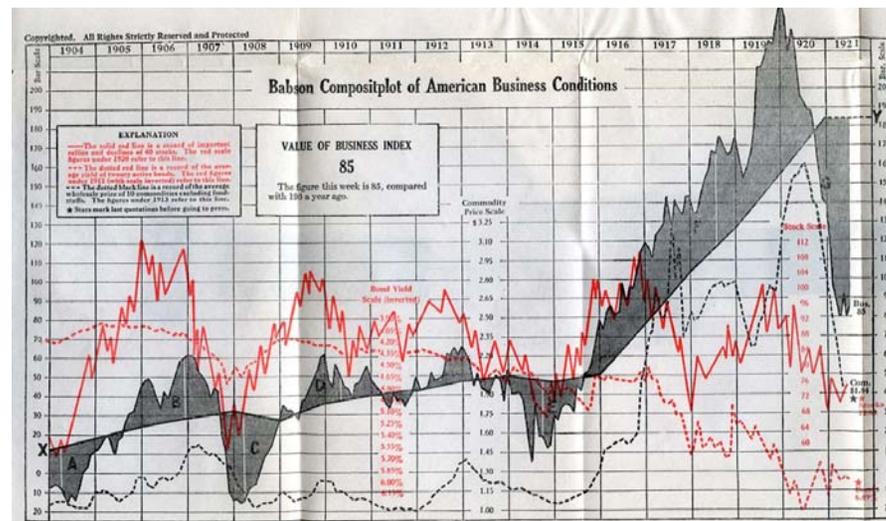


Comment on: “The International Monetary and Financial System: A Capital Account Historical Perspective” By Borio, James and Shin



Eric Hilt

Wellesley and NBER

June 2014

Lessons from History

When financial panics hit, policy makers, market participants often caught off guard

Financial innovation drives intermediation (and vulnerability to panics) into new markets & institutions

Mechanisms to deal with panics take time to evolve – do not develop without concerted effort, experience

This paper argues that focusing only on current account may blind policymakers/market participants to important sources of risk

Large stock of short-term debt may make a country vulnerable to a run

Important domestic markets and institutions may be vulnerable to international shocks

Historical Emphasis on Current Account

At peak of classical gold standard (1900-14), gross and net international investment positions were *roughly equal*

Principal flows were long-term, and unidirectional

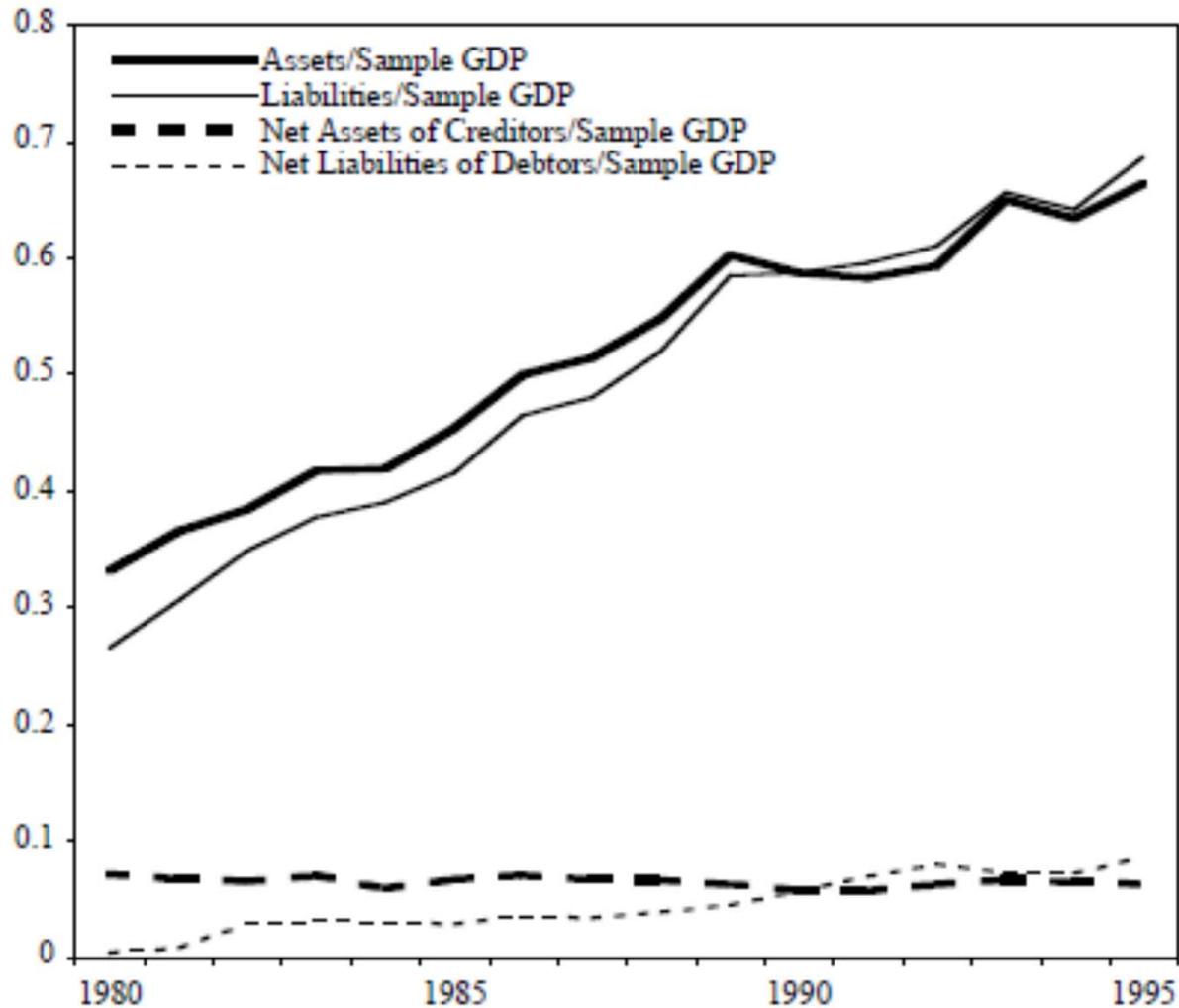
Creditor nations (UK, also Germany, France) financed capital accumulation in other countries, developed enormous one-way positions

Today, gross foreign assets for many countries are roughly equal to gross foreign liabilities; net investment positions are radically different from gross

Flows dominated by investments among rich countries; large creditor nations are also large debtor nations

This may explain traditional emphasis on current account, and implies that the need to monitor gross investment positions is uniquely important in modern era

Gross v. Net



(Source: Obstfeld and Taylor, 2002)

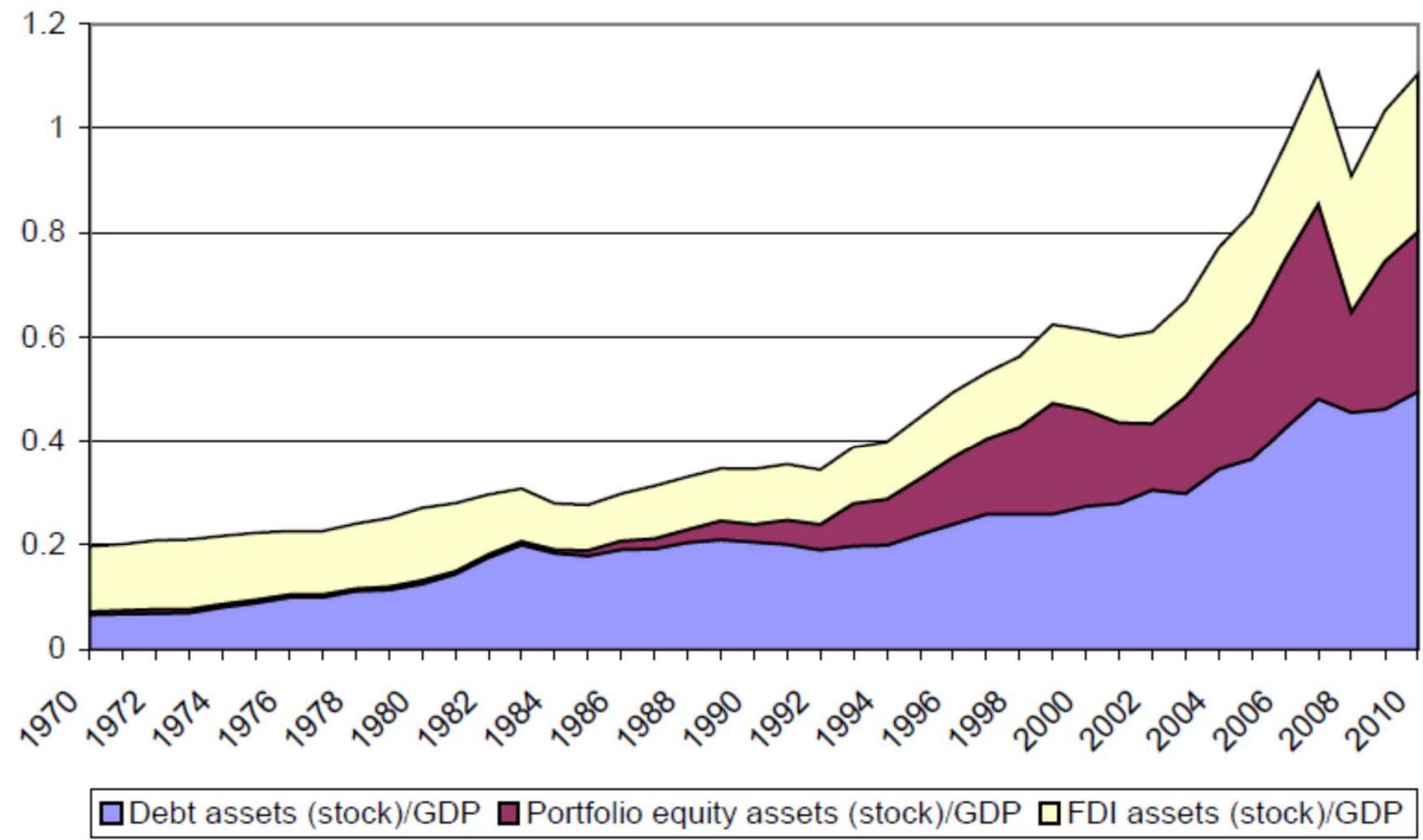
Netting is Misleading

Composition of claims on the rest of the world may be quite different from composition of claims on domestic economy

Even if the country holds a large net foreign asset stock, *it does not follow* that the particular agents with short-term foreign liabilities hold enough liquid assets to pay them off

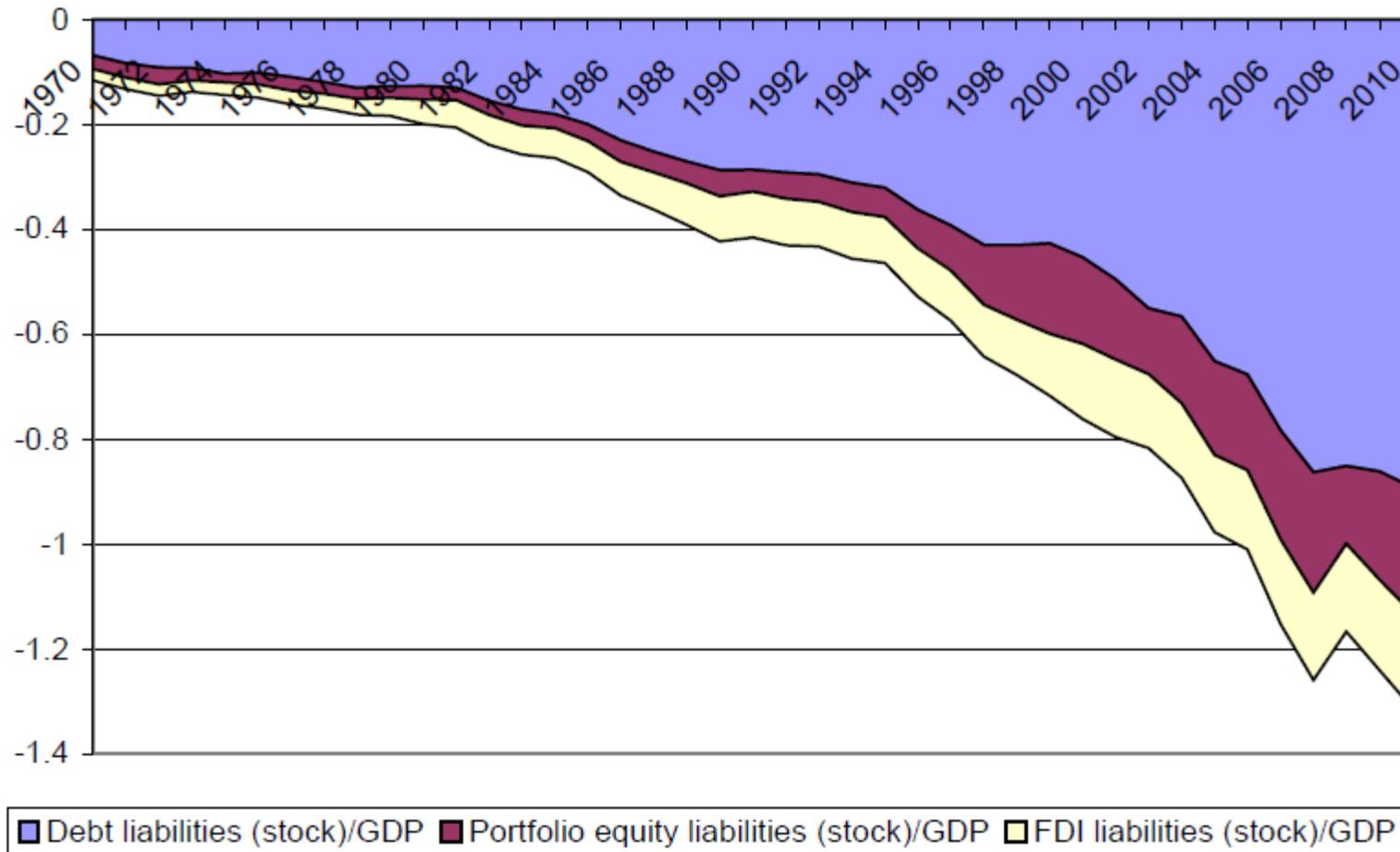
Need to know institutions' gross assets and liabilities; those institutions' branches may cross international boundaries

Composition of Gross External Assets



(Source: Obstfeld, 2012)

Composition of Gross External Liabilities



(Source: Obstfeld, 2012)

Historical Evidence

The interwar period in Germany

The interwar period in the U.S.

The modern era

Interwar Period in U.S.

The U.S. Becomes a Creditor

Between 1914 and 1930, U.S. gross external assets rose from 10% of GDP to 20%; liabilities fell from 21% to 9%*

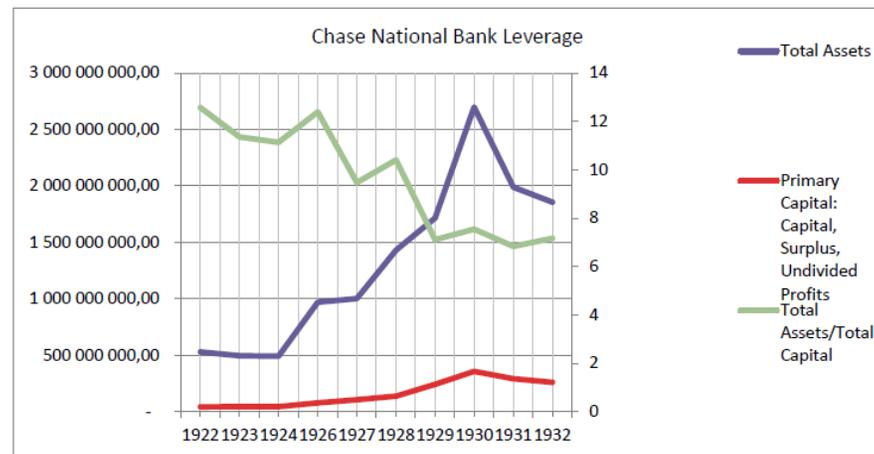
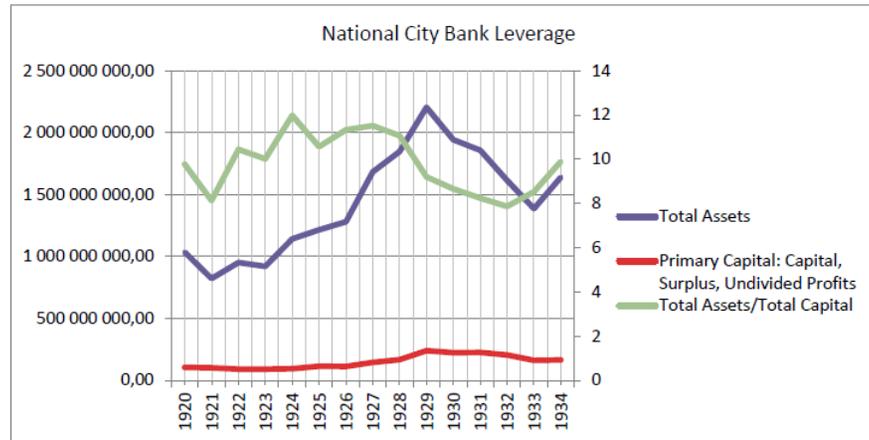
Paper argues US experienced “considerable financial innovation,” with “new market for foreign bonds”; generalized “banking glut”

“Financial fragility played a major role in the build-up of vulnerability, and then in the propagation of the crisis”

Emphasis on Germany, but also implies that international lending contributed to propagation of crisis in U.S., especially among “internationally active” banks

*Calculations from Eichengreen, 1989, and exclude war debts

Major New York Banks in the 1920s



Financial Innovation Among Major NY Banks After WWI

Expansion of branching (within NYC)

Heavy participation in securities underwriting
(through securities affiliates)

Provision of “trust” services

Call market lending substantially expanding, as
stock market rises in value

International Exposure and the Crisis?

Total holdings of foreign bonds (sovereign + private) accounted for \$51.6 million; total bonds owned, \$1.045 billion*

Due from foreign banks: \$31.5 million; bills & acceptances payable in foreign countries, \$34.6 million – total resources, \$6.3 billion*

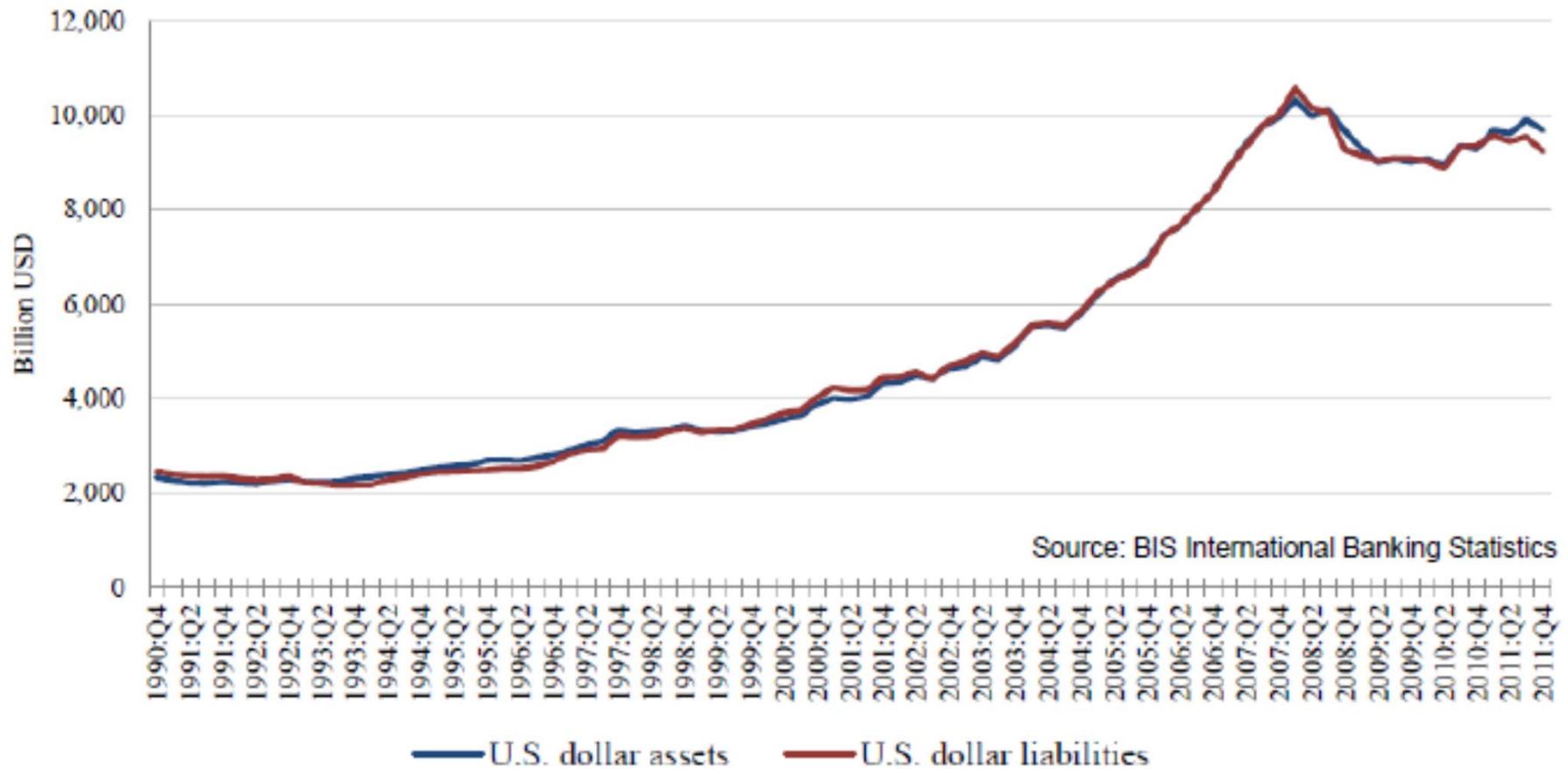
Most severe impact of panics felt among small, rural banks

International dimension of crisis in 1930s operates through monetary policy, commodity price changes – for the US, it does not seem to be an “international banking glut” causing a crash

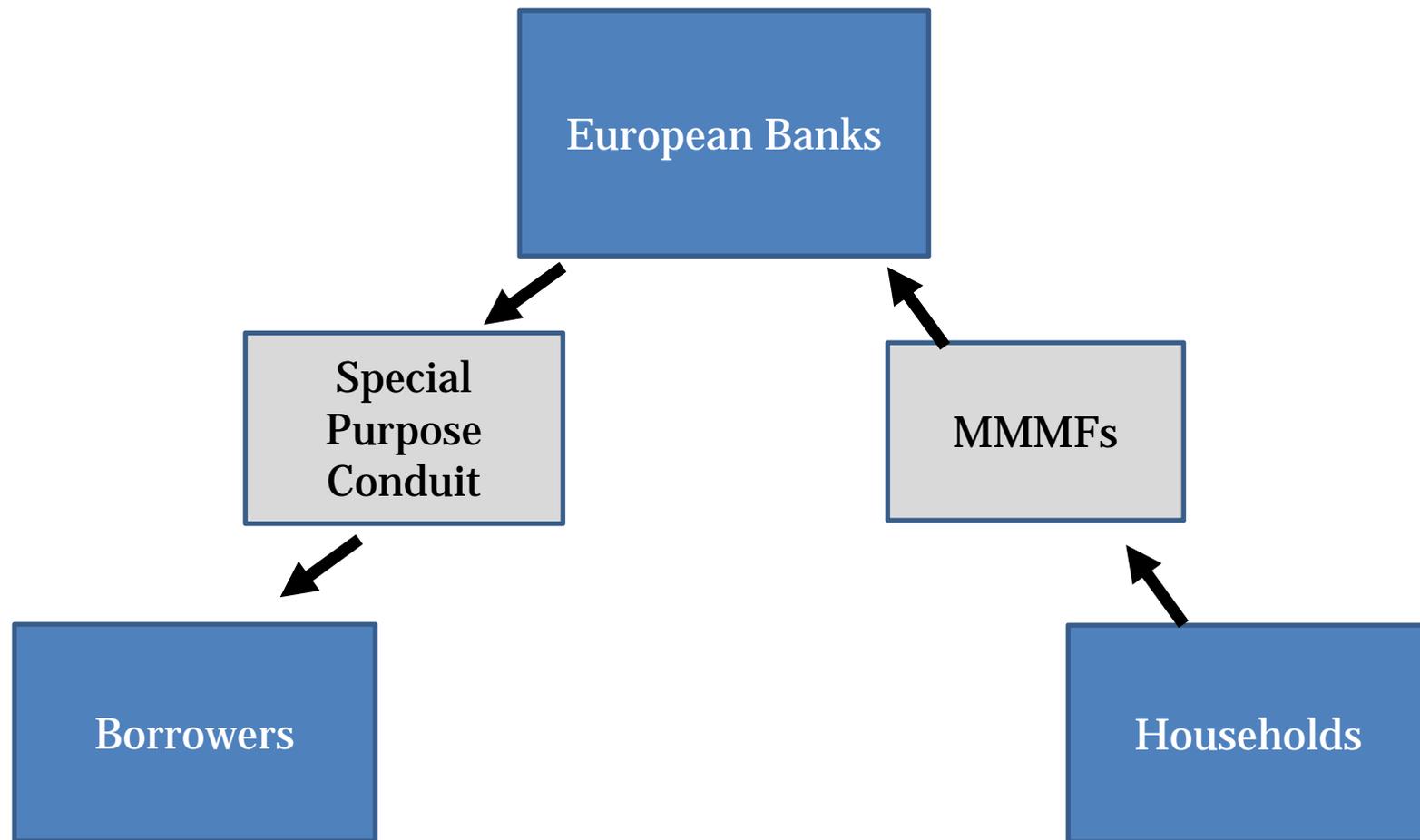
*Source: *Annual Report of the Comptroller of the Currency, 1929*

European Lending and the Current Crisis in the US

USD Assets, Liabilities of Foreign Banks



(Source: Ivashina, Scharfstein and Stein, 2012)



Banks funded dollar assets (loans, MBS) with wholesale dollars often borrowed from U.S. money-market funds.

Eurozone Banks Significant Participants in Syndicated Loan Market in US

	Fraction of	Lending in	
	Total Lending	Euro	USD
Eurozone	45.50%	90.90%	8.60%
Rest of Europe	18.50%	29.50%	30.20%
US	21.80%	0.90%	99.00%

Banking inflows originated in current-account surplus and deficit countries

Notes

Transactions raise gross foreign debt assets and liabilities – net out completely

Run on MMMFs caused scramble for USD liquidity; Fed provided swaps to foreign central banks

It has happened again – during Eurozone debt crisis, MMMFs reduced exposure to Eurozone banks; those banks, in turn, reduced their USD lending (Ivashina, Scharfstein and Stein, 2012)

Conclusion

Interesting, provocative work – forceful argument for thinking beyond current account

Problem of national boundaries a complex one

Large fraction of many countries' gross external assets belong to foreign nationals (through foreign headquartered financial institutions)

In some respects the most important data to follow are individual institutions/firms

Financial globalization requires us to re-think some elements of our models and data

Extra Slides

International Branching

TABLE NO. 48.—Condition of foreign branches of National City Bank and Chase National Bank, of New York, N. Y., and First National Bank of Boston, Mass., June 29, 1929—Continued

LIABILITIES

[In thousands of dollars]

Country and city	Capital	Undivided profits, including amounts reserved for taxes and interest accrued	Due to branches	Due to home office	Due to other banks	Certified and cashiers' checks outstanding	Cash letters of credit and travelers' checks outstanding	Demand deposits	Time deposits	Bills payable and rediscounts	Acceptances of other banks and bills of exchange or drafts sold with indorsement	Acceptances executed for customers	Acceptances executed by other banks for account of reporting branches	Other liabilities
NATIONAL CITY BANK OF NEW YORK, N. Y.														
Argentina:														
Buenos Aires.....	990	241	2,284	233	6,085	74	155	10,271	6,700	2,101	4,534	14	300	270
Rosario.....	248	10	130		54		36	4,645	3,757				706	92
Belgium:														
Antwerp.....		75	98	286	190		22	2,709	2,168	215	180	584	5,866	2
Brussels.....		18	1,149	400	1,570		9	1,946	89	3	16	697	3,699	4
Brazil:														
Pernambuco.....		13	136	290	148	37	66	1,485	907		356	172		412
Rio de Janeiro.....	1,065	40	265	643	248	261	269	6,693	2,968		1,010		67	654
Sao Paulo.....		213	455	3,936	664	518	191	6,554	4,940		3,659		659	1,468
Chile:														
Santiago.....	2,411	10	516	3,142	8	65	118	6,916	2,628		4,438		12	2,549
Valparaiso.....		45	1,288	523	53	16	231	882	951		2,082		69	699
China:														
Canton.....		29			53		1	978	3,554					
Dairen.....		7	2,096	165				364	285	401				
Hankow.....		14	1,390		438			1,210	945					
Harbin.....		29	9,003	993	561	32	14	2,788	3,546		2,942			5
Hong Kong.....		272	3,291	680	47	3		2,808	8,960					67
Mukden.....		10	178	1,094	87			422	476		136			
Peking.....		33	31		887	2		1,478	2,368					
Shanghai.....		164	4,919	835	1,385	19	48	16,788	3,974					3
Tientsin.....		55	365	121	1,297	9		13,634	2,401	733				
Colombia: Bogota.....	601	1		729	2	7	20	209	28			10	45	11
Cuba:														
Caibarien.....		5	916			287		1,144	268				160	5
Canaguey.....		7			37	178	7	868	570				23	2
Cardenas.....		7	3,719			58		815	197				7	1
Ciego de Avila.....		1				13	1	269	385				10	

Recent Financial Crisis