“Taming the global financial cycle: what role for the global financial safety net?”

by Beatrice Scheubel, Livio Stracca & Cédric Tille


Robert McCauley*
Senior Adviser
Monetary and Economic Department
Bank for International Settlements

The views expressed are my own and do not necessarily reflect those of the BIS.
What SST do

- Reduce various prices, quantities and flows to a latent variable called the global financial cycle (GFC)

- Define and correlate capital flow episodes with the GFC.

- Measure the macroeconomic effect of capital flow episodes.

- Measure the effect of what they call the Global Financial Safety Net on modifying macro effects.
An analogy to what SST do

World weather → Natural disasters → Macro effects

Self-insurance Insurance
Something left out?

World weather → Natural disasters → Macro effects

- Self-insurance
- Levees, dikes
- Building codes
Questions re factor analysis

- Do Bayesian sign restrictions really make it “structural”?

- Does dropping sign restrictions on flows really address circularity of explaining country flows with global flows?

- Choice of variables raises questions:
  - Why not bank flows?
  - Why not Taylor flow deviations in US monetary policy?
  - Or Adrian/Crump/Moench term premium?
Questions re capital flow episodes

- Own variation (2 s.d.) used to define episodes a la Forbes & Warnock.

- Do quantities matter? Reversal of private capital flows in Thailand, Korea in 1997-98 reached something like 15% of GDP.

- Would study of natural disasters reduce cases to 0 vs 1?
Questions re macro effects

- Do quantities matter?
- Sufficient controls?
Questions re global financial safety net

- Should own reserves count as *global*?
- Reduce likelihood of sudden stop/ currency crisis or reduce macro harm from same?
- How purge valuation effects?
- Does reserve use include the “forward book” changes from SDDS?
- Do quantities matter? Both Reserves and IMF access % of GDP?
Varieties of financial cycle

- Borio, Drehmann and others: national cycles
  - Build-up in credit accompanied by buoyant real estate prices.
  - Use Kalman filter to distinguish departures from trend.
  - Longer than business cycle
  - Can ask what capital flows accompany or enable rapid domestic credit growth, as Lane & McQuade (2014) or Avdjiev et al (2012)

- Shin, Rey and others: global financial cycle
  - Drivers in centre, effects elsewhere
  - Use factor analysis to measure latent factor
  - Business cycle frequency, including short-term eg VIX
  - Question of whether the driver has changed since 2007-08 and what is important now: dollar’s value, term premium?
Measuring capital flows with multinational firms

- The Petrobras problem
  - One of biggest borrowers in EM
  - Sells bonds through offshore affiliate, funnels funds back to head office as inter-affiliate debt, a direct investment inflow

- Can we rely on measures of portfolio inflows into EM?

- Use net issuance of international bonds alongside capital flows?