International Monetary Challenges and Responses

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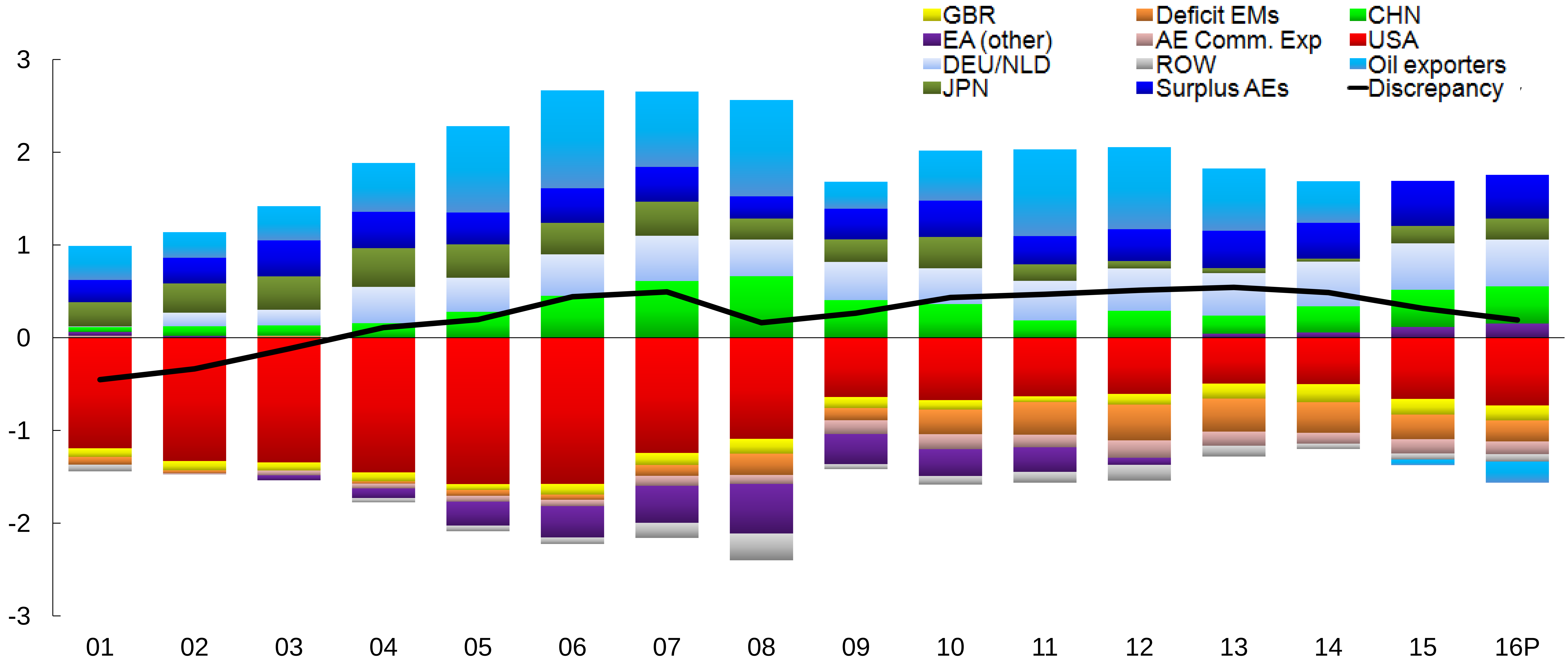
Recent evolution of global imbalances

Evolution of global current account imbalances

(percent of world GDP)

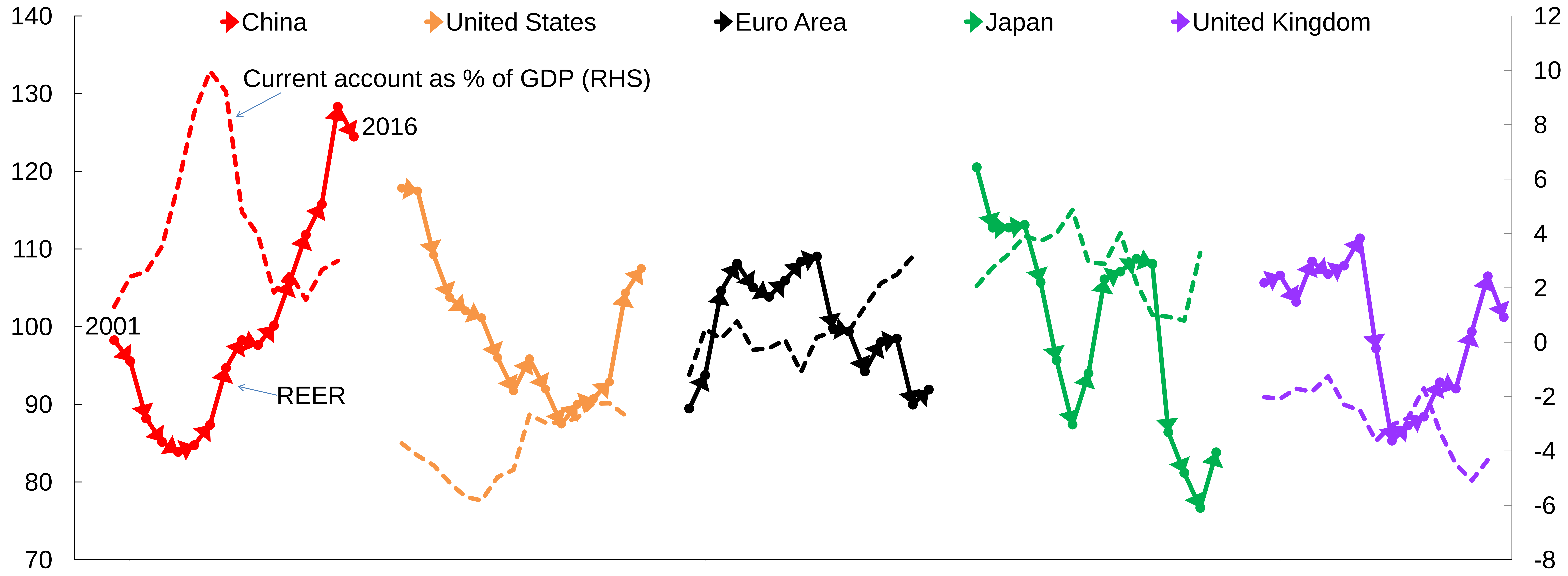


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

Unconditionally, XR does not closely track CA

REER and current account of selected economies, 2001-16

(REER as index, average 2001-16 = 100 1/; Current account as % of GDP, RHS axis 2/)

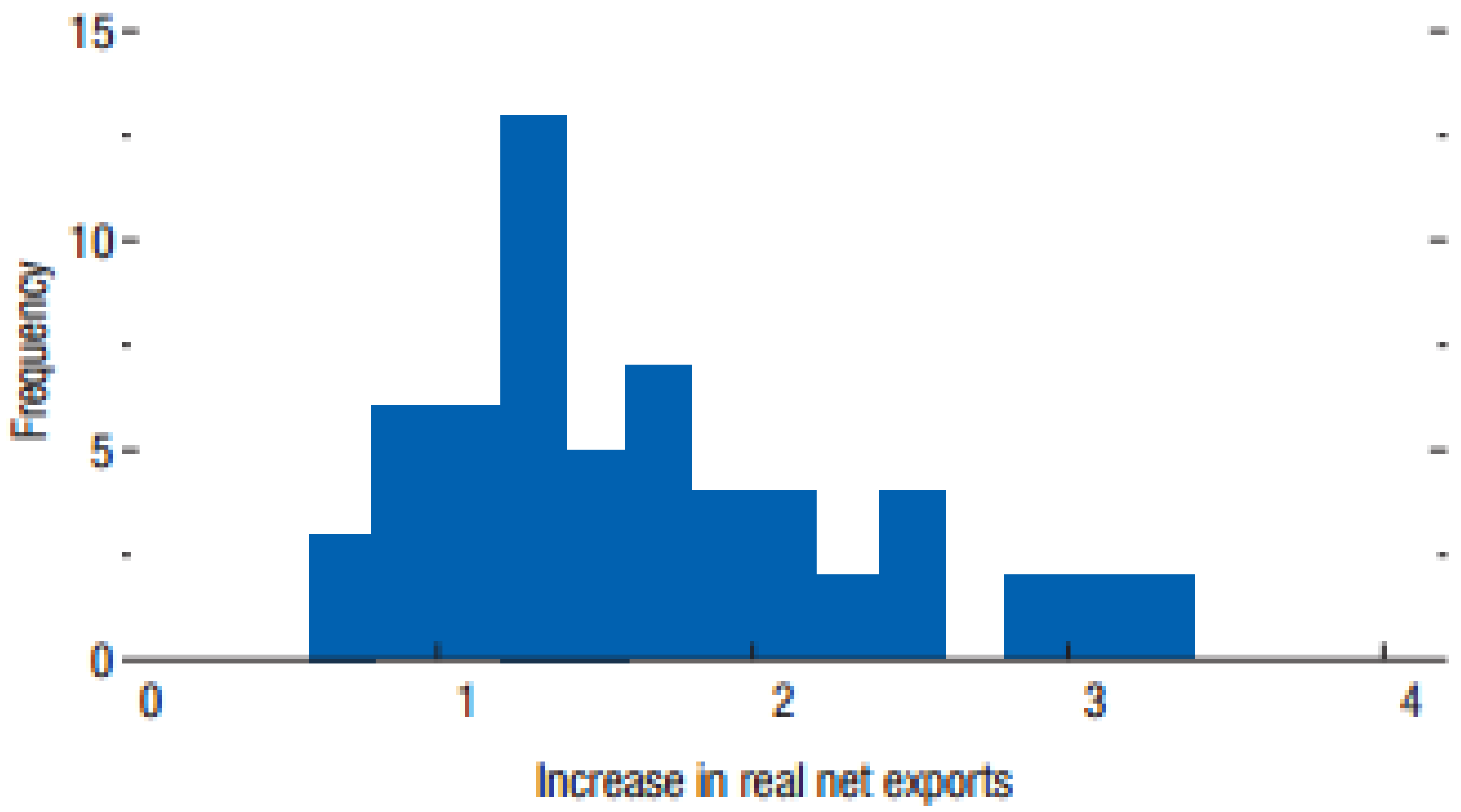


Source: IMF, *World Economic Outlook*; IMF; *Information Notice* System; and IMF staff calculations.
1/ Data runs up to May 2016.
2/ Data runs until 2015.

But XR changes still operate in the old-fashioned way

- On average, a 10% REER depreciation raises NX by 1.5% of GDP, but with substantial cross-country variation (Oct 2015 WEO).

Long-term effect of a 10% REER depreciation on real net exports
(percent of GDP)



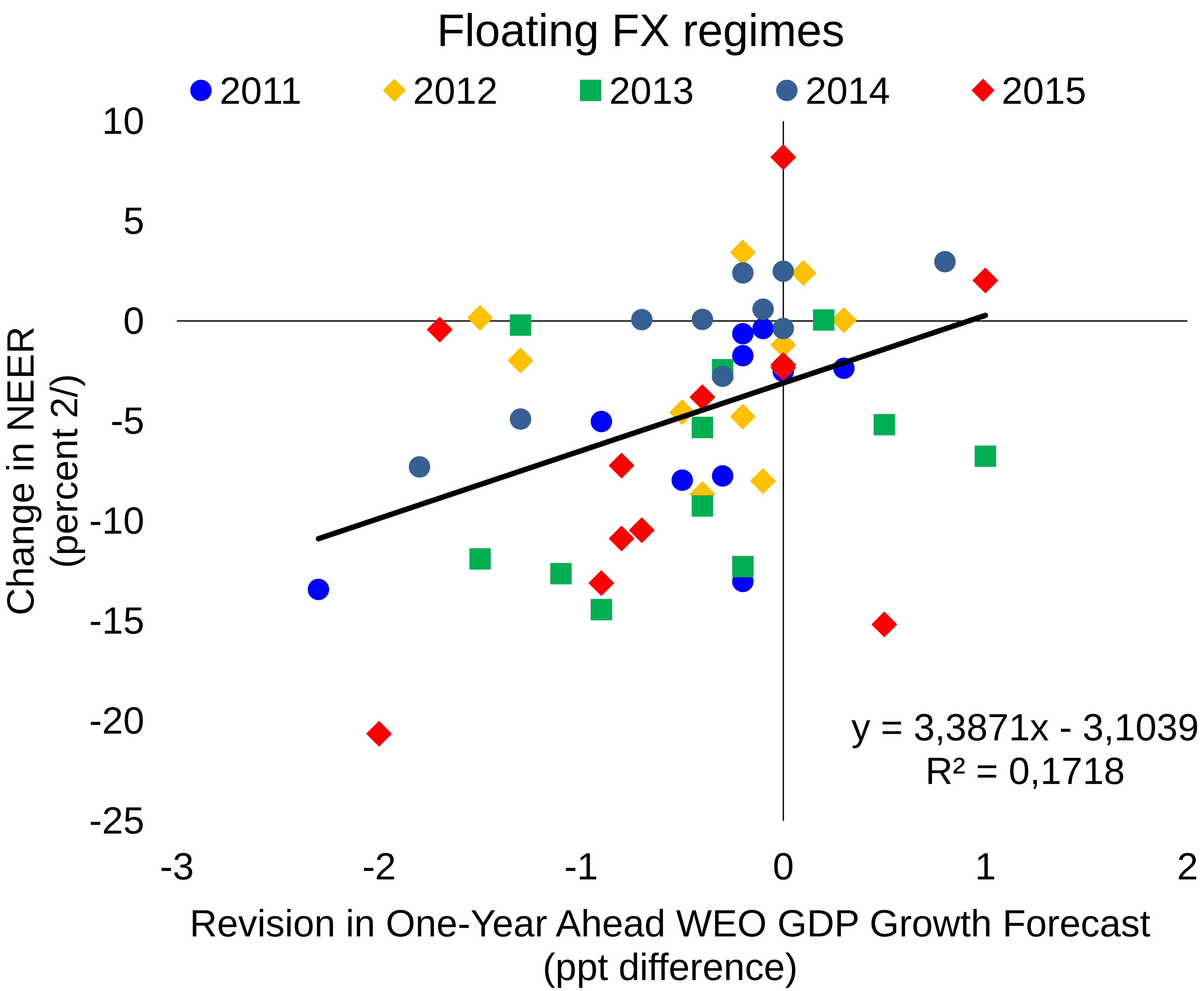
Source: IMF, October 2015 *World Economic Outlook, Chapter 3*.
Note: Figure shows long-term effect on level of real net exports in percent of GDP based on country-specific import- and export-to-GDP ratios and the average producer price index–based trade elasticities for 60 economies.

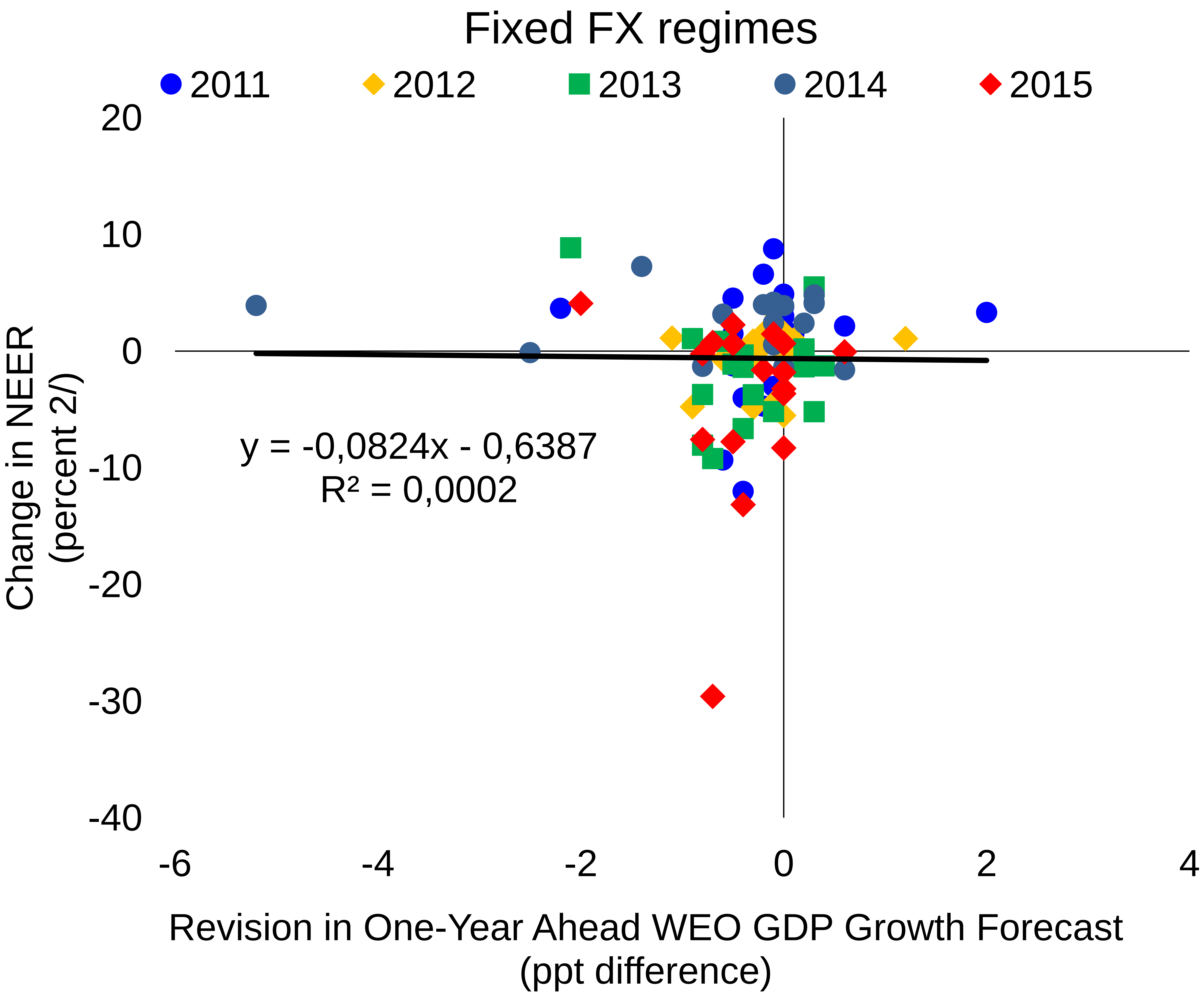
Complex interaction among shocks, CA, and REER

- CA deficits needn’t signal depreciation over any specific time frame.
- Even in a world with only bonds and (uncovered) interest parity – making gross capital flows uninteresting – fall in world demand and rise in domestic demand lead to deficits but opposite exchange rate, output effects.
- Life indeed is more complex when portfolio shifts among a rich set of gross positions are an independent source of disturbance to exchange rate.

But XR flexibility has a buffering role

Currency adjustments and growth forecast revisions in EMs 1/

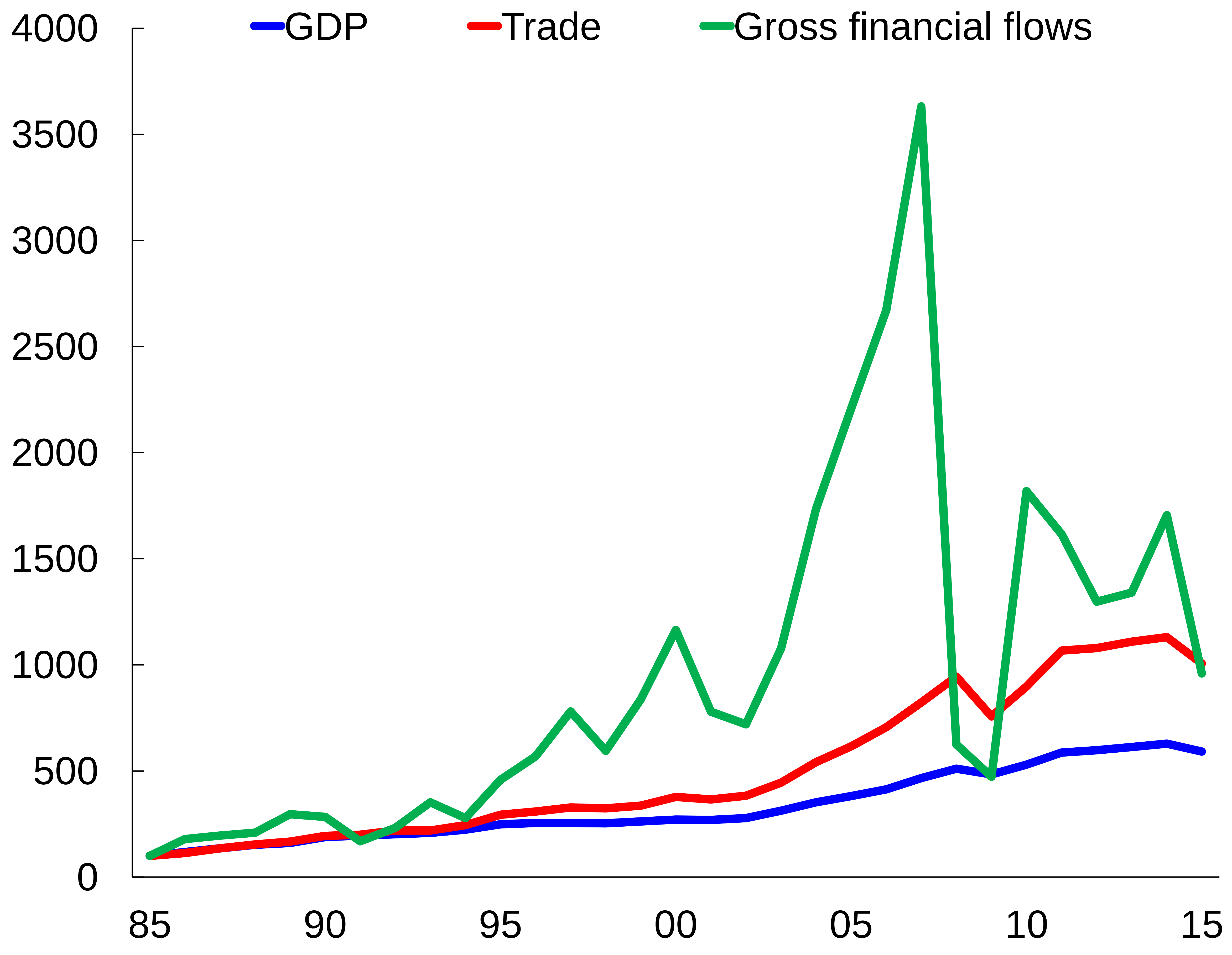




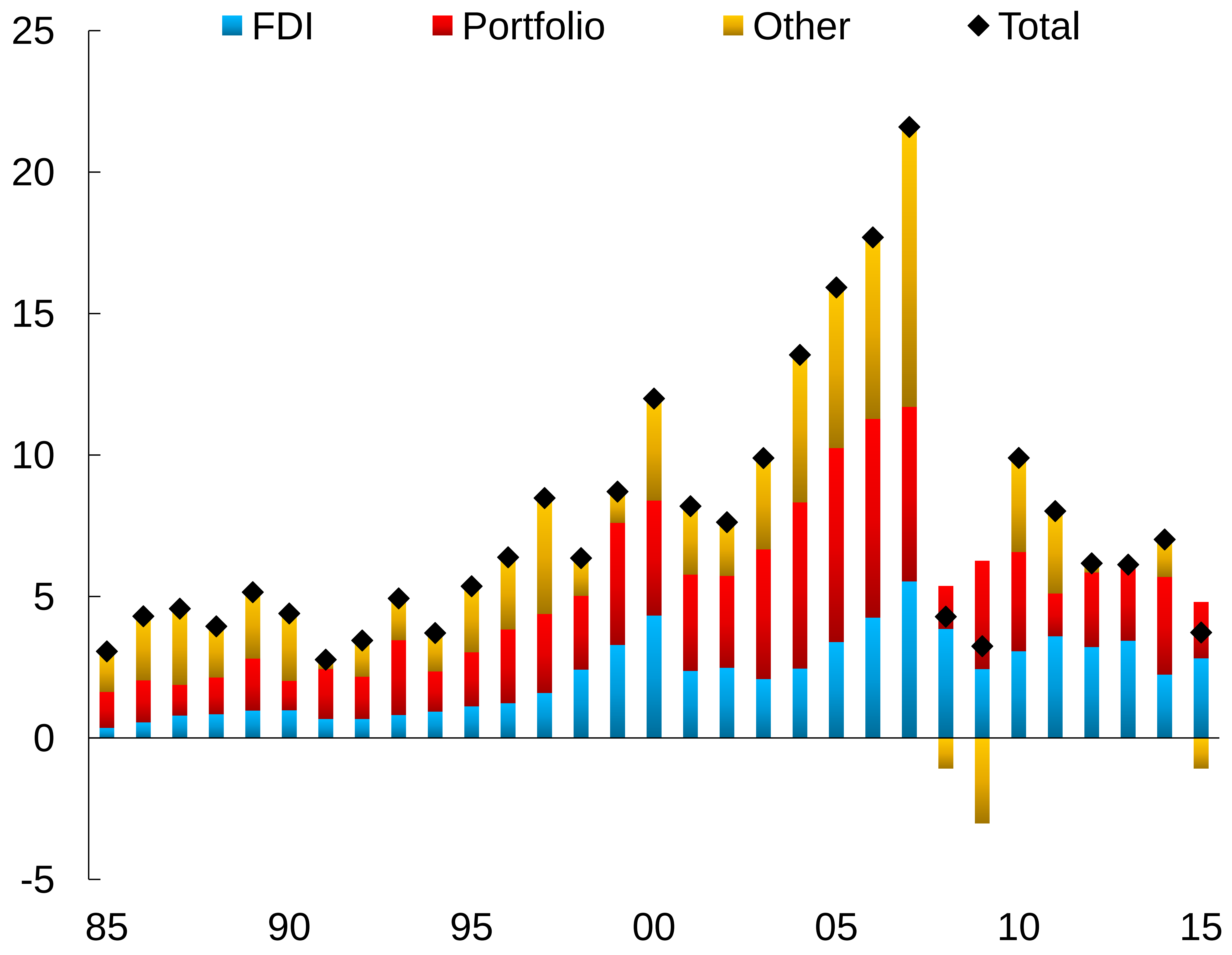
Sources: IMF, *World Economic Outlook*; IMF; *Information Notice* System; and IMF staff calculations.
1/ 29 largest EM economies.
2/ Positive change in NEER denotes appreciation.

Net CA imbalances might hide vulnerabilities connected with *gross* flows…

Growth of global GDP, trade in goods and services, and gross financial flows
(indices; 1985=100)



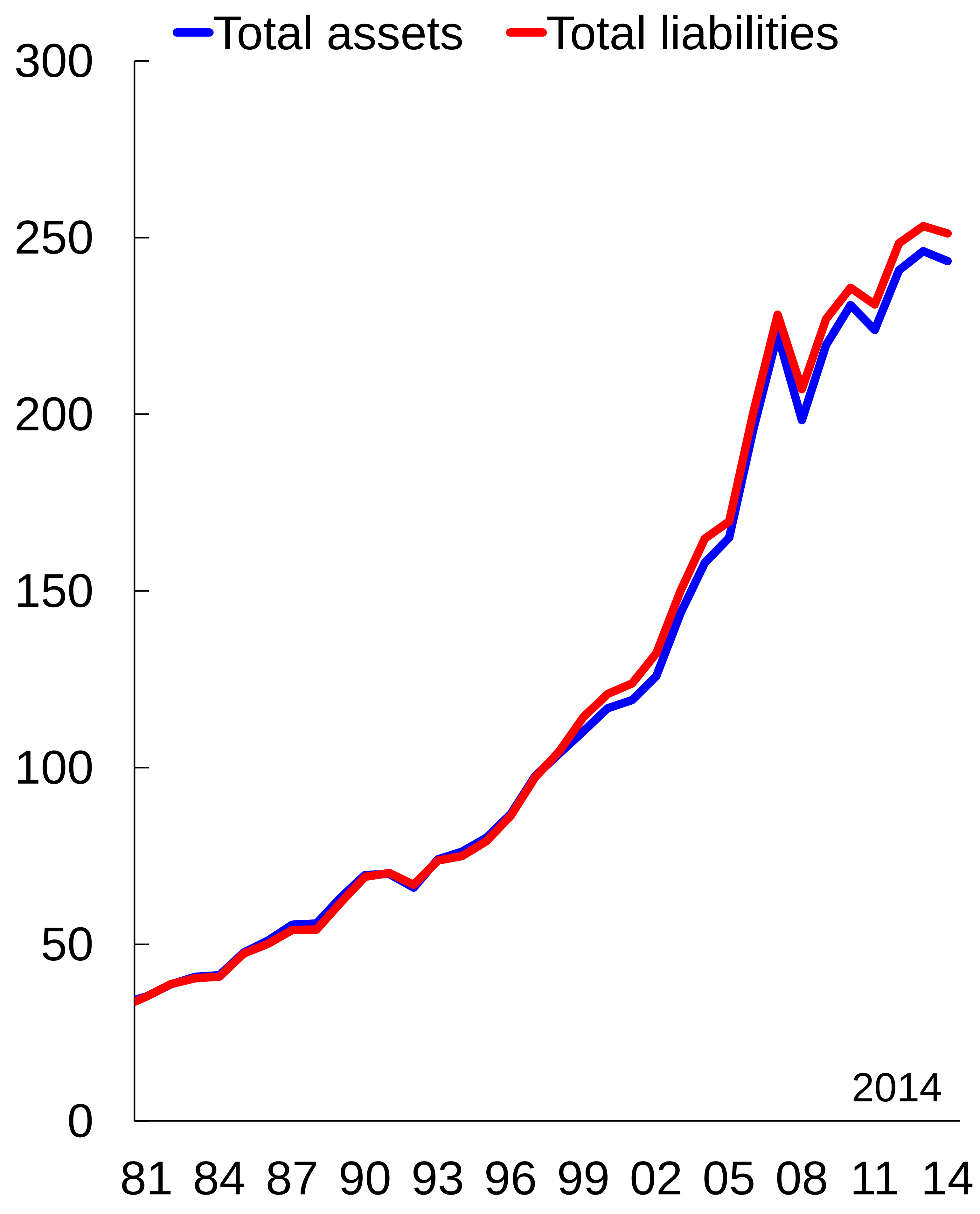
Evolution of global financial inflows
(percent of world GDP)



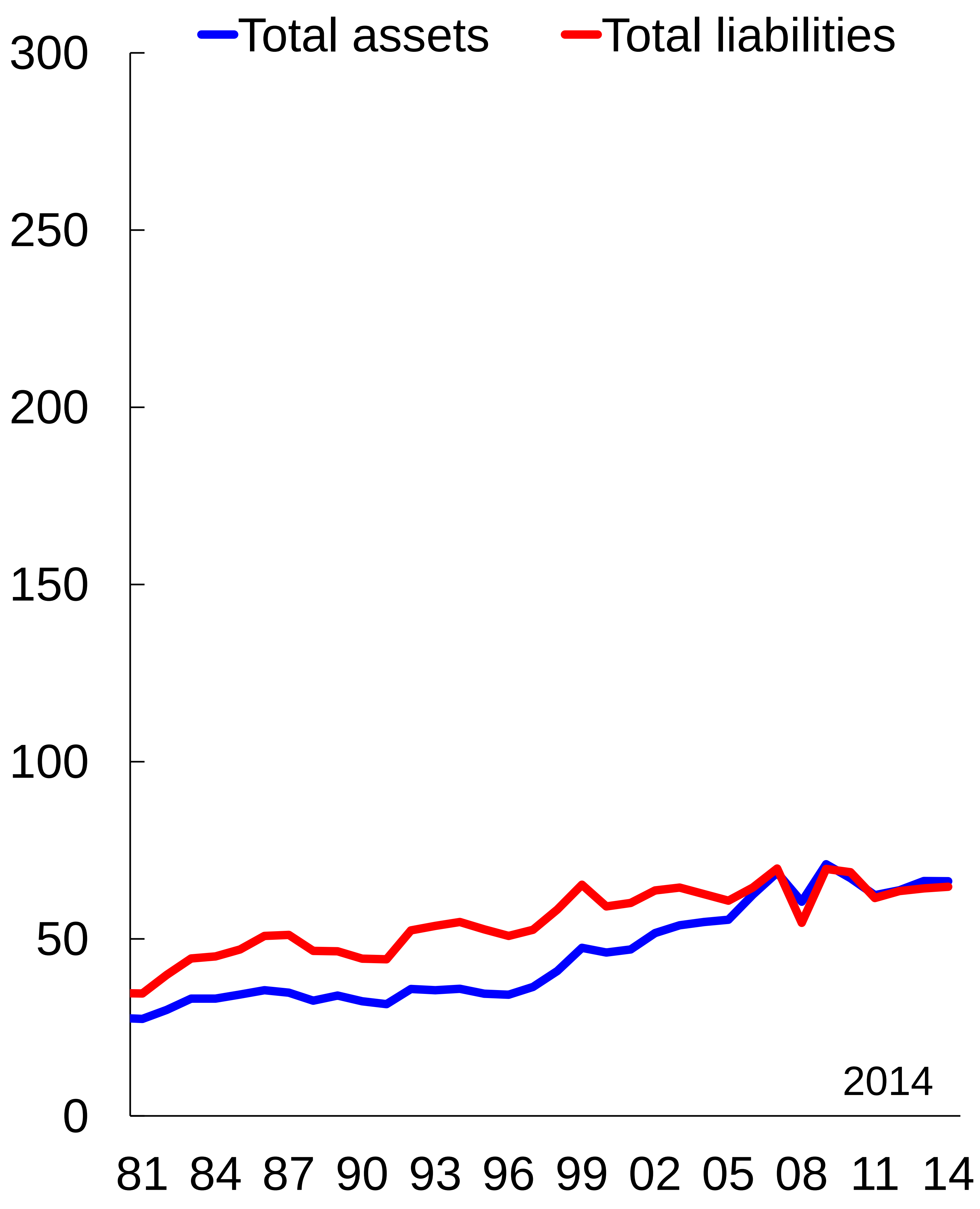
Sources: IMF, *World Economic Outlook*; IMF, Financial Flows Analytics; and IMF staff calculations.

…and the stock of gross liabilities and assets

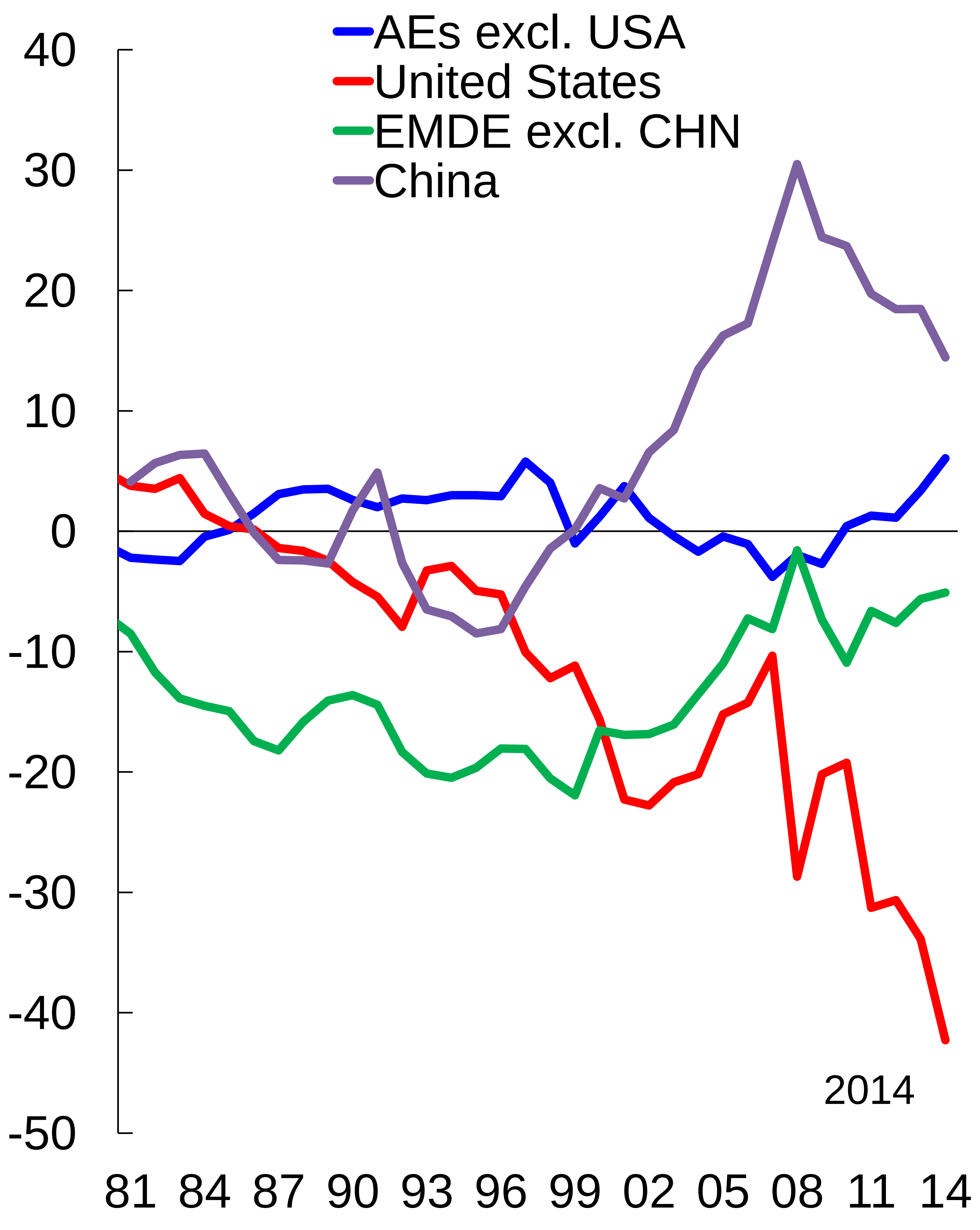
Advanced economies
(percent of GDP)



Emerging market economies
(percent of GDP)



Net foreign assets
(percent of GDP)



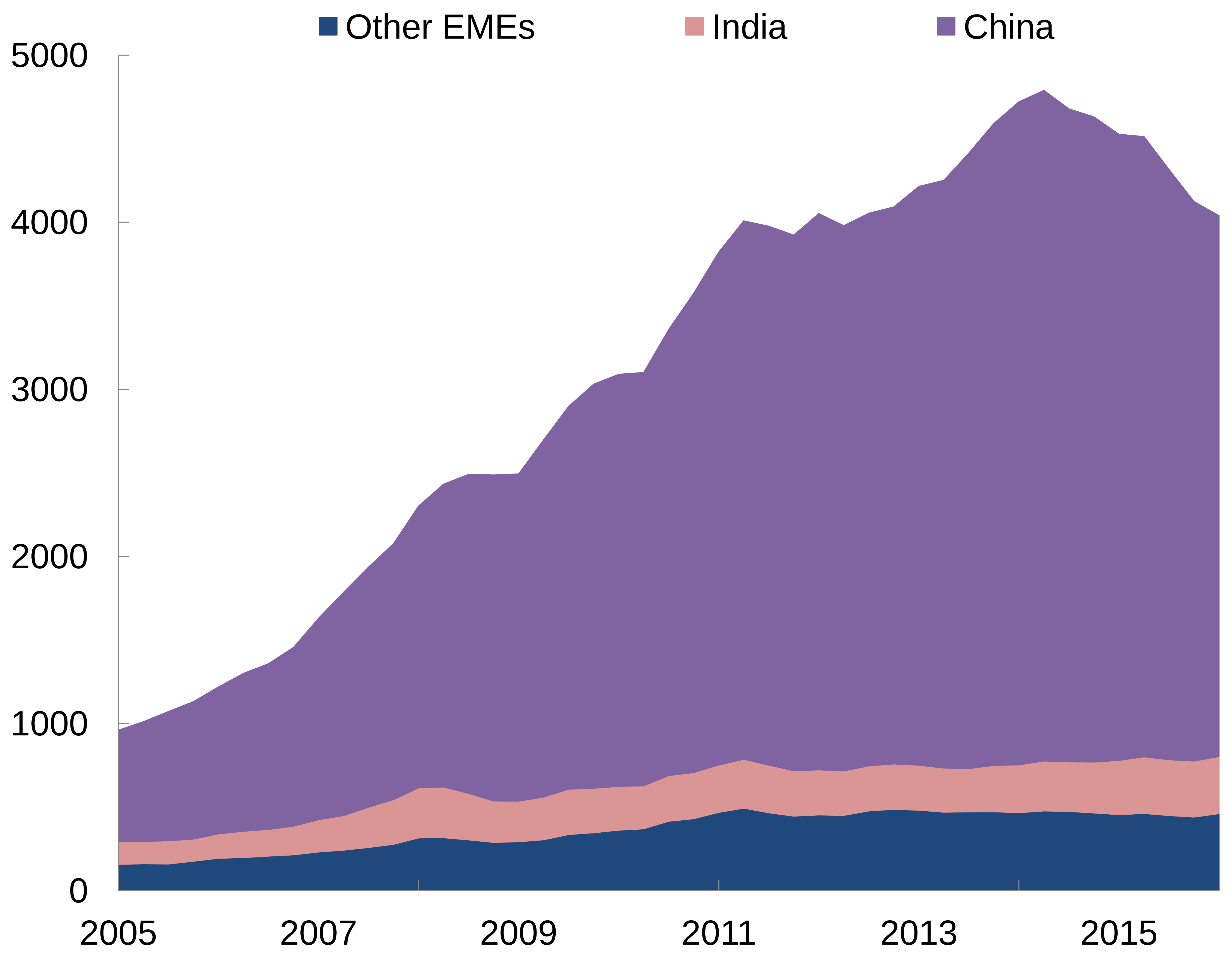
Source: Updated external wealth of nations database, by Lane and Milessi-Ferretti (2007).

Some EMs have been using reserves

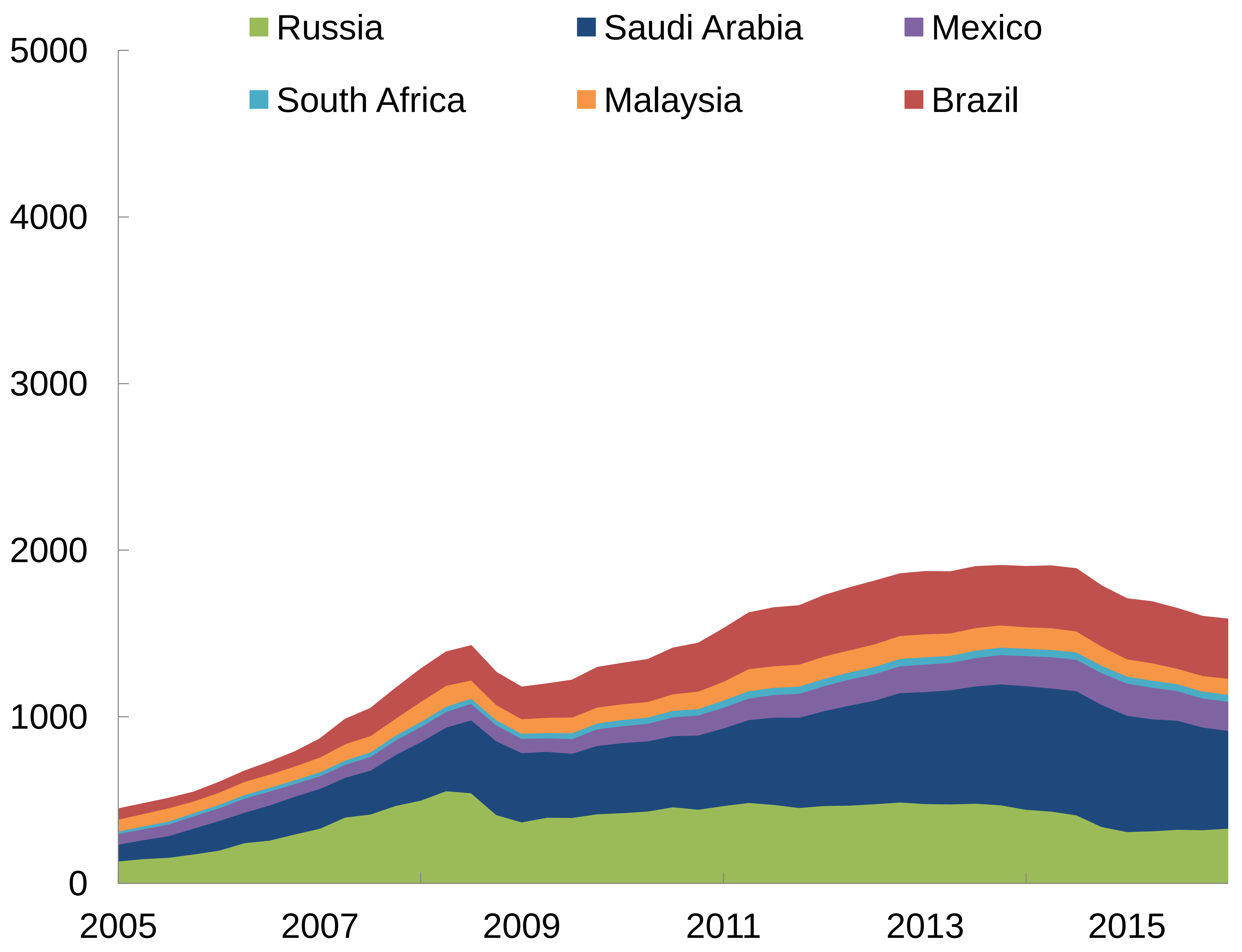
Gross international reserves, 2005Q1-2016Q1

(in billions USD, at end-quarter)

Commodity Importing EMEs



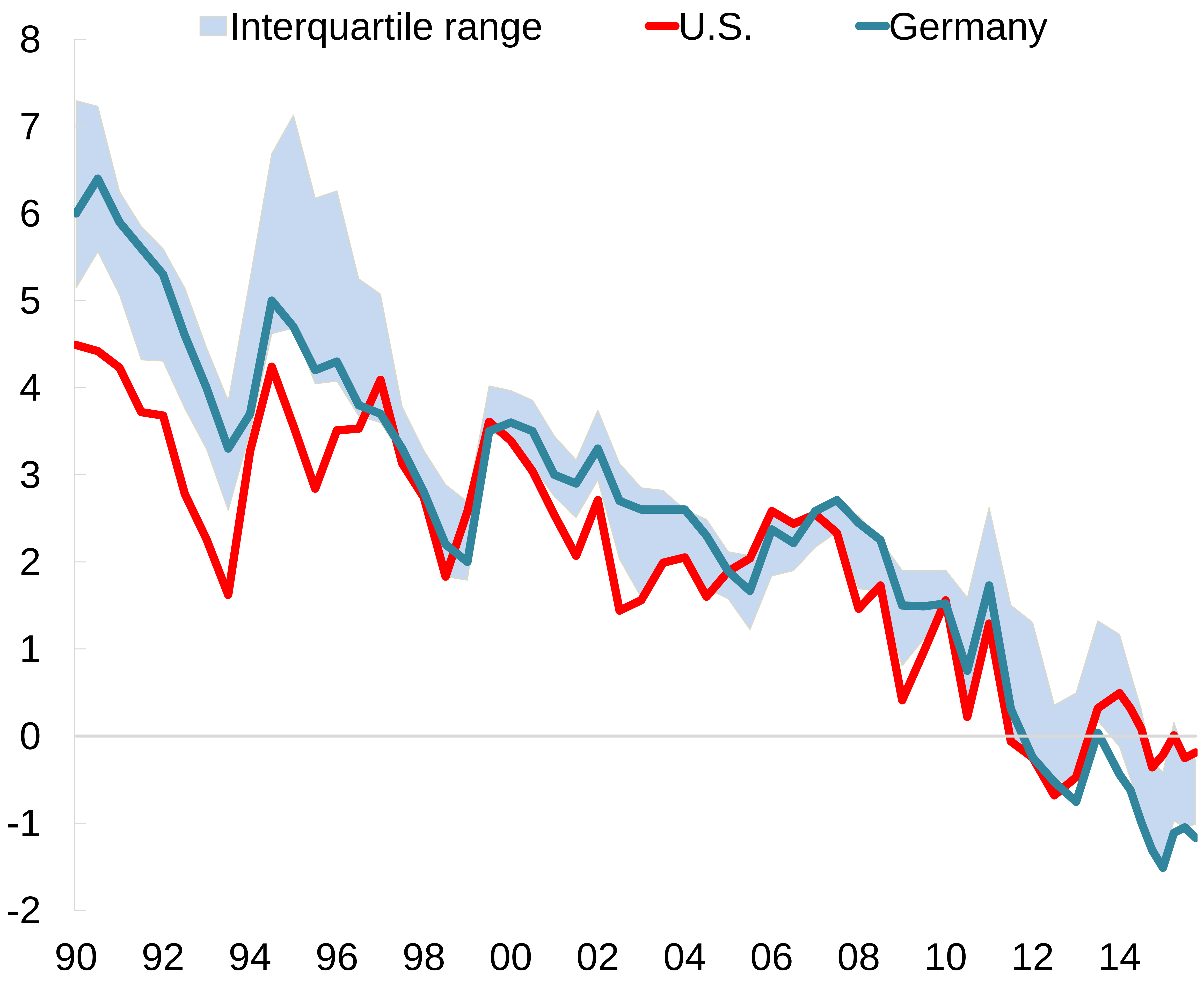
Commodity Exporting EMEs



Source: 2016 External Sector Report.

Two views of global equilibrium: Real interest rates

10-year real interest rate in advanced economies
(quarterly; percent)



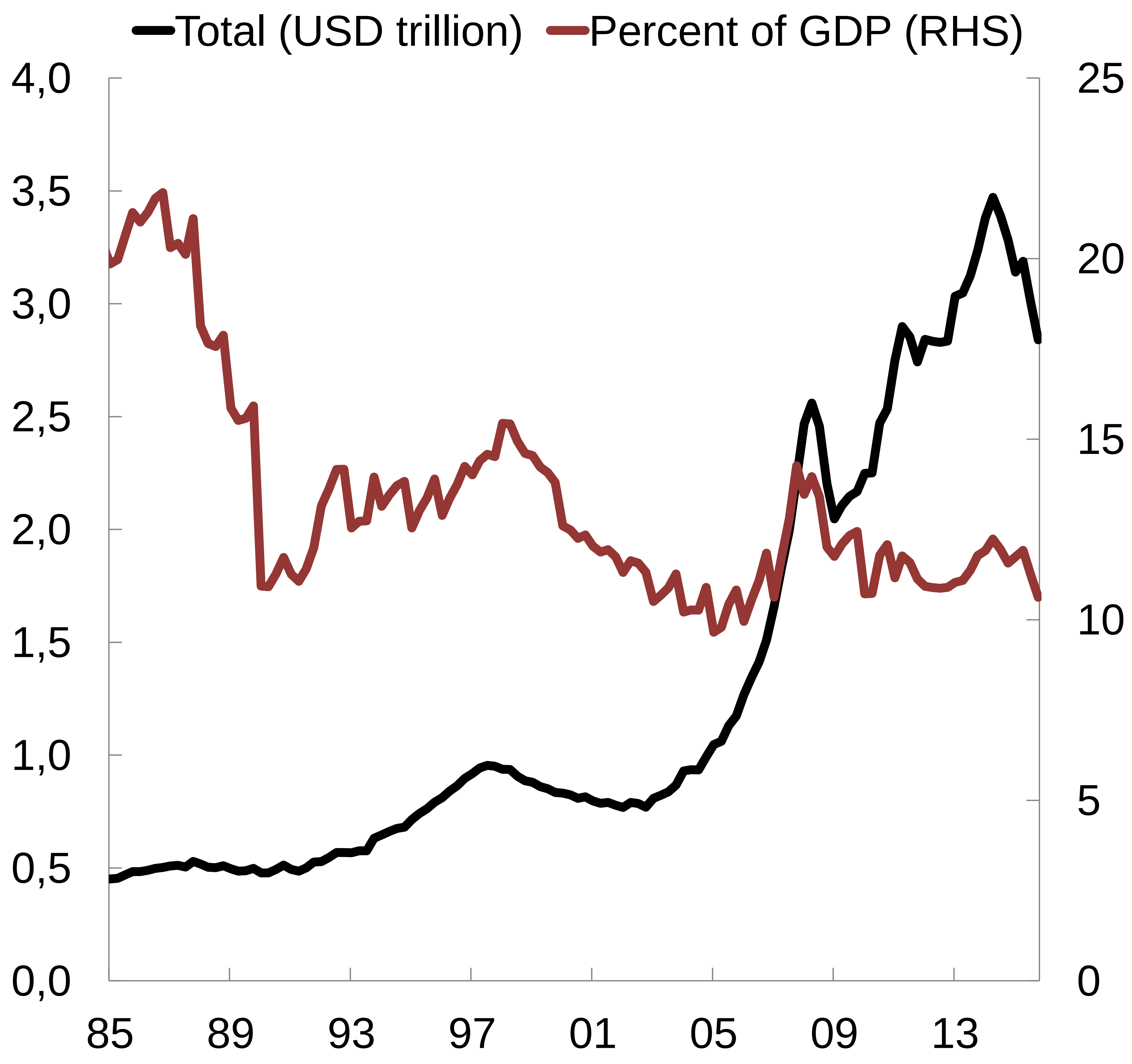
Sources: IMF, *Global Data Source*; Bloomberg L.P.; and Consensus Forecasts.
1/ Calculated as nominal 10-year bond yields minus 10-year ahead CPI inflation forecast (Consensus forecast).

Potential explanations:

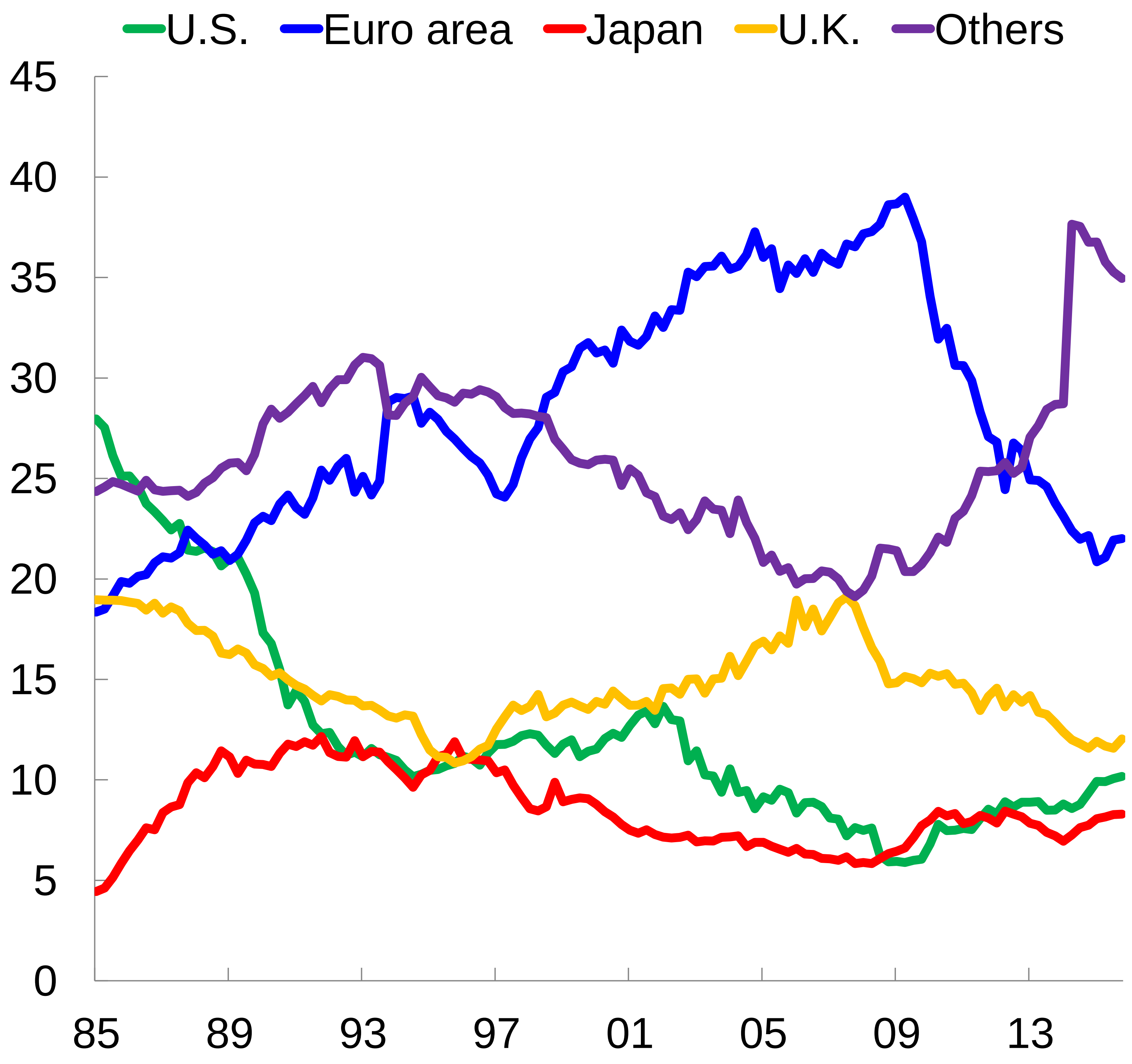
- Global saving glut.
- Monetary policies.
- Uncertainty.
- Safe asset shortage.
- Demographics.
- Low expectations of technology progress.

Two views of global equilibrium: Dollar financing conditions

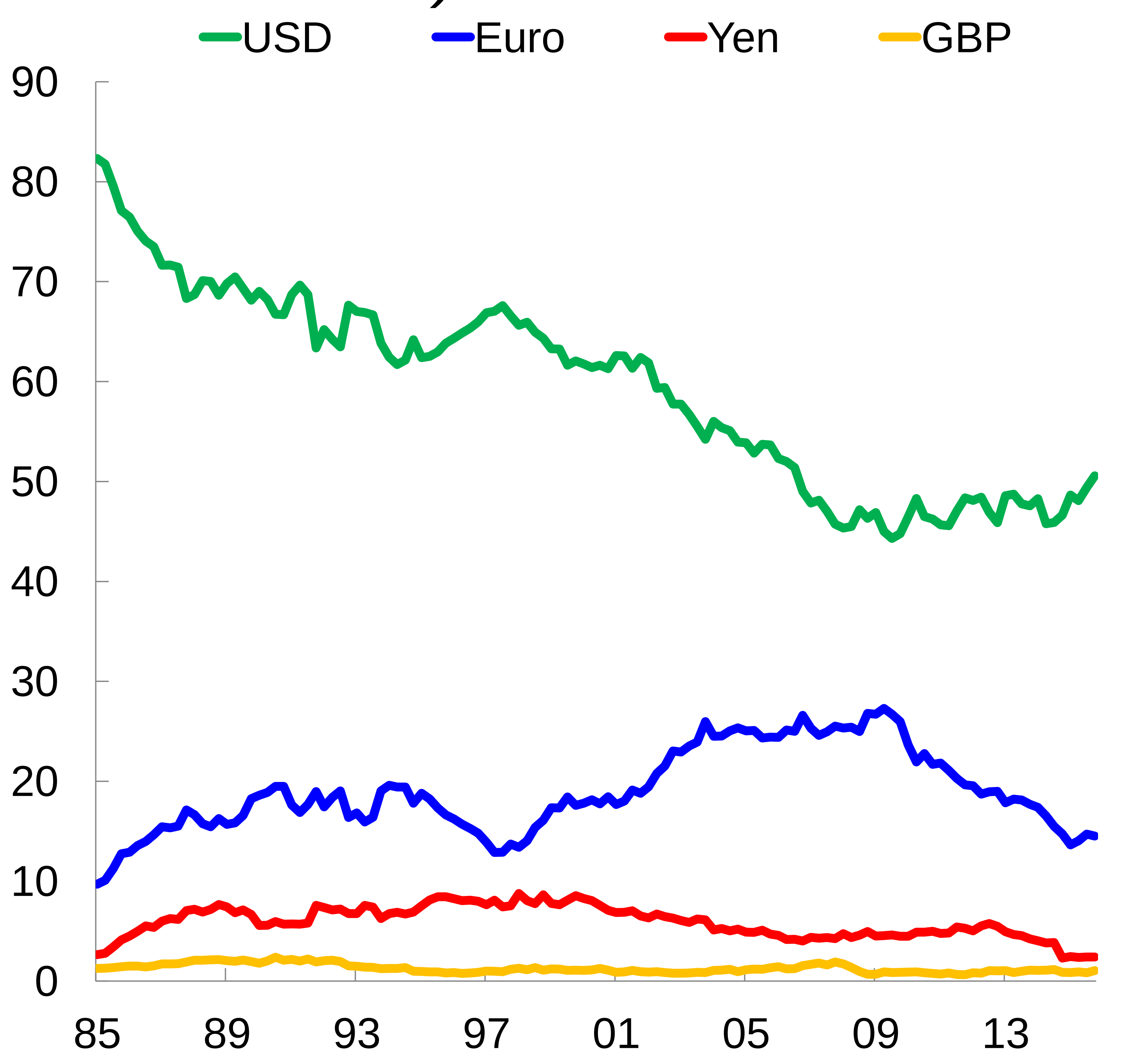
Substantial cross-border bank claims on EMs…
(BIS reporting banks' cross-border claims on EMs 1/)



…with Euro area banks having a key role…
(percent; share of cross-border bank lending to EMs by banking systems)



…but with the U.S. dollar being the dominant currency
(percent; share of cross-border bank lending to EMs by currency denomination)



Sources: BIS Banking Statistics; and Cerutti, Claessens, and Ratnovski (2016).
1/ The sample of EMs include 49 large emerging markets

Can the two be reconciled? With the right model

Tobin’s portfolio-balance approach reconciles stocks and flows

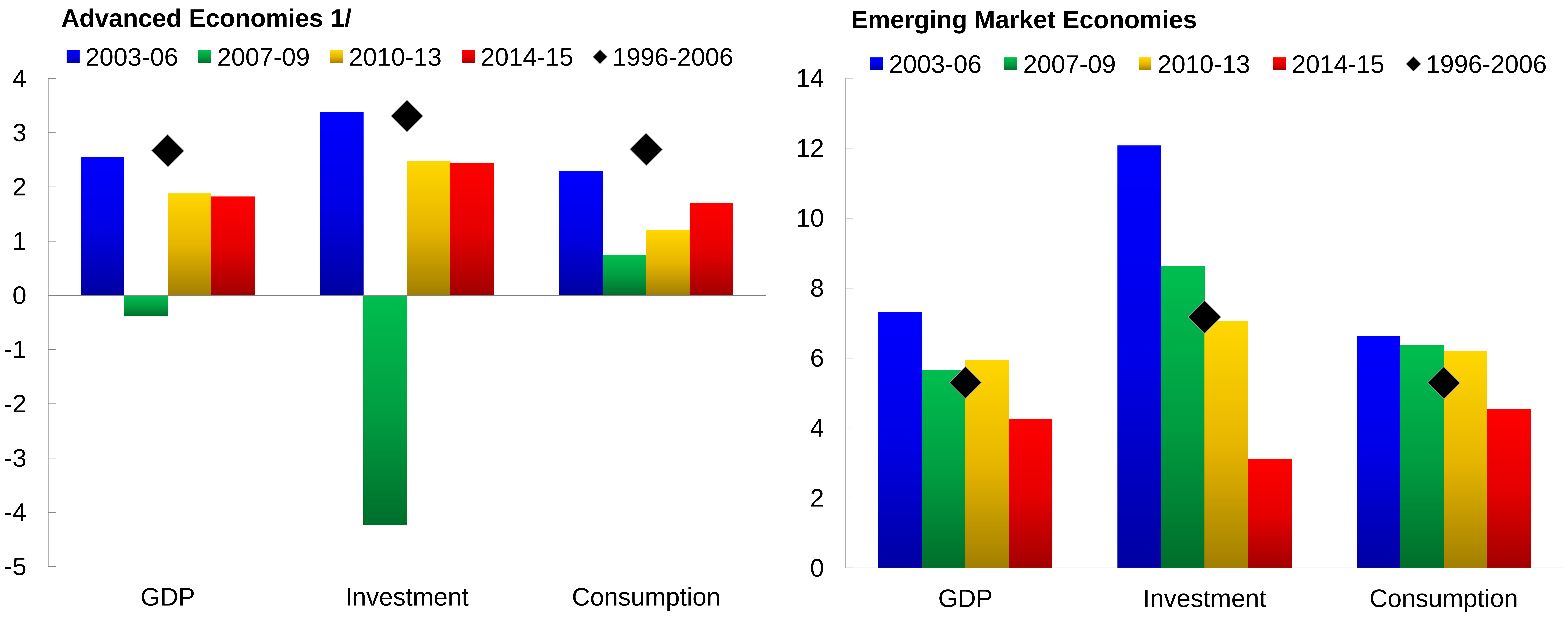
Given state variables (e.g., W, K), asset stocks = demands.

- Equality of saving and investment determines a constellation of asset returns – “natural” returns in a flex-price equilibrium.
- Flows drive stock equilibrium; portfolio shifts can drive flows.
- Example: Increase in demand for “safe” assets.
  - Tobin’s q $\Downarrow$, risk-free rate of interest (RFR) $\Downarrow$
  - I falls, K falls, MPK rises over time, RFR partially recovers.

Data are showing a fall in investment

Evolution of growth

(percent change; year-over-year; ppp-weighted)



Sources: IMF, *World Economic Outlook;* and IMF staff calculations.
1/ G-20 economies.

Policies: More growth, more stability

A three-pronged approach to growth:

- Continue monetary support and balance sheet repair.
- Deployment of fiscal tools (especially in infrastructure, where fiscal space is available) would support demand; collective action would mitigate effects on external imbalances.
- Need for well-sequenced structural reforms; might be most effective with some fiscal support.

Also need to seek financial stability:

- Better regulatory frameworks and coordination.
- More systematic regime for capital flows.
- Improved global financial safety net.