



BANK FOR INTERNATIONAL SETTLEMENTS

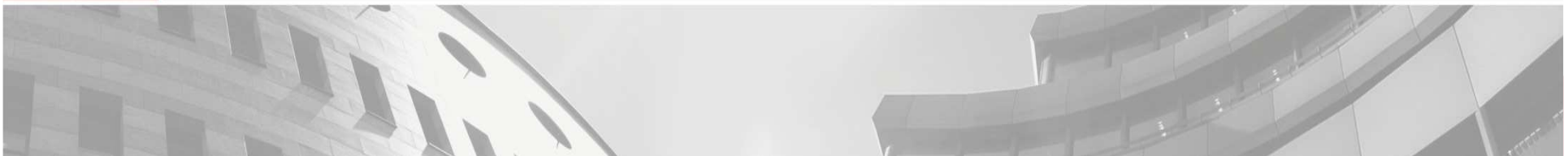
Vulnerability of EMEs and central bank policy buffers

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UNCTAD Intergovernmental Expert Group on Financing for Development, Geneva, 7 November 2018

The views expressed are those of the author and not necessarily those of the BIS.



Outline

1. Risks and vulnerabilities
2. Policy space for central banks

Risks and vulnerabilities

Background

- Long period of inflows: strong growth and search for yield
- Improved buffers in many countries but risks to financial stability may have emerged
- Rise of foreign debt, in particular of non-bank borrowers, in addition to expansion of domestic debt markets.

External shocks

- Tighter monetary policy in AEs
- Dollar appreciation
- Political risk (eg trade)

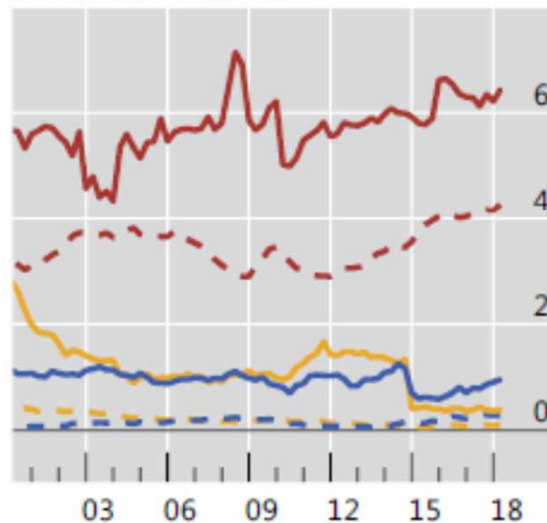
Dollar prevails among EME FX debt

- In all EM regions, the growth of US dollar credit outpaced that of other foreign currencies
- Dollar debt prevails even in Central and Eastern Europe

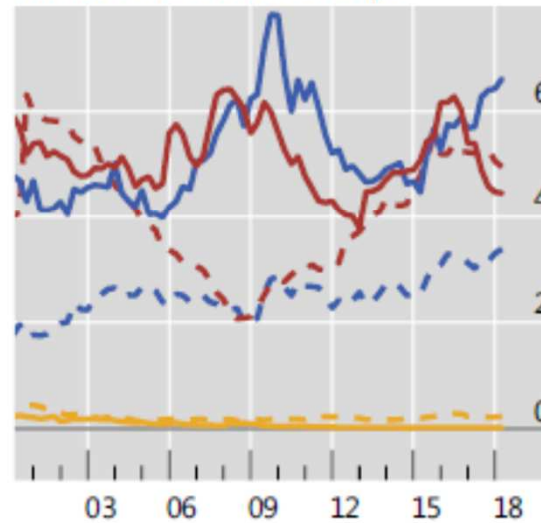
Foreign currency credit to non-bank borrowers in EMEs

Amounts outstanding,¹ as a percentage of regional GDP

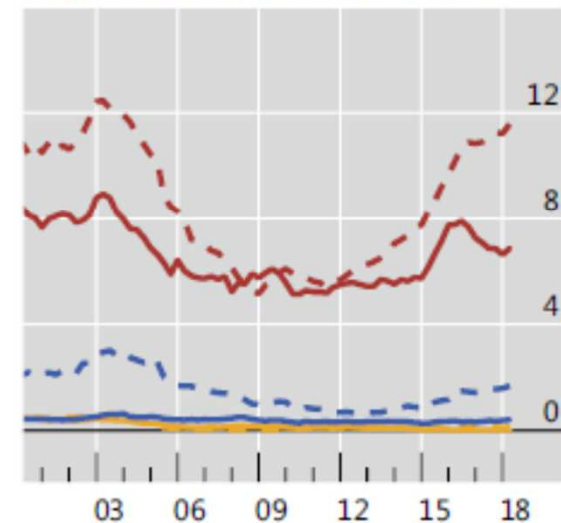
Asia, excluding China



Central and eastern Europe²



Latin America and the Caribbean



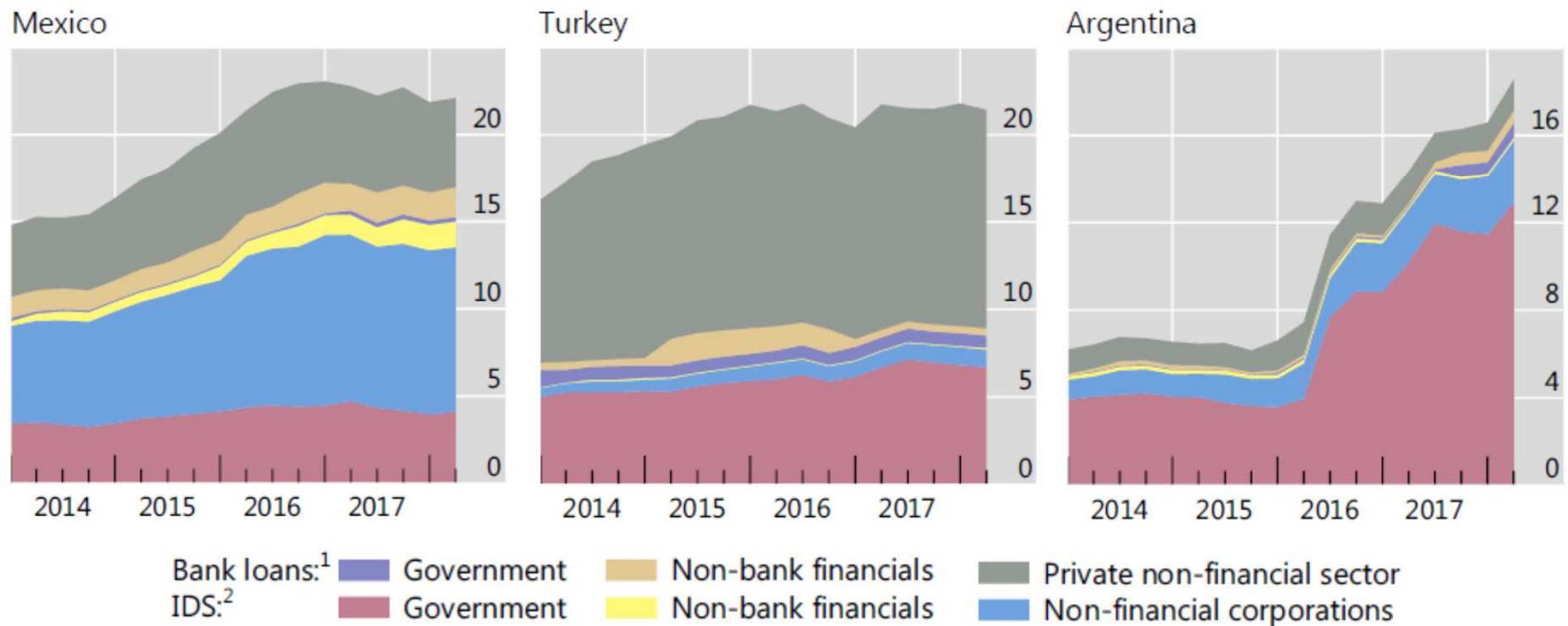
USD: EUR: JPY:
Bank loans: — — —
IDS:³ - - - -

Patterns of sectoral borrowing vary widely

- Hence, risks and vulnerabilities are also heterogeneous

The sectoral heterogeneity of dollar borrowing across selected EMEs

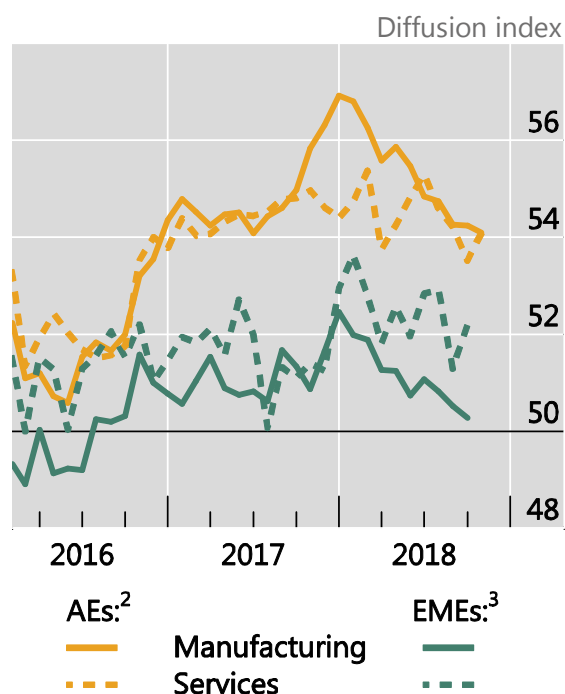
Amounts outstanding, as a percentage of GDP



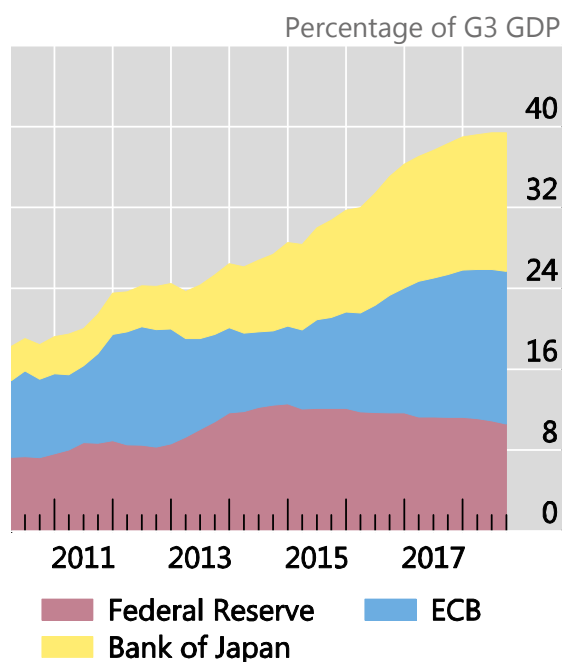
Supply of global liquidity appears on the wane

- Gradual end of QE and monetary policy normalization
- US dollar liquidity could be tightening fast

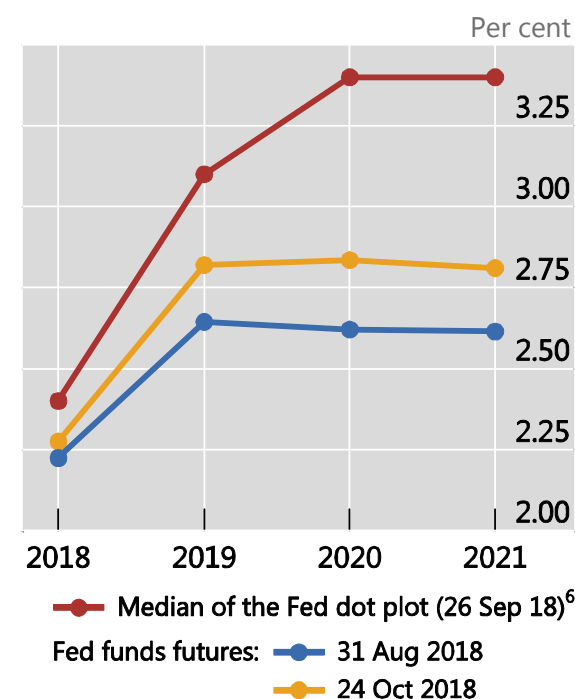
Manufacturing and services PMIs¹



Quantitative easing is ending



US monetary policy expected to continue to tighten⁴

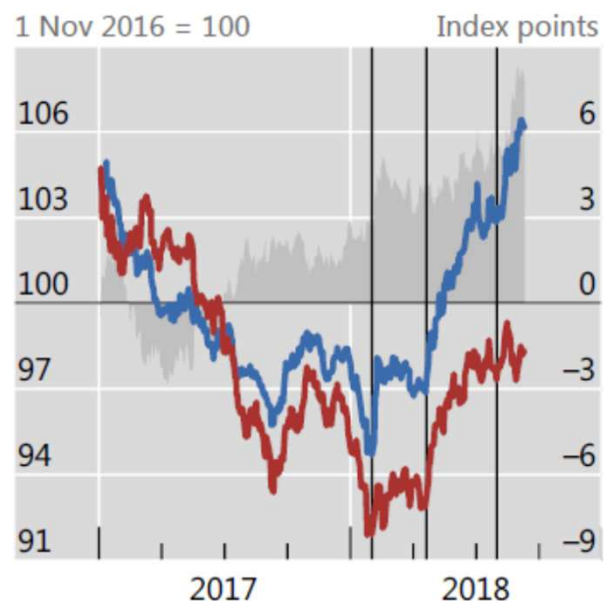


¹ Purchasing managers' indices. A value of 50 indicates that the number of firms reporting business expansion and contraction is equal; a value above 50 indicates expansion of economic activity. Weighted average based on GDP and PPP exchange rates of the economies listed. ² EA, GB, JP and US. ³ AR, BR, CL, CN, CZ, HK, HU, ID, IN, KR, MX, MY, PE, PL, RU, SG, TH, TR and ZA. ⁴ Economic projections of US Federal Reserve Board members and US Federal Reserve Bank presidents.

Source: Federal Reserve Bank of St Louis (FRED); Bloomberg; national data; BIS calculations.

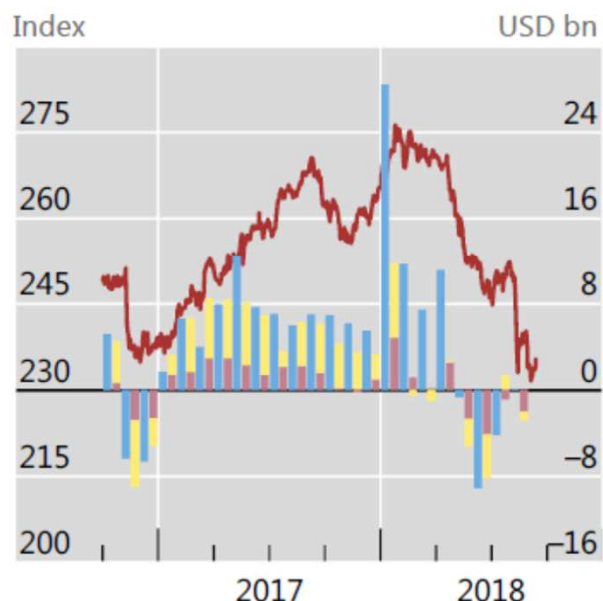
Sentiment shifts against EMEs

US dollar strengthens more against EME currencies¹



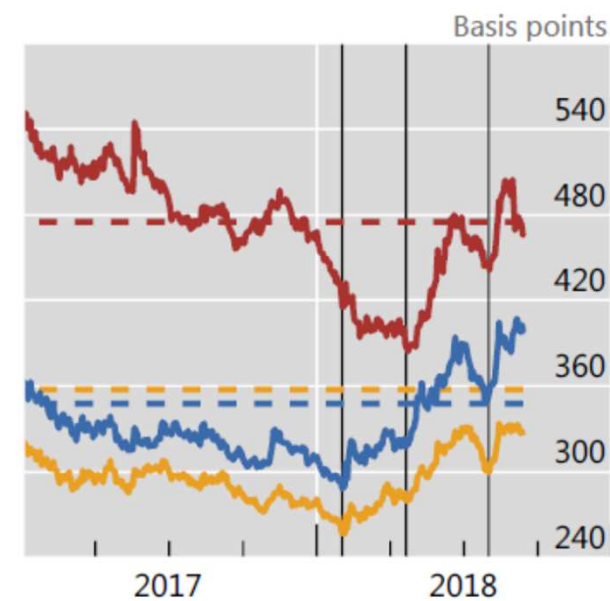
Lhs: — Major AE currencies²
 — Major EME currencies³
 Rhs: ■ Difference⁴

EME fund flows turn



— EME carry trade index (lhs)⁵
 ■ Equity (rhs)
 ■ Local currency
 ■ Hard & blend currency⁶

EME spreads widen



Sovereign spreads:
 — Local currency⁷
 — US dollar⁸
 Corporate spread:
 — US dollar⁸

The vertical lines in the left- and right-hand panels indicate 2 February 2018 (US labour market report triggers stock market jitters), 20 April 2018 (Argentina starts large intervention to support the peso) and 1 August 2018 (US government announces sanctions on Turkey).

Room for manoeuvre for central banks

How much room for manoeuvre in response to weakening growth prospects and the risk of large-scale capital outflows?

- Monetary policy
- Exchange rate interventions
- Macroprudential policy

Room for manoeuvre: monetary policy

- No clear-cut policy response to weakening growth prospects when there is a risk of large-scale capital outflows.
- Inflation close to targets: room for easing
- Externally, not much room for easing. Widening interest rate differential. Currency depreciation may sap confidence in the central bank's ability to ensure price stability. FX debt burden rises.
- So should interest rates rise? Aside from business cycle, financial stability issues if domestic currency debt high / short maturity / variable rates.
- Excessive debt makes the monetary policy response particularly difficult.

Room for manoeuvre: FX market interventions

Level of international reserves generally high

- Increased capacity to intervene can be stabilizing
- FX interventions can help stabilise the exchange rate and smooth external adjustments. Perhaps more effective in counteracting appreciation than depreciation.
- Some evidence that communication can help if it provides guidance to the market.
- Can also be used to provide FX liquidity to firms

Room for manoeuvre: macroprudential policy

- Macroprudential policies appear to have smaller impact on credit growth when eased than when tightened.
- To have an impact, regulatory requirements need to bind.
- For easing to be effective when financial conditions tighten and market requirements rise, need to have built large buffers.
- Buffers do not appear large:
 - CCyB close to zero
 - Some structural buffers that improve resilience
 - Easing sectoral measures (eg LTVs for mortgages) may not have much macro impact.
- Too late to continue to build buffers now?

Conclusions

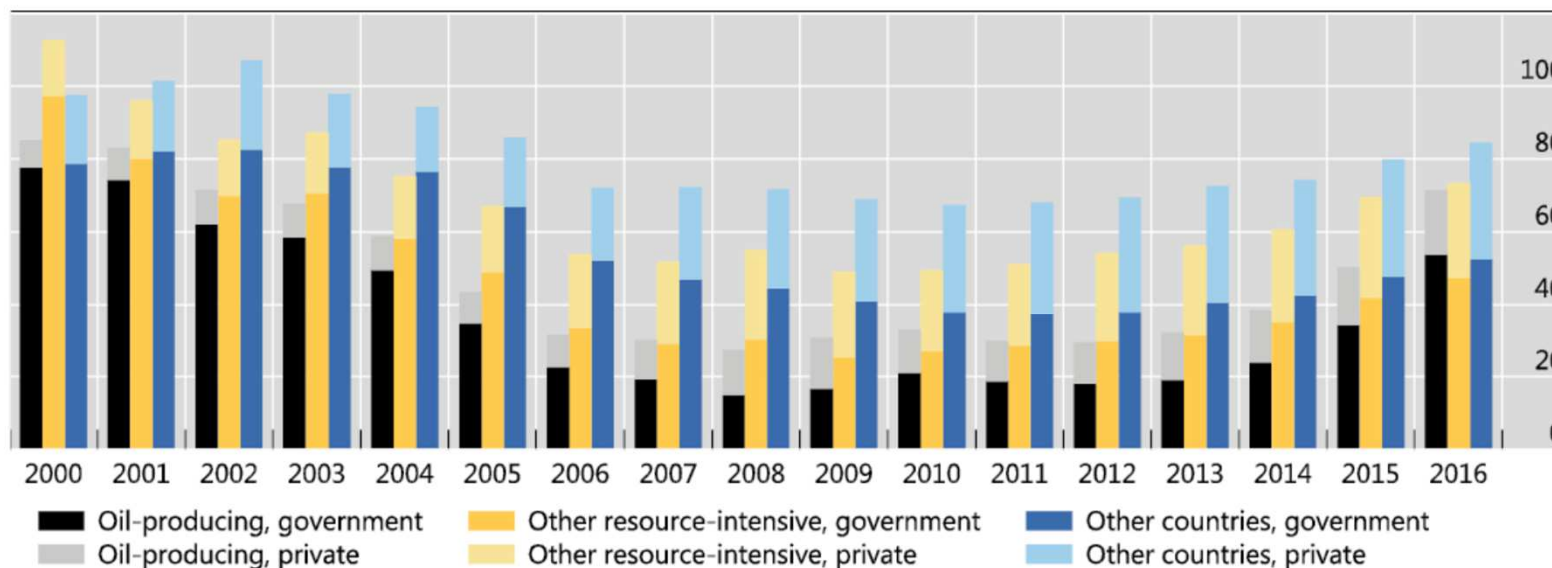
- Economic environment weakening but still solid
- Some EMEs have borrowed heavily in US dollars. The level and sectors of borrowing vary a lot across countries
- Dollar liquidity to continue to shrink
- Monetary policy in EMEs constrained by financial stability and capital flows
- Foreign exchange reserves have increased, but effectiveness of FX intervention unclear
- Macroprudential policy buffers appear too low to offset significant tightening of financial conditions.

African economies: concerns about government debt

Private and government debt, by country type and borrowing sector

As a percentage of GDP

Graph 1



Estimate, using simple averages across countries where data are available. For country groups, see Annex. For Congo, Egypt, Ethiopia, Mauritius, Tanzania, Uganda and the UEMOA, "government" refers to general government debt; for other countries, it is central government debt.

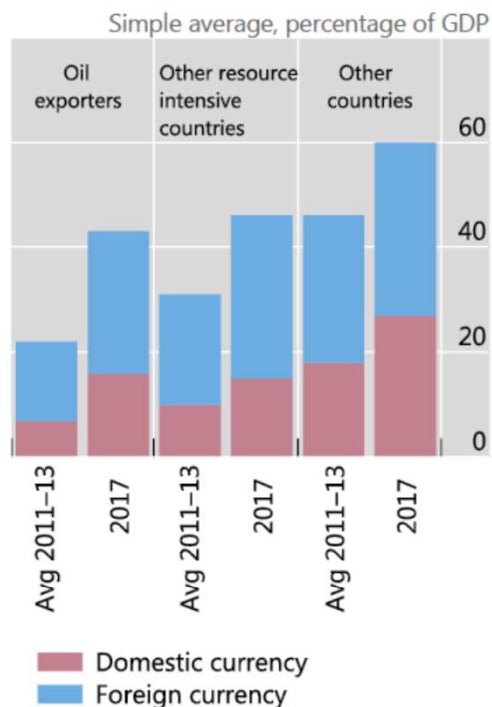
Sources: IMF; BIS calculations.

African economies: debt composition

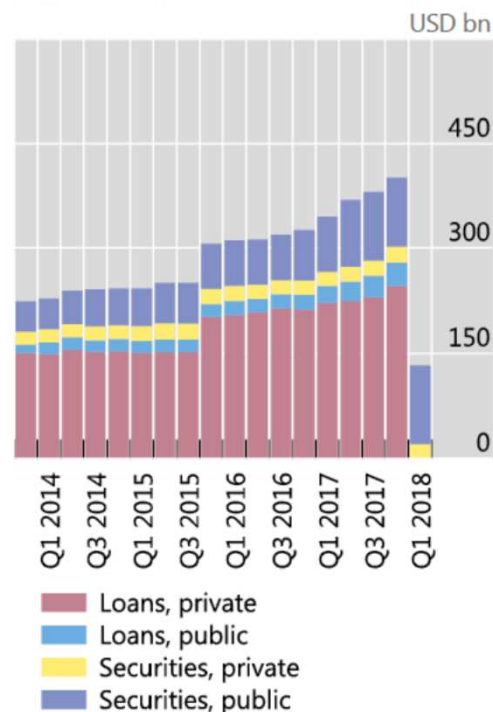
Debt composition

Graph 2

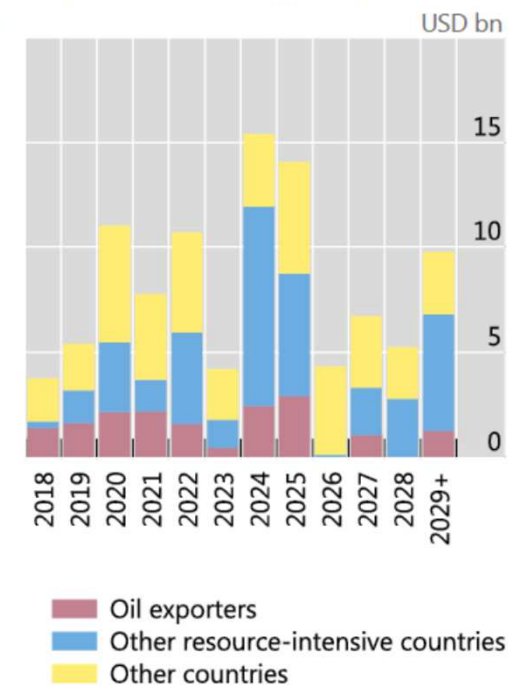
Total public sector debt, sub-Saharan Africa



Cross-border borrowing from banks and international debt securities¹



Repayment schedule for international debt securities



¹ International debt securities (IDS) show the amounts outstanding of debt securities issued by African residents outside their local markets. "Public securities" are IDS issued by governments and public corporations. "Public loans" are stocks of cross-border bank loans to African governments; "private loans" are the difference between total and "public" cross-border loans. Cross-border bank loans exclude loans by pan-African banks other than those reporting in South Africa. The jump in cross-border loans in Q4 2015 coincides with the inclusion of China and Russia as reporting countries. Loan data for Q1 2018 have not yet been published.