia, Egypt, India, Peru, Russia, Thailand, Albania, Algeria, Jordan, Kazakhstan, Serbia, Uruguay, Vietnam. and Korea

# Overview of select RFAs

Arrangement	Resource size	Size relative to GDP (2011, percent)	Size relative to IMF quota (2011, percent)	Link to IMF
<b>Arab Monetary Fund (AMR)</b>	Authorized capital of US\$2.7 billion	0.1	10.9	No explicit link
<b>Latin American Reserve Fund (FLAR)</b>	Subscribed capital of US\$2.34 billion	0.2	29.2	No explicit link
<b>North America Framework Agreement (NAFA)</b>	US\$9 billion	0.1	10.9	US Treasury Secretary requires letter from IMF Managing Director stating confidence in the borrower's policies.
<b>European Financial Stability Facility (EFSF)</b>	Maximum lending capacity €440 billion at time of establishment	4.7	702.4	Framework Agreement envisages that financial support shall be provided in conjunction with the IMF
<b>European Stability Mechanism (ESM)</b>	Maximum lending capacity is €500 billion (combined lending capacity of EFSF/ESM is €700 billion)	5.6	798.1	A euro area Member State requesting financial assistance from ESM is expected to address, wherever possible, a similar request to the IMF
<b>Chiang Mai Initiative Multilateralization (CMIM)</b>	US\$120 billion (to be increased to US\$240 billion when the amended Agreement takes effect)	0.8 (planned increase to 1.6)	219.1 (planned increase to 438.2)	Disbursement of an amount in excess of 20 percent of the maximum access is conditional on the existence of a Fund-supported program (planned increase to 40%)

# IMF resources have been augmented, but inadequately so

Size of the Fund (SDR billions)



Source: IMF (2013)