Session IV: Sequels of the Crisis: Reorientation of the Financial System Along National Lines?

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Jacob Funk Kirkegaard

Peterson Institute for International Economics

Peterson Institute For International Economics
1750 Massachusetts Avenue, NW Washington D.C. 20038
Jacob Funk Kirkegaard | jkirkegaard@piie.com | 202 454 1375|

Is “Mild Financial Repression” Re-emerging?

Is advanced economy domestic credit being redirected?

Emerging market attempts to “keep capital (hot money) out” are widespread and increasingly – in the face of ultra-low G-7 interest rates – viewed as appropriate “capital inflow management” (IMF 2011; Ostry et al. 2011; Ostry et al. 2010)

But is advanced economies also increasingly “trying to keep capital in”, thereby re-nationalizing capital markets?

Recent work with Reinhardt and Sbrancia suggests so, even if the tools are less forceful than in earlier periods!

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Mild Financial Repression

An elusive concept, but seems to be rising today

Mild financial repression occurs when governments implement policies to redirect to themselves financial resources that in a deregulated market environment would go towards more profitable uses with private investors elsewhere.

There are many necessary financial regulatory functions that have similar characteristics (good financial repression), but risk is that the secondary objective becomes to lower government cost of capital (bad financial repression)

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Mild Financial Repression – Conceptual Examples

Mild financial repression often works indirectly and (perhaps) unintended

I. Directed lending to the government by captive domestic audiences
II. Explicit or implicit caps on interest rates
III. Regulation of cross-border capital movements
IV. A tighter connection between government and banks, either explicitly through public ownership of some of the banks or through heavy "moral suasion"
V. Relatively high reserve requirements or liquidity requirements, and other types of "macro-prudential regulation"
VI. Financial transaction taxes, especially differentiated levies that exempt certain asset classes (e.g. government bonds)
VII. Prohibition of purchases of some assets classes
VIII. The placement of significant amounts of government debt that is nonmarketable

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Mild Financial Repression – Practical Examples

Mild financial repression often works indirectly and (perhaps) unintended

I. France; Liquidation of the FRR (€37bn shifted to st French gov bonds)
II. Spain; MoF doubles DGF contributions for institutions that offer "above market deposit interest rates"
III. EU; Current CRD IV draft exempts sovereign derivatives trades from credit value adjustment (CVA) capital charge
IV. EU; 95% "Voluntary participation" in Greek debt restructuring
V. Euro area; Sizable increase in bank purchases (financed by ECB liquidity) of domestic sovereign bonds
VI. UK; Royal Mail privatization sees £24bn in assets transferred to Treasury
VII. Portugal; Portugal Telecom €2.8bn pension fund transferred back to government
VIII. Ireland; Use of National Pension Reserve Fund (NPRF) for bank recapitalization purposes
IX. Japan; Reversal of Japan Post privatization and increase of deposit ceiling

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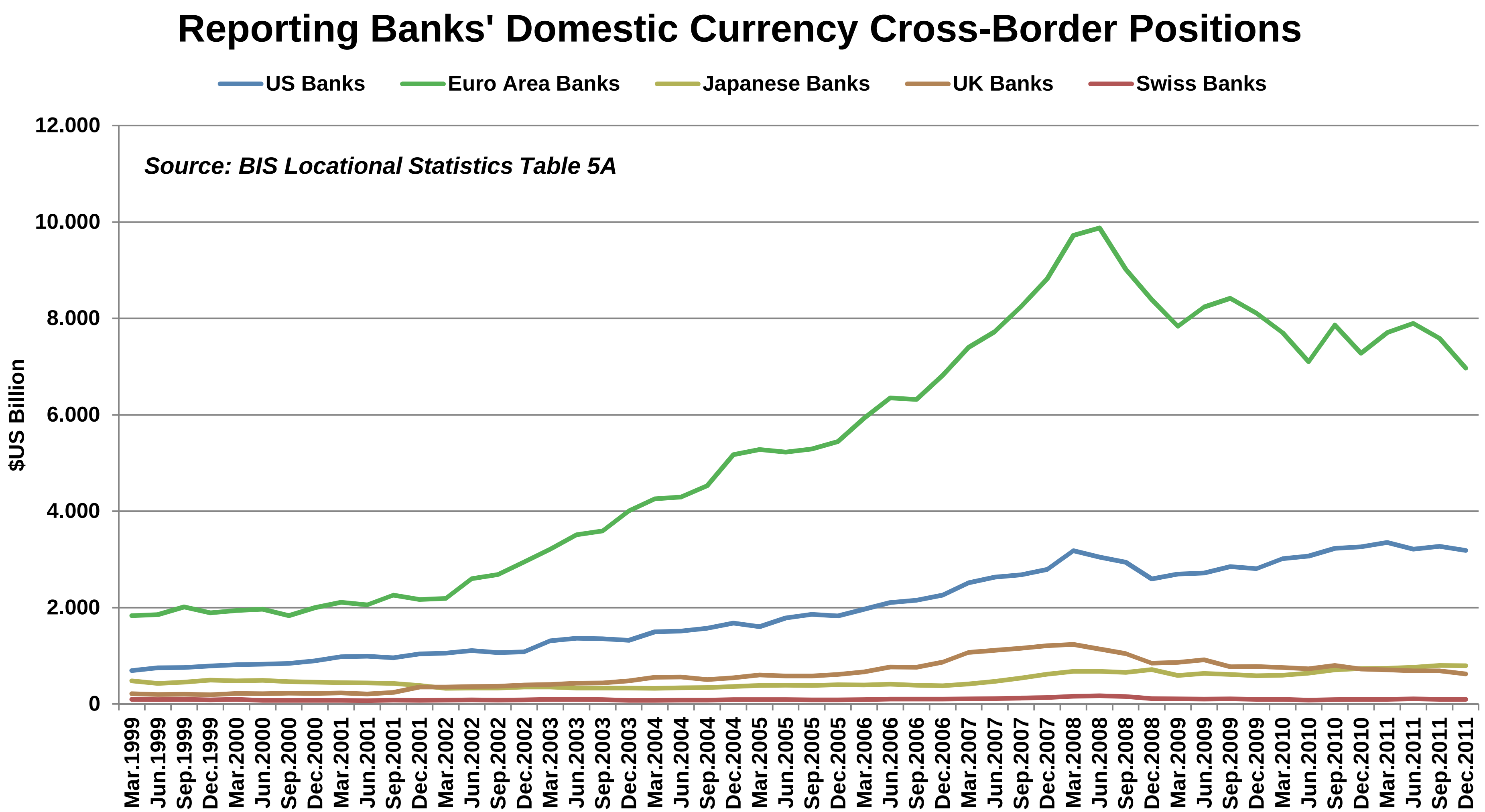
The Euro Introduction – A Special Case

Re-nationalization of euro area financial markets forces "real integration"



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