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

Alfred Kammer
Deputy Director
International Monetary Fund
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 center of economic 'gravity' is shifting to EMDCs...

EMDCs are increasingly integrated into the global economy
Financial deepening, especially in advanced economies

Contributed to large cross-border flows and liabilities

...and has become financially interconnected
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
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
- Impaired bank and corporate balance sheets
- Asynchronous normalization of monetary policy in main reserve issuers
- Slow productivity growth and demographic challenges
- China rebalancing
- 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
Current account imbalances have narrowed since the crisis...

...but mainly through demand compression in deficit countries...

...with exchange rates playing a limited role
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
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
GFSN expanded significantly since the global crisis

...and is multi-layered

...with uneven coverage
Foreign Exchange Reserve Coverage for Emerging Markets (end-2015)

(Source: IMF staff estimates.)

(Reserves in percent of ARA metric)
Larger, but multi-layered with uneven coverage

GFSN expanded significantly since the global crisis

...and is multi-layered

...with uneven coverage
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.
GFSN expanded significantly since the global crisis...

...and is multi-layered

...with uneven coverage
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.
GFSN expanded significantly since the global crisis

...and is multi-layered

...with uneven coverage
With excessive reserve accumulation

Holding reserves is costly

Reserve accumulation inhibits global rebalancing and...

...distorts capital to flow to the reserve issuers

**Systemic Costs**

**EMDCs: Reserve Holdings and ARA metric**

- **Adequate reserve range**
- **Reserve holdings**

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
Benefit to the IMS as a whole, but

High exposure to domestic policies of reserve currency issuers

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
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**

- 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
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