BANK OF ENGLAND

Addressing the Growing Challenges in the International Monetary and Financial System

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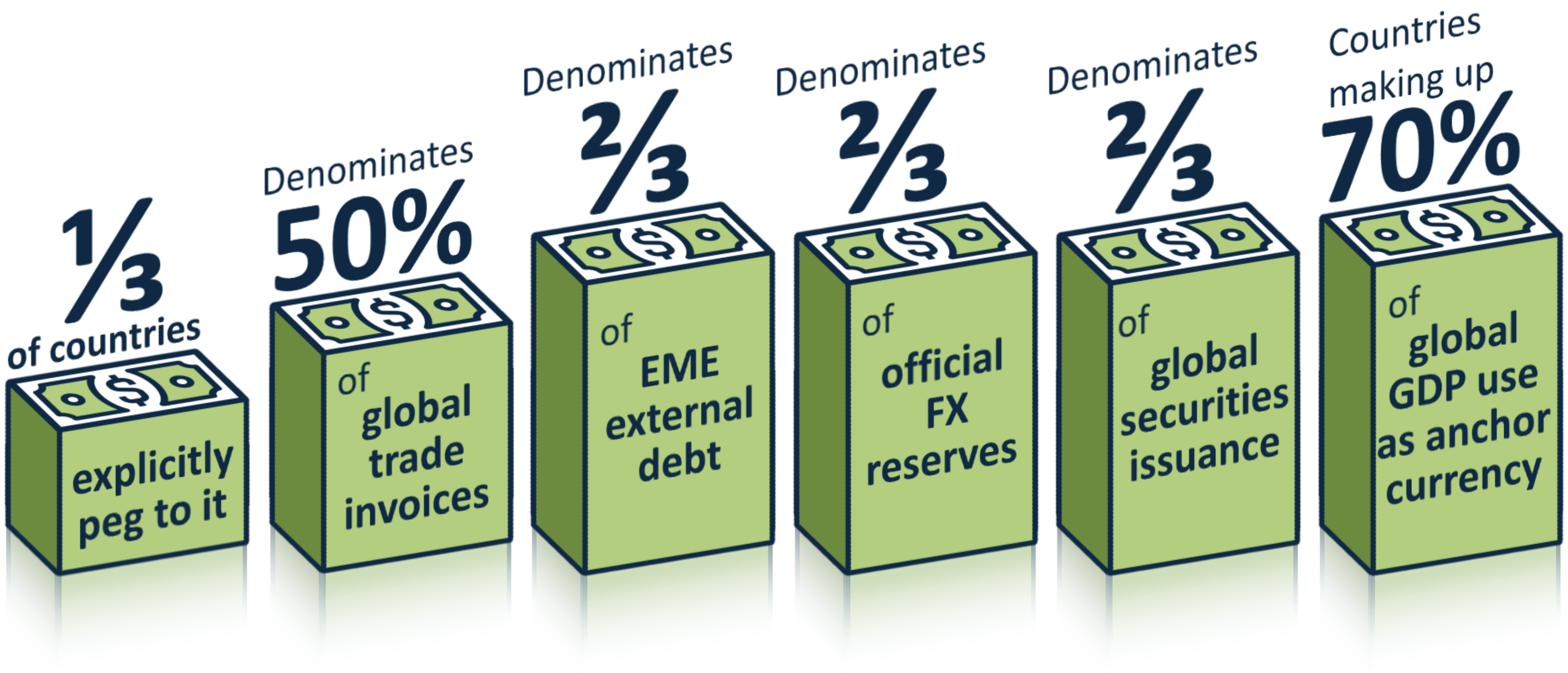
18 October 2019

See also:
https://www.bankofengland.co.uk/speech/2019/mark-carney-speech-at-jackson-hole-economic-symposium-wyoming

Asymmetry at heart of IMFS is growing

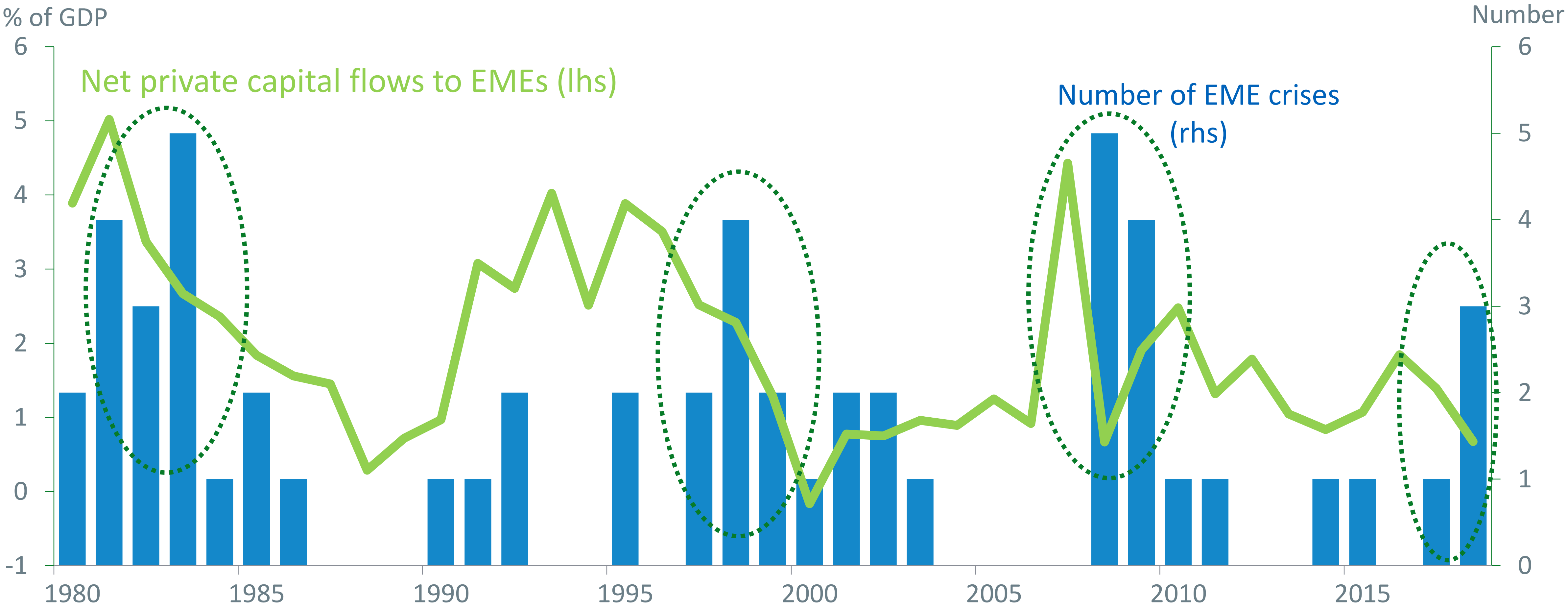
US share of global economy shrinking…

…yet network effects mean US $ dominates international trade and finance



- US developments have large spillovers, even for countries with limited direct exposure

For EMEs, US $ dominance reduces sustainable capital flows



- Capital flow volatility reduces potential growth and increases risk of crises, encouraging EMEs to accumulate costly reserves as insurance

A holistic Capital Flows-at-Risk framework: Pull, Push, Pipes

Pull factors

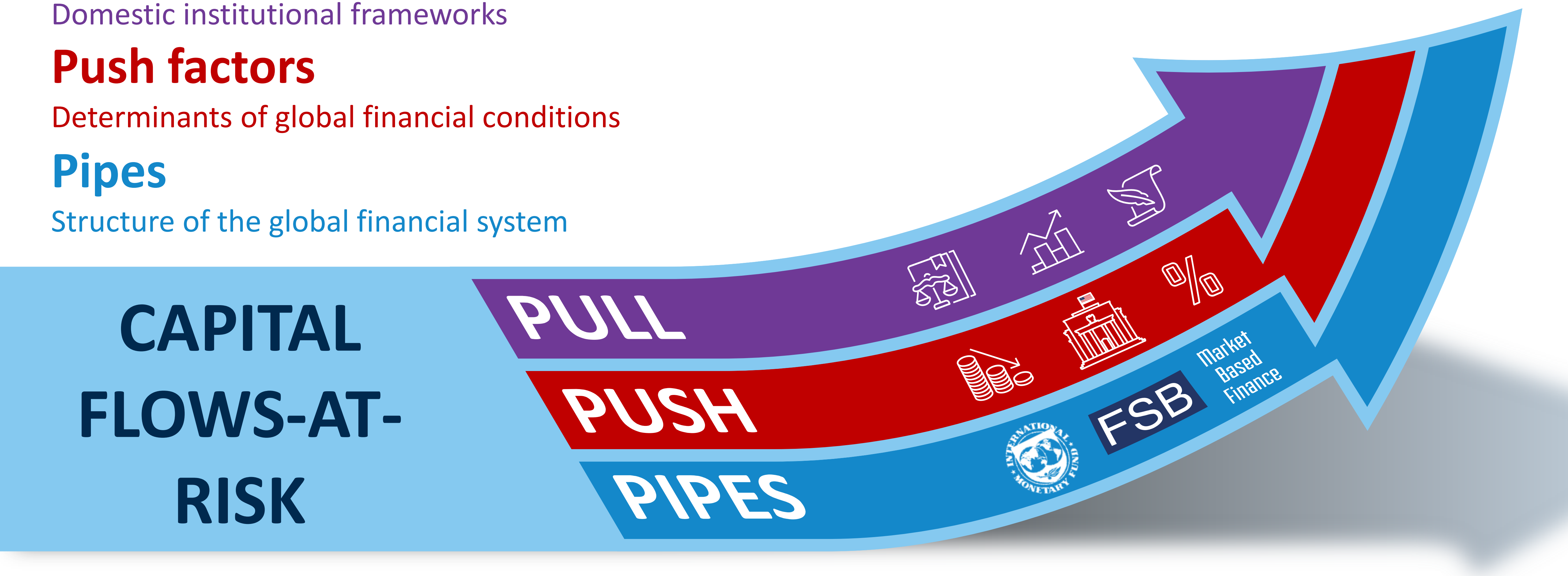
Domestic institutional frameworks

Push factors

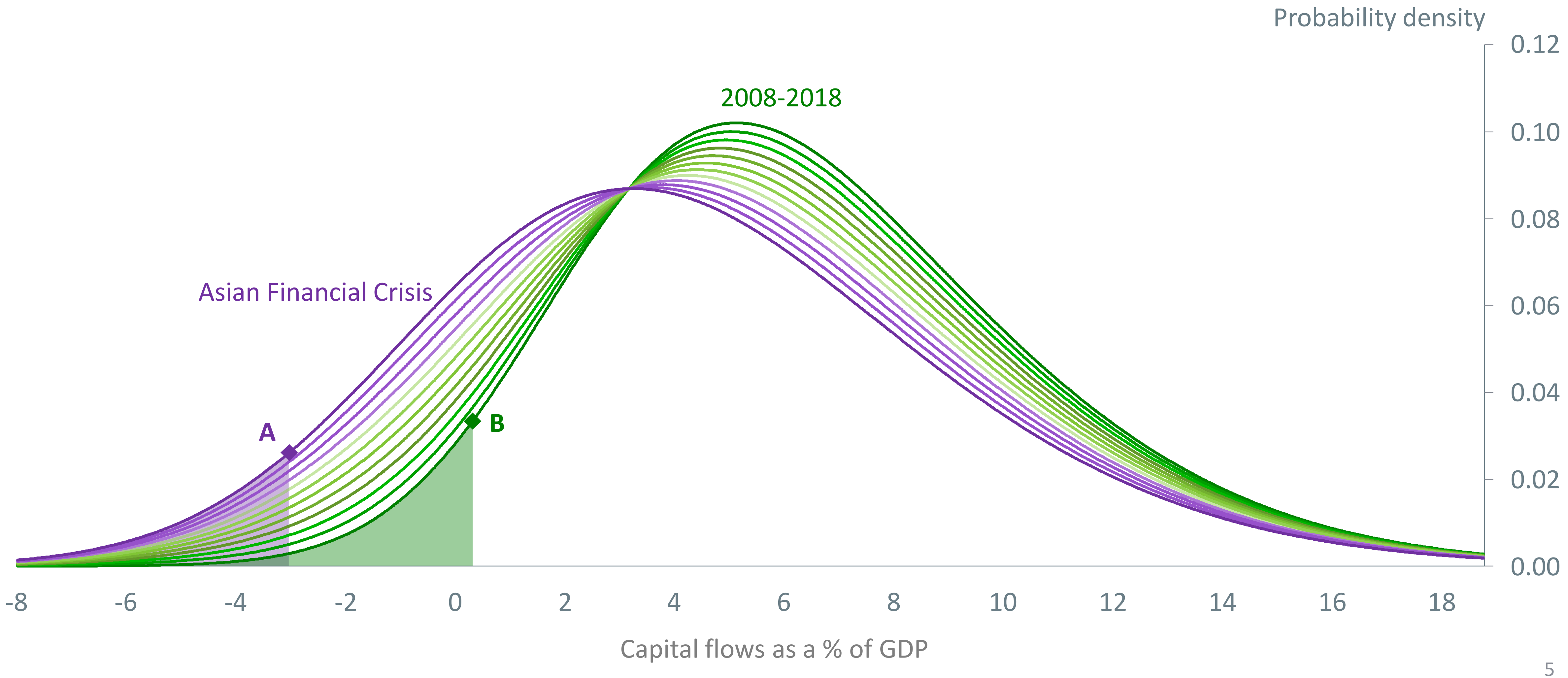
Determinants of global financial conditions

Pipes

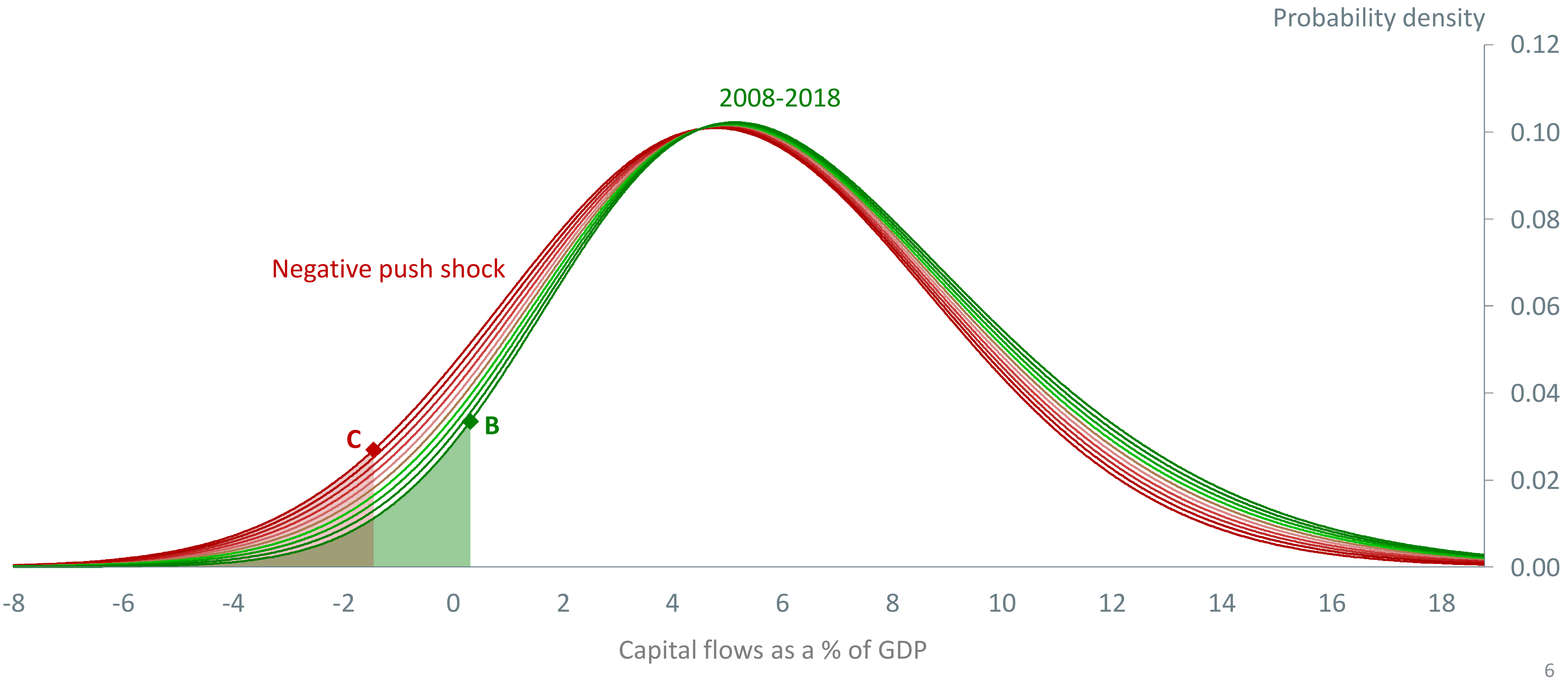
Structure of the global financial system



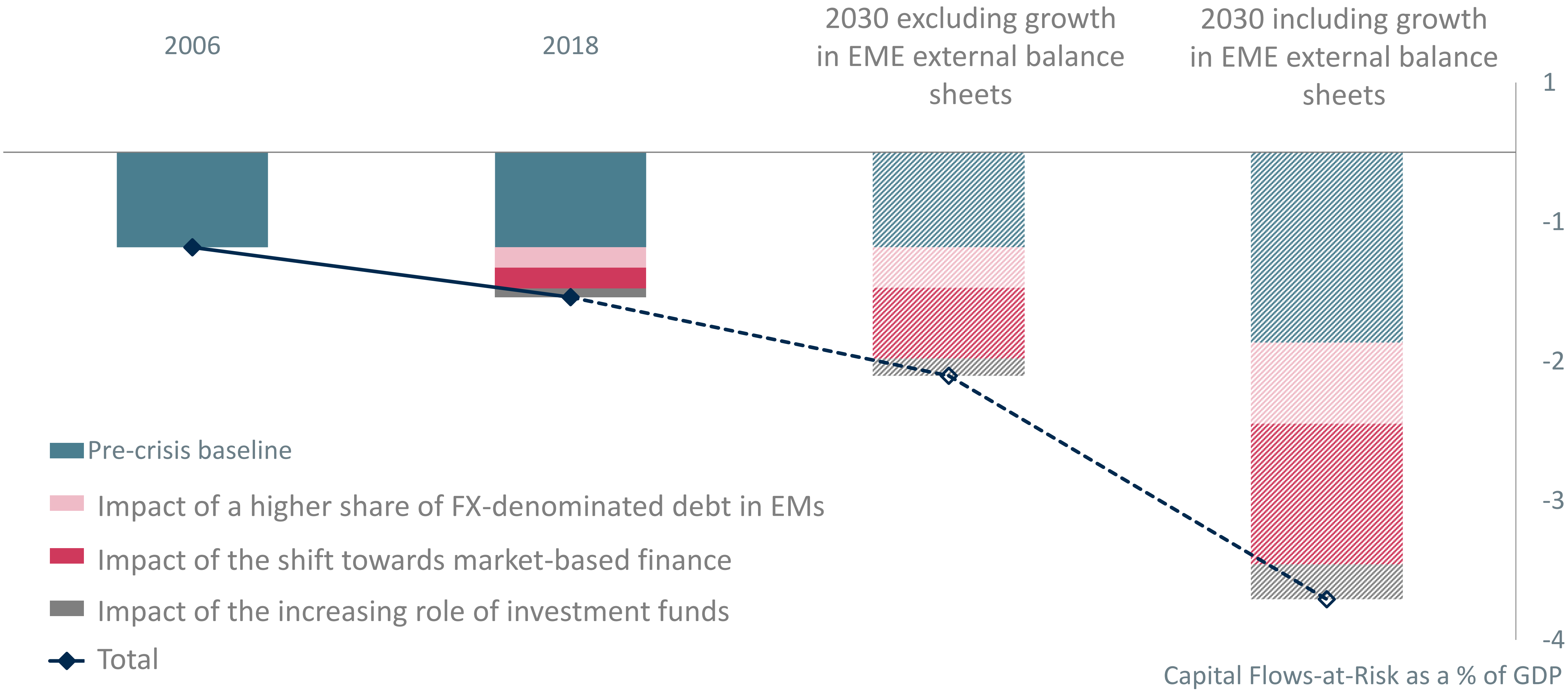
Reforms to domestic institutional “pull factors” have substantially increased sustainable capital flows



Push factors weighed more heavily over the past decade, offsetting some of the improvement in pull factors



Structure of IMFS could overwhelm EMEs' efforts to increase sustainable capital flows

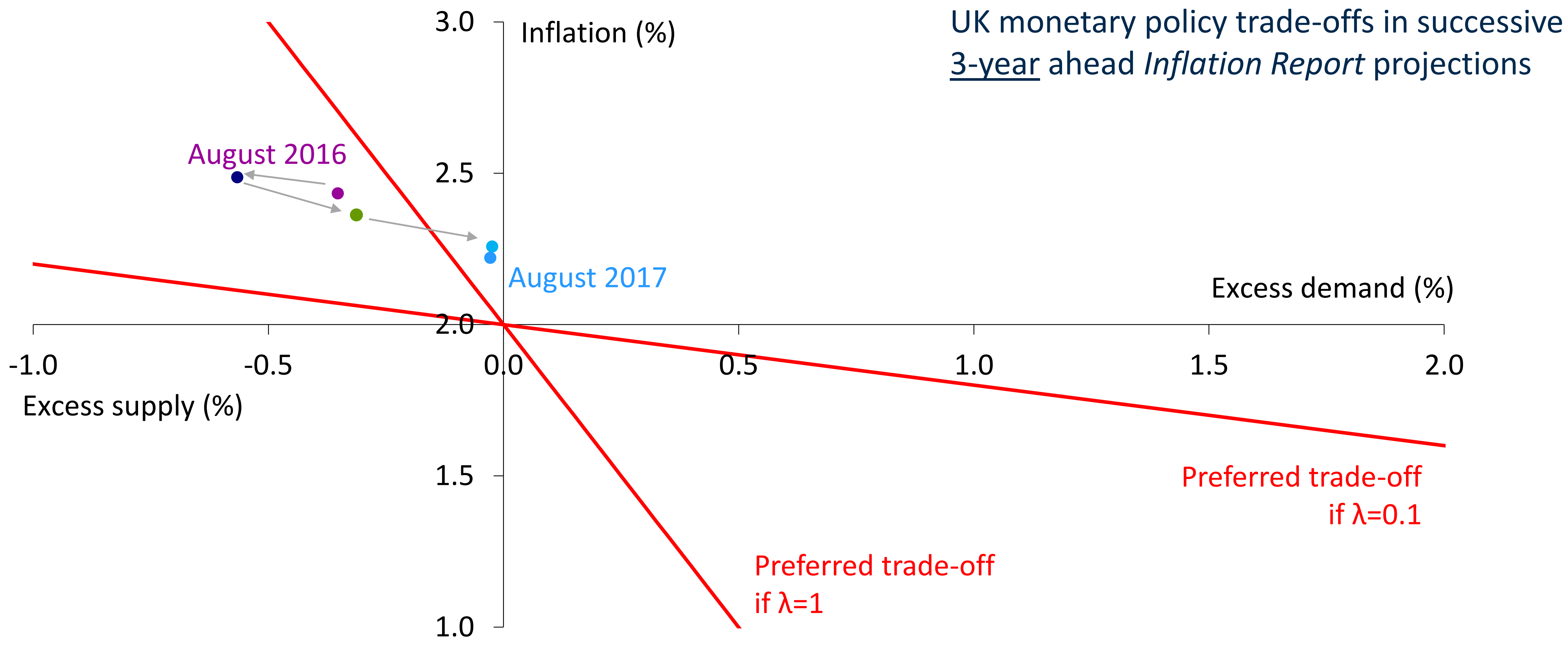


IMFS asymmetry increases risks of a global liquidity trap

- IMFS structurally lowering global equilibrium interest rate, r*, by:
  - feeding a global savings glut: EMEs defensively accumulate reserves of safe US $ assets against backdrop of inadequate and fragmented global financial safety net;
  - lowering the rate of global potential growth due to less sustainable cross border flows; and
  - increasing the downside skew and fattening of the left-hand tail of likely economic outcomes.
- Increasingly integrated world: global r* exerts greater influence on domestic r*.
- Strains become more evident when – as recently – US conditions warrant tighter policy there than elsewhere.

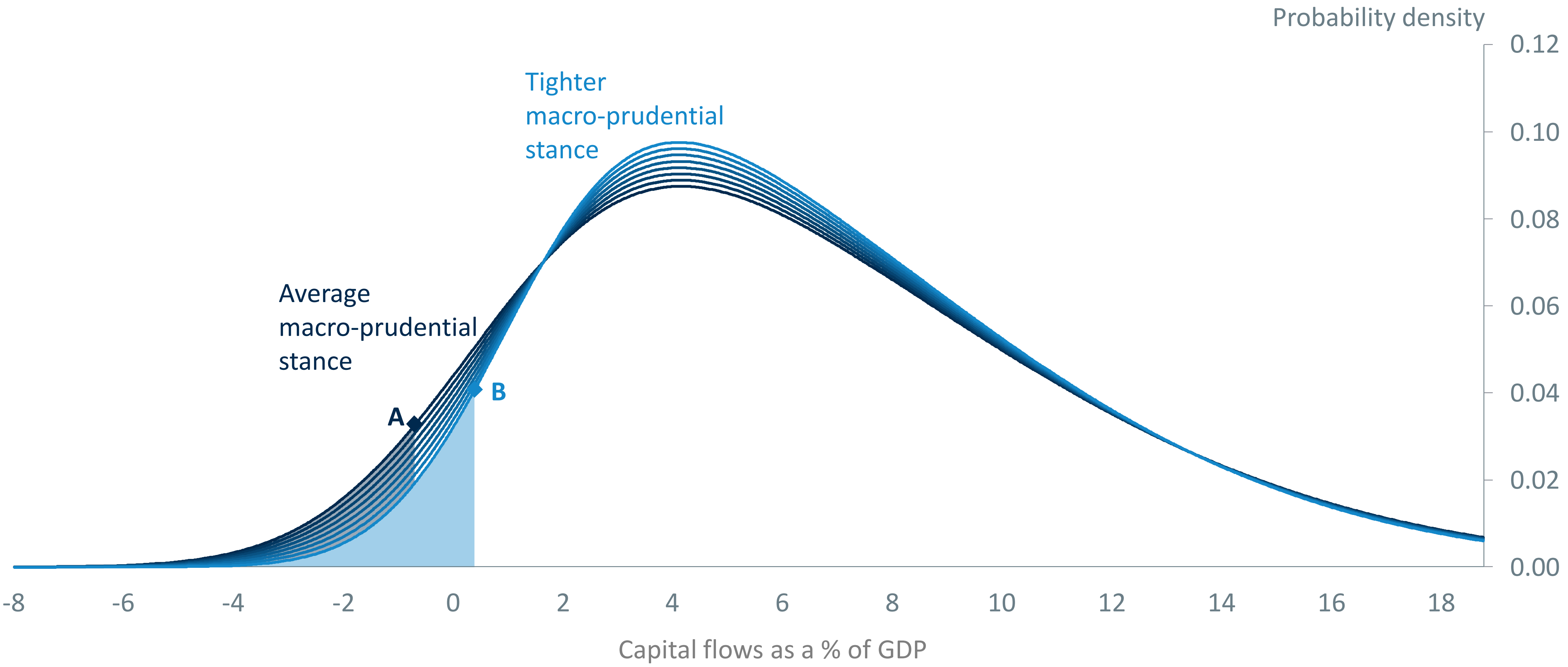
What then can be done?

Short term: central banks must play hand they've been dealt



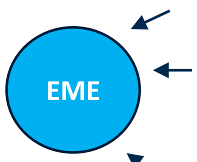
- Use full flexibility in flexible inflation targeting

Short term: central banks must play hand they've been dealt

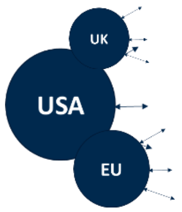


- Macroprudential policy in EMEs can reduce Capital Flows-at-Risk

Medium term: reshuffle the deck – reform current IMFS



Address **pull factors** in EMEs:
- ❑ Reinforcing monetary stability, including by safeguarding central bank independence
- ❑ Ensuring resilience of domestic financial sector



Moderate **push factors**:
- ❑ Strengthen resilience of banks at the core of the global financial system
- ❑ Make sure investment funds prudently manage leverage and liquidity

Fix the **pipes of the global system:**
- ❑ Reinforcing the Global Financial Safety Net, by ensuring that IMF resources are maintained
- ❑ Further improve IMF surveillance for analysing spillovers and traction to support coordinated actions

Long term: change the game – move to a multipolar system

Benefits of multiple reserve currencies

Diversification: the supply of safe assets increases, lowering the downward pressures on the global equilibrium interest rate

Reduced spillovers from the core, including less synchronised trade and financial cycles

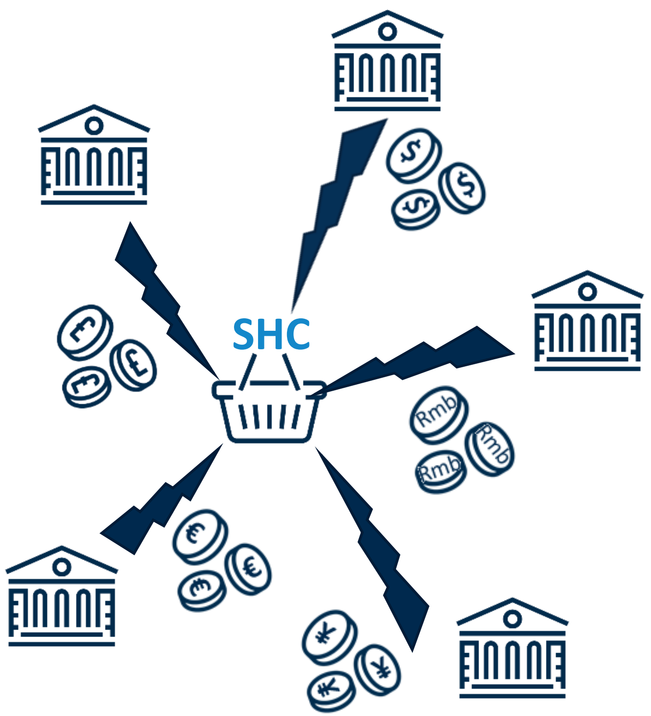
Easier to **manage coordination problems**

No illusions that IMFS can be reformed overnight

- Network effects reinforce dominance of US $
- Transition to a new global reserve currency didn’t proceed smoothly in the past and may not in the future
- Doesn’t make sense to swap one reserve currency for another; a multipolar world deserves multipolar system

Consider for long term: Synthetic Hegemonic Currency

- Publicly issued basket of central bank digital currencies made widely available to settle payments and store value



- ✓ Central bank liabilities are safe, already widely-accepted means of payment
- ✓ Reliable, instantaneous, low cost domestic and international payments
- ✓ Addresses many of the shortcomings of private sector solutions (privacy, treasury management, trust)
- ✓ Decision between wholesale (SDR) vs. retail (SHC) must be mindful that usage as medium of exchange has historically driven reserve currency adoption

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