CAPITAL FLOWS AND COVID: WHAT DID WE LEARN ABOUT THE RESILIENCE OF THE GLOBAL SYSTEM?


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The views expressed in this presentation are those of the author and not necessarily those of the Bank of England
Three Questions

1. The Backdrop: how can policy makers improve the trade-off associated with financial openness?

2. The Crisis: how did capital flows respond to the Covid shock?

3. The lessons learnt: what does the crisis tell us about vulnerabilities in the NBFI sector?
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Financial openness is a double-edged sword

Capital flows growth & GDP growth

Capital flow volatility & GDP growth

Source: IMF.
Notes: Volatility is the coefficient of variation of gross inflows scaled by external liabilities. Real GDP growth, gross inflows to GDP and volatility are averaged over 1970 to 2017 for 38 emerging market economies.
A framework for thinking about capital flows

- “Pull” factors [domestic policy settings] most important pre-GFC.
- “Push” Factors [such as global monetary policy in the centre country] increase in importance over time
- The “Pipes” [the structure of the global financial system] are crucial
Upgrading the Pipes: A responsible and open financial system

- Build a system based around
  - Shared commitment to markets
  - Common minimum standards
  - High degrees of cooperation amongst regulators
  - Resilient institutions

- But... what about the parts of the system that are outside the prudential regulatory perimeter?
Market based finance is more susceptible to “push” shocks

Sources: IMF, EPFR, Bank calculations.
Notes: Chart shows the sensitivity of different capital flows to a negative “push” shock. Coefficients are standardised by each component’s share of total flows e.g. the red MBF bar shows how total Capital Flows-at-Risk would respond to a one standard deviation tightening in global financial conditions if all capital flows were accounted for by MBF.
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Macroprudential frameworks can support lending

Effective CCyB rates before and after the Covid-19 Shock (%)

Global banks’ required capital due to CCyBs ($bn)

Sources: ESRB, HKMA, BIS, national authorities’ websites. Listing countries which had a non-zero pending or effective rate at some point since 2015 Q1. Information up to 2020 Q2.

Sources: ESRB, HKMA, BIS consolidated banking statistics and authors’ calculations.
Flight to safety, liquidity strains, and the ‘dash for cash’

Chart A.2 In mid-March, even 10-year government bonds came under selling pressure
Year to date changes in 10-year nominal yields

Chart A.3 Liquidity was strained even in the typically deep UK government bond markets
Bid-offer spreads in selected gilts(a)

Sources: Bloomberg Finance L.P. and Bank calculations.

(a) The chart plots the five-day rolling average of the bid-offer spreads.
Capital flowed out of EMEs, particularly portfolio flows

Weekly non-resident portfolio flows from 10 NCEMEs in recent episodes\(^{(a)(b)(c)}\)

![Graph showing weekly non-resident portfolio flows from 10 NCEMEs in recent episodes.]

Quarterly change in UK banks’ consolidated claims on 10 large NCEMEs\(^{(a)(b)}\)

![Graph showing quarterly change in UK banks’ consolidated claims on 10 large NCEMEs.]

Sources:
- Eikon from Refinitiv, IMF World Economic Outlook (WEO), Institute of International Finance and Bank calculations. (a) Ten NCEMEs are Brazil, Hungary, India, Indonesia, Mexico, Philippines, Poland, South Africa, Thailand and Turkey. (b) Seven countries with latest data are Brazil, Hungary, India, Indonesia, Philippines, South Africa and Thailand. (c) Start of episodes taken as 1 September 2008, 1 May 2013, 1 April 2018 and 17 January 2020 respectively.

Source: Bank of England, and Bank calculations. (a) Brazil, Hungary, India, Indonesia, Mexico, Philippines, Poland, South Africa, Thailand and Turkey. (b) Respective ‘episode quarters’ used are Q4 2008 and Q1 2020.
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Central bank interventions were unprecedented in speed and size

Changes in components of central banks’ balance sheets since the end of February 2020 as a proportion of 2019 nominal GDP in their home jurisdictions


(b) ECB lending operations: Lending to euro-area credit institutions related to monetary policy operations denominated in euro. ECB asset purchases: Securities held for monetary policy purposes.

(c) Federal Reserve lending operations: Repurchase agreements, Loans and Net portfolio holdings of TALF II LLC (less TALF II LLC Treasury contributions and other assets). Federal Reserve asset purchases: Securities held outright.
The Financial Policy Committee’s Agenda for addressing risks in NBFI

- Five risks:
  - Resilience of non-bank liquidity management in stress
  - Factors that limit dealers’ capacity to intermediate
  - Role of leveraged non-bank investors in the functioning of core markets
  - Are MMFs really cash like?
  - Role of OEFs in driving pro-cyclical behaviour in periods of stress

- International work is coming via the FSB holistic review
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