

REFORMS OF THE GLOBAL FINANCIAL SAFETY NET FOR 21ST CENTURY CHALLENGES

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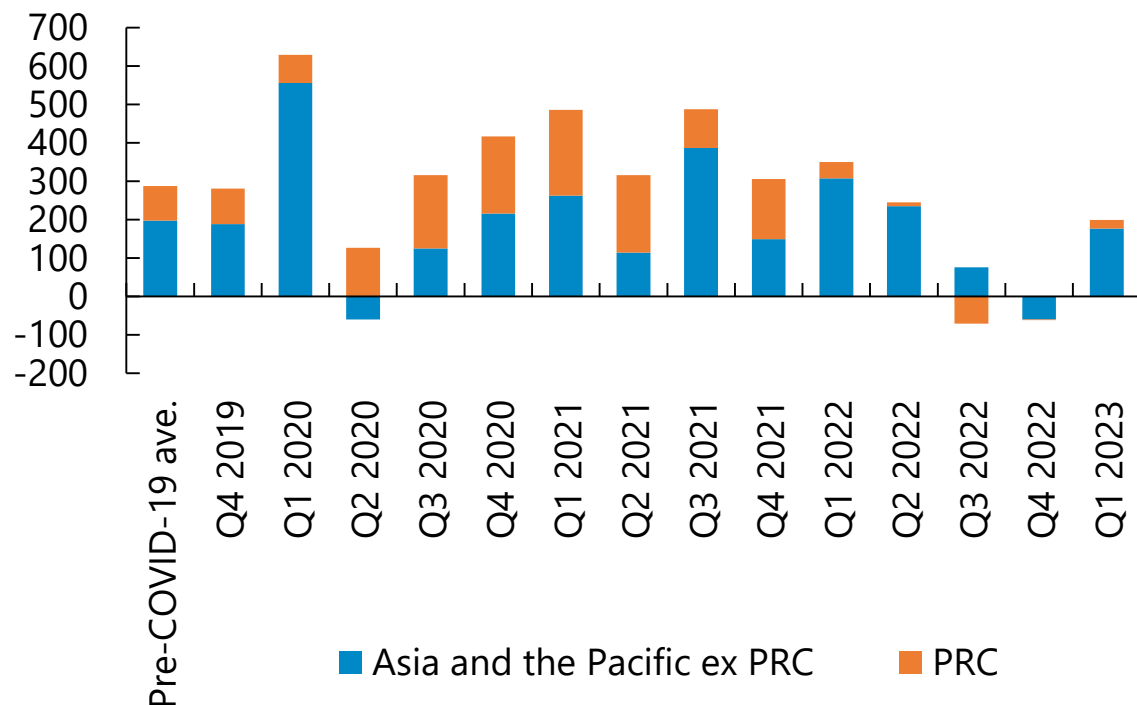


How to Ensure Liquidity Access for Emerging and Developing Economies

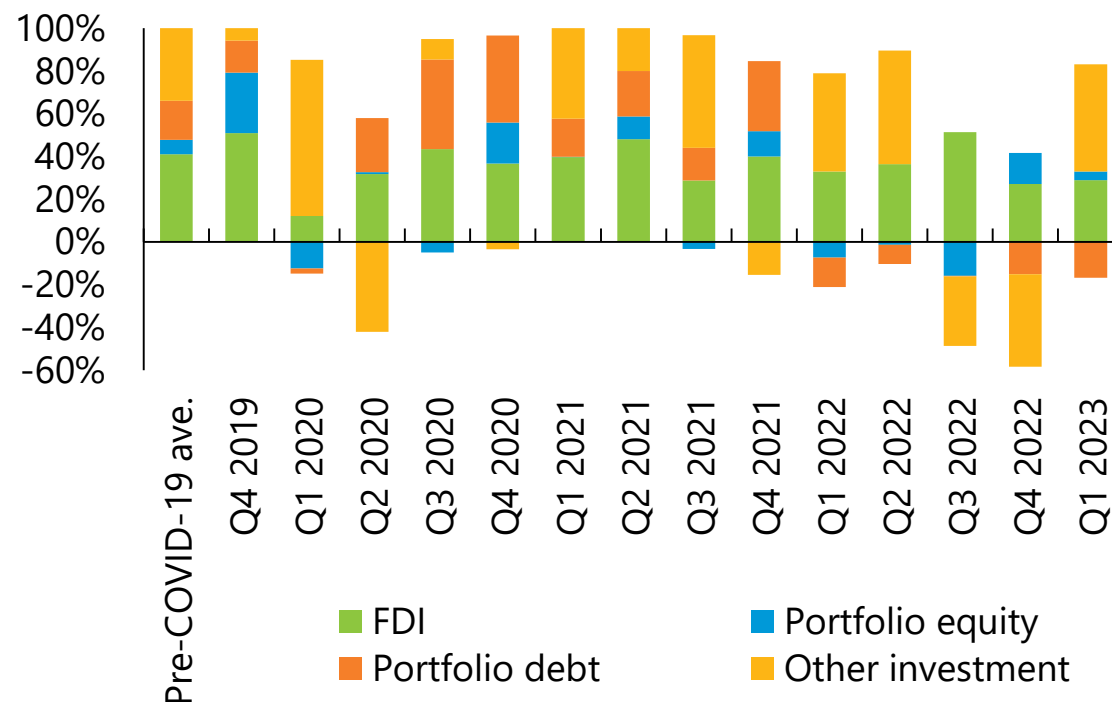
2022 saw significant capital outflows from Asia, with only partial recovery in 2023

Nonresident Capital Flows—Selected Asian Economies

(a) \$ billion



(b) % of total



COVID-19 = coronavirus disease, PRC = People's Republic of China

Notes: Nonresident net capital flows in Q3 2022 amounted to \$4 billion. Positive values denote inflows, negative values denote outflows. Pre-COVID-19 average spans Q1 2010 to Q3 2019. Selected Asian economies include Armenia; Azerbaijan; Bangladesh; Cambodia; Fiji; Georgia; Hong Kong, China; India; Indonesia; Japan; Kazakhstan; Malaysia; Pakistan; the People's Republic of China; the Philippines; the Republic of Korea; Samoa; Tajikistan; Taipei, China; and Thailand; and Uzbekistan. Other investment category includes currency and deposits; insurance, pension, and standardized guaranteed schemes; loans; other accounts payable; other equity; special drawing rights; and trade credit and advances.

Source: ADB. Forthcoming. Asian Economic Integration Report 2024. Manila; using data from the International Monetary Fund. Balance of Payments and International Investment Position Statistics. Accessed from CEIC Data Company.

Sources of global financial uncertainties and shocks

Financial stability risks from climate change



Global geoeconomic fragmentation

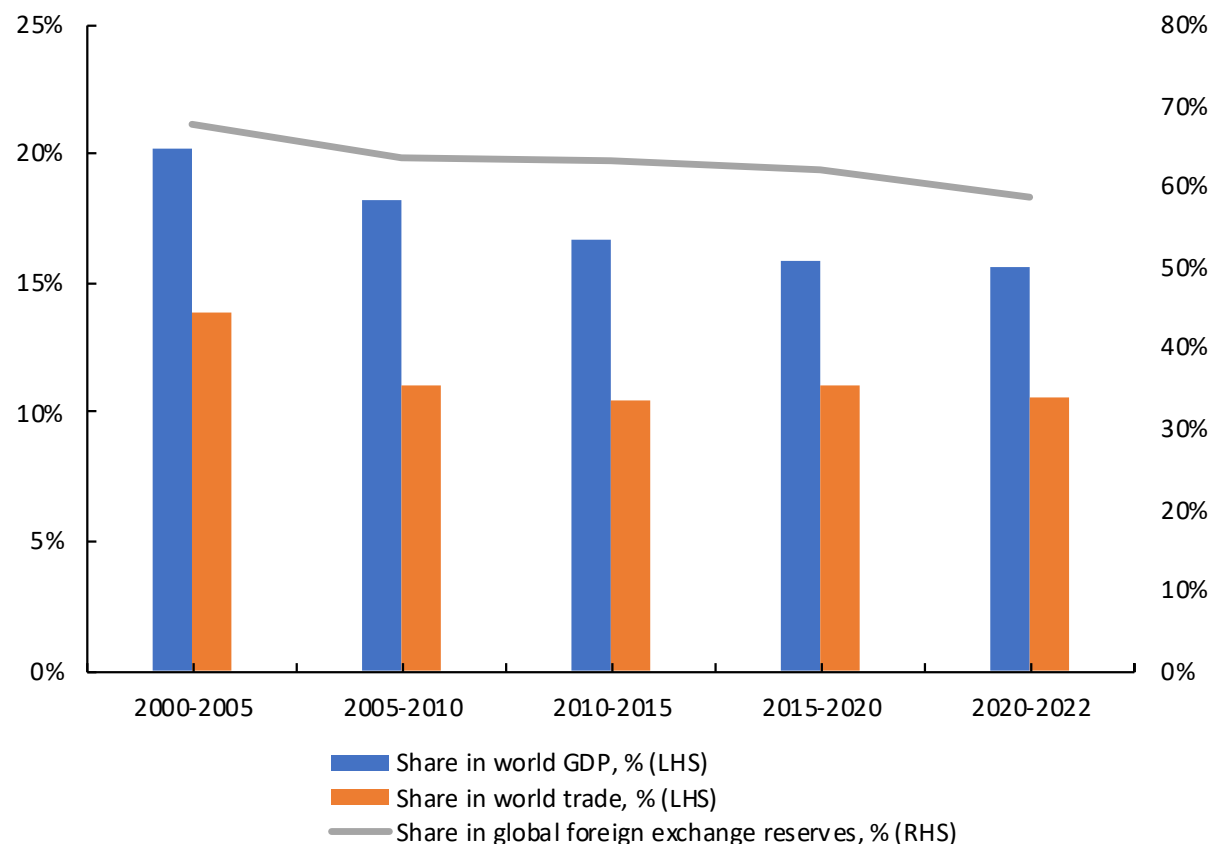
Higher for longer interest rates globally



Volatility of US dollar funding

The US dollar has been the globally dominant reserve currency for 60 years

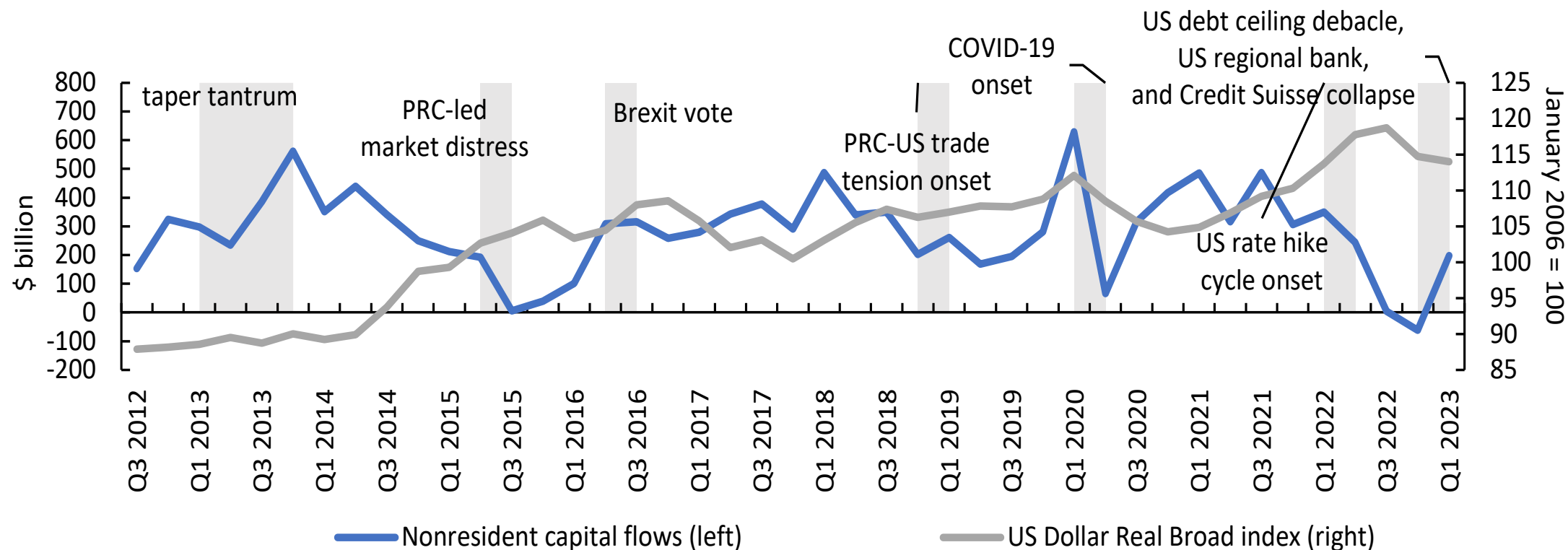
United States Share in Global Transactions and US Dollar Share in Foreign Exchange Reserves



- US dollar's share in global foreign exchange reserves remains uncontested despite a slow decline of the US economy's share in global GDP and trade
- US dollar-denominated assets are considered the ultimate safe asset globally thanks to:
 - US financial markets' unmatched depth and liquidity, ensuring low transaction costs
 - High US institutional quality

Sources: ADB calculations using data from IMF. Coordinated Portfolio Investment Survey. <https://data.imf.org/cpis>; IMF. Currency Composition of Official Foreign Exchange Reserves. <https://data.imf.org/COFER>; International Monetary Fund. Direction of Trade Statistics. <https://data.imf.org/dot>; and World Bank. World Development Indicators. <https://databank.worldbank.org/source/world-development-indicators> (all accessed September 2023).

Aggregate Capital Inflows Timeline—Asia and the Pacific



COVID-19 = coronavirus disease, PRC = People’s Republic of China, US = United States.

Note: The US dollar Real Broad index denotes the trade-weighted real effective US dollar exchange rate against a broad basket of 26 currencies.

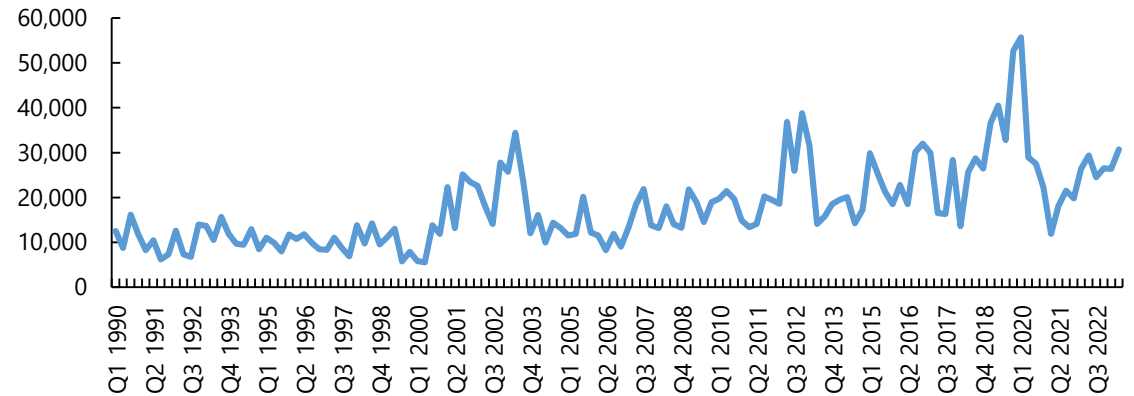
Source: ADB. Forthcoming. Asian Economic Integration Report 2024. Manila; using data from CEIC Data Company.

US dollar funding shocks are a major driver of capital flow volatility in Asia 2/2

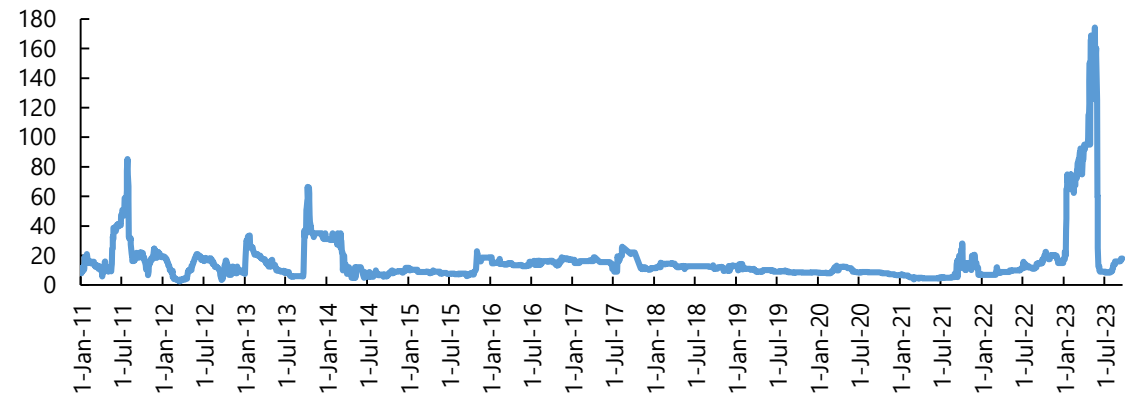
2023 US dollar funding shocks:

- Advanced Economies' monetary policy tightening, led by the US Federal Reserve
- Global geoeconomic fragmentation intensified
- US regional bank crises and Credit Suisse collapse
- US debt ceiling debacle and worsening US fiscal sustainability

Trade Uncertainty Measure—Asia and the Pacific (index)



USD 1-year EUR CDS—United States (basis points)



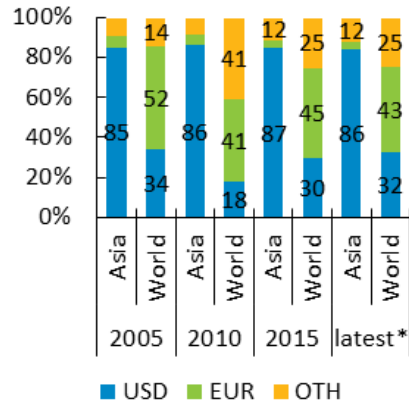
CDS = credit default swap, EUR = euro.

Source: ADB. Forthcoming. Asian Economic Integration Report 2024. Manila; using data from Ahir, Bloom, and Furceri (2022); and Investing.com. <https://www.investing.com/rates-bonds/united-states-cds-1-year-eur-historical-data> (accessed 22 September 2023).

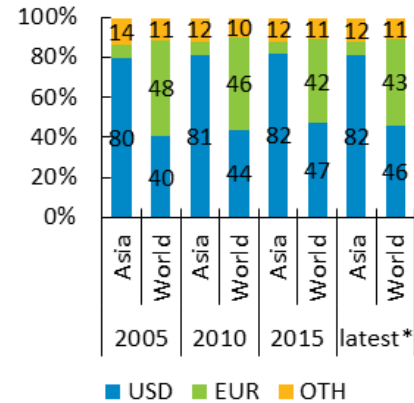
High US dollar dependence makes Asia prone to US dollar funding shocks

Currency Composition by International Currency Use (%)

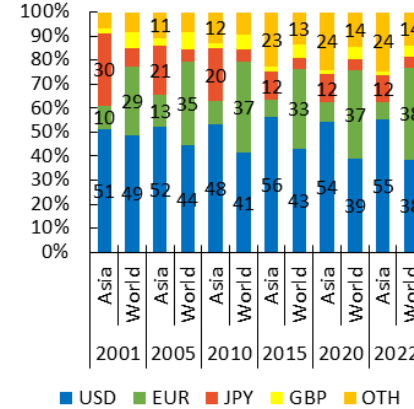
Export invoicing—Asia and the Pacific and World



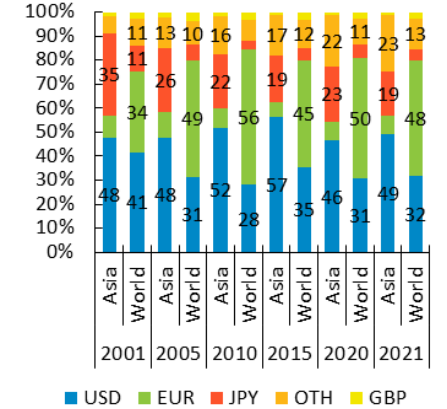
Import invoicing—Asia and the Pacific and World



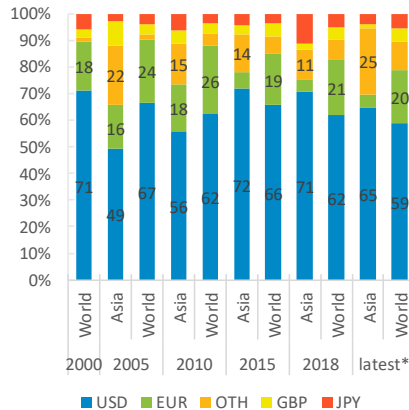
Bank assets and liabilities—Asia and the Pacific and World



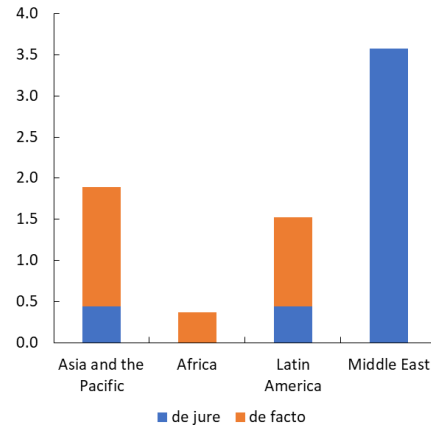
International debt liabilities—Asia and the Pacific and World



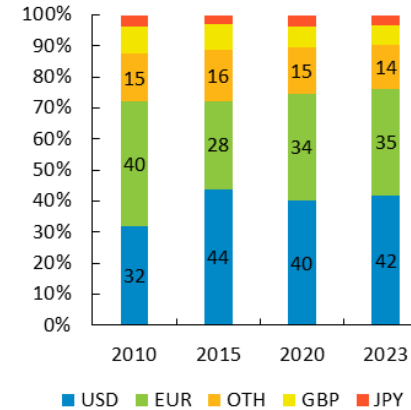
Official FX reserves—Asia and the Pacific and World



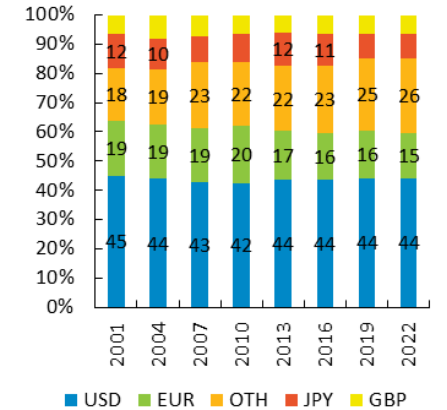
Currencies anchored to the US dollar—% to world GDP



Cross-border payments—World



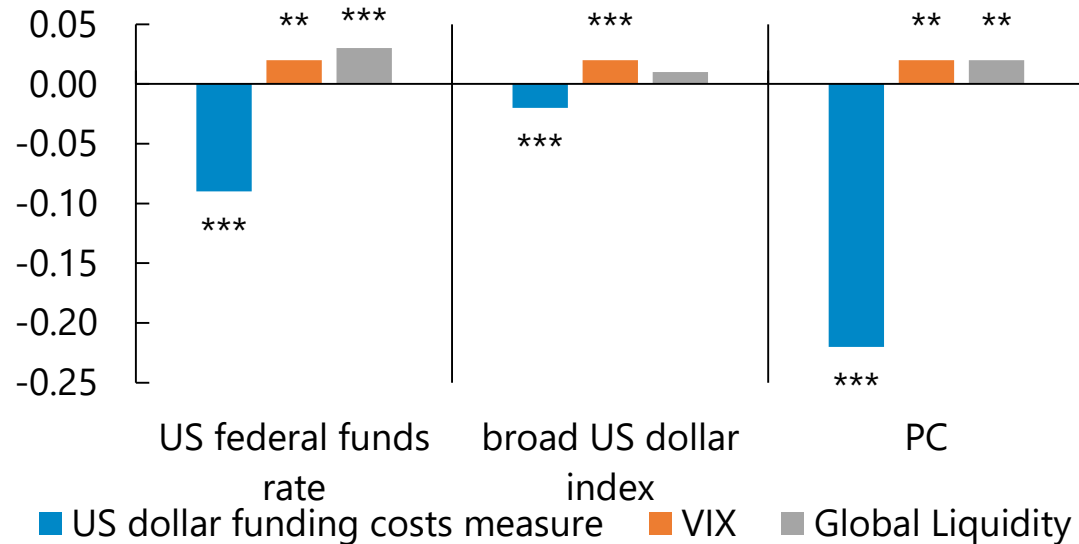
Foreign exchange turnover—World



Asia's US dollar funding dependence puts capital flows to the region at risk

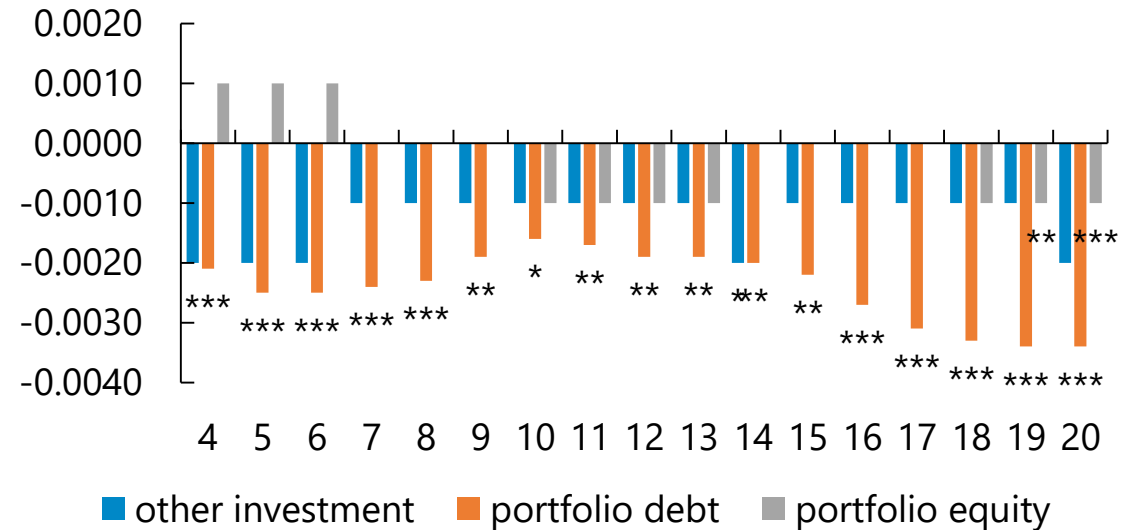
Capital flows to Asia reverse in response to US dollar funding shocks

Regression Coefficients of Capital Inflow Determinants



Dollar dependence amplifies capital flow reversals driven by US dollar funding shocks

Regression Coefficients— International Debt Share and US Dollar Funding Costs



PC = first principal component of the US federal funds rate and the US dollar Real Broad index, US = United States, VIX = volatility index. Stars denote statistical significance levels: *** at 1%, ** at 5%, and * at 10%.

US = United States. X-axis shows quarters. Stars denote significance levels: *** at 1%, ** at 5%, and * at 10%.

National policy options can mitigate exposure to US dollar funding shocks

1. Strengthen Asian banks' balance sheet resilience:

- Improve regulatory oversight of banks' foreign exchange liquidity risks
- Broaden currency hedging mechanisms

2. Develop local currency bond markets:

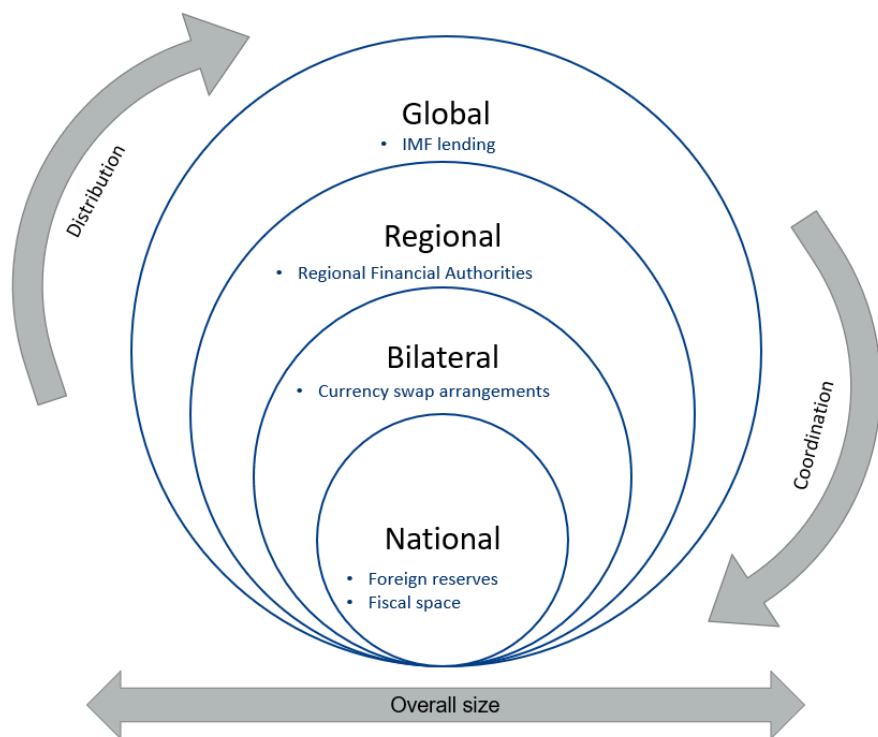
- Promote cross-border issuances and trading
- Broaden the domestic investor base due to the transfer of currency mismatches to international investors ("original sin redux")

3. Deploy carefully calibrated policy interventions:

- Policy rate adjustment
- Use macroprudential policies, foreign exchange intervention and capital controls to improve policy trade-offs

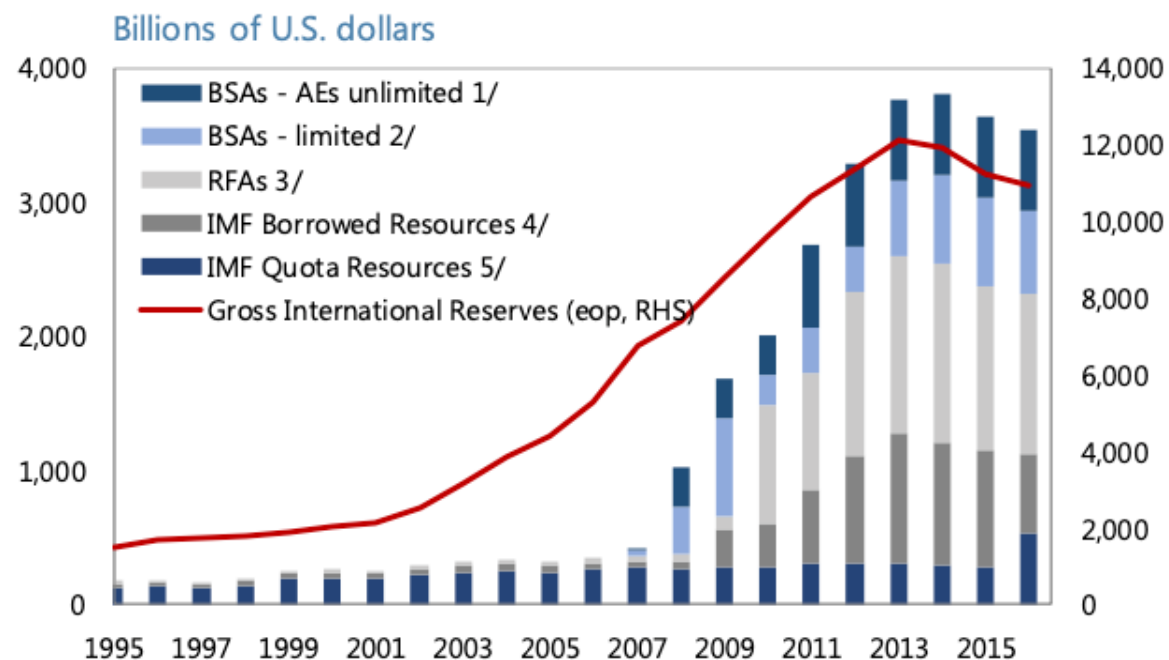
How to Strengthen the Global Financial Safety Net

Regional and bilateral safety nets complement the Global Financial Safety Net



- Regional and bilateral safety nets emerged in line with increased financing needs.
- Increased GFSN complexity raises the need for close policy coordination to ensure coherent and complementary financial assistance from various GFSN layers.

Evolution of the Global Financial Safety Net



RFA = Regional Financing Arrangement; BSA = Bilateral Swap Arrangement

1/ Estimated based on known past usage or, if undrawn, on average past maximum drawings of remaining central bank members in the network. Two-way arrangements are only counted once.

2/ Includes all arrangements with an explicit value limit and excludes CMIM arrangements, which are included under RFAs. Two-way arrangements are only counted once.

3/ Based on explicit lending capacity/limit where available, committed resources, or estimated lending capacity based on country access limits and paid-in capital.

4/ After prudential balances.

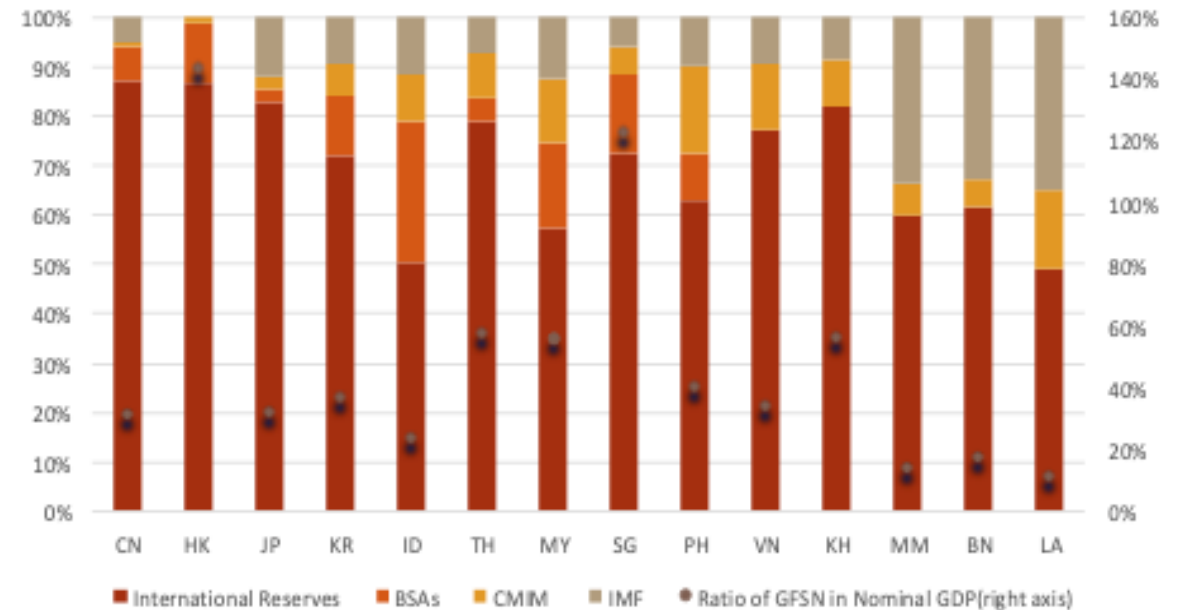
5/ For countries in the Financial Transaction Plan (FTP) after deducting prudential balance.

Source: IMF. July 2017. Collaboration between RFAs and the IMF. IMF Policy Paper..

The Chiang Mai Initiative Multilateralization (CMIM) liquidity pool constitutes the backbone of Asia's financial safety net

- **When:** Created after the 1997 Asian Financial Crisis
- **What:** Bilateral swap arrangements to address short-term liquidity needs, swapping local currency for US dollars, or local currency (since 2021)
- **How much:**
 - Lending capacity of USD240 billion, of which 60% linked to an IMF program
 - Precautionary credit line for eligible member countries
 - Additional USD381.6 billion through bilateral swap arrangements
 - additional USD2 billion through ASEAN Swap Arrangement

Composition of GFSN for ASEAN+3



Notes: IMF: Stand-by-Arrangement credit facility; CMIM: IMF-linked portion; BSA: calculated in USD as of 18 April 2019, including local currency swaps; International Reserves: as of December 2018. Source: AMRO (2019).

- What else: Macroeconomic surveillance provided by ASEAN+3 Macroeconomic Research Office's (AMRO)

Several initiatives could strengthen the CMIM for a more agile crisis response

- | | | |
|----------|--|--|
| 1 | Close cooperation between CMIM/AMRO and IMF | Set clear operational guidelines for the coordination of both institutions' financial assistance in crisis times |
| 2 | Reducing the share of CMIM liquidity linked to IMF conditionality | Allow for more agile crisis response rooted in regional expertise in line with AMRO's improving surveillance capabilities |
| 3 | Extending the maturity of CMIM financial assistance | Extend the maturity of financial assistance to cover solvency issues in addition to short-term liquidity needs |
| 4 | Enhancing AMRO's capacities | Enhance AMRO's capacities to cover regionally active systemically important financial institutions, and design emergency loans |
| 5 | Modifying the CMIM's operational design | Raise CMIM's lending capacity through financing by bond issuances backed by paid-in capital |

Thank you!