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The changing pattern of international financing

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The Chair asks…

(i) What form of international financing would best support a resumption of growth in the world economy, and what form of policy proposals by the G20 might promote this?

(ii) What form of international financing might best support investment in infrastructure in emerging market economies, and in less developed economies?

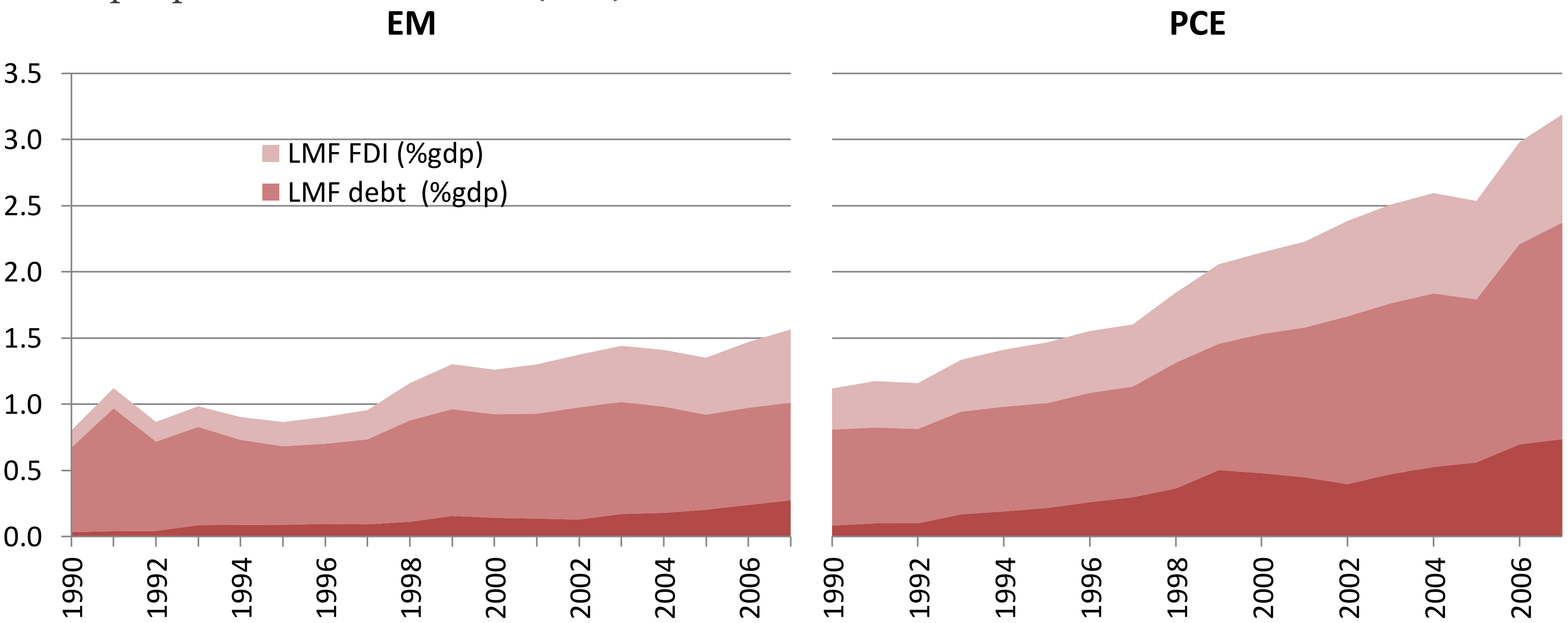
(iii) What form of international financing might best reduce risk including the risk of overlending which was partly responsible for the buildup of risk, and vulnerability to crisis, in many countries in the early 2000s.

… and the speaker answers

1. Finance and growth: Not sure whether there is an answer to that question. Long-term, stable funding?
   - But there are studies showing that crises are the price for growth accelerations. I do not concur.
2. Finance and infrastructure: (If “best” means “stable and safe”) long-term local-currency finance.
   - Commercial banks, retrenching.
   - Official credit should play a complementary, catalytic role.
   - Variable income OK (but FDI takes its toll on CA flows, and equity is closely correlated with global risk drivers).
3. Overlending: Difficult to embed self-discipline in financial instruments and markets. No substitute for regulation.
   - What is overlending? Wide dispersion of credit ratios. It depends on composition as well as international infrastructure.
4. Financial risks: Again, long-run local currency finance. Countercyclical FDI flows. Unhedged equity flows may be a source of contagion.

Composition: From fixed to variable income instruments

- The 2000s witnessed declining bonded debt ratios, compensated by FDI and equity investment. Still, bonded debt does not seem to be a problem for stable and fast'growing peripheral core economies (PCE).



Source: Levy Yeyati (2011).

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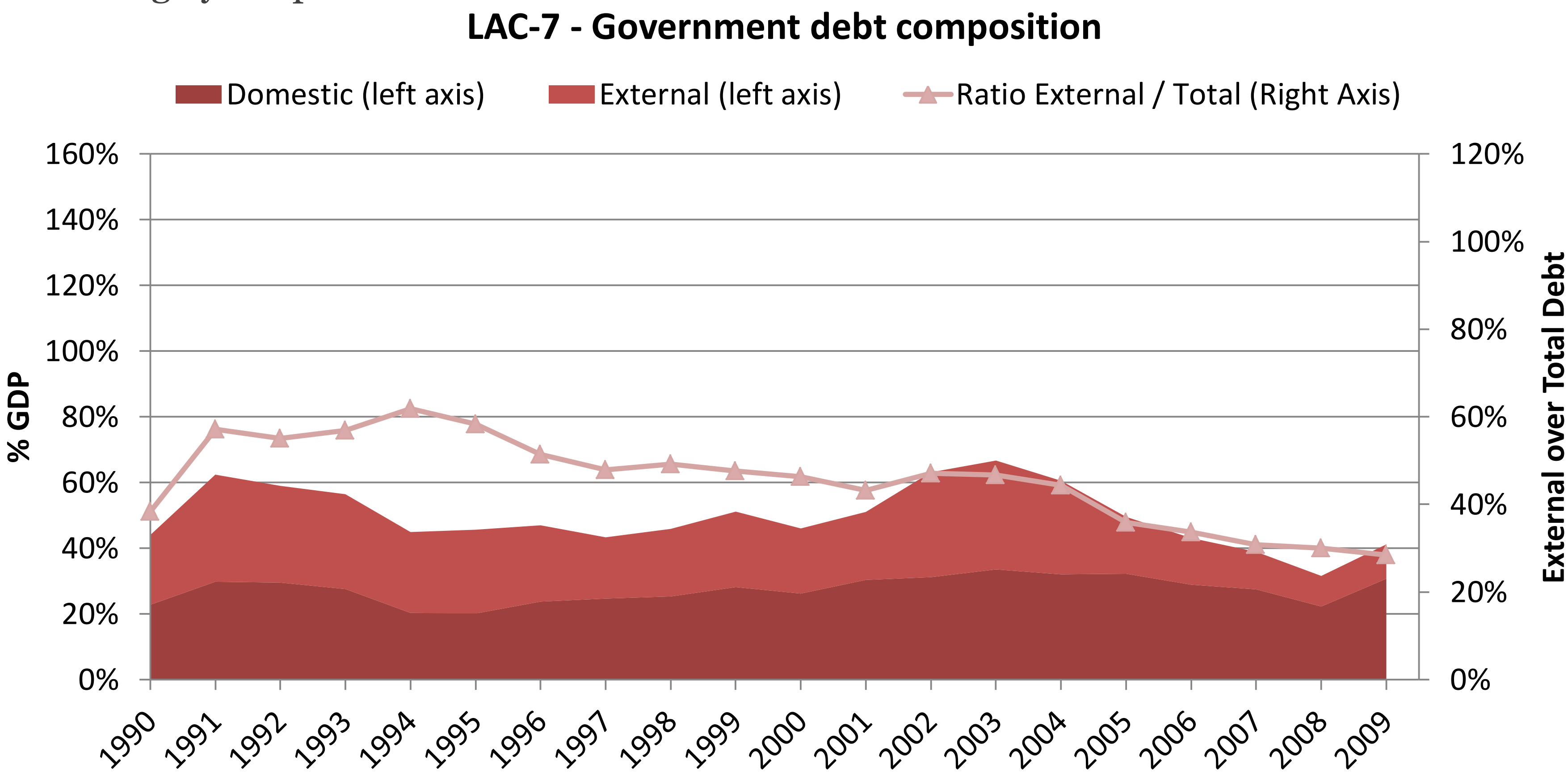
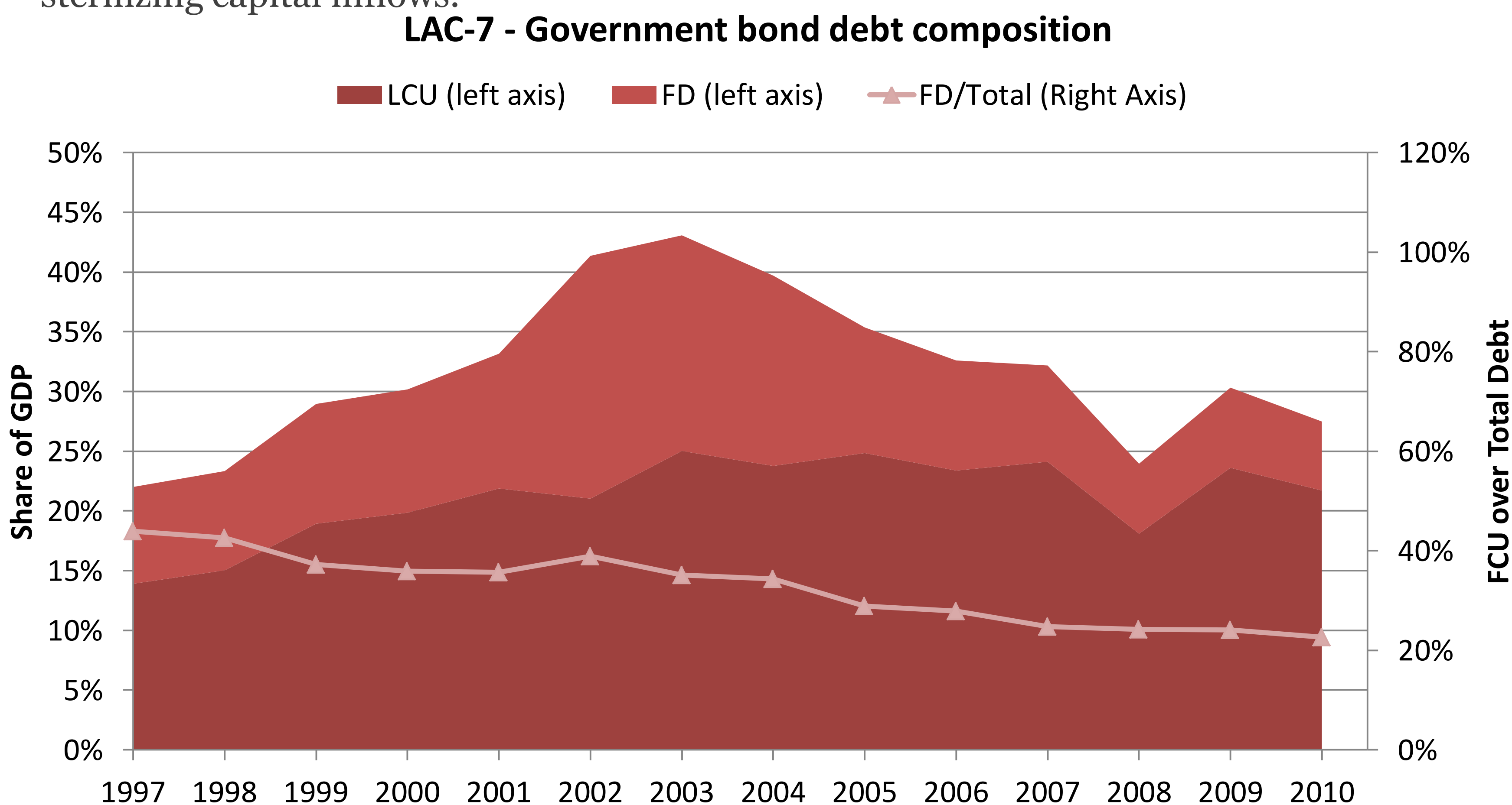
LAC - Debt leveraging and domestication

- Deleveraging also involved a deliberate attempt to develop local markets as a key lesson from debt crises: repaying external debt with domestic debt and catalyzing local curreny funding by the private sector.



...and dedollarization

- ...substituting local currency domestic debt for dollarized external debt –incidentally, sterilizing capital inflows.



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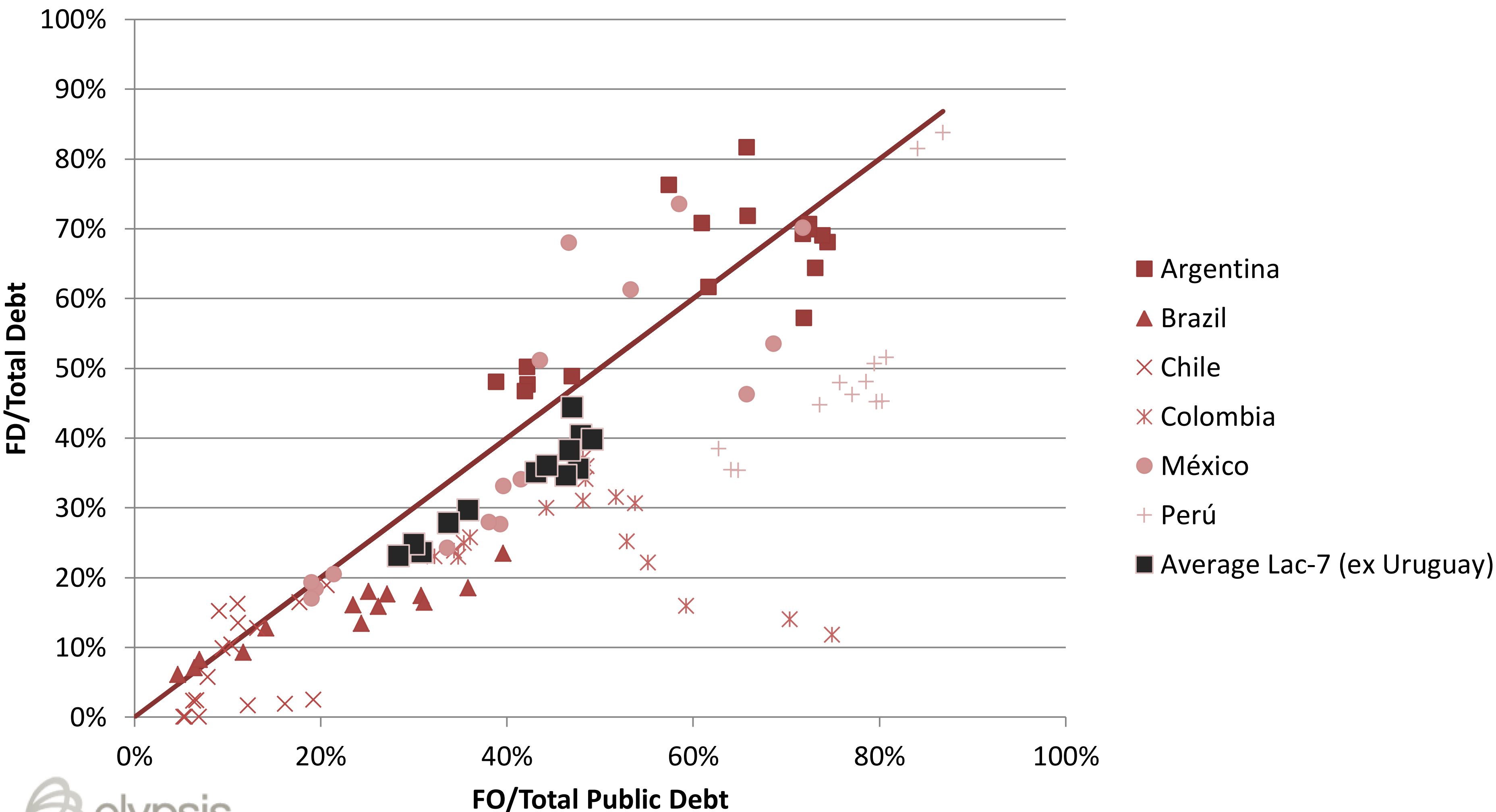
Domestication and dedollarization

- A key correlation: Local fixed income markets and local currency debt.



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Some casual related remarks

- All EM crises were ultimately currency crises. (The currency crunch in Eastern Europe was now different.)
  - Russia, for example: Reserve accumulation helps bail out private debtors but is only one side of the solution. Besides, it may encourage currency mismatches.
- Defaults (should) happen.
  - The risk of default should be internalized by the lender. International (or domestic) bailouts (as opposed to liquidity assistance) should not be at the expense of local taxpayers.
- Finance and growth face a greed vs. fear dilemma. Beyond certain threshold, deeper markets mean riskier markets.
  - What will we choose when the fear is gone?
- Emerging markets as reserve markets: what would it take?

Thank you

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