International Monetary System Challenges and Reforms

Hitotsubashi University and the IMF Regional Office for Asia and the Pacific Joint Seminar

The Future of International Monetary System for Asia

March 8-9, 2017

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The IMS has displayed great strength

Supported strong broad-based income growth

Facilitated unprecedented economic integration

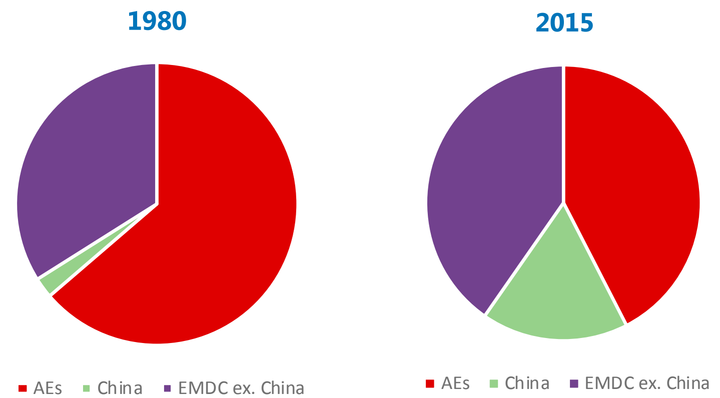
Evolved to provide greater resilience to shocks, and

Needs to continue evolving with the global economy

The world is increasingly multipolar…

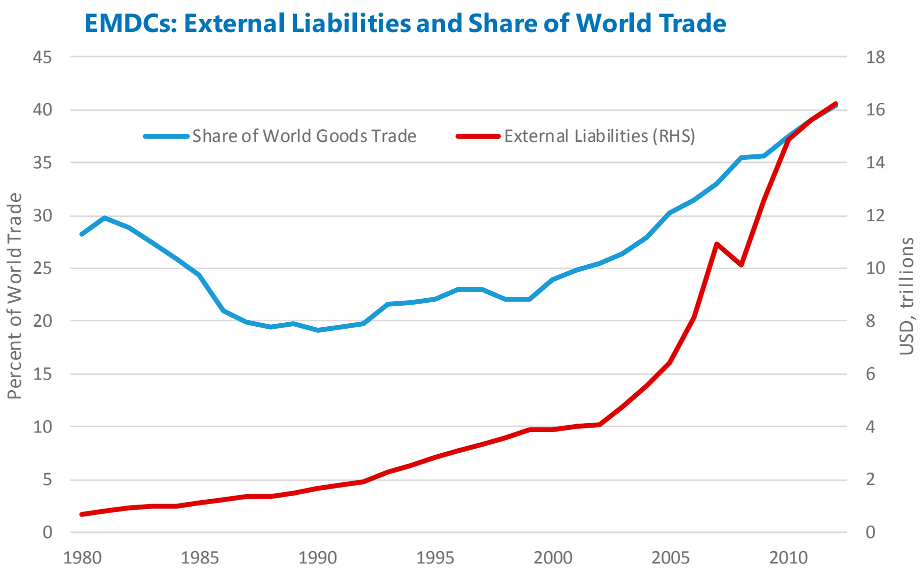
The center of economic 'gravity' is shifting to EMDCs…

Share of World GDP 1/



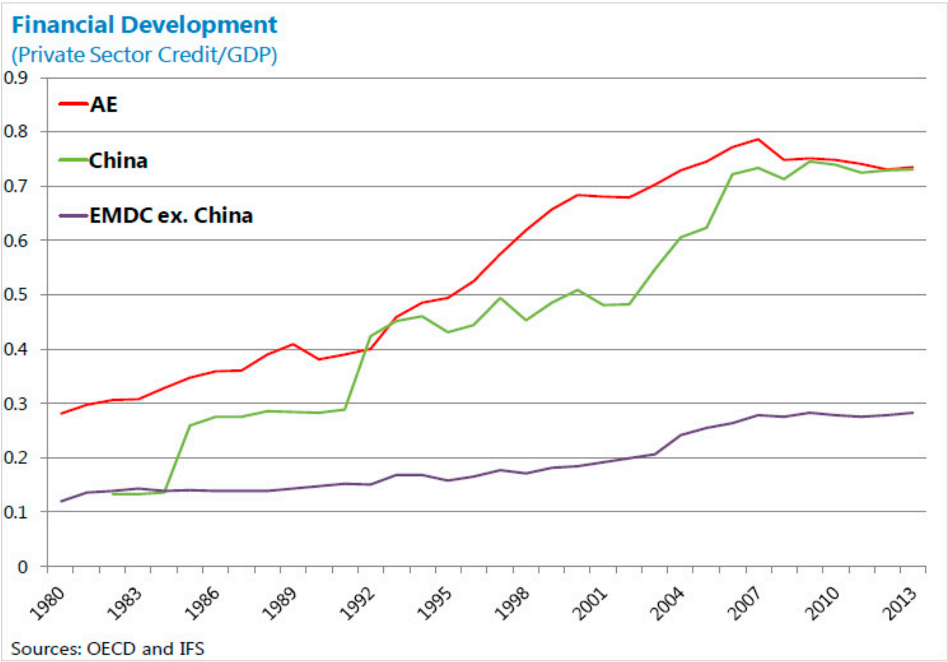
1/ US$ GDP in PPP exchange rates.

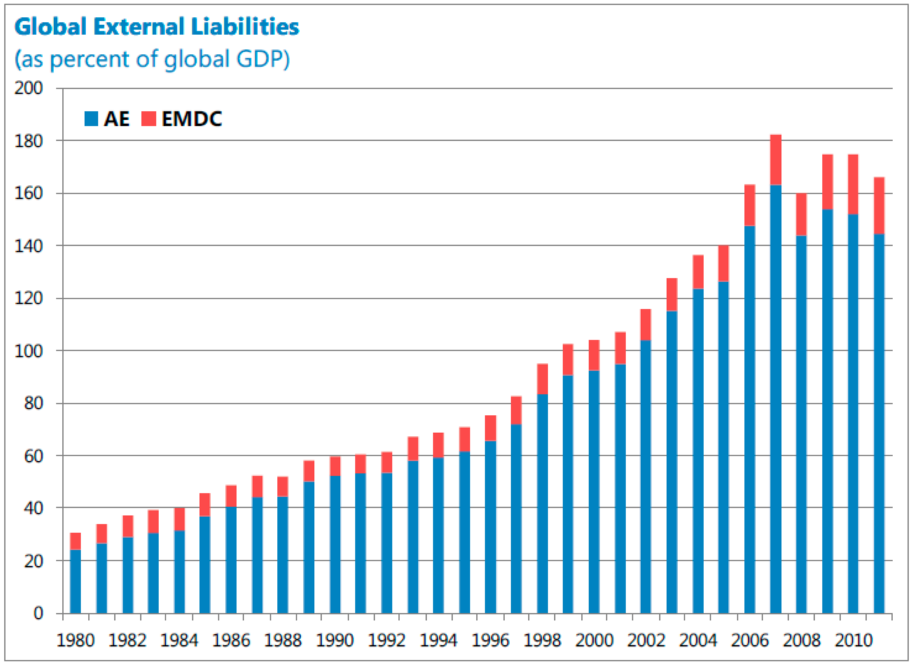
EMDCs are increasingly integrated into the global economy



…and has become financially interconnected

Financial deepening, especially in advanced economies	Contributed to large cross-border flows and liabilities



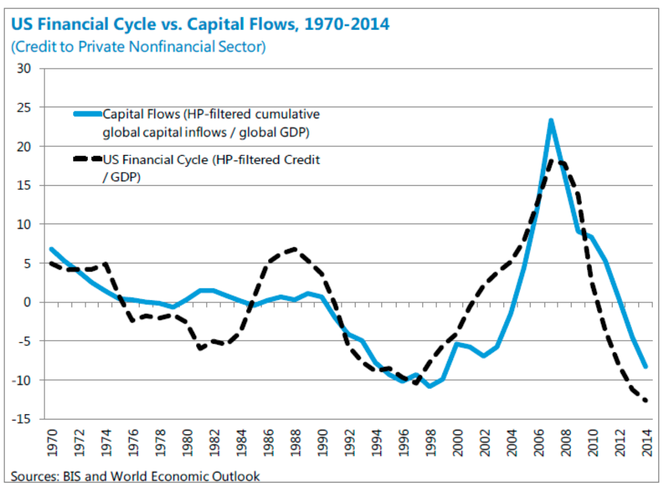


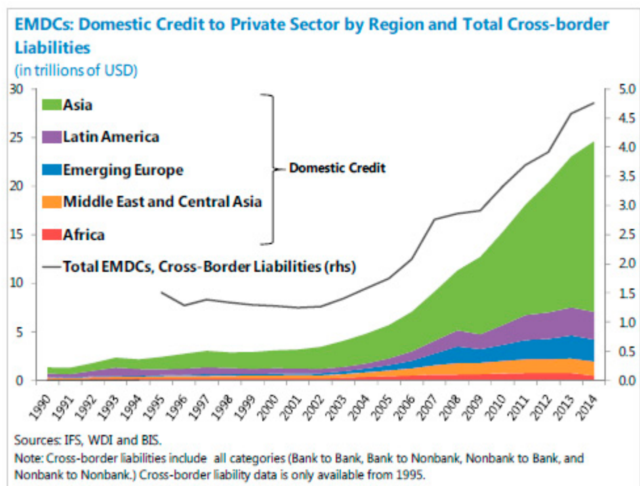
Synchronized financial cycles and volatile capital flows…

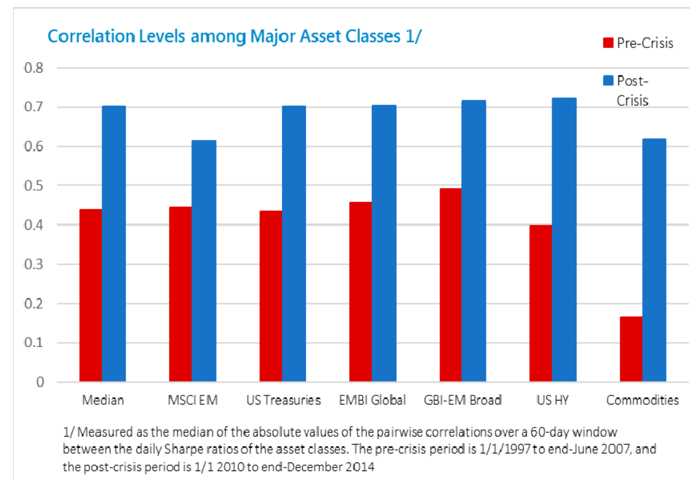
Financial cycles in large economies generate cyclical global capital flows…

…fueling domestic credit cycles across the world…

…and a high degree of synchronization







…complicate macroeconomic management

Trade-offs between macro stabilization and financial stability

Higher risk of systemic liquidity crises with large and rapid spillovers

Large demand for safe liquid assets

Dependence on domestic policies of few reserve currency issuers

…exacerbated by conjunctural shifts

Tight and volatile financial conditions

Slow productivity growth and demographic challenges

Impaired bank and corporate balance sheets

China rebalancing

Asynchronous normalization of monetary policy in main reserve issuers

End of the commodity super cycle

Imperfections of the IMS exposed

Weak Global Adjustment Mechanisms	Regulatory Gaps
Multilayered Global Financial Safety Net	Few Internationalized Currencies

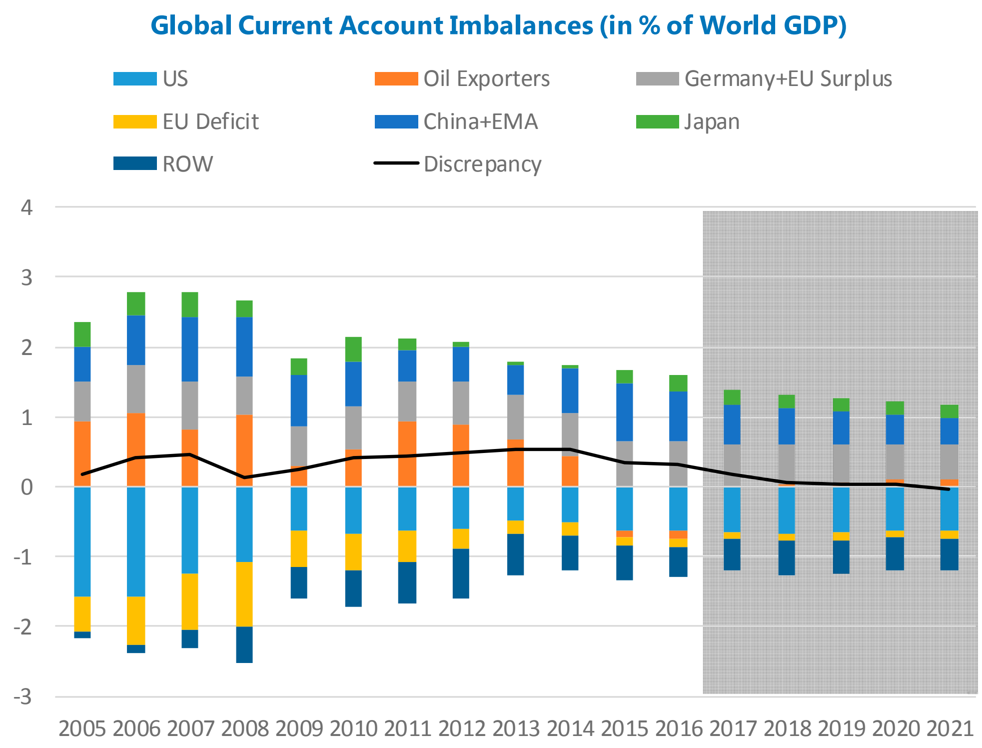
Weak global adjustment mechanisms

Lopsided adjustment since the global crisis…

Current account imbalances have narrowed since the crisis…

…but mainly through demand compression in deficit countries…

…with exchange rates playing a limited role

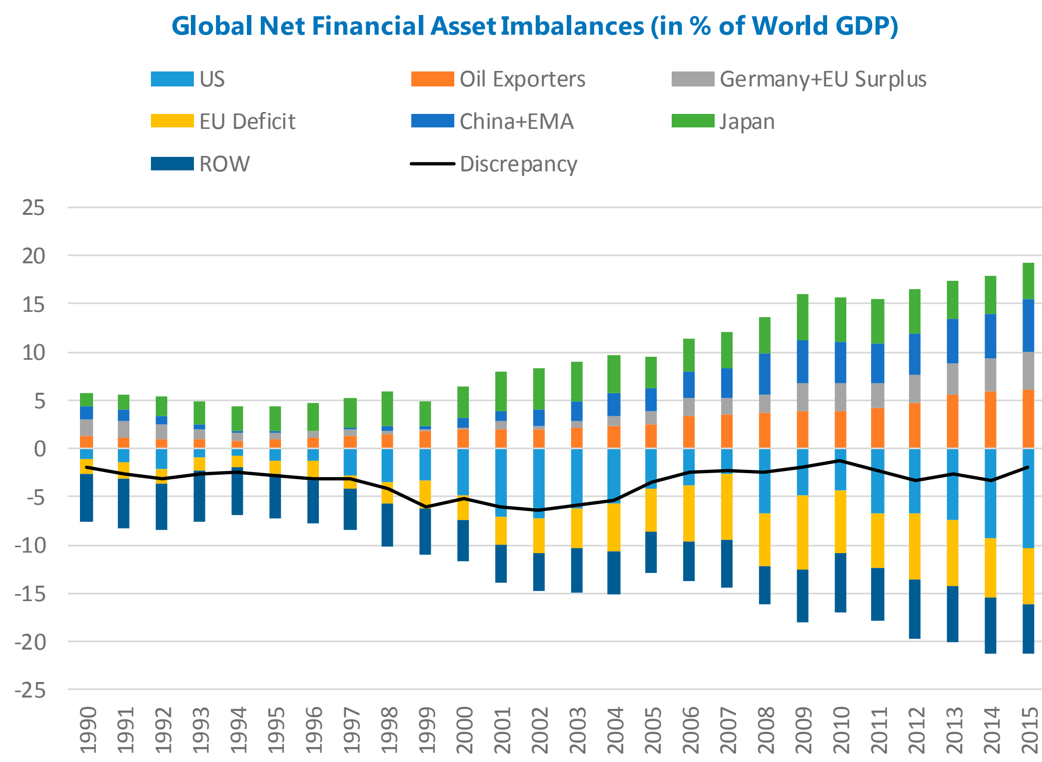


…has contributed to financial imbalances

Low growth in deficit countries…

…has contributed to a widening of stock imbalances

Expansionary monetary policies have fueled balance-sheet mismatches and asset price inflation



Regulatory Gaps

No global oversight of capital flows…

Capital flows dwarf other cross-border flows…

…and can provide significant direct and indirect benefits but…

…they can lead to a build up of vulnerabilities…

…exposing countries to the risk of destabilizing outflows

…with partial global financial regulation

Local regulation alone is not effective

Inadequate coordination opens room for circumvention

Uneven regulation could lead to regulatory arbitrage

The rise of nonbanks leads to new systemic risks

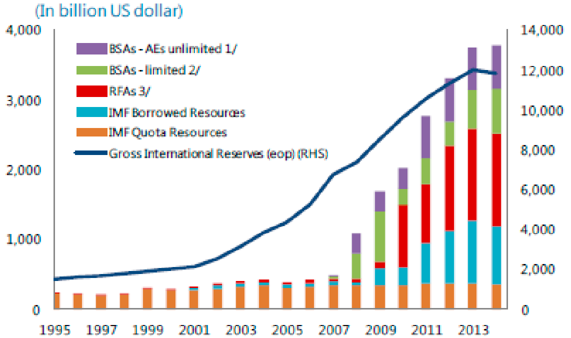
Multi-layered Global Financial Safety Net

Larger, but multi-layered with uneven coverage

GFSN expanded significantly since the global crisis

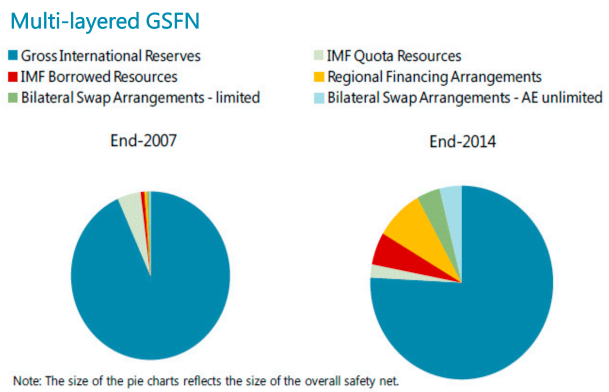
…and is multi-layered

…with uneven coverage

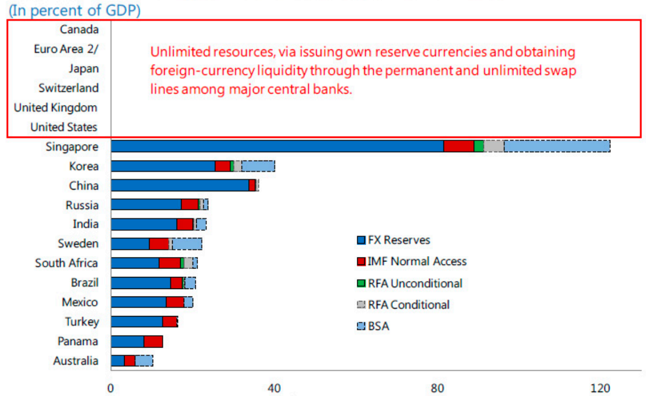


1/ Unlimited swap arrangements are estimated based on known past usage or, if undrawn, on average past maximum drawings of the remaining central bank members in the network. Two-way arrangements are only counted once.
2/ Limited-value swap lines include all arrangements with an explicit value limit and exclude all CMIM and NAFA arrangements, which are included under RFAs. Two-way arrangements are only counted once.
3/ Based on explicit lending capacity/limit where available, committed resources, or estimated lending capacity based on country access limits and paid-in capital (see Figure 5).

Sources: Bank of England; Central Bank websites; and IMF staff estimates.



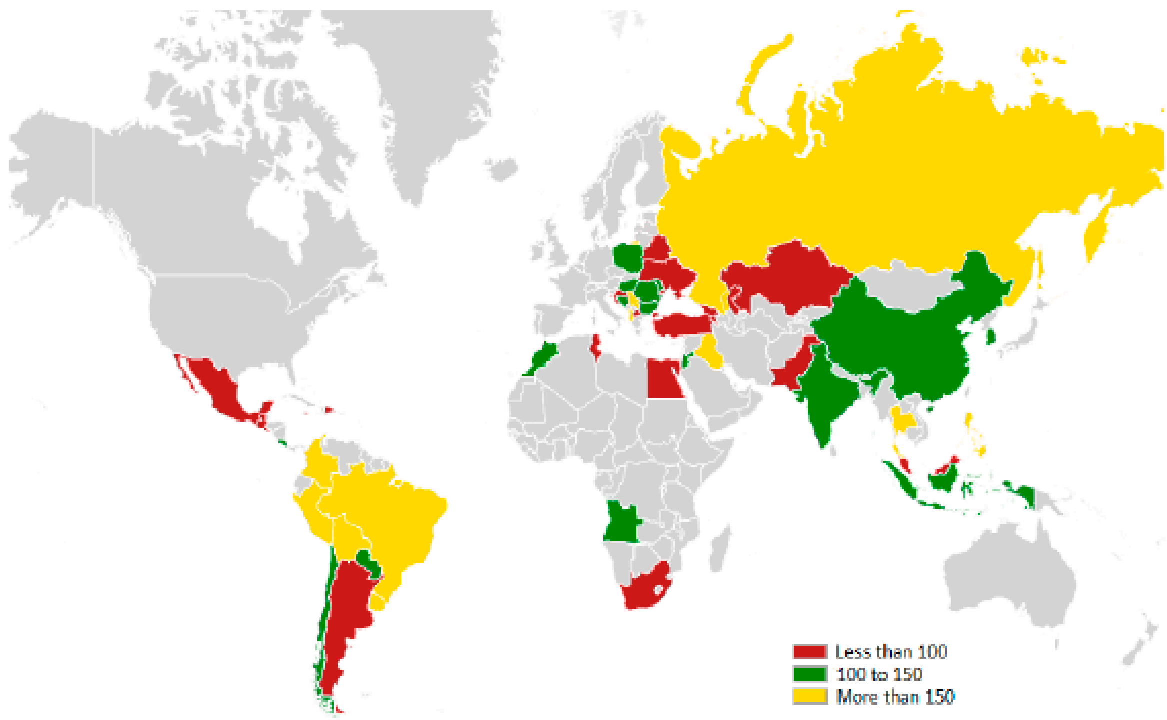
Note: The size of the pie charts reflects the size of the overall safety net.
Sources: Bank of England; and Fund staff estimates.



1/ The chart shows normal access to Fund resources for all countries--it does not take into account existing Fund arrangements with some of these countries.
2/ The ESM is currently limited and access to ECB liquidity support is subject to certain rules.
Source: IMF staff estimates.

Foreign Exchange Reserve Coverage for Emerging Markets (end-2015)

(Reserves in percent of ARA metric)



Source: IMF staff estimates.

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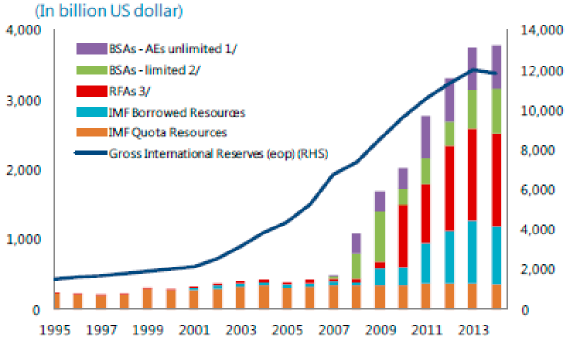
Evolution of the Global Financial Safety Net, 1995—2014
(In billion US dollar)



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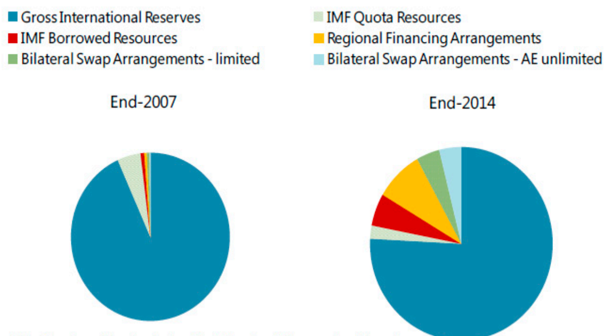
Multi-layered GSFN



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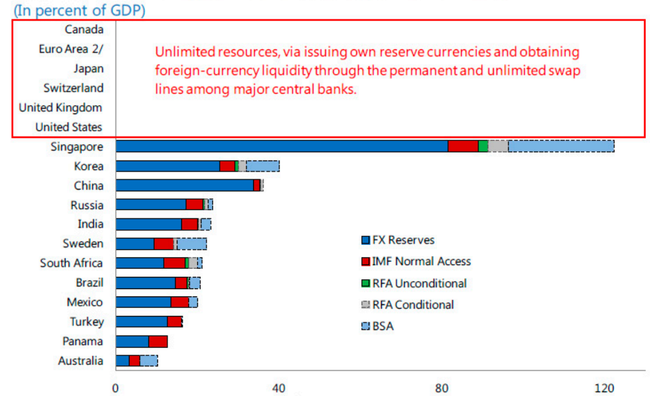
GFSN Resources for Systemic and Gatekeeper Economies 1/
(In percent of GDP)



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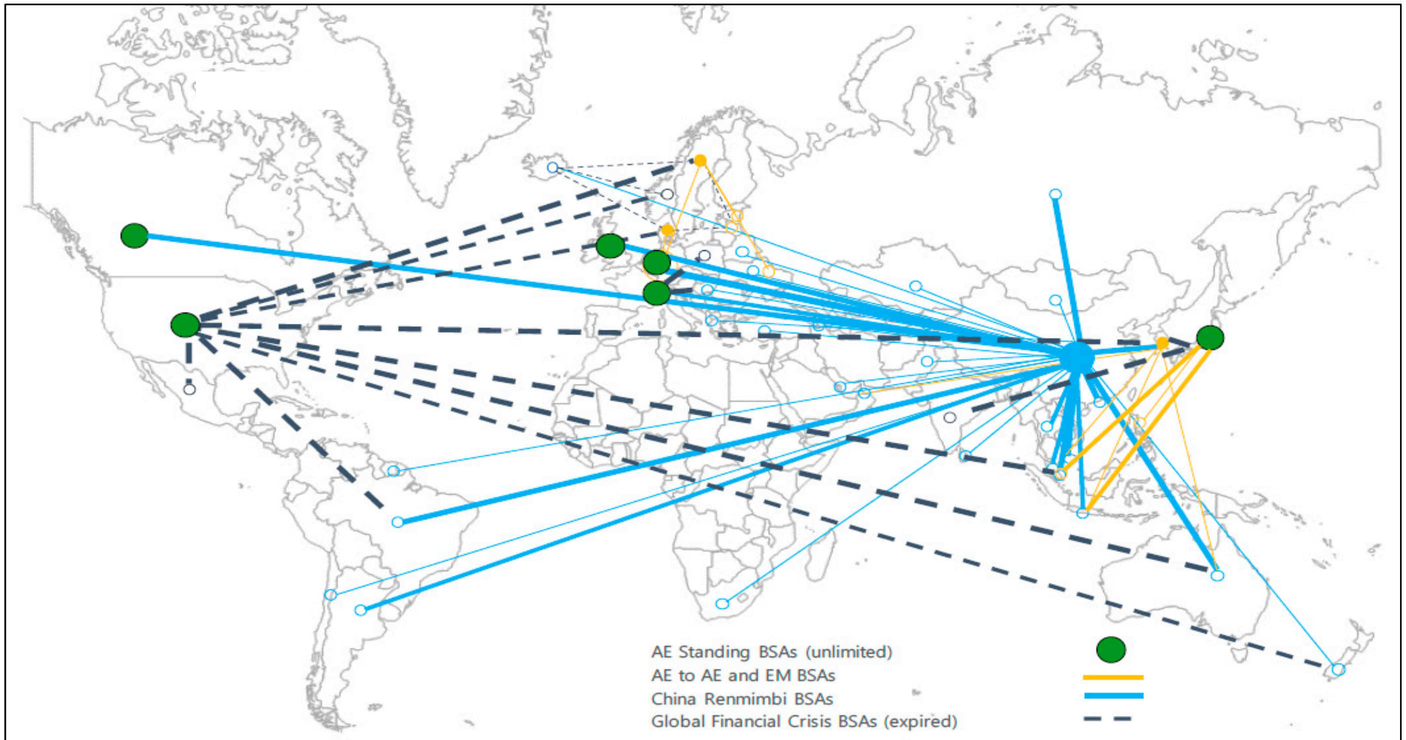
Central Bank Swap Arrangements (BSAs)



Note: The Global Financial Crisis BSAs denote swaps established or expanded during the 2008-09 period, which have subsequently expired and have not been replaced. For all the limited-value BSAs, line thickness denotes the maximum size of the arrangement in U.S. dollar terms.

Sources: Bank of England; and IMF staff estimates.

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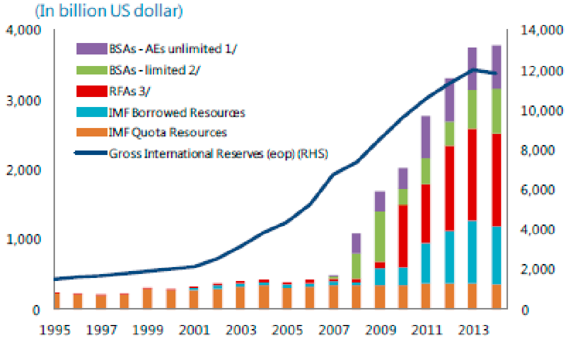

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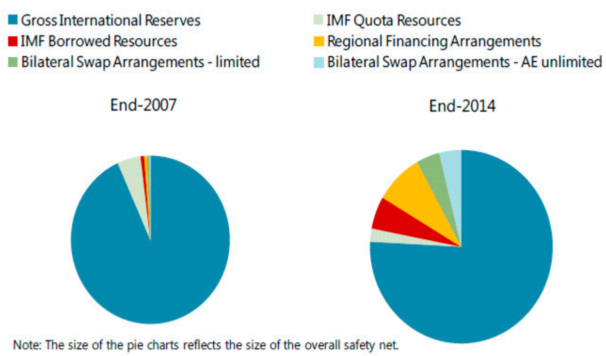

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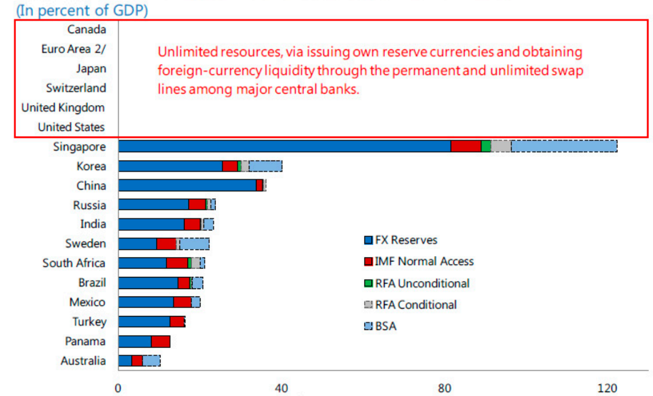

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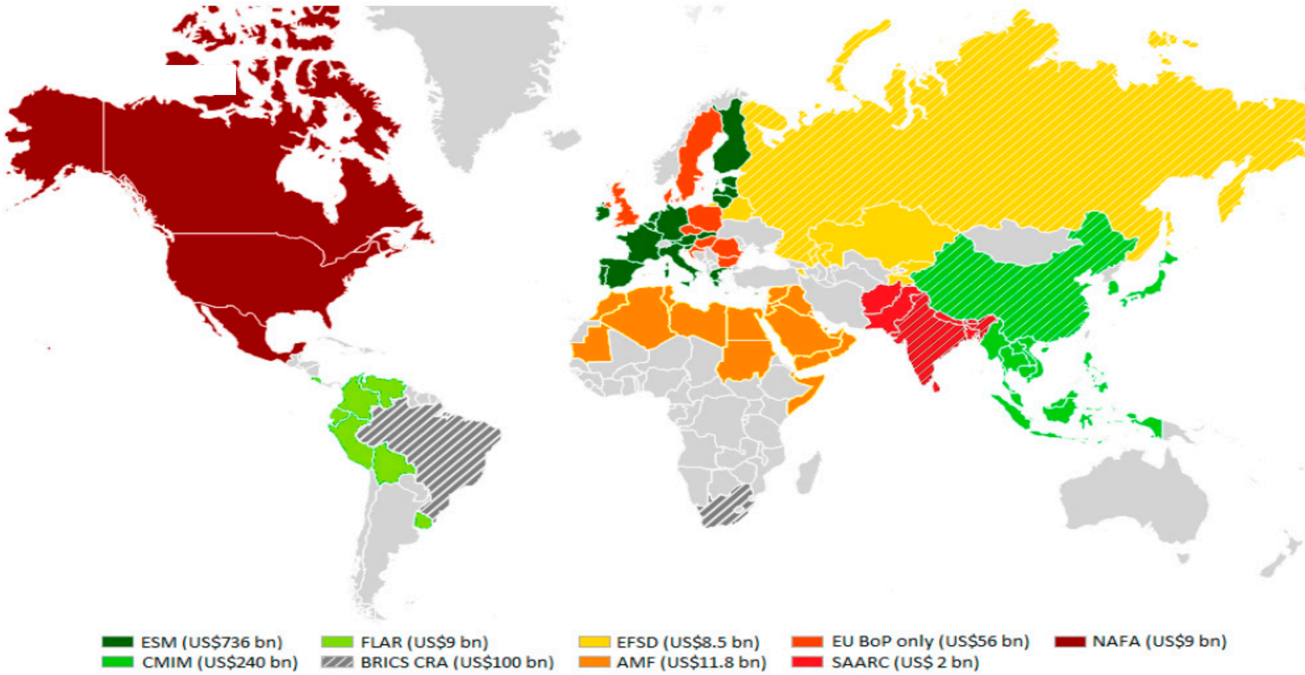
Regional Financial Arrangements (RFAs)



Note: The lending capacity of the RFAs (indicated in brackets) is the explicit capacity/limit where available (euro area and EU facilities, CMIM, NAFA, and SAARC), committed resources (BRICs CRA), or estimated capacity based on country access limits and paid-in capital (AMF, EFSD, and FLAR). The ESM figure also includes outstanding loans under the EFSF. RFAs are ranked based on their average coverage, measured as the RFA lending capacity in percent of the RFA GDP, from high coverage (dark green) to low coverage (dark red).

Source: IMF staff estimates.

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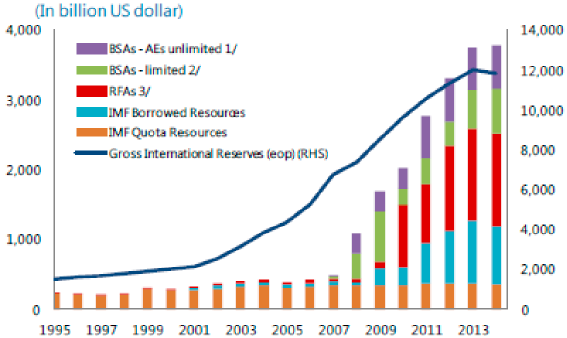

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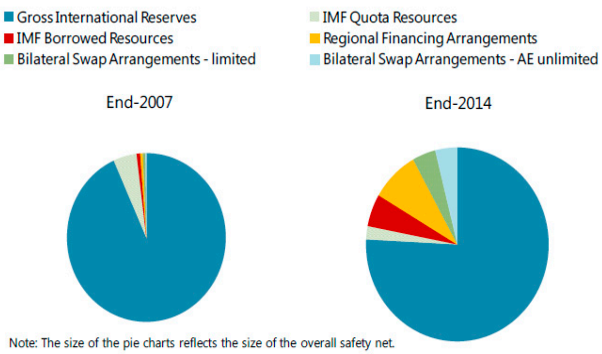

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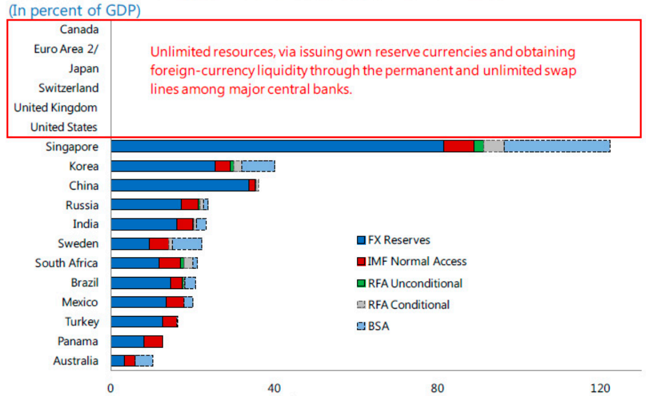

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With excessive reserve accumulation

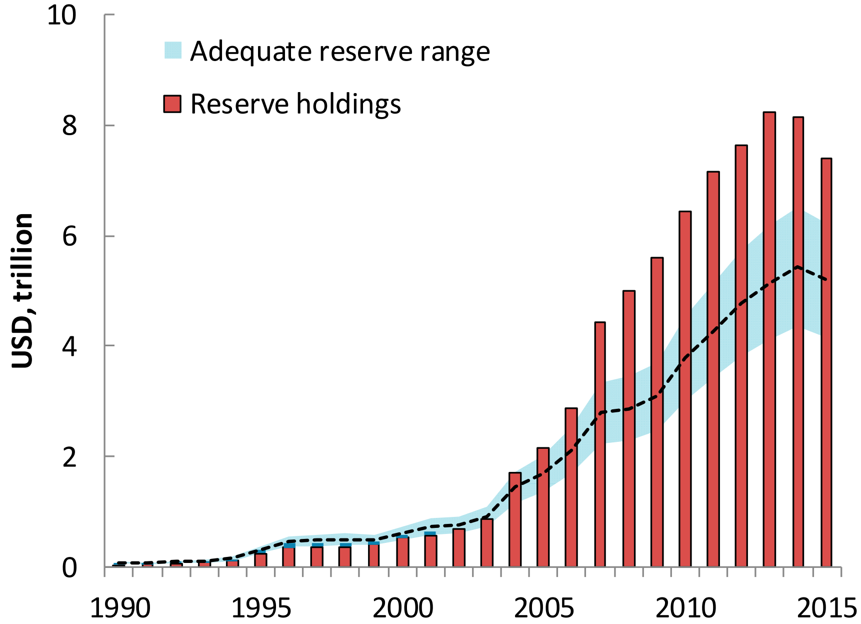
Systemic Costs

Holding reserves is costly

Reserve accumulation inhibits global re-balancing and...

...distorts capital to flow to the reserve issuers

EMDCs: Reserve Holdings and ARA metric



Source: IMF, International Financial Statistics; and Fund staff calculations.
Note: ARA metric is an IMF developed reserve adequacy measure that assesses an adequate level of reserves from a precautionary perspective.

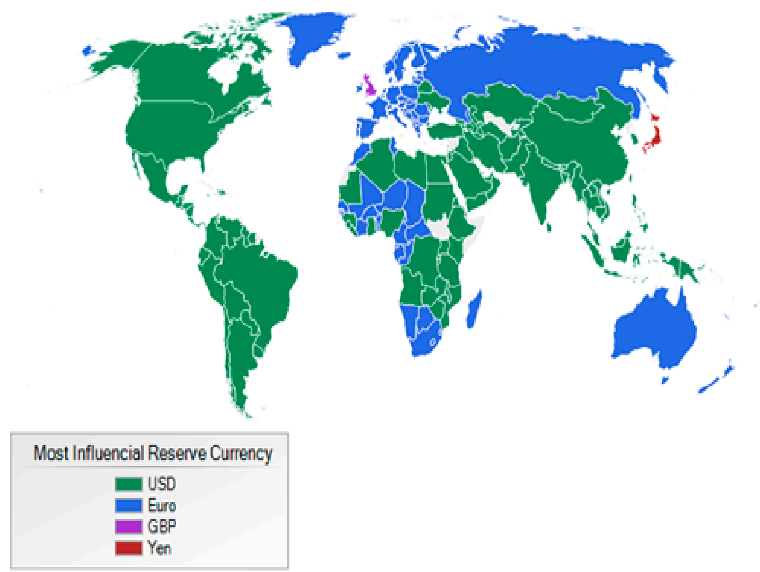
Reliance on few Internationalized Currencies

International transactions concentrated in few currencies

Benefit to the IMS as a whole, but

High exposure to domestic policies of reserve currency issuers

Zones of Influence of Main International Currencies



Sources: Haver Analytics; and IMF staff calculations.

Note: Shading reflects the international currency against which the country's currency is most stable, with the calculations performed by regressing changes in each currency against the change of the exchange rates of the major international currencies. The degree of influence of each currency is then determined using the corresponding regression coefficients.

How has the Fund responded?

Tools to facilitate rebalancing

- 2012 Integrated Surveillance Decision
  - Integrate better bilateral and multilateral surveillance
  - Improve coverage of spillovers from domestic policies
- External Sector Report
  - Multilaterally consistent assessment of external positions
- Early Warning Exercise and Vulnerability Exercises
  - Upgraded risk analysis
- G-20 Mutual Assessment
  - G-20 note—e.g., Strong Sustainable and Balanced Growth

Surveillance of capital flows and financial sector

- Adopt an Institutional View on capital flows (2012)
  - Sound macroeconomic policies are the first line of defense but
  - Capital flow measures may be warranted
  - 2016 review: more attention to capital flow reversals and policies in both source and recipient countries
- Mainstream macrofinancial surveillance
  - Highlight linkages between the financial sector and the economy
  - Greater focus on macroprudential policies
- Support global financial regulatory agenda

Overhaul Fund Facilities

New financing instruments—FCL and PLL…

…with higher and more frontloaded access

Rapidly disbursing instruments—RFI and RCF

Streamlined conditionality to reduce stigma

Work in progress…

New short-term liquidity facility

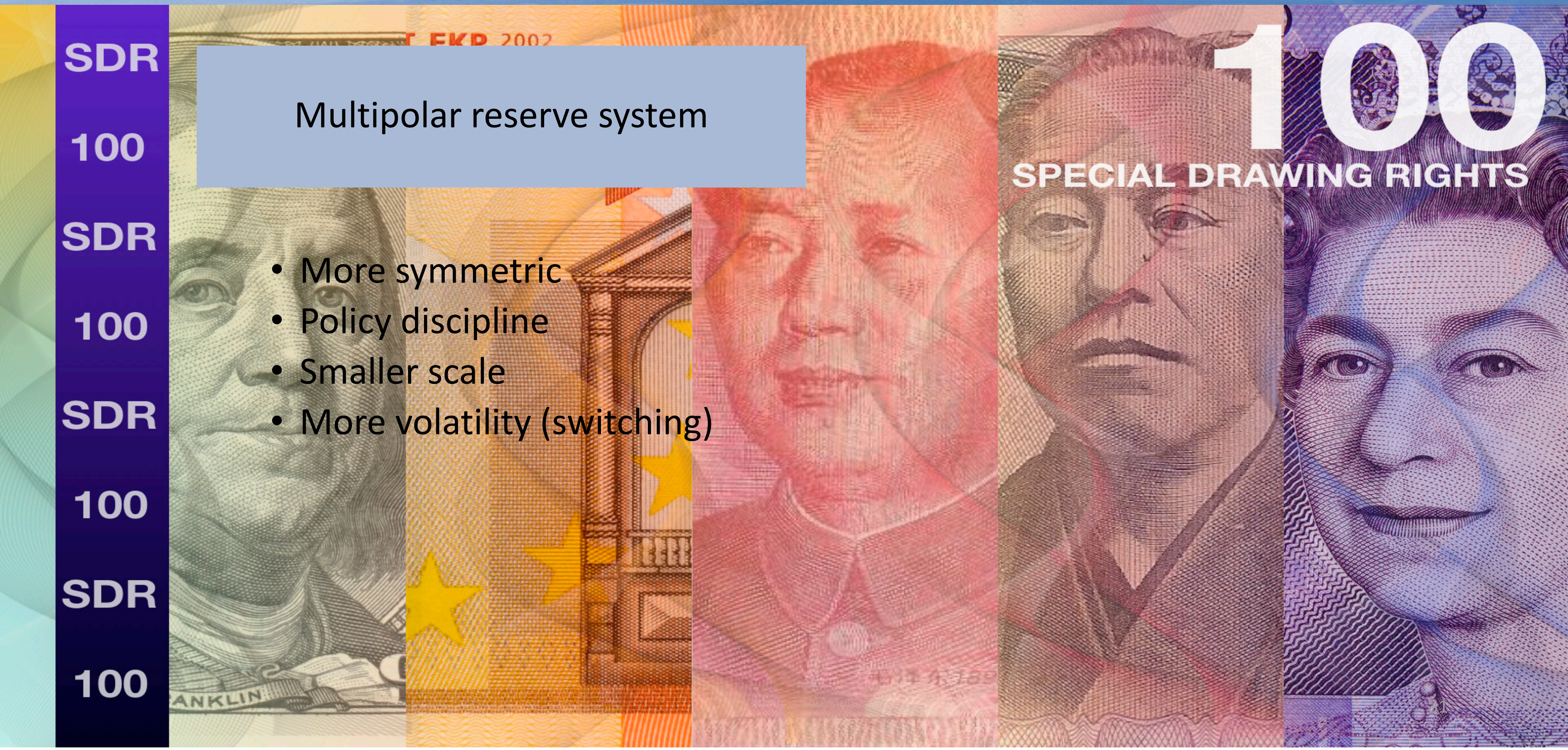
Non-financial policy monitoring instrument

Integrated view on macroprudential and capital flow measures

Completing the global financial regulatory agenda

Cooperation with RFAs—structured dialogue

The Future of the Reserve System—Any role for the SDR?



Multipolar reserve system

- More symmetric
- Policy discipline
- Smaller scale
- More volatility (switching)

O-SDR – unconditional official SDR

Benefits	Implementation challenges

Benefits

- Reduce precautionary demand for reserves
- Facilitate external adjustment
- Lower exposure to policies in reserve issuers

Implementation challenges

- Untargeted allocation of liquidity
- Moral hazard

M-SDR – financial market SDR-instrument

Benefits

- Diversification benefits: lower ER and interest rate risk
- Lower exposure to policies in reserve issuers

Implementation challenges

- Insufficient scale and liquidity
- Undeveloped ecosystem
- Basket revision risk

U-SDR – as unit of account

Benefits	Implementation challenges

Benefits

- Greater price stability to international transactions
- Enhanced adjustment of trade to exchange rates
- Smooth out valuation changes

Implementation challenges

- High transaction costs w/o settlement in SDRs
- Limited demand for data

Concluding thoughts: IMS reform needs

Improved cooperation to prevent/reduce global imbalances

Continued work on capital flows and global financial regulation

Stronger GFSN through better coordination

Adequately resourced Fund with facilities meeting member needs

Explore future role for the SDR