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Financial 'deglobalization'?: capital flows, banks and the Beatles - speech by Kristin Forbes

- Kristin introduces the topic of global financial flows by noting that "in the 1960s the UK was at risk of running out of dollars and….the saviour was the Beatles…earning world-record dollar concert receipts". She notes that "the band's last commercial concert was in the summer of 1966 …. Just one year later [the UK] was forced to abandon its [exchange rate] peg, sterling was devalued by 14% against the dollar and the UK signed an emergency IMF loan package".

- Turning to more recent history, Kristin notes that today "countries have become much more financially integrated". But "international capital flows fell sharply during the crisis and show no signs of recovering….cross border financial flows ….(scaled by the size of their economies) are now as 'globalized' as they were in 1983". Put another way "International capital flows are now only 1.6% of global GDP, ten times less than the peak of 16% in 2007". Kristin suggests that it is "remarkable" that capital flows have remained at such depressed levels despite the broader recovery in the global economy.

- The data suggest that "banking is the culprit". "Portfolio flows, and foreign direct investment have both since stabilized at positive (albeit somewhat lower) levels since the crisis, while banking flows have continued to contact recently. In other words, banks around the world appear to currently be reducing their foreign exposures and bringing money home". As a result there has been a "major contraction in the global banking network" and "the contraction in banking flows related to the UK is particularly striking".

- Banking flows are typically more volatile than other cross border flows, and have tended to be sensitive to perceptions of risk – when risk is perceived to fall, banking flows tend to rise. But Kristin shows that in the years since the financial crisis, banking flows have not responded to the decline in perceived risk.

- Kristin cites a variety of potential reasons for this including higher costs for banks operating abroad (in part due to the risk of penalty fines), reduced access to wholesale funding, weakness in individual bank balance sheets and regulatory changes.

- Kristin draws out a wide variety of possible implications of banking led deglobalization for the UK. The impact on total credit supply to the UK economy is ambiguous, but domestic banks will likely supply more credit while foreign banks provide less. UK total credit supply “will be more tightly linked to the domestic … business cycle” but less linked to foreign shocks. Global banking institutions should become more transparent. But the withdrawal of global banking may reduce liquidity in different markets and that could “increase volatilities and the risk of sharp and disorderly price swings”. Shadow banking (“asset backed securities, money market funds, hedge funds amongst others”) will likely grow in response to any funding shortfall. That “may involve risks. Central banks and international institutions are aware of these potential benefits and risks”.

- "A reduction in international bank flows could make it more difficult, and possibly even more expensive, for the UK to fund its current account deficit”. “A foreign exchange crisis, as occurred in the era of the Beatles is unlikely however, due to changes such as the move to a flexible exchange rate”.

- Finally, “this deglobalization in banking could influence the functioning of monetary policy”. “Global banks respond to changes in the cost of borrowing… by transferring funds across borders….[which] can partially insulate global banks from changes in domestic interest rates”. “As global banking networks contract, there may be less room for cross border banking flows to counteract the lending channel for monetary policy. As a result, traditional monetary policy could become more effective.”

- Overall, “it may be time to shift from focussing on the implications of increasing levels of financial globalization, to a serious discussion of the implications of banking deglobalization”.