

# **Making the Global Financial System Safer – for Emerging Countries**

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Among the many consequences of the crisis, EM have experienced two —contradictory— problems:

- Sharp contraction in cross-border bank lending and foreign bank financing of its subsidiaries in EMs
- Growing wave of speculative capital inflows in search of yields → XR appreciation → CURRENCY WARS

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## Loan supply in emerging markets was affected through 3 channels:

- a contraction in direct, cross border lending by foreign banks;
- a contraction in local lending by foreign banks' affiliates in EMs;
- a contraction in loan supply by domestic banks arising from the decline in cross border lending

# Bank Financing: The Vienna Initiative

- Focus on home-host coordination
- Articulate host country perspective
- Promote long-term framework for financial integration
- **Result:**
  - No chaotic deleveraging (stopped in Central Europe)

# The Currency Wars

- Ultra lax monetary policy in advanced economies are generating incentives to export capital to higher yielding Ems.
- Such capital inflows lead to exchange rate overvaluation, rising current account deficits, and asset bubbles (threatening future crises)
- Loss of competitiveness and employment



# The Domestic Tradeoff and the International “Trilemma”

The central problem is the absence of a wide agenda that make the positions and needs of advance reserve countries consistent with the needs of the emerging countries.

# Such agenda must contain 2 core issues of monetary reform:

1. Coordinated global regulation of cross border capital flows, exchange and capital controls and cross border transaction taxes.

# Such agenda must contain 2 core issues of monetary reform:

2. A shift towards a new international monetary system based on a true global reserve currency and with EMs proper institutional representation.

# A word on Central Bank Independence

- The crisis and the adoption of multiple goals has eroded de legitimacy of CB Independence (and that is probably good).
- Does global policy coordination requires more or less independence?

THANK YOU!