

## GENERAL DISCUSSION

# Global Imbalances and Global Liquidity

Chair: Barry Eichengreen

**Mr. Eichengreen:** I'm going to ask the old fogey's question: What is really new about the new view? If the new view focuses on gross flows, their composition, their currency denomination, and their maturity, is it simply the migration to the advanced economies of issues that a lot of people have been writing about under the rubric of currency and maturity mismatches on the national balance sheet? I think the answer to my own question would be that it's not only currency of denomination and maturity, but other liquidity and risk characteristics also need to be added to the mix. Another "what's new" question would be that the U.S. balance of payments in the 1960s reflected the fact that the United States was acting as banker to the world. The United States had deep and liquid financial markets in the 1960s, but it also had a central bank that could backstop intermediation. It's unprecedented that Europe is now providing the world with financial and intermediation services in a currency that the European Central Bank cannot itself provide. The question at the end of this monologue is, How did that situation arise, where we see an economy with this kind of maturity mismatch denominated in somebody else's currency? Kristin's slide on France suggested that it happened all at once in 1999, when there was a big break in the time series—so what happened in 1999?

**Mr. Gourinchas:** Thank you first Kristin for very constructive and useful comments. Barry, you had multiple questions, so let me try to give partial answers to each of them. If you look at what was going on in the 1960s, there was a lot of discussion that I summarize in the paper about what was the relevant concept of the balance of payments. At the time, Walther Lederer at the Department of Commerce argued that we should define the balance of payments as some measure of net short-term liabilities minus the change in reserves. The Bernstein commission was set up in the 1960s and came up with other definitions of the balance of payments. All of these efforts were addressing the same question that I'm talking about in this paper: they were trying to measure short-term funding or liquidity shortages. Of course at the time we didn't have any data on international balance sheet positions, so we worked with balance of payments

flow data, which was a constraint. I think what made the sort of evolution that Kristin is talking about possible is data, and here the efforts of people like Phil Lane and Gian Maria Milesi-Ferretti at the IMF and various other institutions in collecting better positions data that is broken down by type of assets and by counterparties is extremely useful. So that's one area where clearly we can do a lot better.

How did that situation arise? Well, 1999 may be a break point in the series for the gross flows, but in terms of the maturity mismatch, the turning point is the adoption of Basel II. Viral Acharya and Philipp Schnabl published an interesting paper a couple of years ago on the structure of asset-backed commercial papers. They show that all of the countries that were issuing ABCPs were engaged in some sort of regulatory arbitrage, exploiting the loopholes of Basel II to try to get no capital charge against the triple-A tranches of the securitized products. So that's the answer, regulatory arbitrage. Whichever way you define the liquidity coverage ratio, if you come down to that, a game will be played in terms of how we reclassify things.

Turning to what Kristin mentioned, how do we make this operational? Part of the difficulty is that even with the huge improvements in data we're not there yet. The Bank for International Settlements has been at the forefront, doing a fantastic job spotting dollar shortages almost as soon as they appeared. But they were triangulating, trying to estimate the amount of dollar funding needed, because there was no direct estimate. It was really pretty simple, you need a breakdown of liabilities and assets by currency and by maturity. We don't have that, and we should go in that direction.

**Ms. Forbes:** You said that much of this has been said before, and probably so, but some of it has been forgotten. If you read the debate on imbalances in the mid-2000s, there was very little focus on gross numbers, so maybe that's why it seems new to the younger people in this field. The second thing that is fundamentally new is the size of some of these positions. You can see it on my graph for France. The size of these gross positions relative to their underlying economies is much larger than it ever has been in the past, so I think that changes the debate. The third question is, why the break in the 1990s? Also, adding to what Pierre-Olivier said, if you create graphs like the one for France for these emerging markets, it's striking how gross inflows basically followed current account balances until the 1990s. After that, there was a wave of liberalization and reduction in regulations, such that domestic investors and banks that largely had not been allowed to were able to start investing abroad. That's where the gross outflows started to take off.

**Mr. Truman:** One difference is that the capital flows in the 1960s were dominated by the official sector rather than by the private sector. One needs to ask the question whether they are the same or different. Dong He suggested in his comment on my paper that the official sector capital flows we see now are responding to the private sector. That is a hypothesis, though perhaps a self-serving hypothesis if the reserves are being accumulated for other reasons. But it seems to me if you're going to go this route, you need to think about the private sector and official sector separately, including on the question of the demand and supply of safe assets.

My other comment is that, although Europe essentially had a balanced current account balance throughout the decade since the creation of the euro, it also was supplying about a €1½ trillion buildup in official gross claims on Europe, largely from within greater Europe, implying that the euro area was acting as a liquidity provider to itself through its own safe assets.

**Mr. Goodfriend:** I support what Pierre-Olivier was saying about what's new. Over the last 30 years, U.S. money market finance has been given all sorts of regulatory breaks that facilitated the supply of liquidity services. Exemptions from the mutual fund laws back in 1940 allowed money market funds to have constant net asset value, so they could compete with bank deposits. Exemption of the automatic stay in bankruptcy on repos has facilitated the repo market, and depository sponsors of money market funding were allowed to do so essentially by evading capital requirements. These developments allowed borrowers to fund themselves at lower explicit nominal interest cost. However, because there seemed to be no end to increases in liquidity, it fueled the credit bubble and collapse. This problem seems to have gone international, and is at the source of what's really different now.

**Mr. Kim:** I agree with you on most points, particularly the role of currency or maturity mismatches raising the vulnerability to crises. As for why so much borrowing was short-term, you mentioned this might be because of the disciplinary or liquidity role of short-term debt. But I also think it might be a reflection that maybe short-term liabilities were perceived as cheaper than long-term liabilities, despite risk vulnerability. We need to look at whether the cost difference between short-term and long-term debt instruments was at an equilibrium or else was somehow distorted.

**Mr. Gourinchas:** Thank you for the comments and questions. Ted, you raise an important distinction between the official sector and the private sector. In the normal state of the world there is provision of liquidity from both sectors. But

in times of crisis, private-sector liquidity dries up. Often official-sector liquidity has to step in to offset the decline in private-sector liquidity. That's what we've seen with the facilities for liquidity provision by many central banks around the world, and I think that's an important part of the response kit when we have a funding crisis. In the case of Europe, private liquidity has dried up, but the central bank is not an issuer of dollars, the currency that's needed to offset the shortage. That's when things like the swap lines become critical in alleviating some of the pressures.

So both official and private liquidity are important. It's complicated to measure what is the real pledgeable value of safe assets. On the public sector side, we witnessed in the last year a reclassification of risk-free assets—European sovereign debt—as risky assets. That has broad implication in terms of demand for the remaining safe assets, which is something that Kristin was touching on at the end of her comments.

Marvin, I agree with everything you said.

Jun, the question you raise about short-term debt is interesting. There's a lot of discussion these days about various distortions that can arise in the private provision of liquidity. The general view is that there is too much reliance on short-term debt instruments, so in that sense it might be too cheap. The issuers of liquidity don't face a high price for issuing and don't realize that by doing so they increase the systemic risk. In turn, they don't see a role for intervention in trying to structure the maturity of private-sector insurance. For instance, Jeremy Stein has argued that perhaps government should issue more short-term debt to squeeze that part of the maturity spectrum, raise short-term borrowing costs, and displace some of the private borrowing to the long-term side. In a closed economy analysis, one could imagine an international counterpart of what he's discussing. But then the question would be who would be issuing that sort of global liquidity. That's a hard question to answer.