

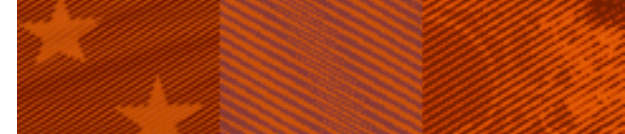
# THE TRANSMISSION OF THE GLOBAL FINANCIAL CYCLE

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INTERNATIONAL AFFAIRS

# CHARACTERIZING THE GLOBAL FINANCIAL CYCLE (GFC) AND TRANSMISSION CHANNELS



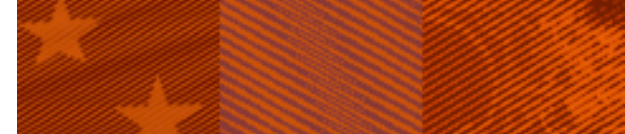
## ❑ The main characteristics of the GFC were summarized by Rey (2013) and Rey and Miranda-Agrippino (2015):

- ❑ There exist a strong co-movement of gross capital in(out) flows, credit growth, banks leverage and risky asset prices across countries
- ❑ Under unconventional monetary policies, also strong co-movement of bond yields
- ❑ In fact, one global factor explains 25% of the variance of cross-section risky asset returns, and this global factor is strongly and inversely correlated with VIX

## ❑ The transmission channels identified in the literature are:

- ❑ Capital flows and leverage of big global financial institutions transmit the monetary and financial conditions of the center country (Bruno and Shin, 2014)
- ❑ Corporate bond market -“search for yield” and shifts in risk premium: global credit in US dollars and Euros extended to non-bank sector (Shin, 2013)
- ❑ US monetary policy (FF rate increase: capital inflows, dollar appreciation, tightening of financial conditions worldwide, reduction of commodity prices)

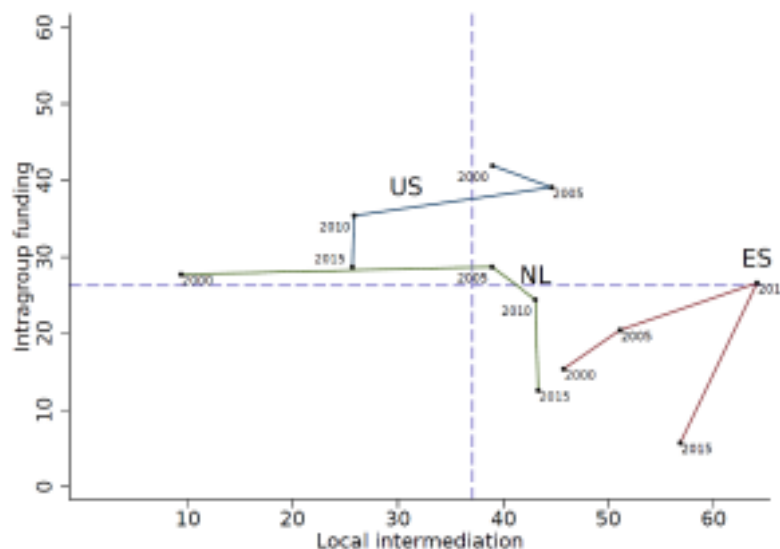
# MONETARY POLICY TRANSMISSION OF BIG GLOBAL FINANCIAL INSTITUTIONS



Argimon et al. (2018) find that banks (as opposed to insurance companies and pension funds) play a very relevant role in the transmission of headquarters country monetary conditions. However:

- These spillovers are much more relevant for global banks operating with a centralized business model (US, cross border operations) compared to a decentralized model (Spain, local operations)
- The spillovers through the bank lending channel decline with the bank size
- The spillovers through the portfolio channel decline with the bank solvency

Figure 1: Degree of banks' (de)centralization



# THE RECENT EVOLUTION OF CROSS-BORDER BANKING ACTIVITY

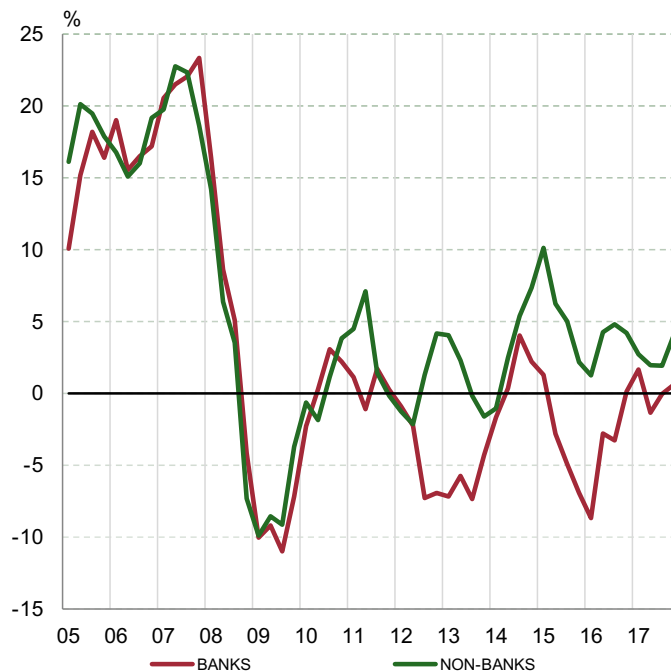


□ According to BIS data, since the global financial crisis the international activity of global banks has diminished in most jurisdictions:

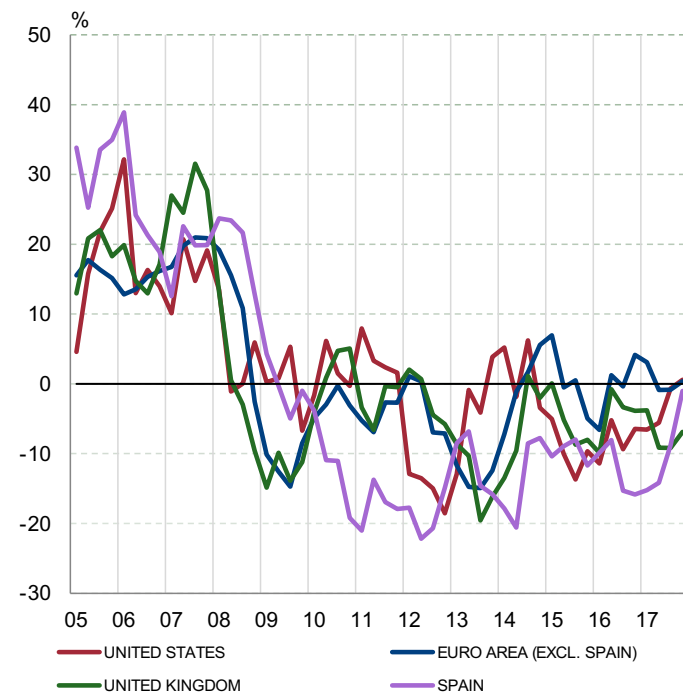
- Due to cross border operations (local operations have remained stable), and...
- ...among banks
- Probably, this implies a reduced role of banks in transmitting the GFC

## EXTERNAL CLAIMS

B. ANNUAL PERCENTAGE CHANGES (c)



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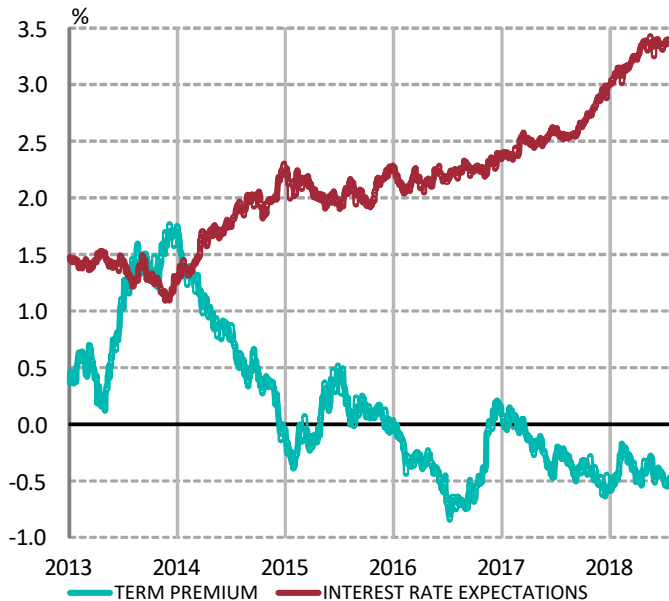
# SEARCH FOR YIELD IN THE NON-FINANCIAL CORPORATE BOND MARKET



❑ The non-conventional monetary policy in most advanced economies has contributed to the flattening of the yield curve, thus favoring “search-for-yield” behaviors:

- ❑ The compensation for risk has diminished both in advanced economies and...
- ❑ ...in emerging markets, facilitating the bond issuance of corporates
- ❑ There has been a generalized extension in maturities

USA: 10 - YEAR PUBLIC DEBT YIELD DECOMPOSITION



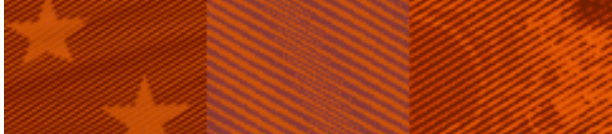
SOURCE: DATASTREAM AND NEW YORK FED

USA: INTEREST RATE SPREADS



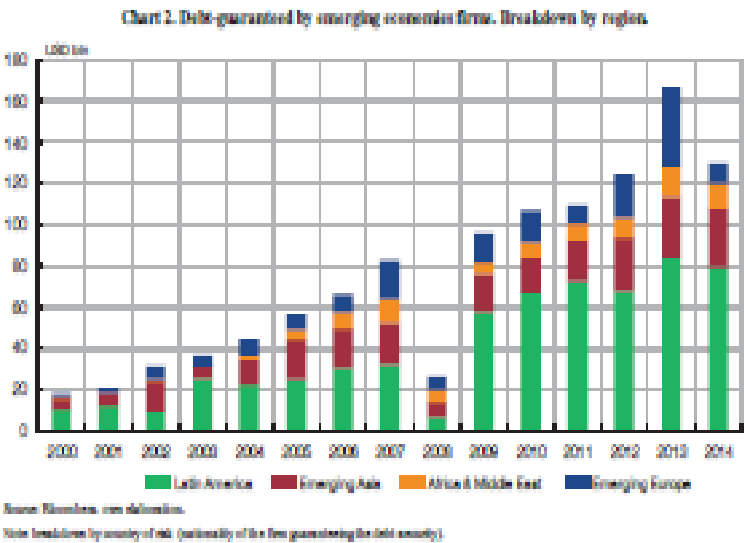
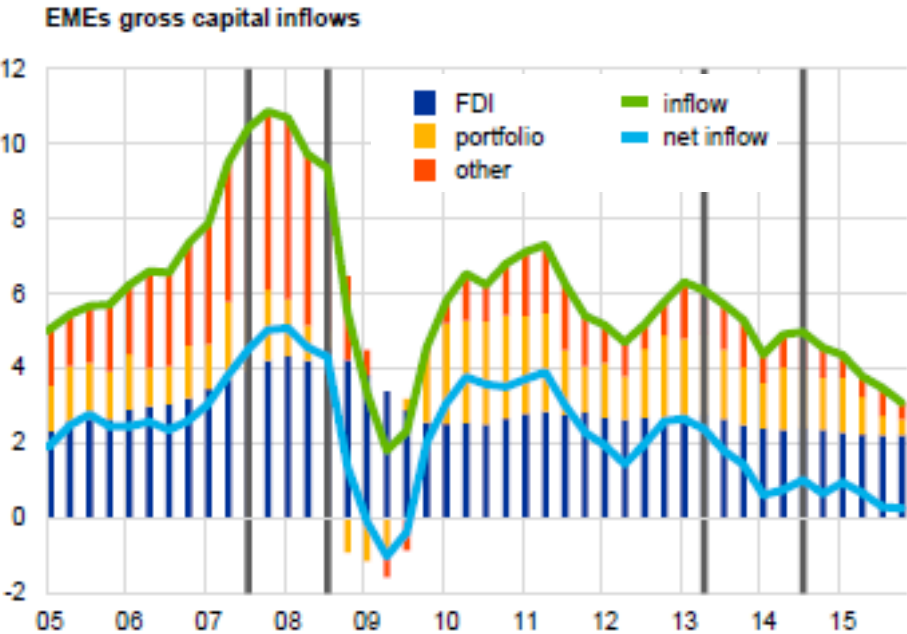
SOURCE: DATASTREAM

# BOND ISSUANCE BY EMERGING MARKET CORPORATIONS



❑ The composition of capital flows to emerging markets after the GFC has changed to some extent, gaining relevance portfolio investment (IRC TF, 2016):

- ❑ In fact, the net issuance of fixed income has increased considerably, especially in the case of Asia and LatAm
- ❑ An important part of this activity corresponds to first-issuers non-financial firms and in foreign currency (Fuertes and Serena, 2014)
- ❑ These new firms operating in bond markets have natural hedges, but they are financially more vulnerable



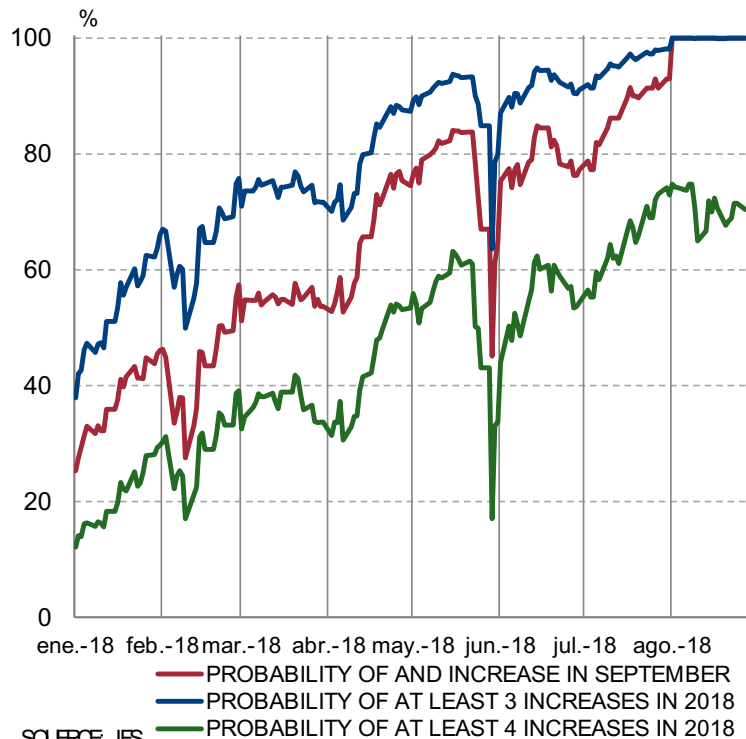
# MONETARY POLICY NORMALIZATION IN US...



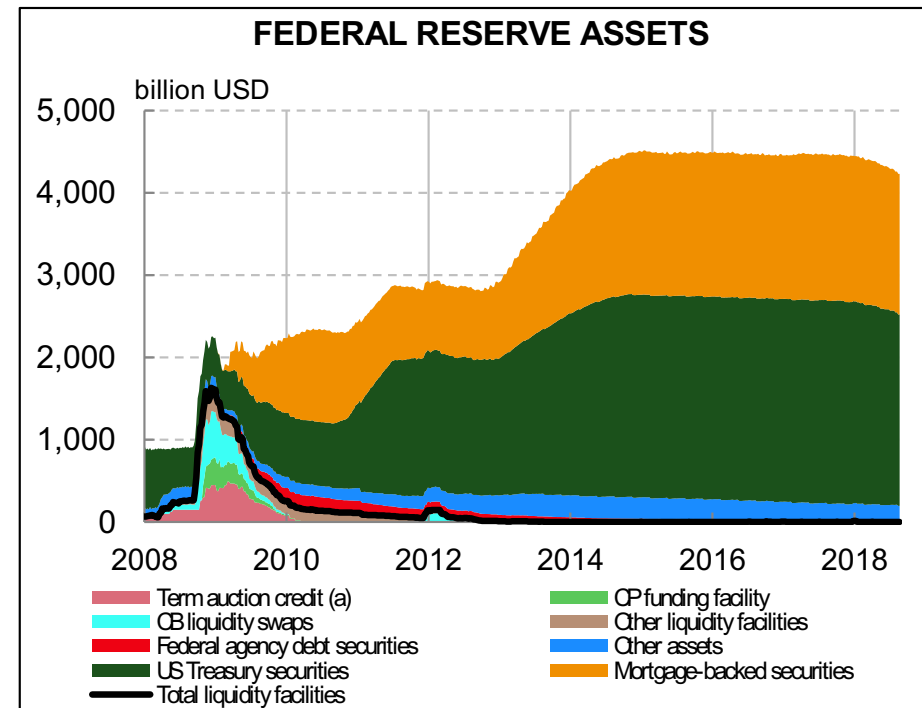
## ■ The US monetary policy has slightly intensified its normalization process:

- In part as a consequence of the expansionary fiscal policy by the Federal Government, now the markets bet for 4 interest rate increases in 2018
- In any case, the monetary authorities are being very cautious with the reduction of the Fed balance sheet

**USA: PROBABILITY OF CHANGES IN THE FEDERAL FUNDS RATE**



**FEDERAL RESERVE ASSETS**

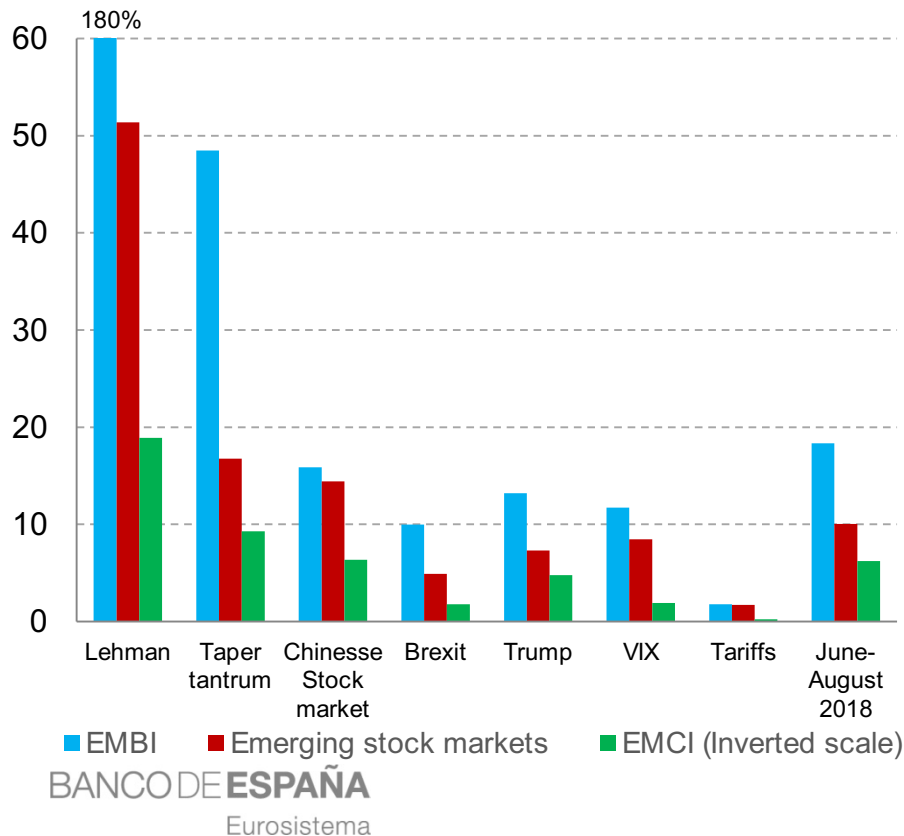


## ...AND SPILLOVERS FOR EMERGING ECONOMIES

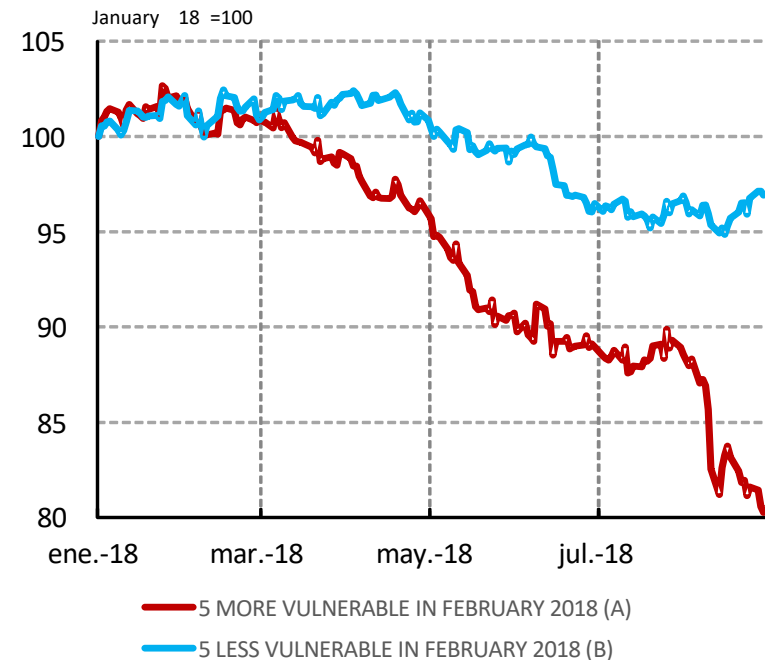
❑ The correction in emerging economies begins to be sizable, although markets seem to be discriminating depending on country vulnerabilities:

❑ Most emerging economies are better prepared than in the past (room for maneuver in macro policies, reserves,...), but...

EMERGING MARKET INDICATORS (Change since...)

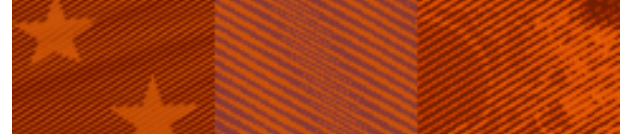


EXCHANGE RATES vs. DOLLAR



(a) Nigeria, Egypt, Tunisia, Brazil, Turkey  
(b) Korea, Chile, Czech Republic, Thailand, and Romania





# THANKS FOR YOUR ATTENTION