**Finance Globalisée: le défi de la régulation et de l’évaluation des risques**

IGIP SEMINAR
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**Qu’est-ce que la Globalisation?**

Extension mondiale de l’économie de marché, à tous les secteurs et à tous les pays

**Globalisation = Nouveau Monde + Ancien Monde**

**Le Découplage**

La Globalisation a subordonné la politique à l’économique et l’économique à la finance

**Double Emancipation**

Phase I: 1970s-80s: Système économique/Politique

Phase II. 1990s: Système financier/Economique
Phase I - L’Emancipation de l’Economique par rapport au Politique

1. Flexible exchange rates 1970s
2. Economic and trade liberalization (IMF/GATT/WTO)
3. Privatization (1970-80s until 2013!)
4. Economic automatic pilot (Maastricht 1992)
5. Washington consensus (late 1980s)
6. Rating agencies

Governments are bypassed by market forces and under the scrutiny of IFIs and rating agencies

| Rating Distribution of Sovereign Issuers on Selected Dates |
|-----------------|-----|-----|-----|-----|-----|-----|-----|-----|
| AAA             | 75%  | 33%  | 16%  | 5%   | 3%   | 2%   | 1%   | 1%   |
| AA              | 2%   | 2%   | 2%   | 1%   | 5%   | 5%   | 3%   | 2%   |
| A               | 0%   | 1%   | 1%   | 2%   | 3%   | 4%   | 5%   | 6%   |
| Ba              | 0%   | 0%   | 2%   | 4%   | 10%  | 15%  | 15%  | 20%  |
| B               | 0%   | 0%   | 0%   | 0%   | 5%   | 2%   | 1%   | 3%   |

Moody’s Summer 2013

Dégradation de classement fin 2013

**FITCH**
- Tunisia = BB
- Egypt = B-
- Greece = CCC

**MOODY’s**
- USA = AAA
- Egypt= Caa1
- Tunisia = Ba2-
- Greece = C

**S&Ps**
- USA = AA+
- Egypt = CCC+
- Tunisia = B-
- Greece = B- + selective default

**DAGONG**
- Tunisia = BBB-
- Greece = C-
- USA = A

Les 15 pays classés Triple à fin 2013 (Moody’s)

<table>
<thead>
<tr>
<th>Sovereigns</th>
<th>Foreign Currency Debt</th>
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<tbody>
<tr>
<td>Australia</td>
<td>Aaa STA</td>
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<tr>
<td>Austria</td>
<td>Aaa NEG</td>
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<tr>
<td>Canada</td>
<td>Aaa STA</td>
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<td>Denmark</td>
<td>Aaa STA</td>
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<tr>
<td>Finland</td>
<td>Aaa STA</td>
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<tr>
<td>Germany</td>
<td>Aaa NEG</td>
</tr>
<tr>
<td>Isle of Man</td>
<td>AAA RUR</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>Aaa NEG</td>
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<tr>
<td>Netherlands</td>
<td>Aaa STA</td>
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<td>New Zealand</td>
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<td>Norway</td>
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<tr>
<td>Switzerland</td>
<td>Aaa STA</td>
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<tr>
<td>USA</td>
<td>Aaa STA</td>
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</tbody>
</table>
Le “consensus de Washington”: Une taille pour tous!
“Dix règles de politique économique”
John Williamson (IIE 1990)

1. Fiscal discipline
2. Redirection of public expenditure priorities toward high economic returns and improving income distribution (health care, primary education, infrastructure)
3. Tax reform (to lower marginal rates and broaden the tax base)
4. Secure property rights
5. Interest rate liberalization
6. Competitive exchange rate
7. Trade liberalization
8. Liberalization of FDI inflows
9. Privatization
10. Deregulation

La Globalisation stimule la croissance économique (mais pas le développement!)

= Globalisation + Ouverture internationale
= Productivité & Compétitivité =
= Croissance dynamique

High correlation between globalization, competitiveness (economic performance, institutions quality, business efficiency, infrastructure), and dynamic growth rates

Source: Salvatore (Fordham 2010)

Corrélation Libéralisation économique/PIB

Correlation incertaine

Economic freedom – Human development

y = 0.7755x + 21.431
R² = 0.4899
Phase II - 1980s-90s
Le dentifrice sort du tube

MH Bouchet/SKEMA © 2013

L’Emergence de l’Hyperfinance?
1. Financial Market Globalization (1980s)
2. Capital market deregulation (1990s)
3. Financial innovations and dematerialization (securitization, options, derivatives…)
4. NTIC (Internet!)
5. TBTF global banks

La finance globale en « roue libre »?

La croissance du secteur financier depuis 1950 (ratio of loans + assets + M2)/ GDP in developed countries

Croissance Actifs financiers/PIB depuis les années 80

After 1980, financial asset growth accelerated

MH Bouchet/SKEMA © 2013

Source: A. Taylor, BIS 12/2012

MH Bouchet 2013
La suprématie de l’HyperFinance (du ‘virtuel’ sur le ‘réel’)

US$ milliards

400% du PIB

400% in the US, 530% in Japan, 280% in China and in France

Source: IMF & McKinsey 2013

La Globalisation financière

Does financial globalization lead to commodity price volatility?

Unambiguous response according to UNCTAD: Yes! Don’t blame the physical market fundamentals; the main drivers of commodity price bubbles are traders. Financial globalization is the root case of commodity price volatility. Supply and demand changes in the « real economy » do not cause sharp volatility contrary to exchange-traded derivatives on commodity markets now being 20 to 30 times larger than physical production. Financial investors, who accounted for less than 25% of all market participants in the 1990s, represent more than 85% today; trading, herd instinct and price bubbles!

Banques internationales: ratio actifs/PIB

Source: IMF & McKinsey 2013
**Impact de la Globalisation financière sur la Croissance?**

It would equalize marginal returns to capital around the world, transfer savings from rich to poor, and enhance risk sharing, growth and convergence.

1. Fischer, Summers, Kose…
   - Openness to global capital flows = higher capital efficiency North-South + technology spillover + FDI
   - Δ GDP

2. Stiglitz, Krugman, Rodrik, Lane…
   - Financial and capital account liberalization = capital flow volatility + financial crises
   - capital controls + Tobin tax

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**Corrélation entre libéralisation financière et croissance globale?**

Une évidence empirique?

1. No clear evidence that financial globalization improves institutional quality and macroeconomic discipline
2. Strong evidence that financial integration promotes overall financial sector development and corporate governance
3. Strong evidence that financial sector development increases FDI and portfolio equity flows, domestic investment and growth
4. Premature financial liberalization leads to capital flow volatility and financial crisis

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Financial development can become a drag on productivity and real economic growth

The inverted U-shaped effect of financial development:
- A fast growing financial sector is detrimental to productivity growth
- Too high a ratio of private credit/GDP and fast growing financial sector mean that essential resources will get drawn at the expense of the real economy:

More finance is not better
Quelques mythes…

**Myth 1**: Financial Globalization is for ever: there is an ever wider capital mobility worldwide

**Facts**: Don’t take it for granted! There are sharp declines in capital mobility in times of crisis, and crises are numerous!
Global capital flows: crises and cycles

Cross-border capital flows fell sharply in 2008 and today remain more than 60 percent below their precrisis peak.

The rise and fall of financial depth

Has the financial genie escaped from the bottle?

The financial system cut loose from its economic base, hence dwarfing it.

The rise and fall of net private capital flows to EMCs 2002-14

Emerging Market Private Capital Inflows, Net

Source: McKinsey 2013, BIS, IMF

Total central bank reserves: US$10500 billion (45%)

Source: BIS, IMF
Quelques Mythes…

**Myth 2**: Capital flows from rich to poor countries, which have < capital and offer > returns. By borrowing abroad, LDCs should be able to boost investment and growth rates!

**Fact 1**: capital is flowing « uphill » and the US CAD is financed by emerging countries’ purchase of US Treasury securities

**Fact 2**: US bond yields are 2% lower than they otherwise would be, thanks to the purchase of US securities by China and other EMCs. If these countries loose their appetite for US assets, bond yields could jump and the dollar plunge!

 Origine et destination des flux de capitaux?

Pourquoi les pays émergents accumulent-ils surplus de comptes courants et réserves de change?

2. Strong IMF-monitored adjustment + economic and trade liberalization
   - Surge in raw material and oil prices
3. Devaluation + Boost in investment ratio= Current account surplus + Reserve increase
4. Improvement in debt indicators!
5. 2013-2014 QE tapering?

<table>
<thead>
<tr>
<th>Current account balances of OECD (34) and EMCs (160)</th>
</tr>
</thead>
<tbody>
<tr>
<td>US$ billion</td>
</tr>
<tr>
<td>2011</td>
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<tr>
<td>2012</td>
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<tr>
<td>2013</td>
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<td>2014</td>
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<td>2015</td>
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<tr>
<td>2016</td>
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<tr>
<td>2017</td>
</tr>
<tr>
<td>2018</td>
</tr>
</tbody>
</table>

Source: IMF WEO 2013
Quelques mythes…

Mythe 3: The richest developed countries with strong financial systems have surplus savings, hence capital exports

Facts: most of developed countries live « beyond their means » and must import capital

EMCs’ dynamic growth boosts savings relative to investment, hence a current account surplus (China!).
Net saving countries: Major Exporters of Capital

Source: IMF 2013

Les réserves de change de la Chine fin 2013

China holds nearly ¼ of foreign holding of US debt

F Mythe 4: Bulk of capital inflows to developing countries stems from official, bilateral and multilateral, creditors (IFIs and Paris Club)

F Facts: Official net capital flows to EMCS are close to zero (6% of total net flows). External financing comes from private creditors, mainly FDI and capital markets, i.e., bonds
Sources of external financing

Official (bilateral + multilateral)
- Paris Club (government to government credits)
- Export insurance credit
- IFIs
- RDBs
- Debt cancellation

Private
- FDI
- Portfolio Investment
- London Club (international bank loans)
- Working capital lines
- ST Trade credits
- Bonds & International debt securities
- Arrears and rescheduling

Emerging Market Economies: Capital Flows

<table>
<thead>
<tr>
<th>Capital Inflows</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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</thead>
<tbody>
<tr>
<td>Total Inflows, Net</td>
<td>1207</td>
<td>1212</td>
<td>1197</td>
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<tr>
<td>Private Inflows, Net</td>
<td>1146</td>
<td>1181</td>
<td>1145</td>
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<tr>
<td>Equity Investment, Net</td>
<td>598</td>
<td>670</td>
<td>631</td>
<td>633</td>
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<tr>
<td>Direct Investment, Net</td>
<td>593</td>
<td>545</td>
<td>541</td>
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<tr>
<td>Portfolio Investment, Net</td>
<td>5</td>
<td>125</td>
<td>89</td>
<td>110</td>
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<tr>
<td>Private Creditors, Net</td>
<td>548</td>
<td>511</td>
<td>514</td>
<td>479</td>
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<tr>
<td>Commercial Banks, Net</td>
<td>195</td>
<td>121</td>
<td>144</td>
<td>154</td>
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<tr>
<td>Nonbanks, Net</td>
<td>363</td>
<td>390</td>
<td>369</td>
<td>325</td>
</tr>
<tr>
<td>Official Inflows, Net</td>
<td>61</td>
<td>31</td>
<td>43</td>
<td>55</td>
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<tr>
<td>International Financial Institutions</td>
<td>17</td>
<td>4</td>
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<td>21</td>
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<tr>
<td>Bilateral Creditors</td>
<td>44</td>
<td>27</td>
<td>37</td>
<td>35</td>
</tr>
</tbody>
</table>

Quelques Mythes…

- Mythe 5: External financing leads to debt increase, hence looming liquidity and solvency problems.
- Facts: Indebtedness is a key ingredient of socio-economic development process (in the US as much as in Germany, Korea or Japan!) to close the I/S gap

- The key issue is how the debt invested, i.e., the relationship between maturity profile of debt flows and of investment projects, as well as the relationships between interest rates and rate of return?
- Reinhart and Rogoff (2009) have empirically established that a developed economy with > 90% of GDP in public debt can barely manage it; that ceiling is at 60% of GDP for EMCS (questionable!)

Successful economic adjustment:
Improvement in EMCS’ solvency ratios (drop in Debt/X %)

Source: IMF

MH Bouchet 2013
Pertinence des indicateurs de solvabilité?

- Maastricht et agences de notation (ratio <60%)
- Dette/PIB ne tient pas compte de la valeur réelle de la dette mais seulement à sa valeur nominale en année T alors même que le pays n’est pas supposé rembourser sa dette par une année de PIB
- Beaucoup de pays émettent des obligations à coupon zéro (intérêts capitalisés) ou indexés sur l’inflation, ce qui augmente la charge ultérieure de la dette (RU)

Quelques Mythes…

- **Mythe 6**: Les IDE sont une source majeure de financement des pays émergents!
- **Fact**: Though developing countries are considered as key target markets, the bulk of FDI flows continue moving toward developed countries (>56%)
The FDI global confidence index

<table>
<thead>
<tr>
<th>Ranking</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>China</td>
</tr>
<tr>
<td>2</td>
<td>India</td>
<td>India</td>
</tr>
<tr>
<td>3</td>
<td>Brazil</td>
<td>Brazil</td>
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<tr>
<td>4</td>
<td>Russia</td>
<td>Russia</td>
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<tr>
<td>5</td>
<td>United States</td>
<td>United States</td>
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<td>6</td>
<td>Germany</td>
<td>Germany</td>
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<tr>
<td>7</td>
<td>Australia</td>
<td>Australia</td>
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<tr>
<td>8</td>
<td>Singapore</td>
<td>Singapore</td>
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<tr>
<td>9</td>
<td>United Kingdom</td>
<td>United Kingdom</td>
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<tr>
<td>10</td>
<td>Vietnam</td>
<td>Vietnam</td>
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<tr>
<td>11</td>
<td>Mexico</td>
<td>Mexico</td>
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<tr>
<td>12</td>
<td>South Korea</td>
<td>South Korea</td>
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<tr>
<td>13</td>
<td>Turkey</td>
<td>Turkey</td>
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<tr>
<td>14</td>
<td>Sweden</td>
<td>Sweden</td>
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<tr>
<td>15</td>
<td>United Arab Emirates</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>16</td>
<td>France</td>
<td>France</td>
</tr>
<tr>
<td>17</td>
<td>Latin America</td>
<td>Latin America</td>
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<tr>
<td>18</td>
<td>Taiwan</td>
<td>Taiwan</td>
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<td>25</td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

The most attractive EMCs

- China
- India
- Indonesia
- South Korea
- Malaysia
- Canada
- France
- Belgium
- Italy
- Mexico

Cibler la classe moyenne en croissance?

Shares of global middle-class consumption, 2000-2050

Le Top 10 des PIBs 1950-2050

- USA
- UK
- Germany
- China
- France
- Japan
- Russia
- Brazil
- Italy
- India
Germany’s shrinking population:
2005: 82 million
2050: 69 million
= growing birth deficit (1.6)
source: Destatis 09/2013

Les flux annuels d’IDE = $1500 billion

Quelques Mythes

Myth 7: Rating agencies can assess, measure and rank «global risk»

Facts: Rating agencies such as S&Ps, Moody’s and Fitch systematically missed the train. Shortsightedness added a model risk to market risk and country risk, hence no early warning signals!

http://www.cfr.org/united-states/credit-rating-controversy/p22328

Main rating agencies?
- S&Ps (1860)
- Moody’s (1909) 40% market share
- Fitch IBCA (1913)
- COFACE (1946)
- Dagong Credit Rating Co (1994)
- Euler-Hermes
Shortcomings of rating agencies?

- Criticisms:
  - * Power without accountability
  - * Rating shopping by companies
  - * Conformity and sociocultural bias
  - * Punishment of disobedient firms/countries that do not request a rating
  - * Procyclical bias, hence following the majority opinion of market participants without any early warning signals nor predictability track record
  - Spill-over effect!

World Bank: «Doing Business» in 2013

10 Parameters
Ranking does not take into consideration the macroeconomic framework nor organized crime

1. Singapore
2. New Zealand
3. Hong Kong
4. USA
5. UK
6. Denmark
7. Iceland
8. Canada
9. Australia
10. Norway
29. France
91. China
120. Russia
126. Brazil
132. India
182. Congo

Conclusion:
La Globalisation financière et l’impossible régulation? Bâle III?

- FMI 188 pays membres
- OCDE 34 pays développés
- BRI 58 banques centrales: Basel Committee
- Financial stability council
1. Strengthening Tier I capital ratio: common equity + retained earnings + reserves >9% against risk-weighted assets
2. 2,5% additional surcharge for « systemic banks »
3. Increasing liquidity: survival of a 30-day crisis
4. Better transparency and governance
5. Improved risk control and management
6. Maximum debt and leverage ratio: total assets <33 times equity capital

Bank recapitalization needs (FMI-2012)

9/12: 112 of the largest global banks have core Tier 1 capital = 7,7% of risk weighted assets

Sources: European Banking Authority; and IMF staff estimates.