THE CURRENT ACCOUNT AND GLOBAL FINANCIAL MARKETS

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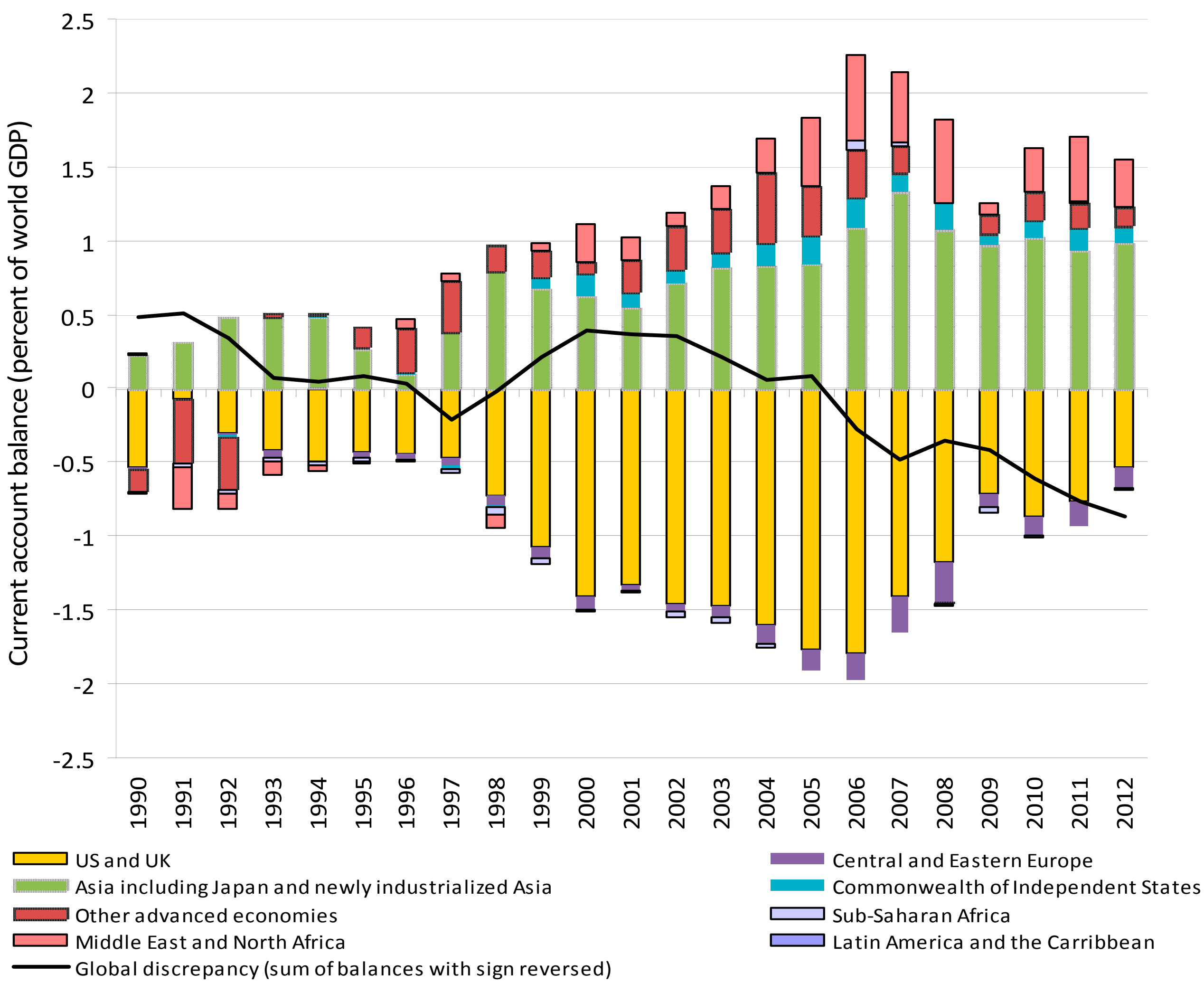
Net Financial Flows

- Global imbalances (apart from errors and omissions and capital transfers) are the mirror image of *net* international financial flows
- These reached unprecedented postwar levels in the 2000s, and since have partially receded

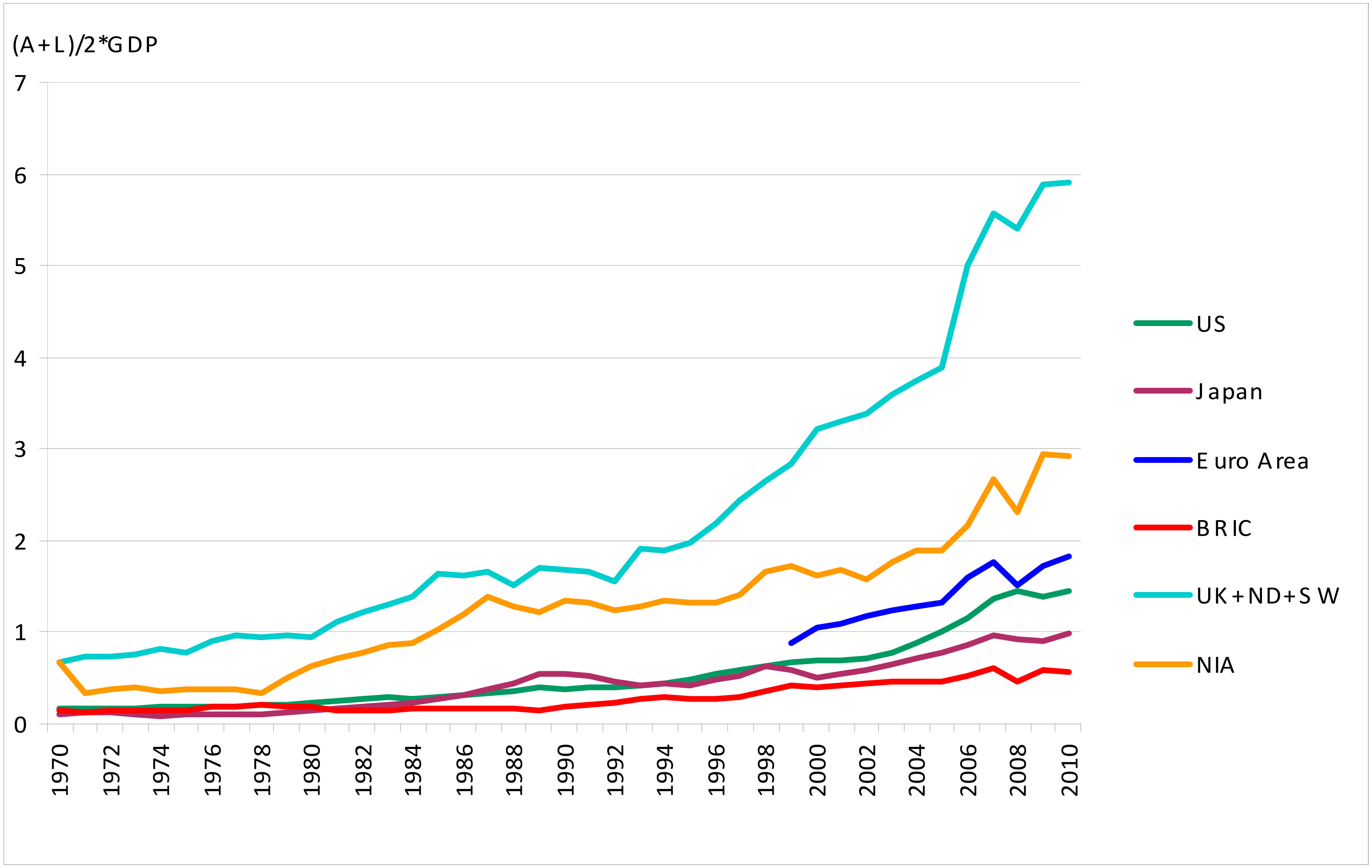
Global Current Account Imbalances, 1990-2012



Gross Financial Flows

- *Gross* financial flows have expanded even more dramatically
- As a result, gross stocks of external assets and liabilities have ballooned

Average of Gross Assets (*A*) and Liabilities *(L)* Relative to GDP



Source: Lane and Milesi-Ferretti, updated EWN data

Challenges for Policy

- How much should we worry about net flows (current accounts)?
- How much should we worry about gross flows and positions?
- What can we do to reduce the hazards due to expanding gross flows?

Role of Current Accounts

- Some assert large external imbalances “caused” the 2007-09 crisis
- Or that they “caused” the euro zone crisis
- I view them instead as symptoms of underlying problems
- I think that in both instances, the ease of external borrowing allowed policymakers to postpone facing more fundamental issues

What Fundamental Issues?

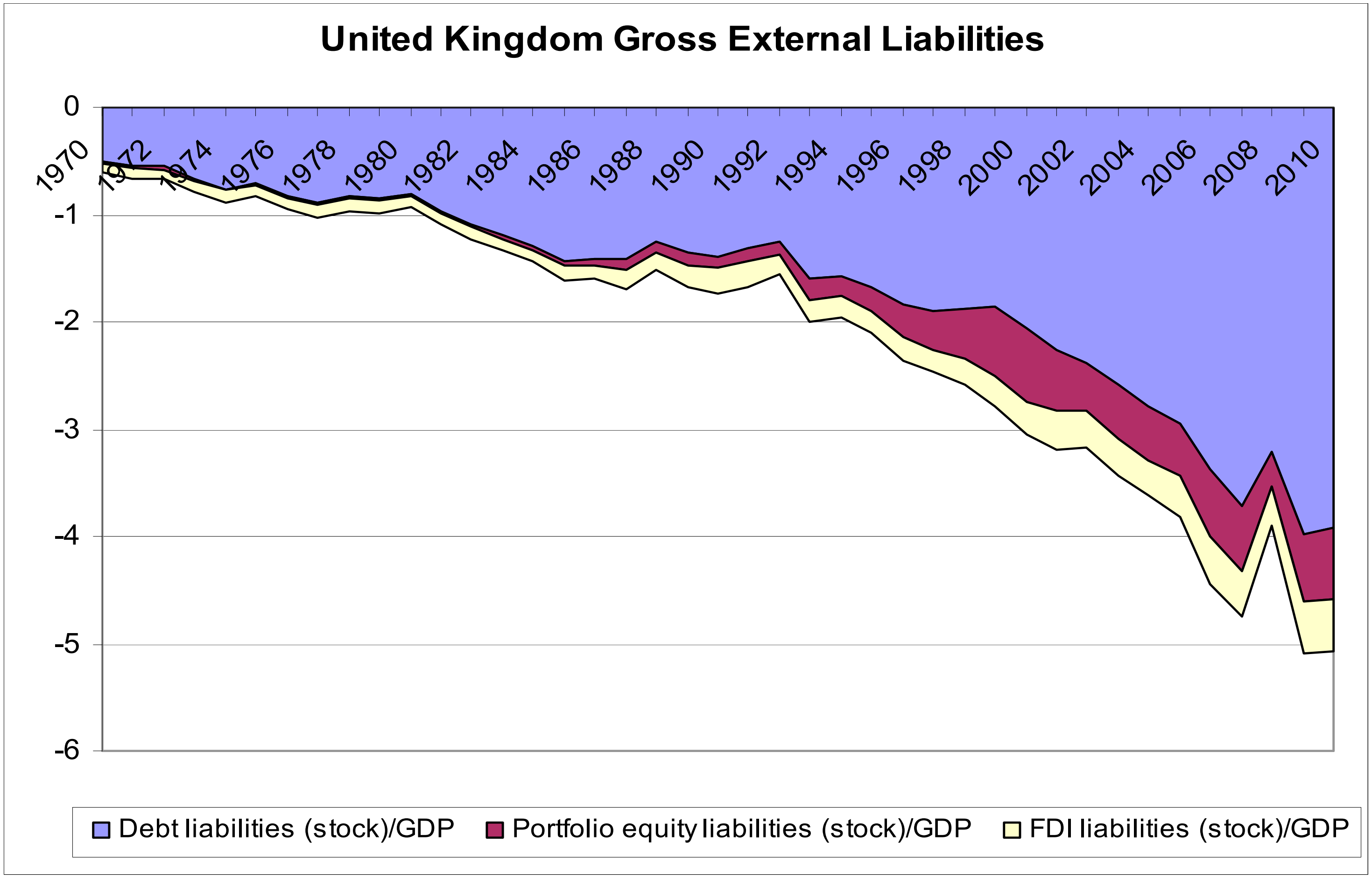
- In U.S. and other countries, housing price bubble, distortions in residential housing markets, poor supervision and incentives in financial markets
- In Europe, housing booms, poor supervision, low and deteriorating periphery growth and competitiveness, weak public finances, etc.
- “Saving glut” played at most a supporting role in generating much larger credit booms

Importance of Current Accounts

- Affects the NIIP, aggregate budget constraint
- Tracks cumulated CA for many countries despite US picture (see my Ely lecture)
- Indicator of possible deeper problems
- CA deficits may forecast domestic credit booms that end in crises
- Vulnerability to sudden stop for economies with limited gross foreign assets
- Coordination in global rebalancing: going forward, deleveraging implies China, others should expand
- Threat of protection

Gross Flows and Financial Stability

- Net CA imbalances financed by much larger gross flows
- Resulting inflated positions for industrial countries largely debt or debt-like
- Only so much real capital is available!
- But these debt-like instruments raise the possibilities of rollover risk, liquidity risk, currency mismatch, etc.
- Counterparty risk can become contagious


United Kingdom Gross External Liabilities
0
-1
-2
-3
-4
-5
-6
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
Debt liabilities (stock)/GDP
Portfolio equity liabilities (stock)/GDP
FDI liabilities (stock)/GDP

Gross Two-Way Flows and Efficiency

- There is a legitimate risk-sharing function
- But there are less benign scenarios
  - Tax avoidance/evasion
  - Regulatory arbitrage
  - Risk leveraging
- Acharya-Schnabl example of ABCP conduits
- Much gross financing of U.S. housing bubble from Europe: K. Johnson, Bernanke et al., Bertaut et al.
- What is the benefit-cost tradeoff?

Is the S-I Perspective Central?

- Some come close to arguing that the main focus should be on financing, not S minus I
  - Notably, Borio and Disyatat, BIS working paper
- But arguing that global imbalances are crisis-irrelevant, because Germany had crisis but no CA deficit, is like arguing that housing booms were irrelevant (Germany had none)
- With globalized finance, factors that generated US deficit were a threat to German stability

What to Do about It?

- Not enough to focus on imbalances (net flows) and stability (gross flows) separately
- Gross flows have price and quantity effects which affect the macro side
- But there is feedback the other way too
- We must ask how the pieces fit together (IMF)
- Policy responses also need to focus on global coordination in supervision/regulation, liquidity provision, resolution, information