

# **Financial De-globalization in Context**

Hyun Song Shin

Ministry of Economy and Finance  
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## A Look Back

- **First Phase of Global Liquidity (2003 - 2008)**

- Bank-driven
- Key theme is **leverage**
- Main actors: global banks

- **Second Phase of Global Liquidity (2010 - )**

- Bond market-driven
- Key theme is **search for yield**
- Main actors: asset managers with global reach

## Three Modes of Leveraging Up

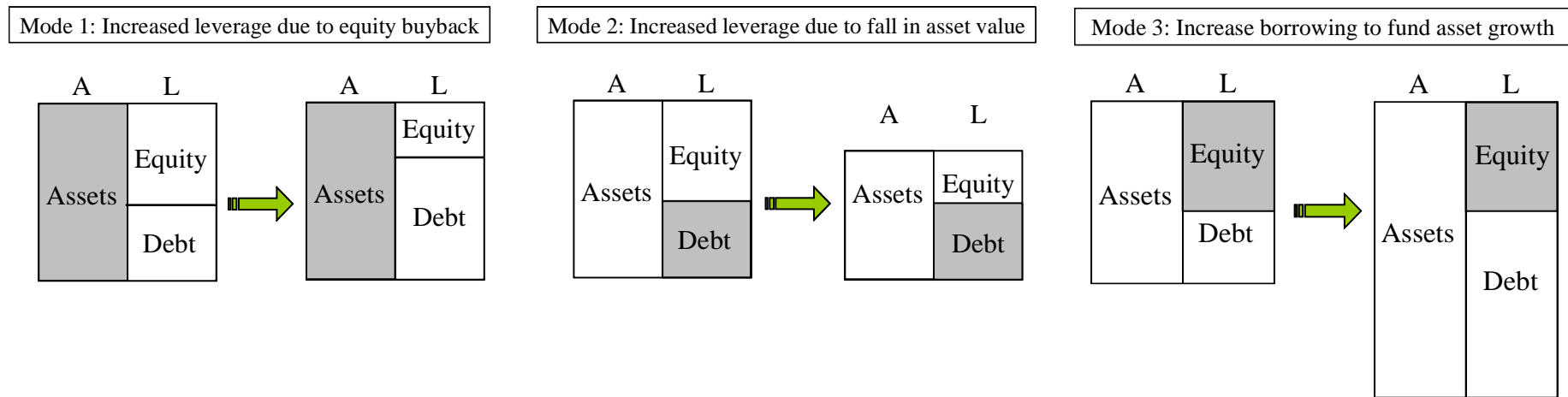


Figure 1. **Three modes of leveraging up:** Mode 1 is through an equity buyback through a debt issue. Mode 2 is through a dividend financed by asset sale. Mode 3 is through increased borrowing to fund new assets. In each case the grey area indicates balance sheet component that is held fixed

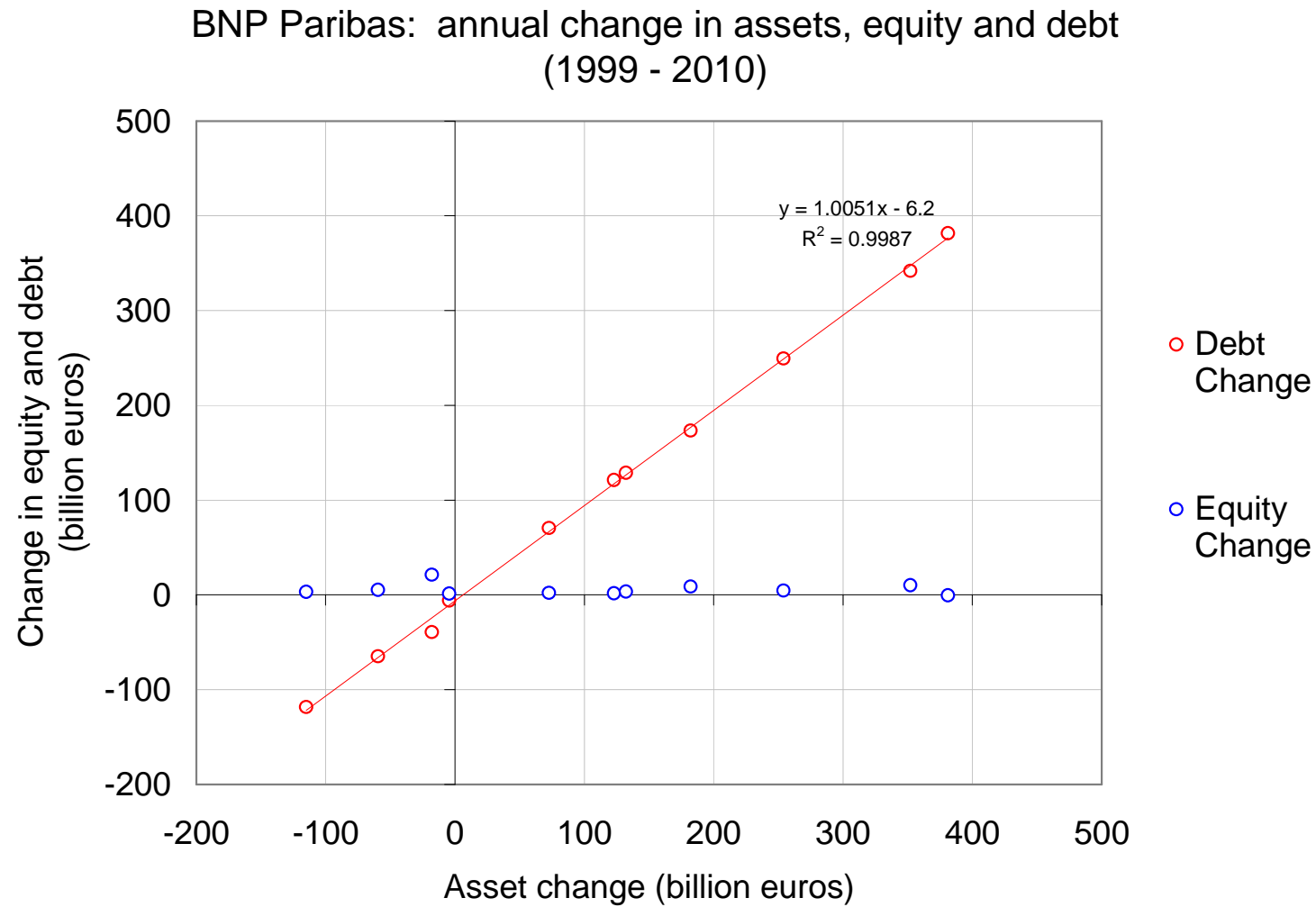


Figure 2. BNP Paribas: annual change in assets, equity and debt (1999-2010) (Source: Bankscope)

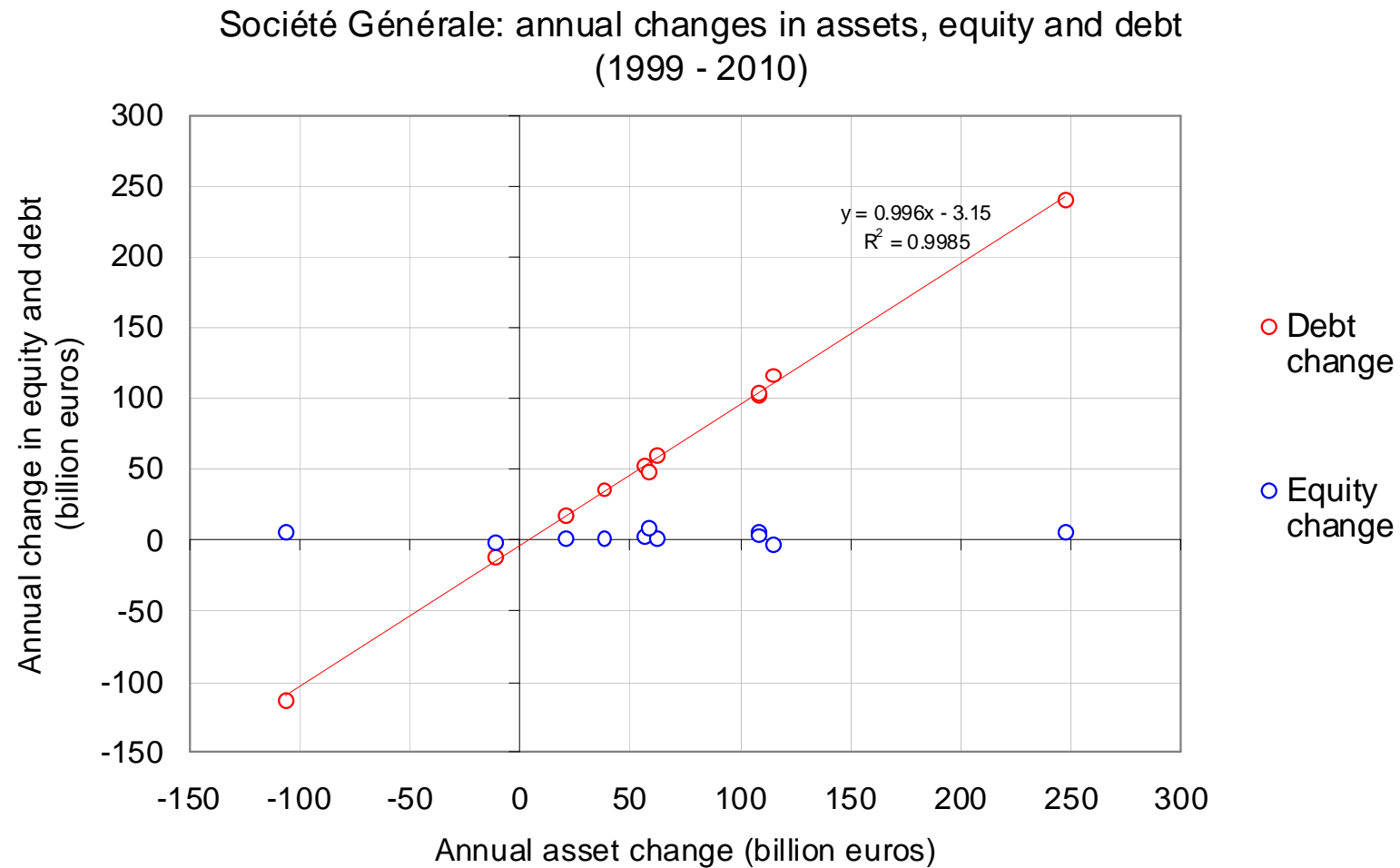


Figure 3. Société Générale: annual change in assets, equity and debt (1999-2010) (Source: Bankscope)

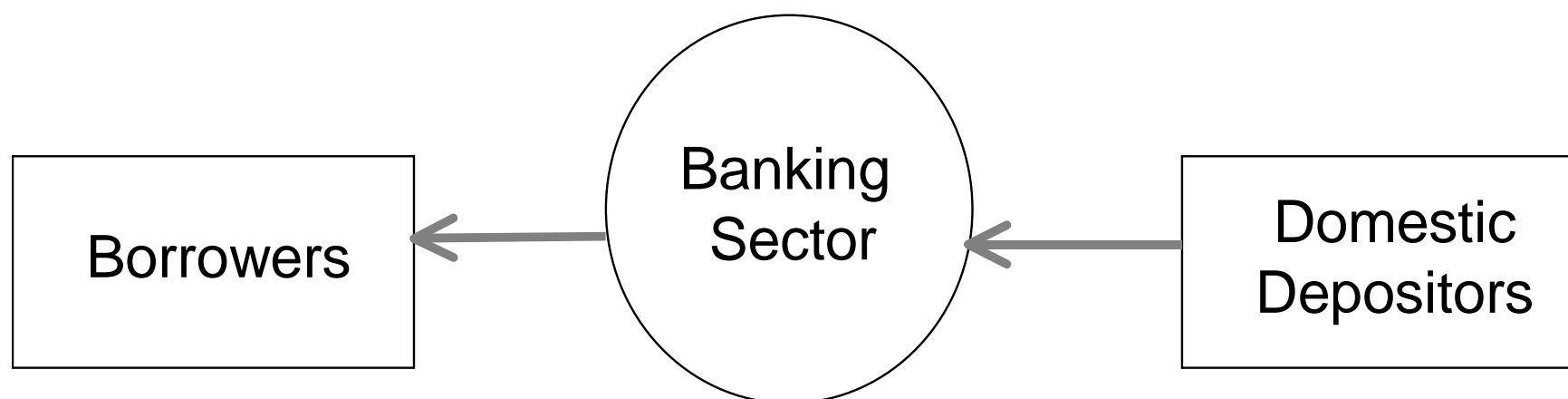
## An Analogy

- Bank capital  $\mapsto$  Foundations of building
- Bank lending  $\mapsto$  Building itself
- Leverage  $\mapsto$  Height of building relative to its foundations

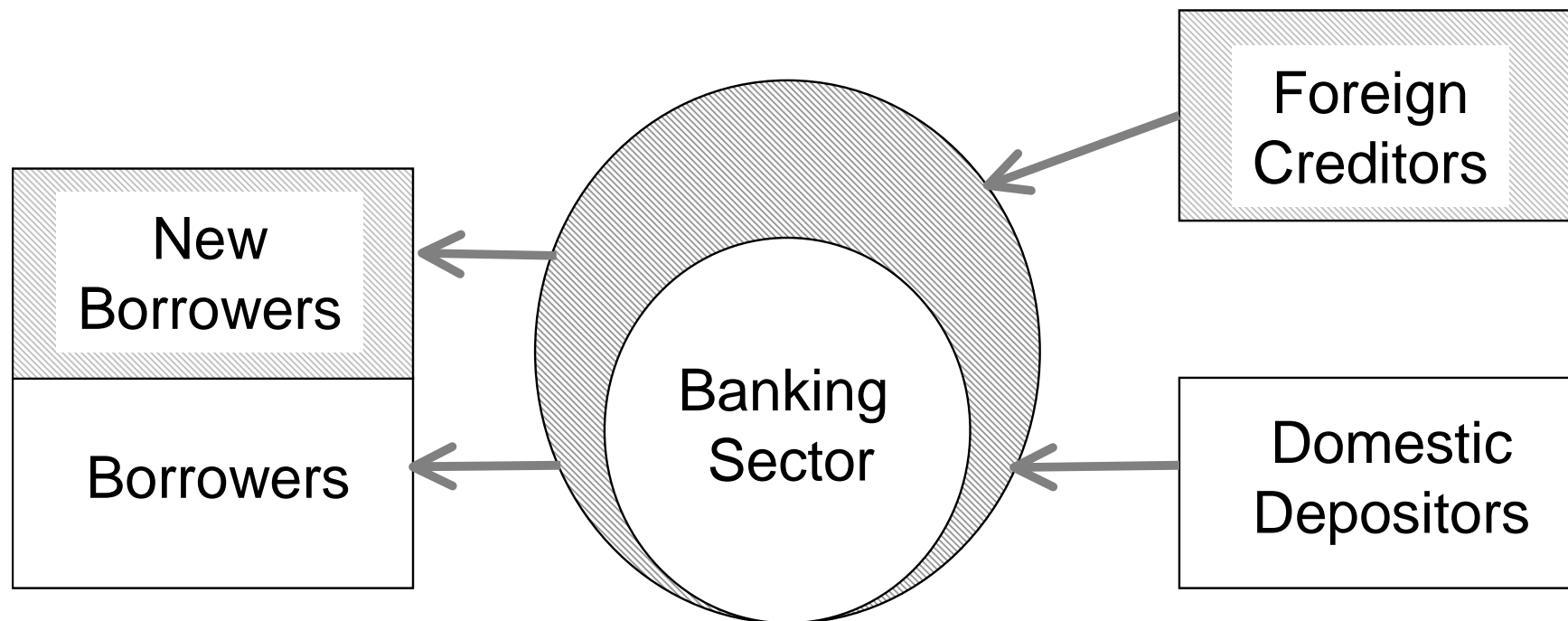
Leverage regulation  $\mapsto$  Building code stipulating how tall the building can be relative to foundation



Figure 4. Sutyagin House, Archangel







## **Second Phase of Global Liquidity (2010 - )**

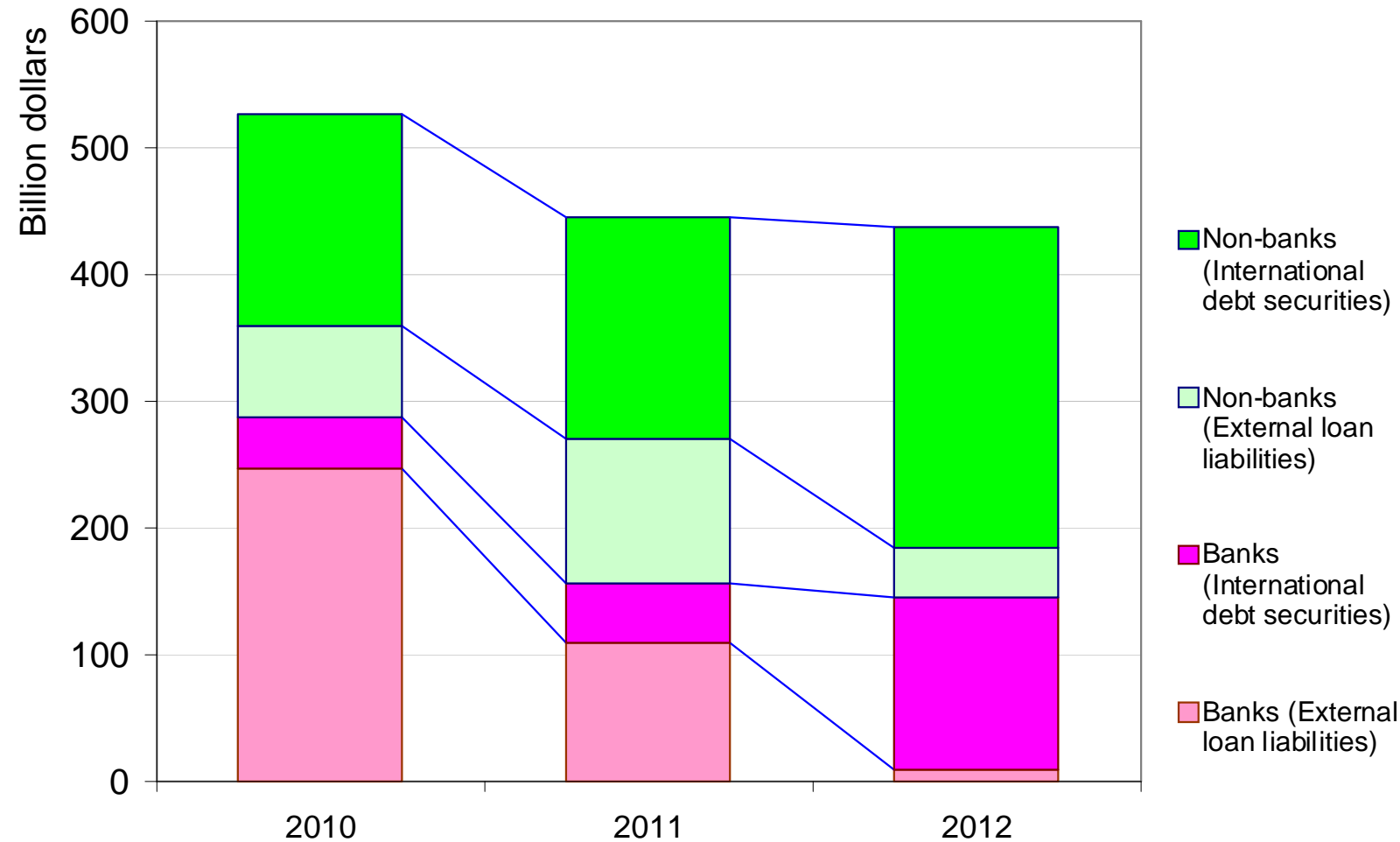


Figure 5. Net “external” financing of emerging economies (Source: Turner (2013), data from BIS banking and security statistics)

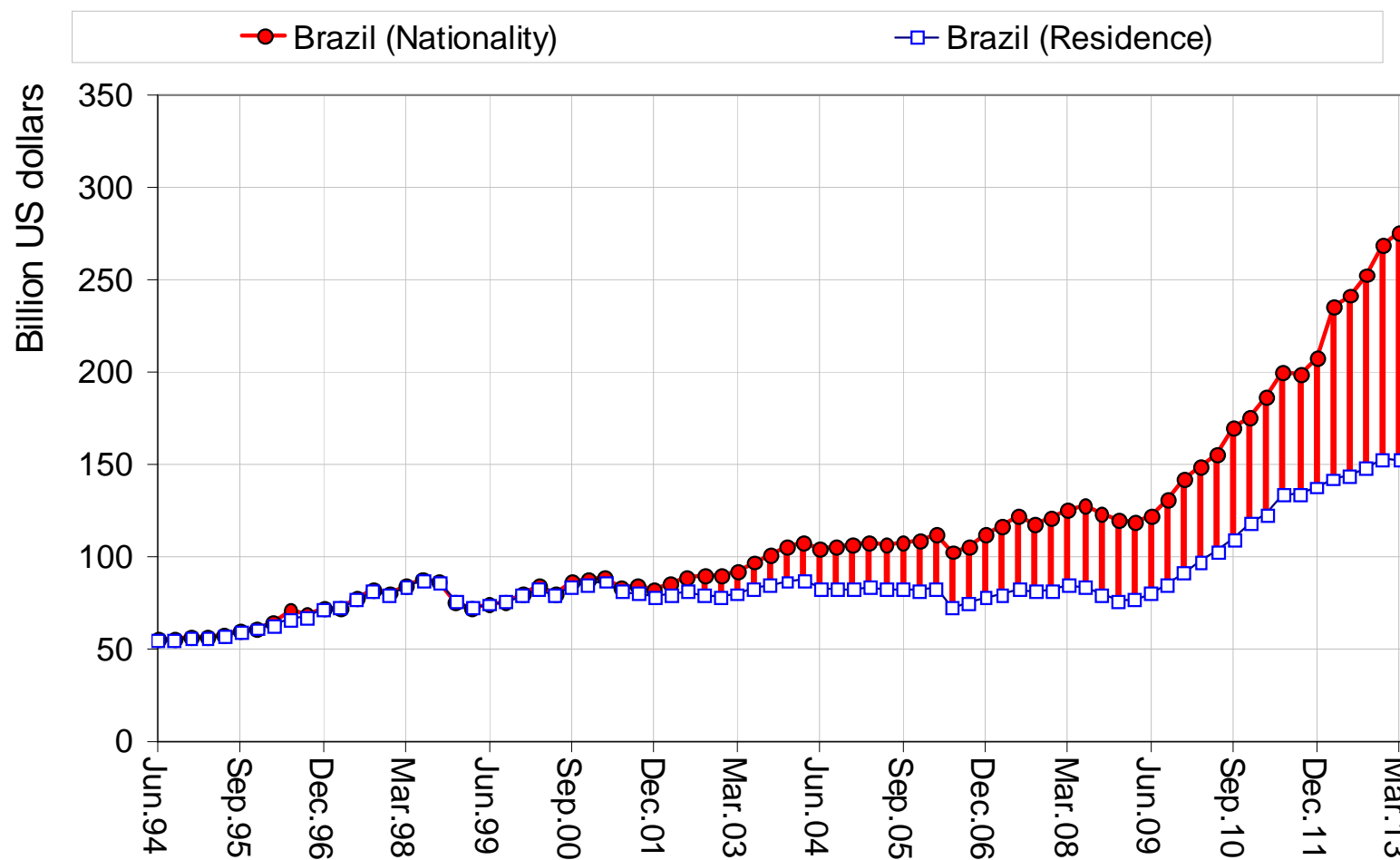


Figure 6. International debt securities outstanding (all borrowers) from Brazil by nationality and by residence (Source: BIS Debt Securities Statistics, Table 11A and 12A)

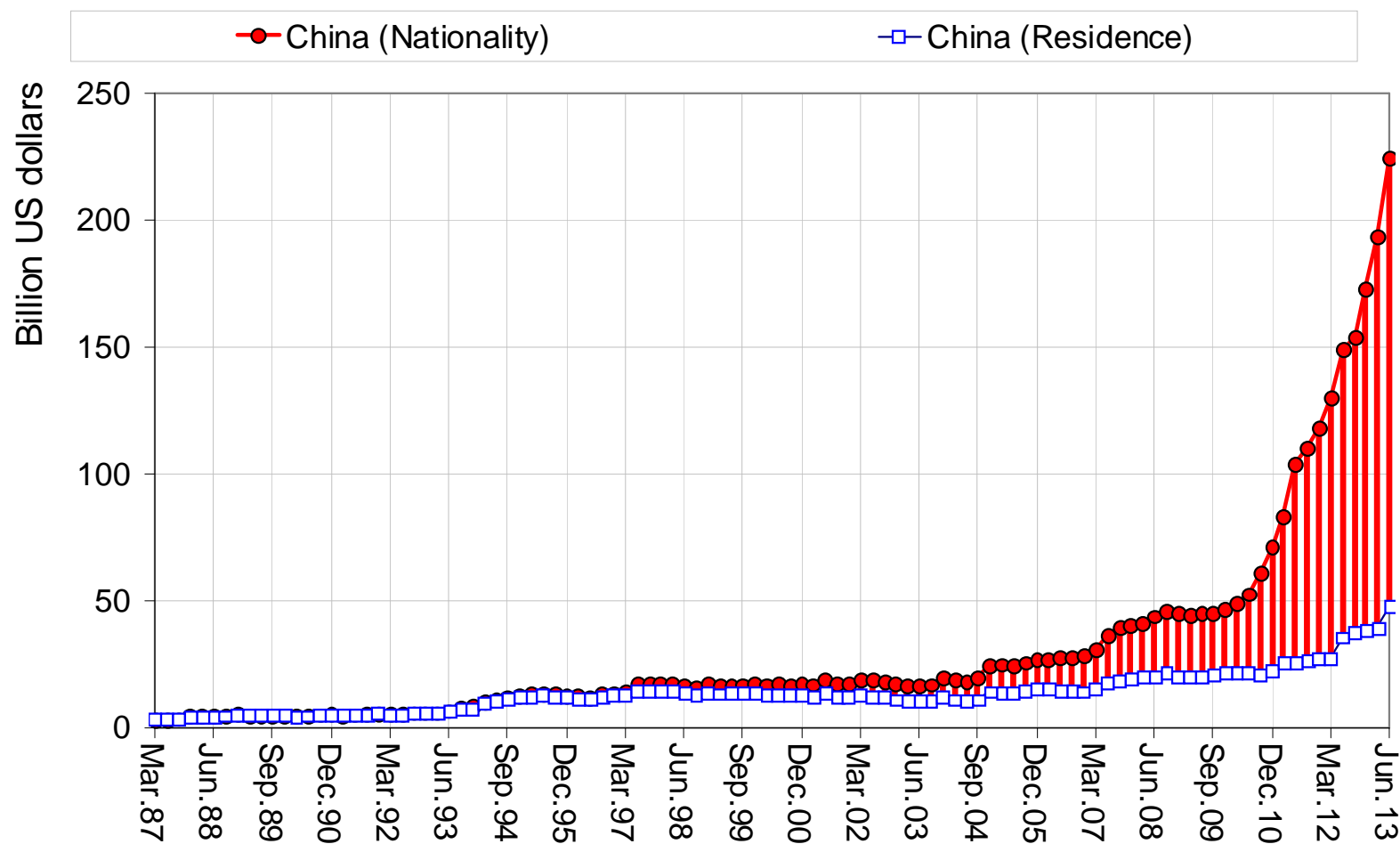


Figure 7. International debt securities outstanding (all borrowers) from China by nationality and by residence (Source: BIS Debt Securities Statistics, Table 11A and 12A)

## Switch from Bank to Bond Financing

- Euro area banks and EME corporates
- EME local currency bond yields
  - have fallen in tandem with advanced economy bond yields
  - have begun to move in lock-step with advanced economy bond yields
- Explosion of EME corporate bond issuance activity, especially offshore issuance
- Transmission channel is reinforced by exchange rate changes

## **What to Guard Against when Tide Turns**

1. Steepening of local currency yield curve
2. Corporate distress, freeze in corporate capital expenditure
3. Slowdown in growth
4. Asset managers cut back EME holdings citing slower growth in EMEs
5. Back to Step 1, completing the loop

## Unfamiliar Problems

- Second Phase of GL demands different questions from policy makers
  1. “Is the leverage of the banking sector too high?” (First Phase Question)
  2. “How far (fast) will yield curve steepen?” (Second Phase Question)
- But temptation is to ask First Phase Question only, and then be lulled into false sense of security