Global Liquidity and Emerging Economies

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Figure 1. Boundary for national income accounting defines “economic territory”
Figure 2. Boundary for national income accounting defines decision-making unit
Figure 3. Boundary for national income accounting defines exchange rates as relative prices across boundary.
Figure 4. Boundary for national income accounting defines balance of payments and external claims/liabilities.
Figure 5. Boundary for national income accounting defines reach of monetary policy; floating exchange rates ensures monetary policy autonomy.
Chinese corporate

Hong Kong bank

Parent bank or wholesale funding market

RMB deposit as collateral for USD loan

Figure 6. US dollar funding of Chinese corporate via Hong Kong bank
Figure 7. HK Banks’ Positions vis-à-vis Non-Bank Customers in Mainland China in Foreign Currencies (Source: Hong Kong Monetary Authority)
Figure 8. International debt securities outstanding (all borrowers) from China by nationality and by residence (Source: BIS Debt Securities Statistics, Table 11A and 12A)
Figure 9. International debt securities outstanding (all borrowers) from Brazil by nationality and by residence (Source: BIS Debt Securities Statistics, Table 11A and 12A)
Figure 10. Schematic of Indian corporate borrowing in international capital market
Figure 11. International debt securities outstanding for non-financial corporates from India by nationality and by residence (Source: BIS Debt Securities Statistics, Table 11D and 12D)
Figure 12. **Non-financial firms as intermediary.** In this diagram, firms with access to international capital markets act as an intermediary for outside funding when the banking sector has restricted access to international capital markets.
Figure 13. Net “external” financing of emerging economies (Source: Turner (2013), data from BIS banking and security statistics)
Figure 14. Non-financial corporate international debt securities outstanding for developing economies (Source: BIS debt securities statistics, Table 12D)
Figure 15. Source: Philip Turner (2014) BIS working paper 441
Impact on Emerging Economies

- EME local currency bond yields
  - fell in tandem with advanced economy bond yields
  - began to move in lock-step with advanced economy bond yields

- Explosion of EME corporate bond issuance activity, especially offshore issuance
  - Implications for domestic monetary aggregates and potential for runs of wholesale deposits
  - Currency mismatch on consolidated corporate balance sheets

- Transmission channel is reinforced by exchange rate changes
Likely Elements in Crisis Dynamics

1. Sharp steepening of local currency yield curve

2. Currency depreciation, corporate distress, freeze in corporate CAPEX, slowdown in growth

3. Runs of wholesale corporate deposits from domestic banking sector

4. Asset managers cut back positions in EME corporate bonds citing slower growth in EMEs

5. Back to Step 1, and repeat...
Unfamiliar Problems

- Asset managers (not banks) are at the heart of transmission mechanism in the Second Phase of Global Liquidity

- Textbooks say long-term investors are benign, not a force for destabilization

- How do we adjust to the new world?