External debt vulnerability

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Three points

1. Old story: dollar debt dependency

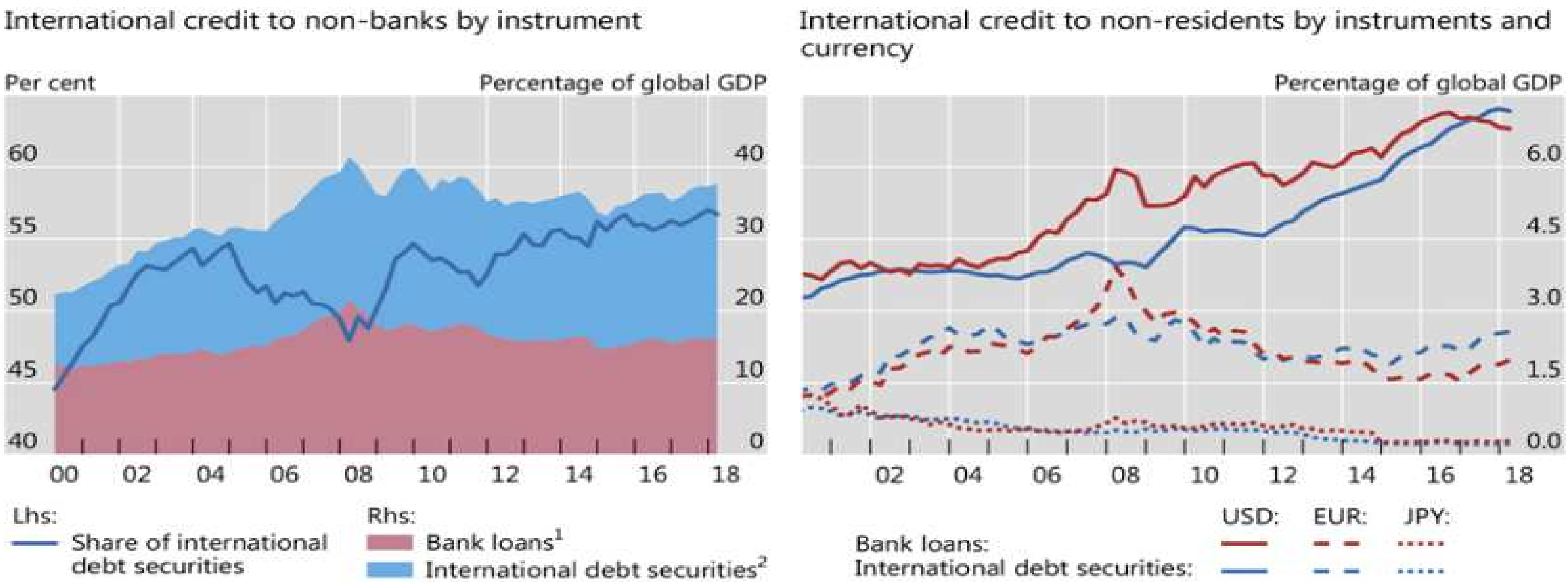
2. A new solution: Maximising Finance for Development

3. The problems with the new solution

USD global footprint

The share of debt securities and the US dollar in international credit has risen

International credit to the non-bank sector, amounts outstanding — Graph 1



Further information on the BIS global liquidity indicators is available at www.bis.org/statistics/about_gli_stats.htm.

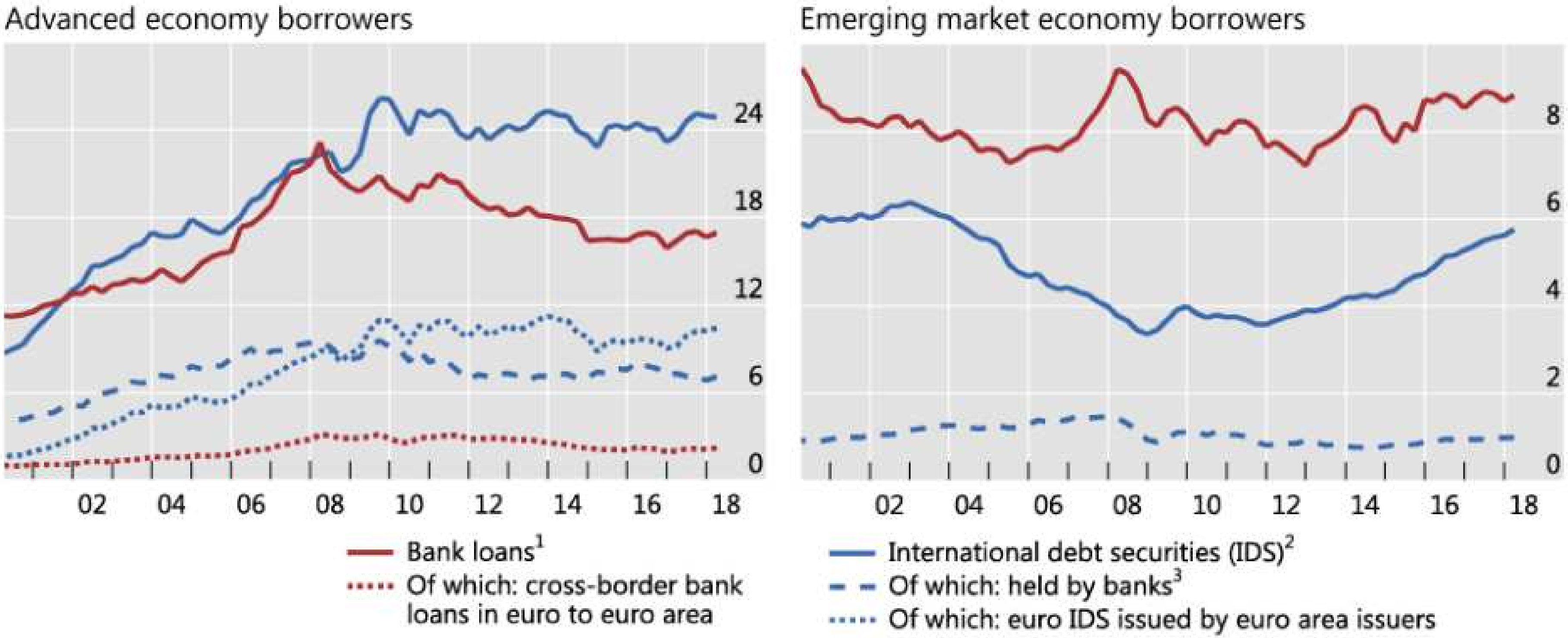
[1] Cross-border loans and local loans in foreign currency to non-bank borrowers. [2] By residence and immediate sector of issuer; all instruments; all maturities; non-bank issuers. International debt securities are debt securities issued by non-banks in a market other than the local market of the country where the borrower resides.

Sources: Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; BIS locational banking statistics and global liquidity indicators; BIS calculations; authors' calculations.

image 1 of 6

The shift to debt securities has been stronger for advanced economy borrowers

Amounts outstanding, as a percentage of regional GDP — Graph 2



[1] Cross-border loans and local loans in foreign currency to non-bank borrowers. [2] By residence and immediate sector of issuer; all instruments; all maturities; non-bank issuers. [3] Cross-border debt securities holdings in all currencies and local holdings in foreign currency reported by LBS-reporting banks.

Sources: Dealogic; Euroclear; Thomson Reuters; Xtrakter Ltd; BIS locational banking statistics (LBS); BIS calculations; authors' calculations.

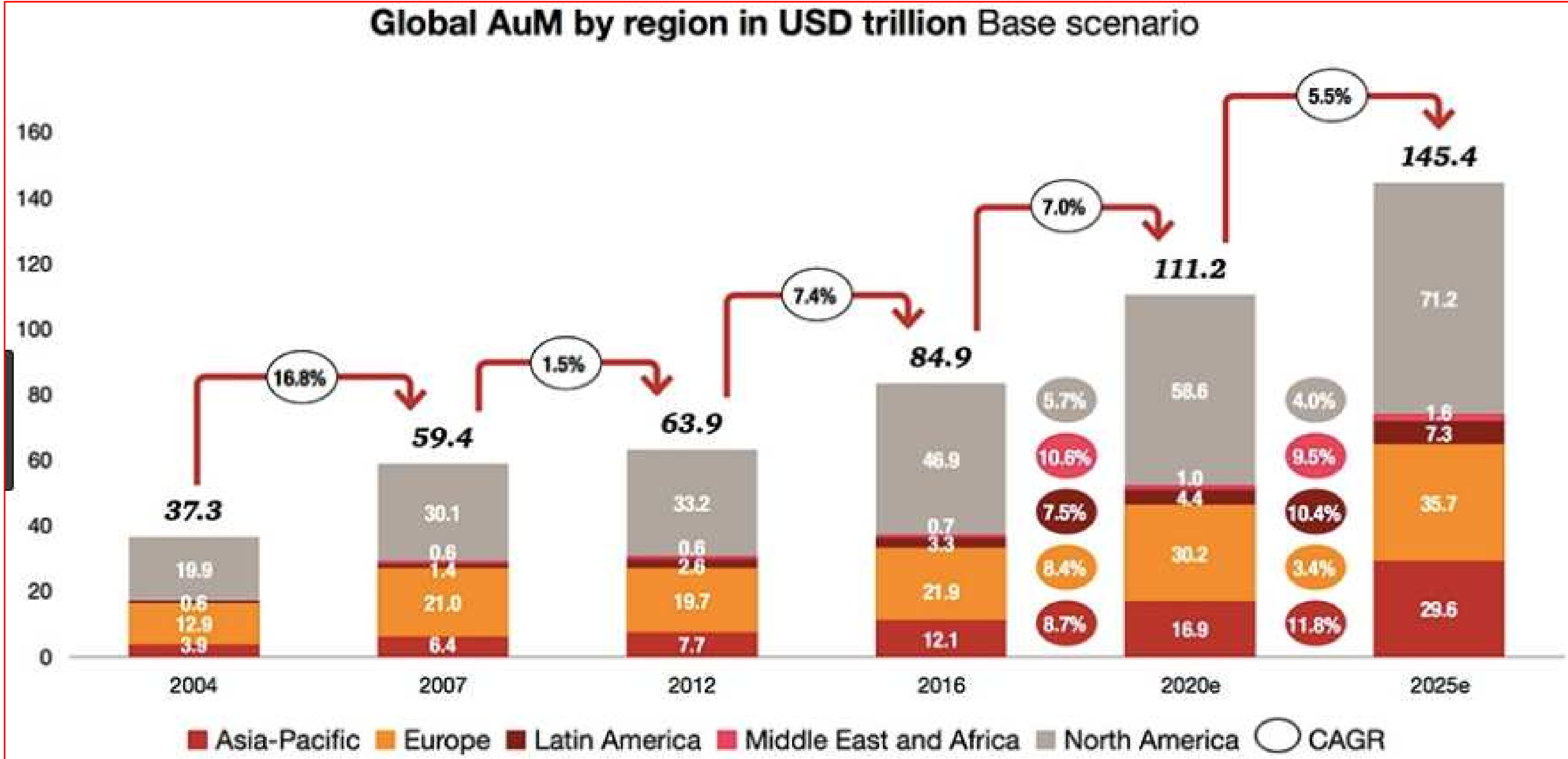
A new Consensus:

Maximising Finance for Development

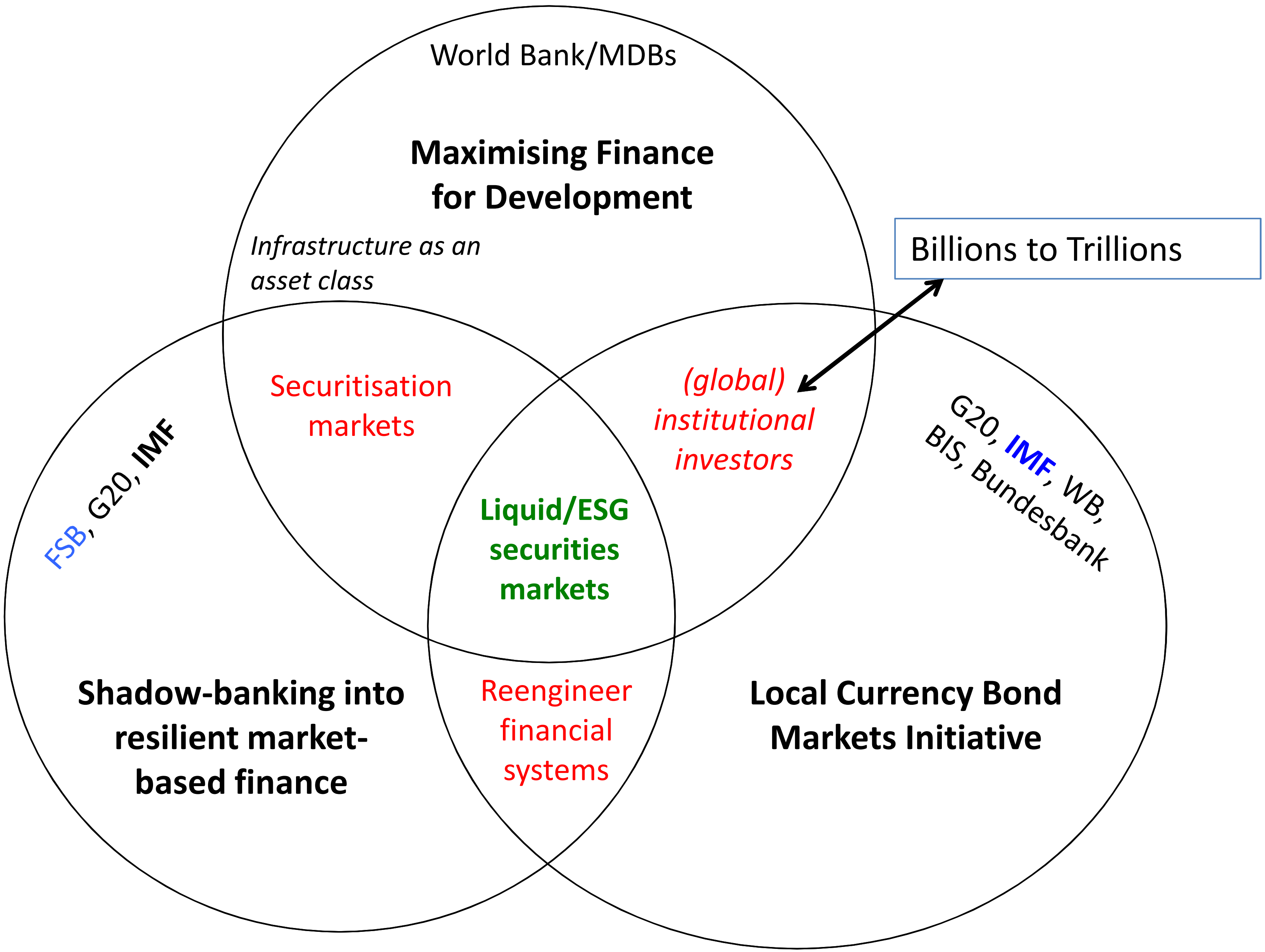
When the global policy elite gathered for the recent IMF and World Bank annual meeting in Bali, their optimism was hard to ignore, along with the new buzzwords of sustainable infrastructure. As Lord Stern, of the influential Eminent Persons Group, put it: "the challenge of achieving the Sustainable Development Goals (SDG) is in large measure that challenge, of fostering the right kind of sustainable infrastructure'

To do so, he said, "you have to have good finance, the right kind of finance, at the right scale, at the right time". The ambition, spelled out in the World Bank's new Maximising Finance for Development agenda, is to create investable opportunities in poor countries that can attract the trillions of global institutional investors.

The age of asset management

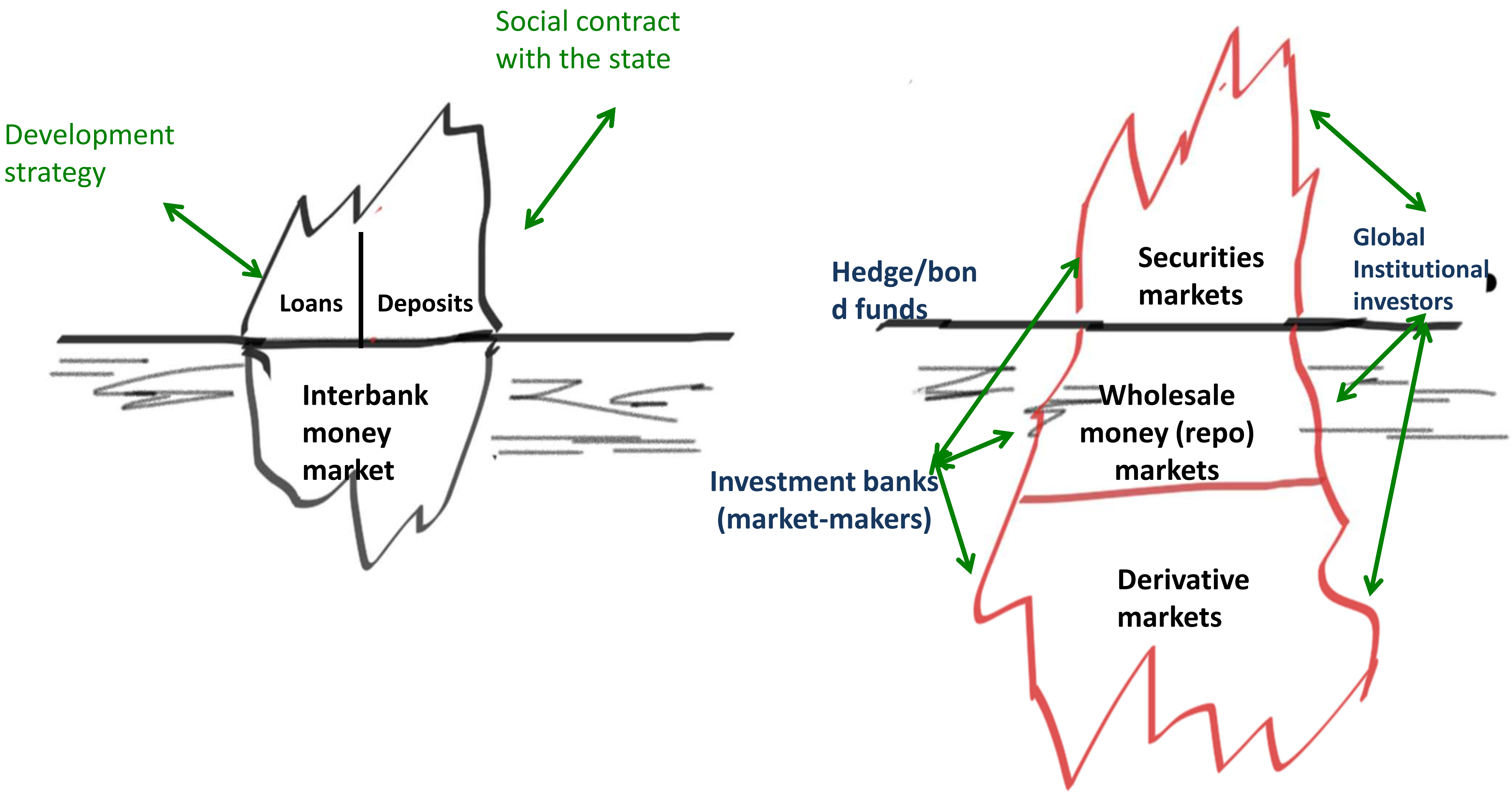


Development aid is dead, long live portfolio flows

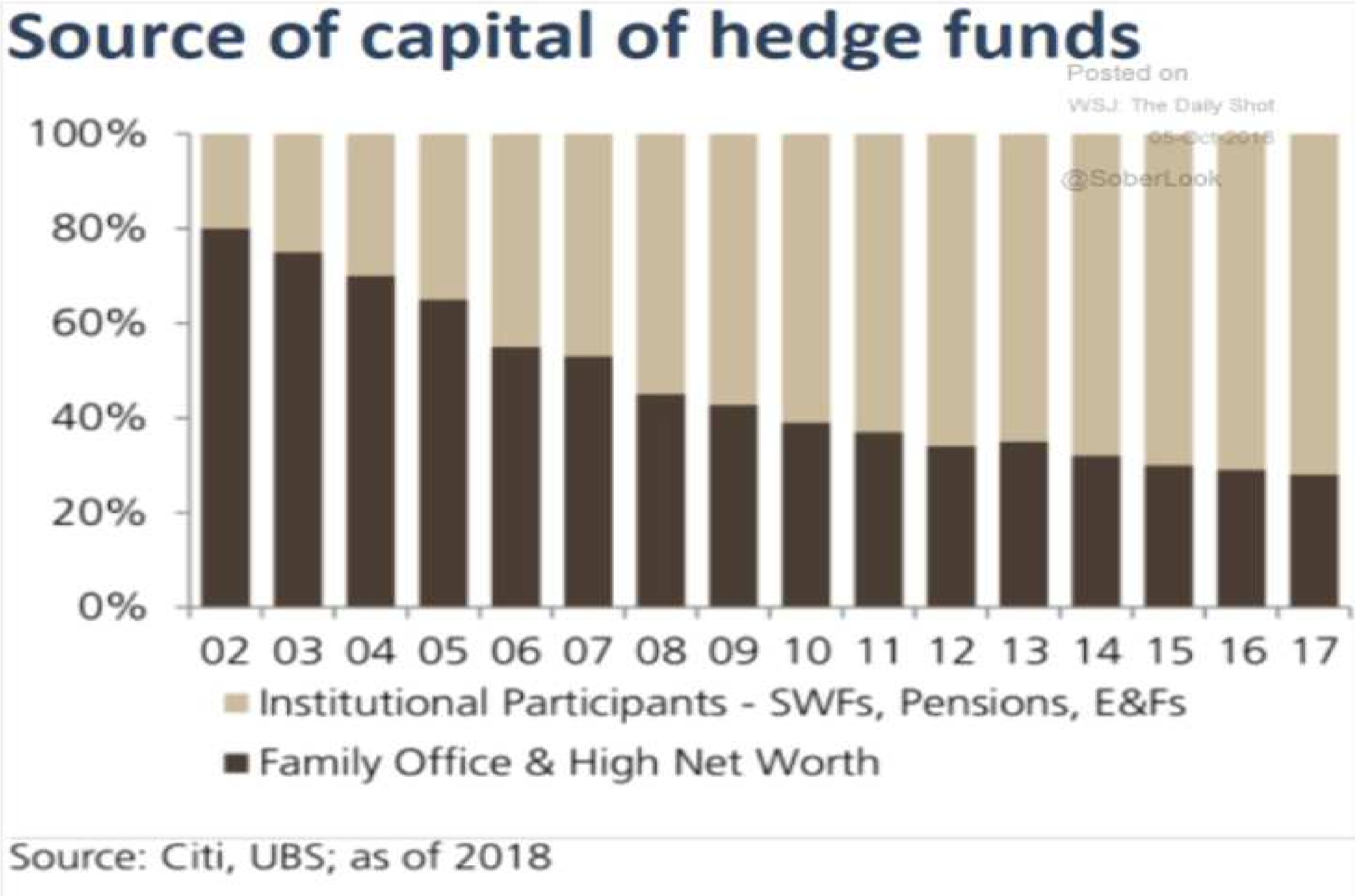


Bank- based financial systems

Securities markets- based financial systems



Patient institutional investors?

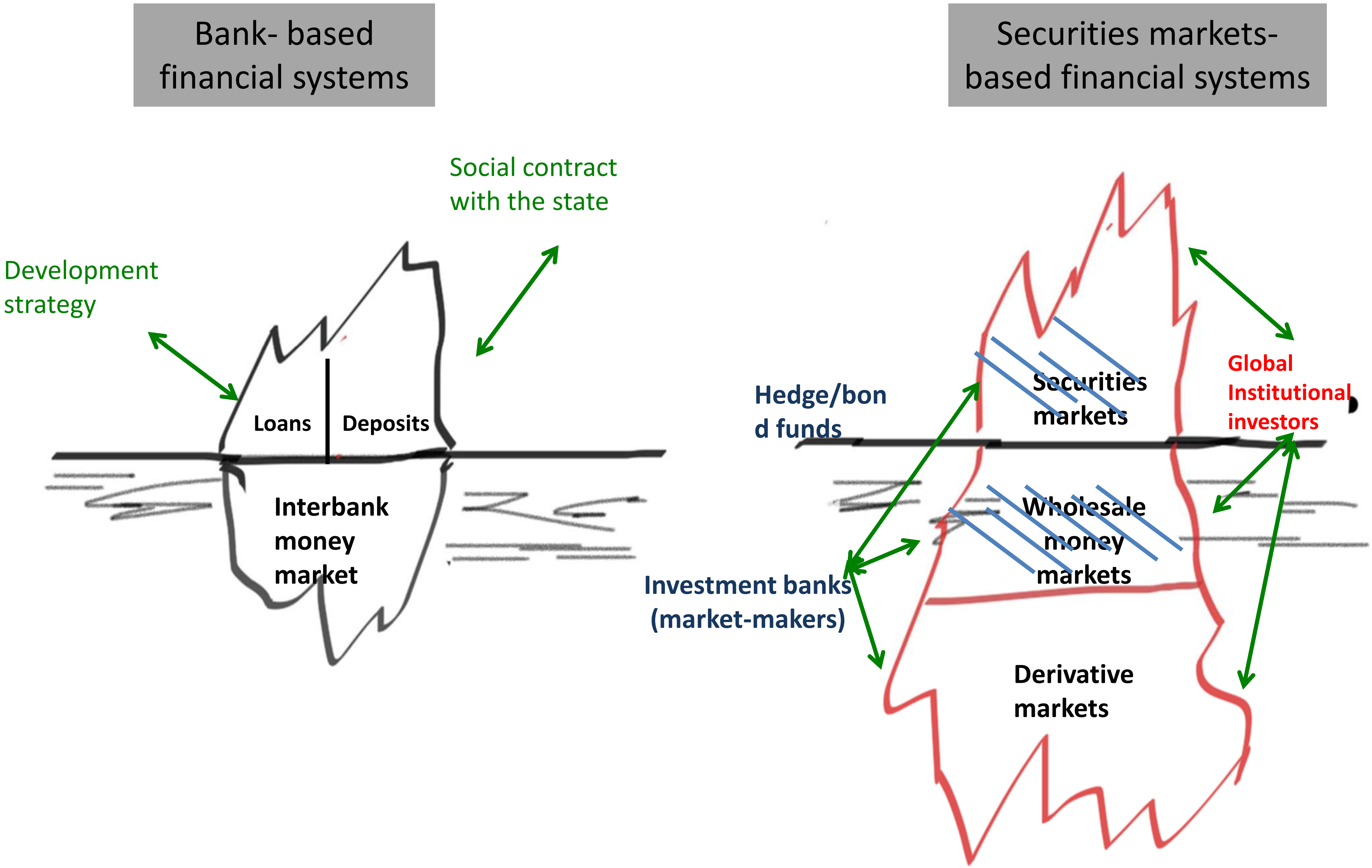


Global diffusion – architecture of US securities (funding) markets

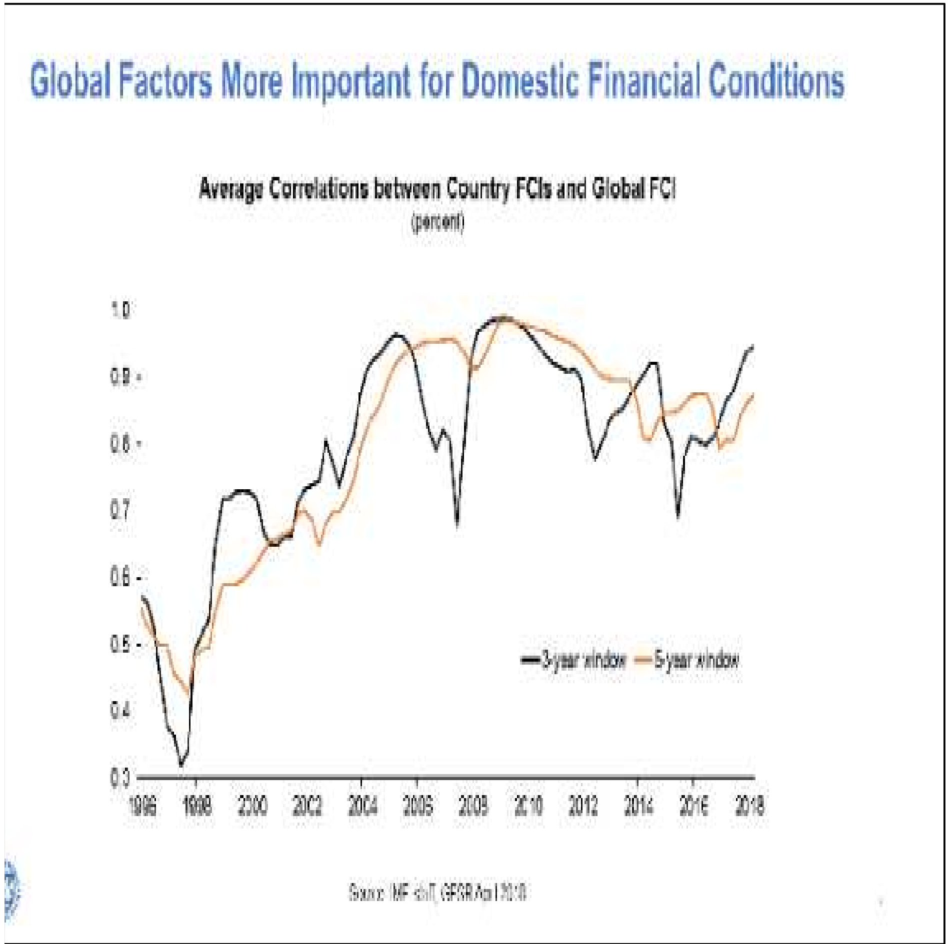
Box 1: Indian bond markets – a view from the Association of Securities and Financial Markets in Asia.

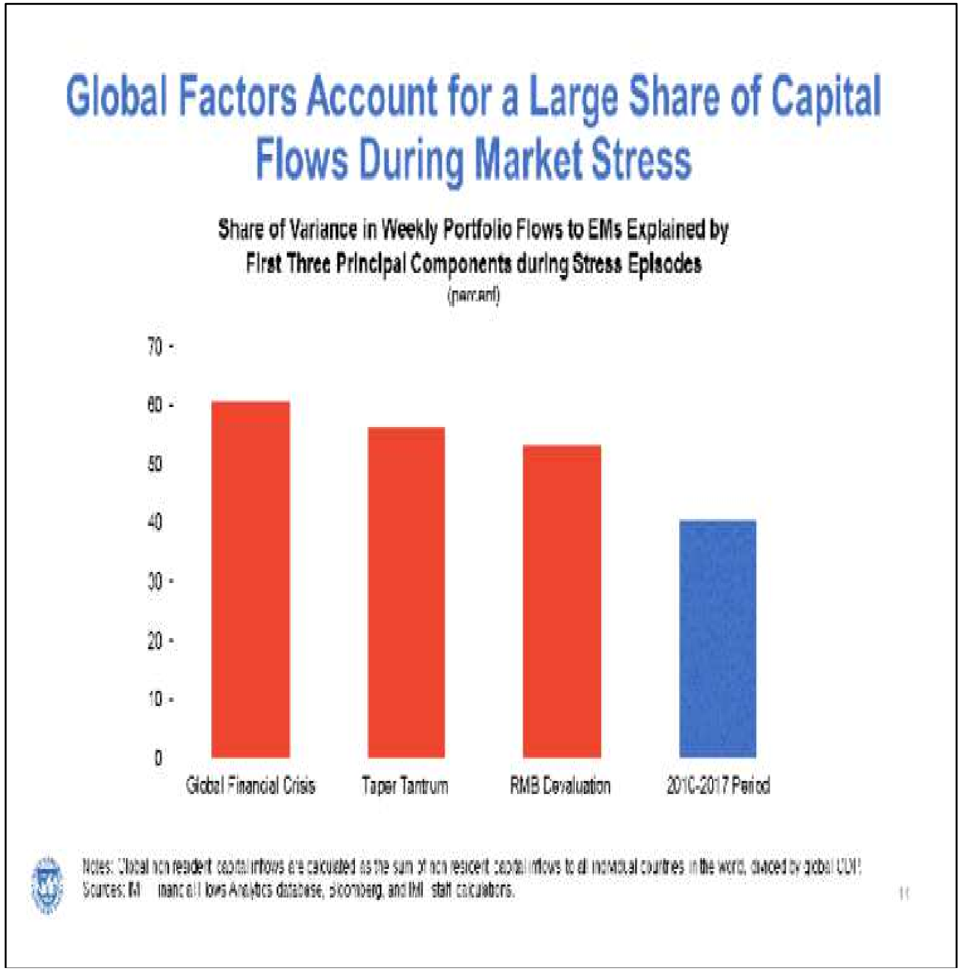
In a 2013 report, ASIFMA identified several bottlenecks in the rapid development of local bond markets, bottlenecks that reduced significantly the interest of foreign investors.

1. *Hold to maturity bias*: local banks held around 80% of government bonds in hold-to-maturity portfolios. This 'patient' strategy, strongly influenced by liquidity regulations, reduced the volume of bonds available for trading in secondary markets, and therefore market liquidity.
   The finance lobby recommended the removal of prudential regulations.
2. *Liquid repo market:* market-makers cannot short securities, and thus provide secondary market liquidity, because the legal framework does not allow for the legal title of collateral to be transferred in a repo. Collateral securities cannot be re-used.
   The finance lobby recommended aligning the legal framework with European/US standards.
3. *Active liquid derivative markets:* foreign investors can only hedge the currency exposure resulting from ownership of local currency securities through non-deliverable swaps outside India (NDSs).
   The finance lobby recommended the development of onshore derivative markets that would increase the liquidity of securities markets.


Bank- based financial systems
Securities markets-based financial systems
Social contract with the state
Development strategy
Loans
Deposits
Interbank money market
Hedge/bond funds
Securities markets
Global Institutional investors
Wholesale money markets
Investment banks (market-makers)
Derivative markets

IMF 2018: domestic financial conditions determined by **global financial cycle**





Key questions

- Global financial cycle: the IMF institutional view vs Rey’s dilemma?
  - IMF: macro-measures first, capital controls last
  - Rey’s dilemma: either capital controls or monetary policy autonomy.

Beijing Consensus?

Clifford Lee, head of Asian fixed income at **DBS** in Singapore, says that the current crisis roiling many emerging market countries is throwing up "existential questions for Asia about what constitutes a developed local currency bond market".

Looming over the debate is China, whose own domestic bond market is still largely insulated from the vagaries of foreign investor sentiment by a government that has always been keen to maintain control and do things at its own pace.

Can the Beijing Consensus be applied to wider Asian domestic bond markets? Lee suggests that it can.

"At the heart of the issue is whether Asian countries want open and Western-style bond markets, which are vulnerable to sell-offs by foreign portfolio investors, or more controlled bond markets limited to domestic players," he commented.

One thing about which Asian policy makers have become very conscious is that "open" is not always a two-way street where Western markets are concerned.

Indonesia: Wall Street Consensus vs Beijing Consensus

benefits of unfettered capitalism.

"Individual markets have to calibrate what works best for them," Lee concluded. "One lesson everyone is learning is how the Western model is not necessarily the most ideal when applied in its entirety."

Over the longer-term, Indonesia is keen to reduce the influence of foreign investors.

Where government bond holdings are concerned, the Ministry of Finance's risk manager, Scenaider Siahaan, recently set a 20% target by 2023. This would be roughly half the level that foreign investors held back in January (41.5%), before they began to cash out. At the end of October, the figure stood at 37%.

RELATED

- Asian bond markets: a case of who'll blink first?
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- Why G3 currency borrowers need to pick their issuance windows carefully

But over the short-term, the government needs them. As such, the country's tax department, led by former borrowing head, Robert Pakpahan, hopes to tempt them back with a reduction in the 20% withholding tax that foreign investors pay on rupiah-denominated debt.

Key questions

- Global financial cycle: the IMF institutional view vs Rey's dilemma?
- Policy-engineered financial globalisation vs policy-engineered (green) industrialisation?

Further reading

- https://ftalphaville.ft.com/2018/10/29/1540799191000/The-World-Bank-pushes-fragile-finance-in-the-name-of-development-/
- Gabor, D. (2018) Goodbye (Chinese) shadow banking, hello market-based finance. *Development and Change*.