

Is the Functioning of the International Monetary System Responsible for the Crisis?



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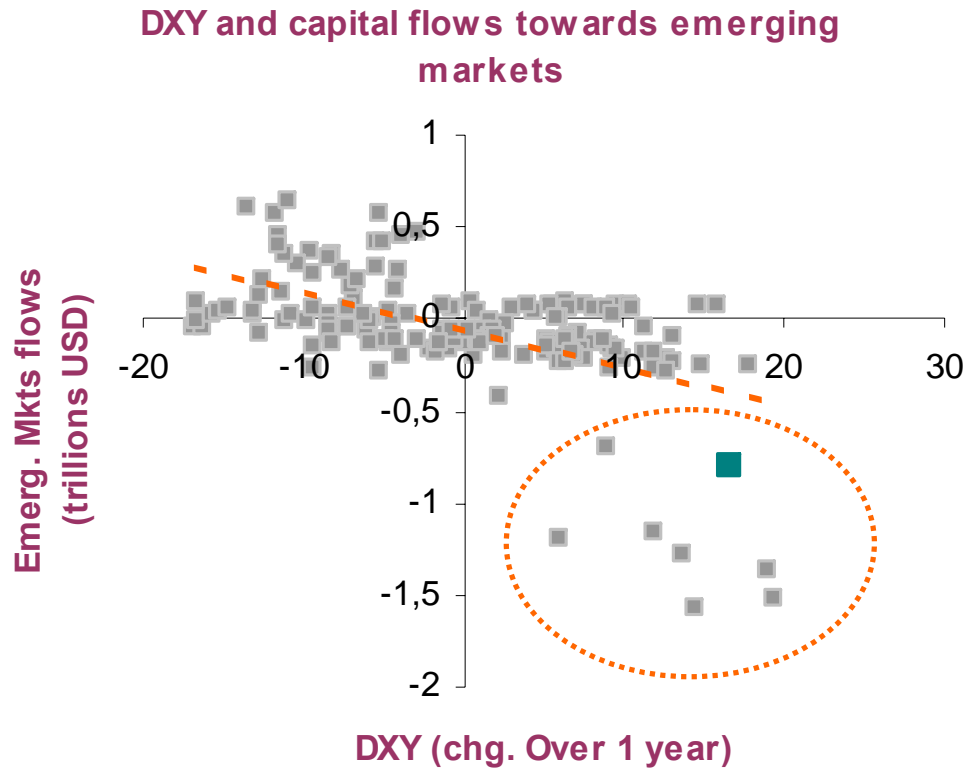
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"We should have a better system for reserve currency issuance and regulation, so that we can maintain relative stability of major reserve currencies exchange rates and promote a diversified and rational international reserve currency system," said Mr Dai, according to the Chinese foreign ministry. FT 7/10/2009

Overview Denying ?

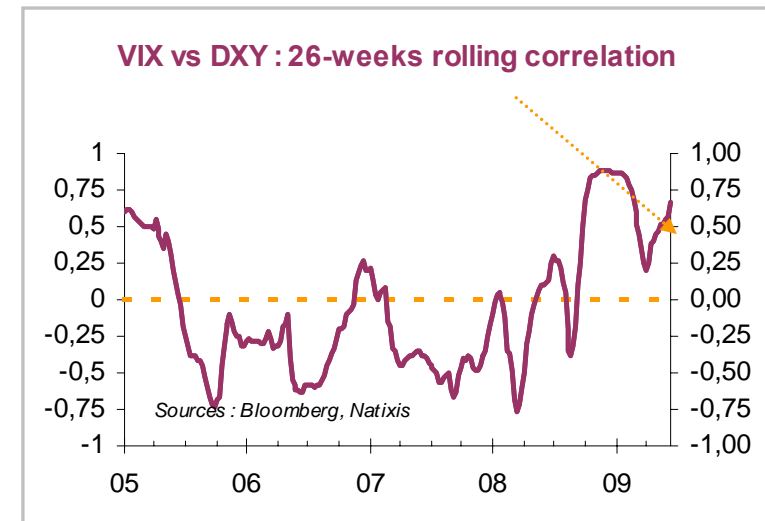
- **The Bretton Woods II story.**

1. **NBER 14731 – Dooley, Folkerts-Landau & Garber** : *“the crisis that we have was unexpected and not directly or indirectly caused by international imbalances that preceded it”*.



1. **The crisis triggered a strong inflow into US assets**

2. **Flight to safety, to quality?**



Overview

The well known causality chain

- **Conundrum and search for yield**

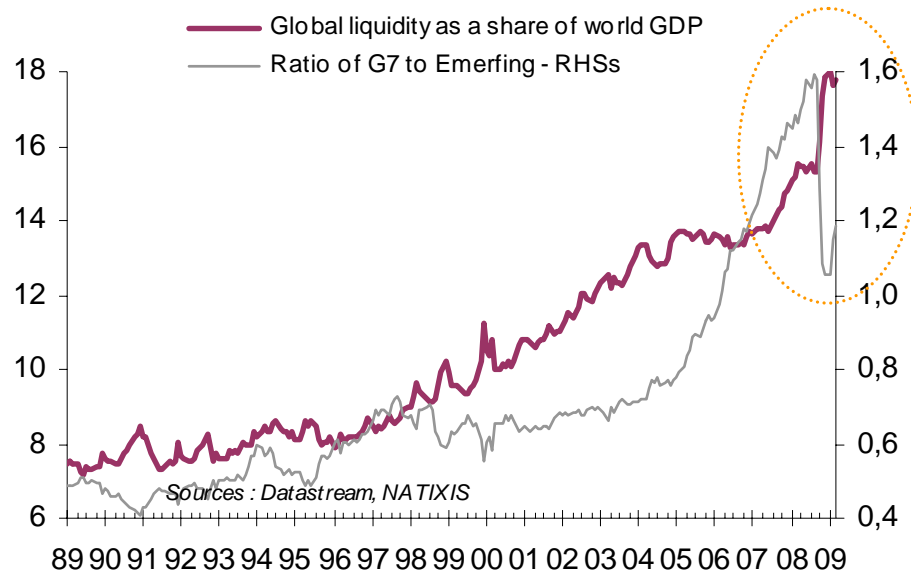
1. **Huge increase in global monetary base** : mostly **FX Reserve hoarding** as is shown in the relative contribution of Monetary base chart. Huge growth in asset prices, saving glut or not the outcome remains the same (leverage, risk appetite, ALM constraints...).

Guidotti Greenspan Rule

Ad hoc model by Obstfeld & al. (2008) taking into account

Likely reversal of capital flows
 Financial openness
 FX regime
 Monetary depth
 Trade balance

Global Liquidity ad relative contribution



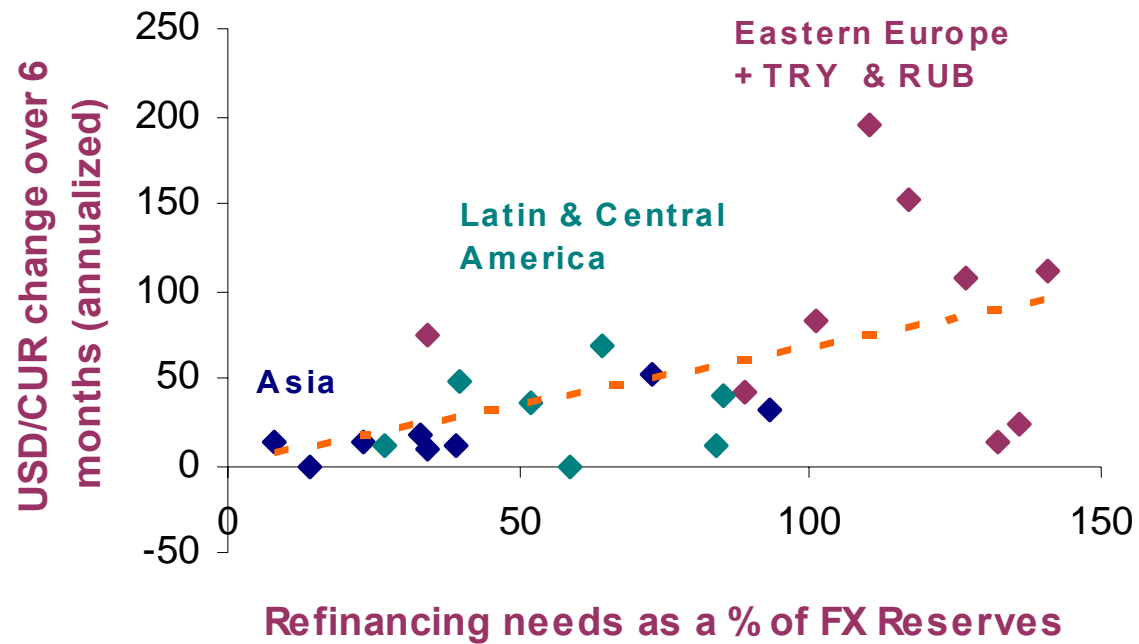
From sudden stop to sudden flight

Overview

Beyond the Greenspan Guidotti rule

- **Precautionary motive still holds ?**
External Debt Roll over risk well included in FX variation lately

Emerging Countries : Foreign Debt rollover and Exchange rates



Sources: IMF, Natixis

Overview

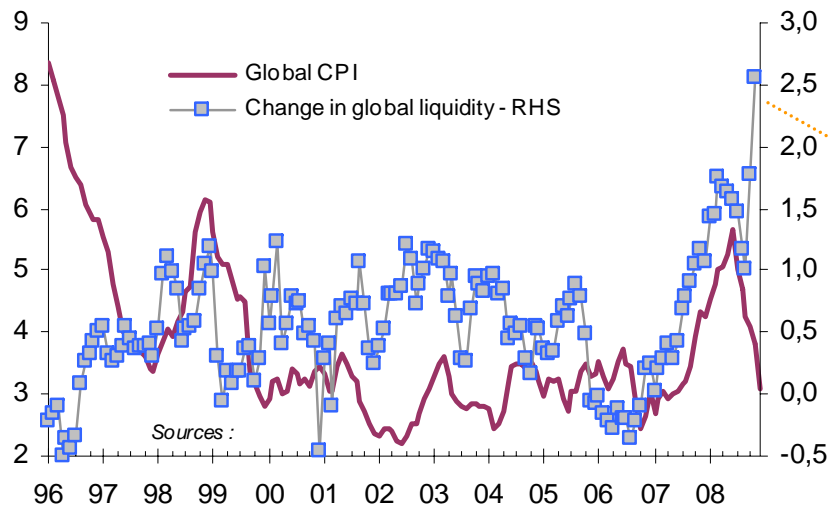
The well known causality chain

2. Non-inflationary growth:

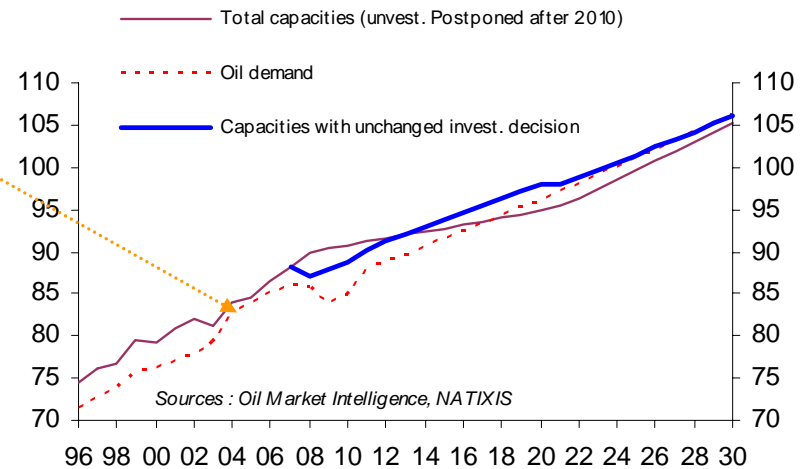
- large global capacities with a rise in I/Y ratio worldwide ;
- higher openness of advanced economies ;
- huge amount of excess (cheap) labor worldwide...

Monetary authorities caught between inflation targeting and asset-price bubbles (credit, commodities, stocks... bonds?) due to financial globalization : no natural limit to global liquidity growth.

A link between CPI and global liquidity ?



Global oil capacities
M/B/D

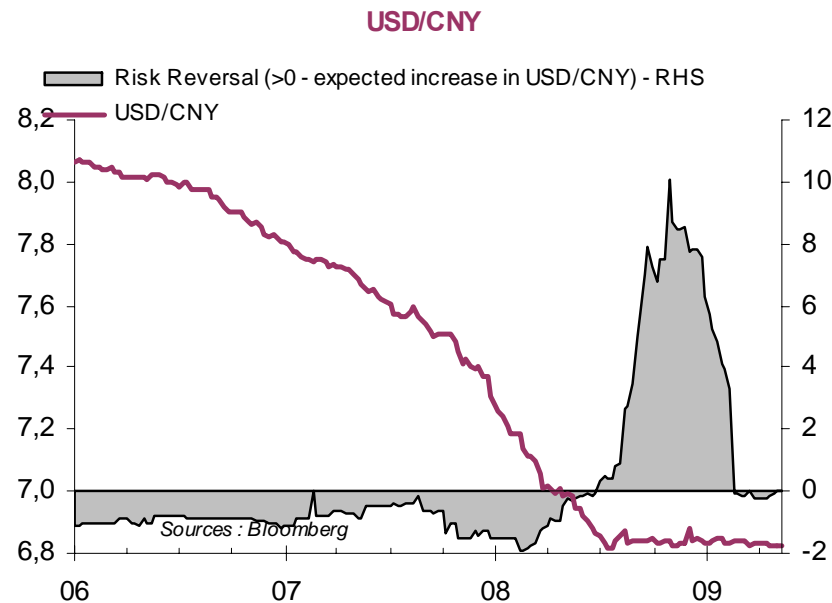


Overview

The well known causality chain

3. Hybrid exchange rate regime:

- Fear of floating vs loosing market shares... against China: a long lasting dollar area ?



OLD QUESTIONS, NEW CHALLENGES ?

Major hurdles to the control of global monetary base: beyond the fear of floating

1. Reserve Accumulation goes beyond the pure **precautionary motive**: is the extension of the IMF credit line a good incentive ?=> **Swap Lines** and **Flexible Credit Lines**.
2. Will **emerging countries** strive to **insulate themselves** further from future shocks ?

Central banks' swap agreements (USD bn)

	ECB*		FED		BOJ		Bank of China
Hungary	5	Brazil	30	South Korea*	20	South Korea	26,4
Poland	10	South Korea	30	Indonesia	12	Indonesia	14
Denmark	15	Mexico	30	Malaysia	1+2.5**	Malaysia	11,7
Iceland	1,5	Singapore	30	Philippines	6	Hong Kong	29,3
Total (EUR)	31,5	Australia	30	Thailand	6	Total	81,4
Total	44,1	Canada	30	Singapore	3		
		Denmark	15	China	3		
		New Zealand	15	Total	53,5		
		Sweden	30				
		Total	240				

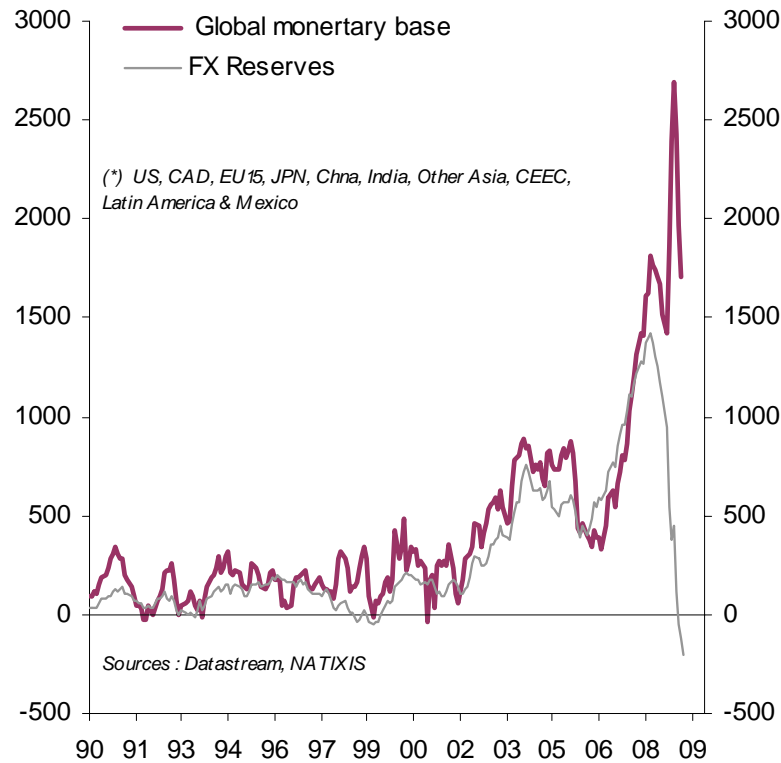
“The swaps may have been quite important but the scale required for effective lending is not available to organizations such as the IMF or other multilateral agencies” (Obstfeld & al. NBER 14826)

Source: Natixis *(until Oct. 2009) **(under the New Miyazawa initiative)

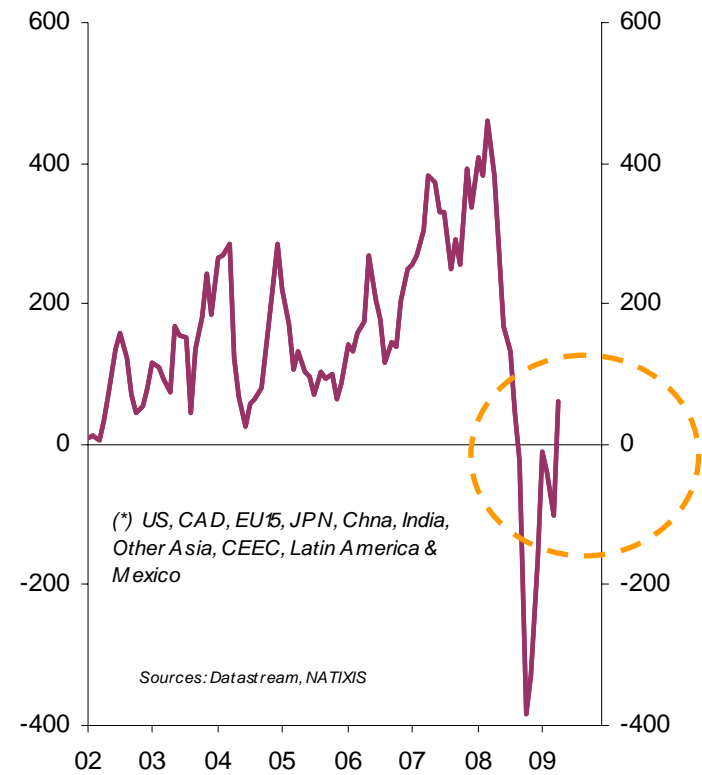
Old questions, new challenges It ain't over till it's over !

- Major hurdles to the control of global monetary base: beyond the fear of floating (2)

1-year change in world money stock*
(b USD)



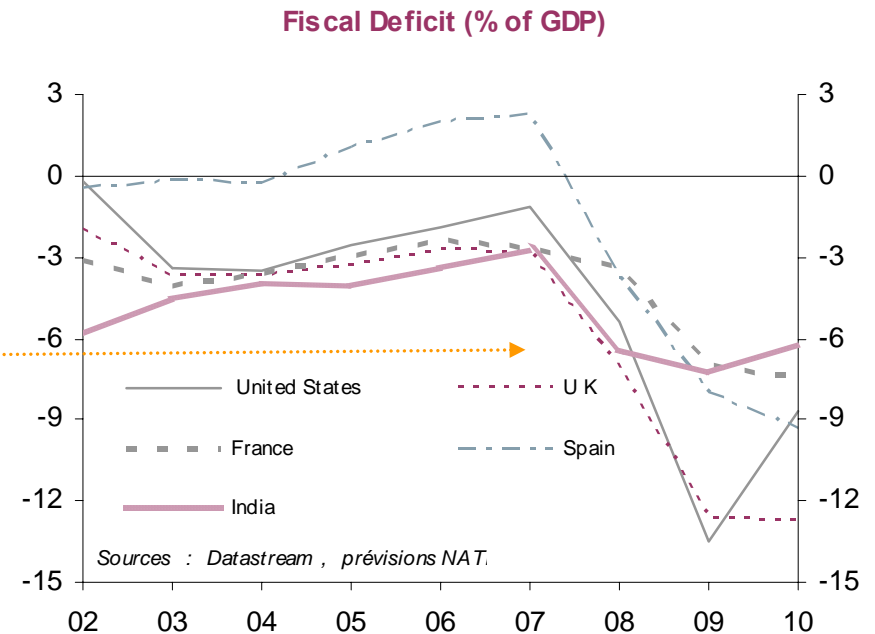
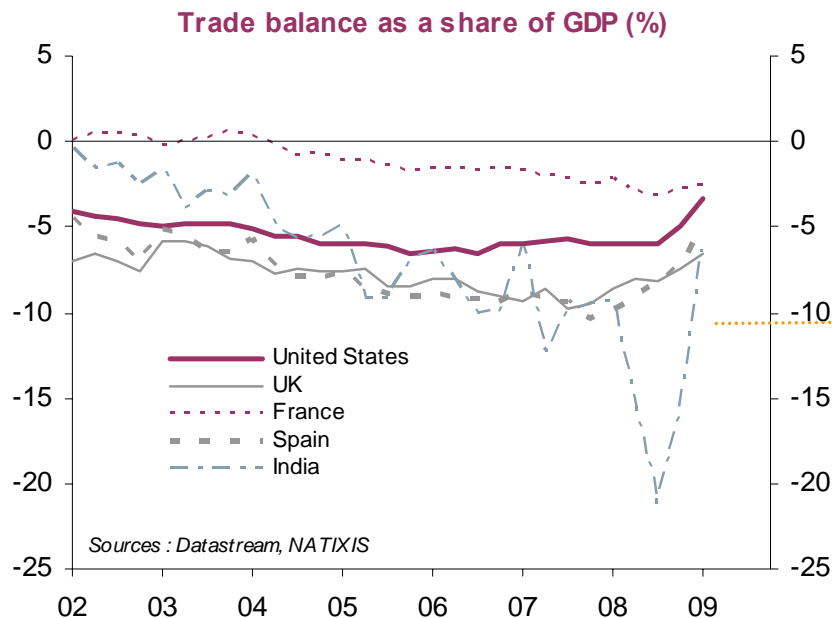
3-months change in global FX Reserves



Major hurdles to the control of global monetary base: exchange rates and capital flows

1. If free floating is not an option, how can we cooperate / find an incentive to **avoid structurally and long lasting high current account surplus** ? Where can discipline come from?

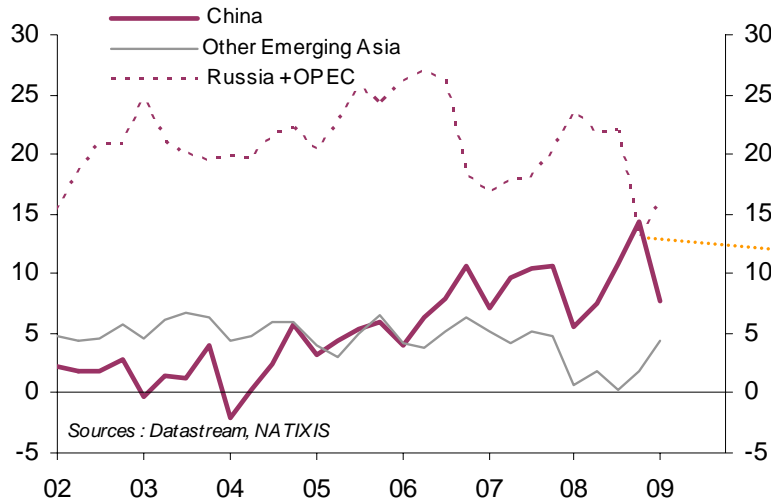
=> **countries with external account deficits (insufficient domestic saving) adopted more aggressive fiscal spending programs.**



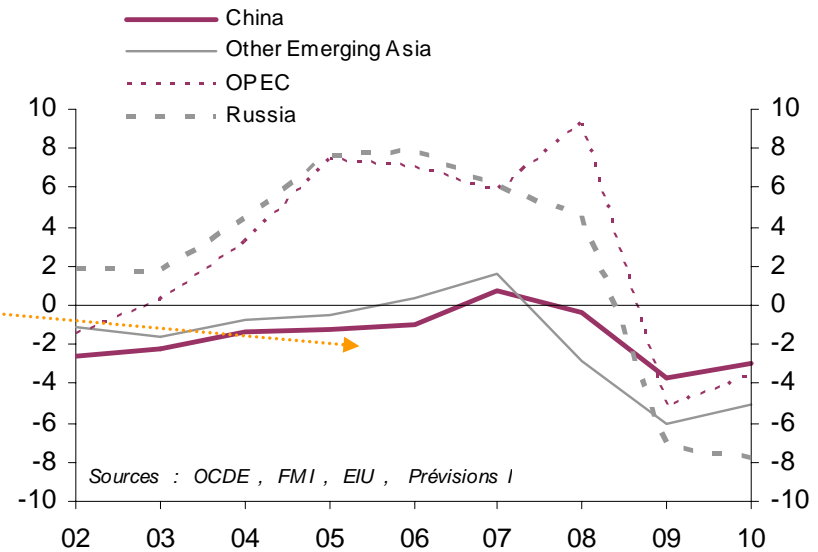
Major hurdles to the control of global monetary base: exchange rates and capital flows

=> Should we expect more aggressive policies from Surplus countries ?

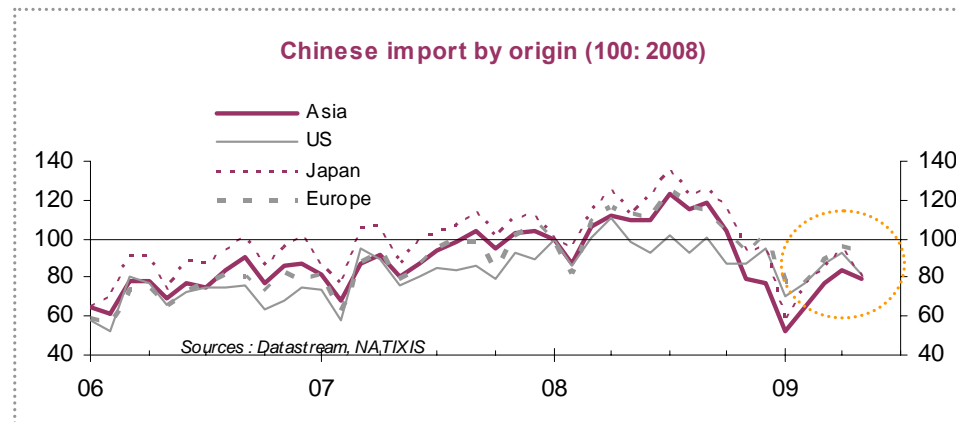
Trade Balance (% GDP)



Fiscal Balance (% of GDP)



Chinese import by origin (100: 2008)



Major hurdles to the control of global monetary base: exchange rates and capital flows



2. Trade balances or capital flows rationale for exchange rates determination ? **Regulate capital flows ? How to control the low side of the balance of payments.**

3. Can **SDR** provide any help ? Eichengreen (2009) ask for IMF to be a liquidity provider. Yet, the question of global money growth control remains unsettled. Dollar remains a dominant currency in FX reserves (cf. cofer data IMF).

Yet, the crisis showed that **USD remains a safe haven**. Problems of depths, liquidity, SRD creation process....

A Pure Coordination Problem ?



1. **Exit strategies questionable** even before the recent implementation of QE policies. How do we **help global liquidity to mean revert** ?
2. On which criteria should we base a **global monetary policy framework**? Countercyclical regional policies ? Free riders ?
3. **Final vs intermediate target** for monetary policy ? $\Delta M + \Delta V = \Delta CPI + \Delta \text{Asset Prices}$
4. Should FX Reserves be regarded as **National Wealth** ?

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