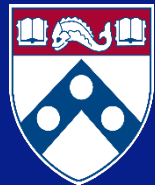
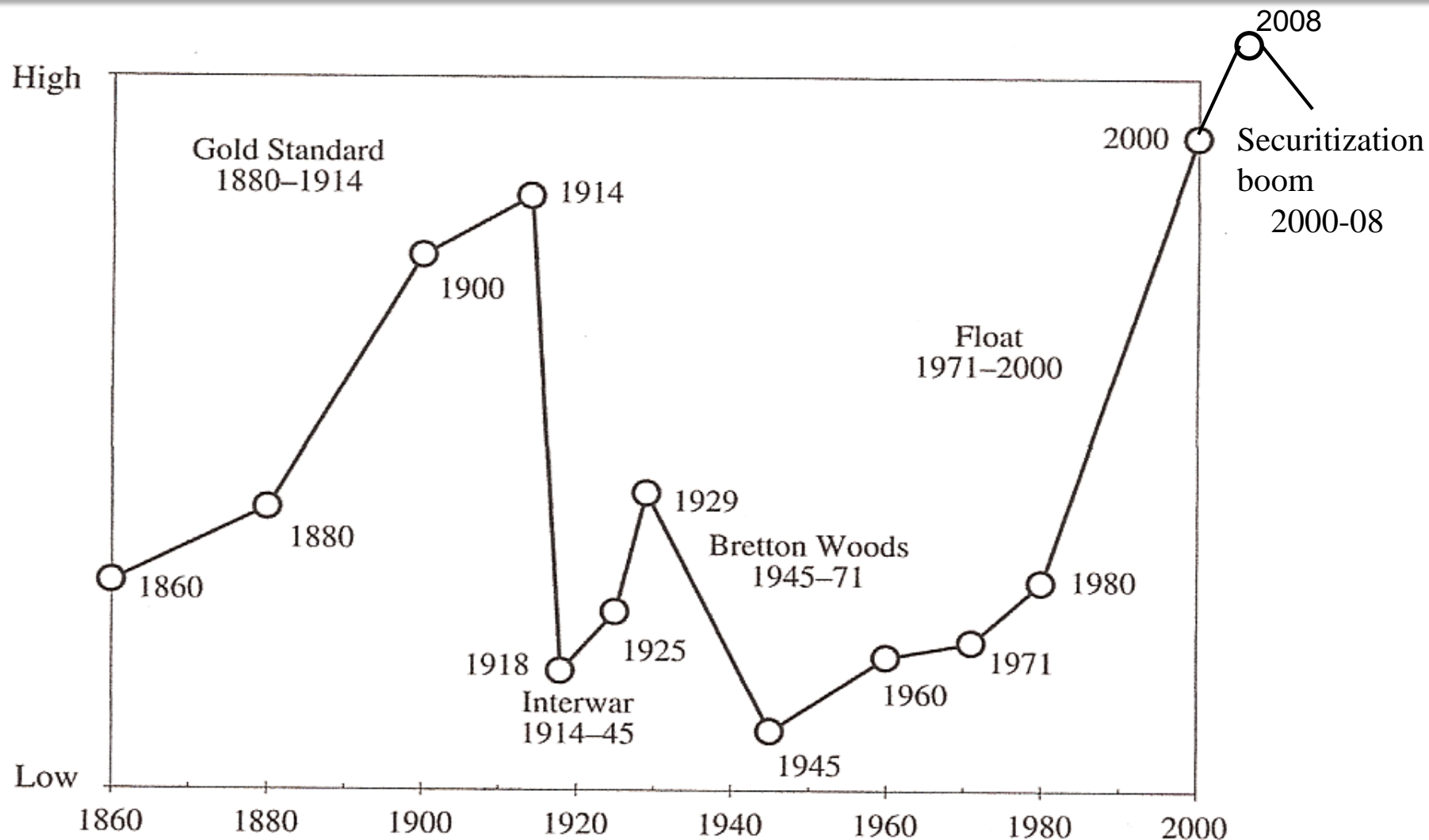


Financial Globalization and Global Imbalances: Promises and Facts

Enrique G. Mendoza
University of Pennsylvania, NBER & PIER



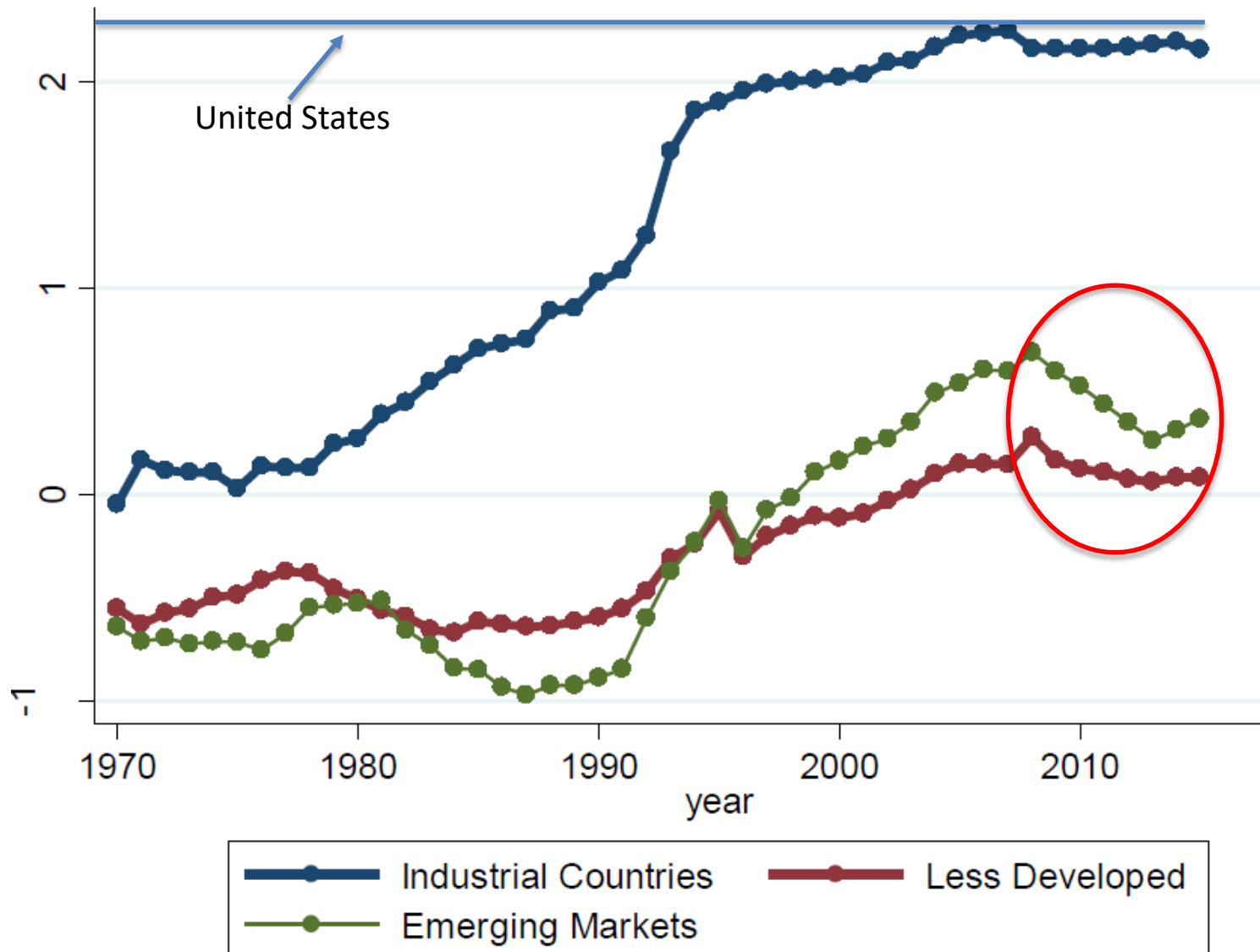
Ages of financial globalization

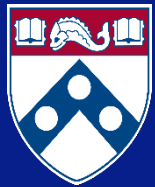


Obstfeld & Taylor's (2004) "introspection" capital mobility index (updated)



Chinn-Ito Financial Openness Index (1970-2015)





The promises

1. Improved risk sharing
2. Enhanced financial intermediation
3. Efficient world allocation of capital
4. Increased growth, reduced volatility
5. Increased social welfare



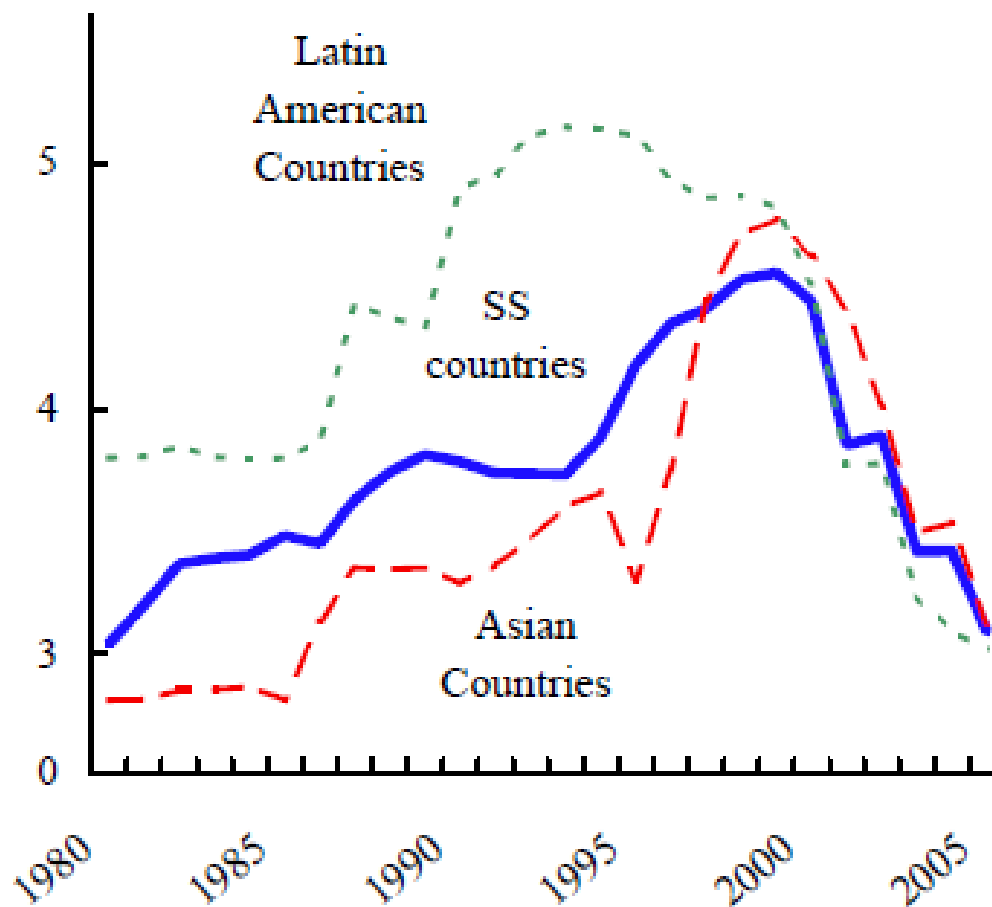
The record so far

1. Weak evidence of improved risk sharing
2. No evidence of permanent growth effects
3. No change in long-run volatility
4. Limited evidence of financial development
5. Large global imbalances
6. Recurrent financial debacles: EMs in 1990s, 2008 global crash, Eurozone crisis, and in 2017-18 Argentina, Sri Lanka, Turkey, Venezuela...



Globalization and GDP volatility

(Durdu, Mendoza & Terrones, 2008)

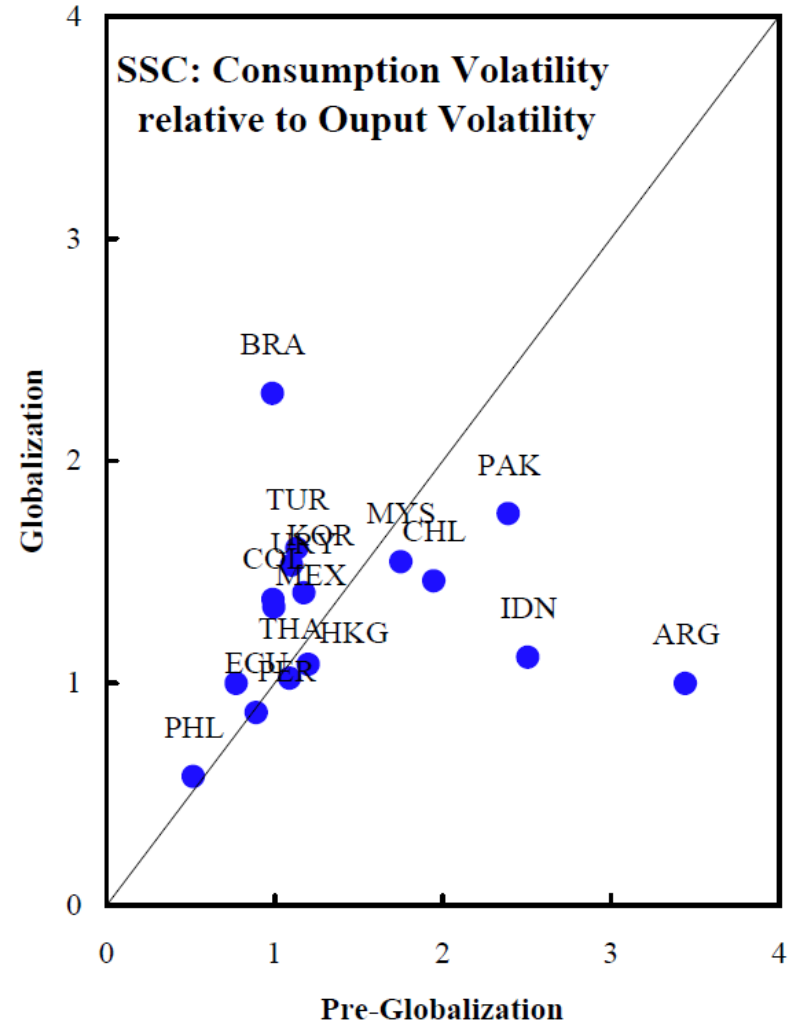
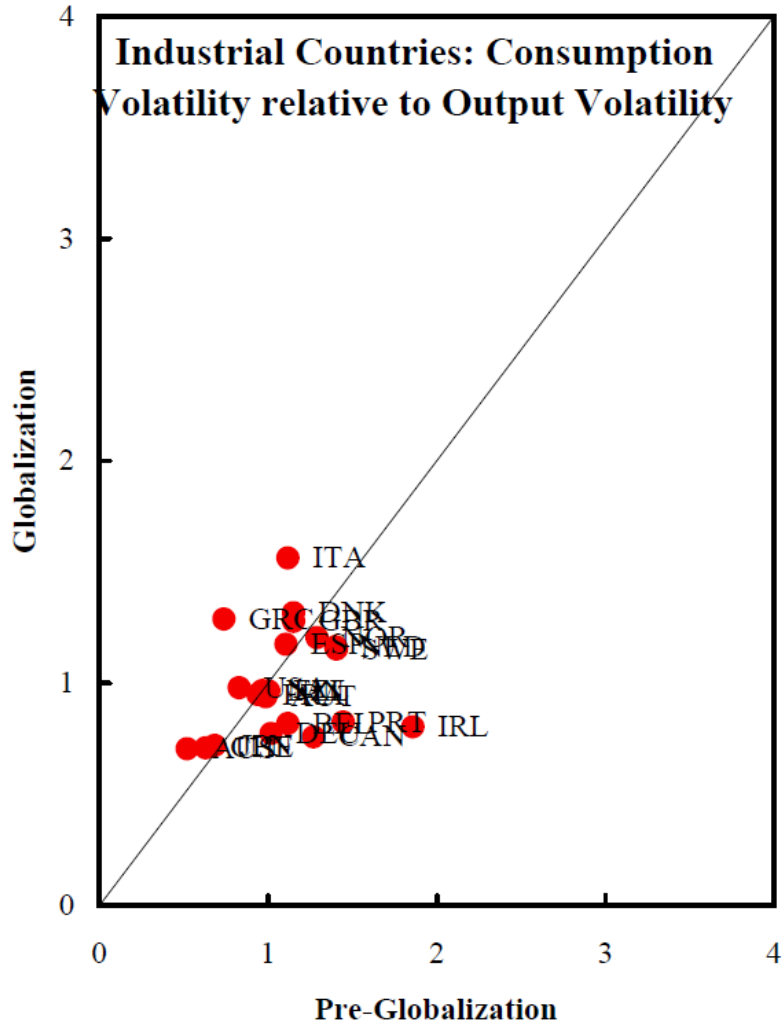


Note: Medians of twenty-year rolling standard deviations of HP-filtered GDP

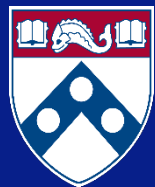


Globalization & consumption volatility

(Durdu, Mendoza & Terrones, 2008)

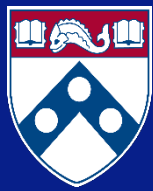


Pre-Globalization and globalization refer to the 1966-1985 and 1986-2005 periods, respectively.

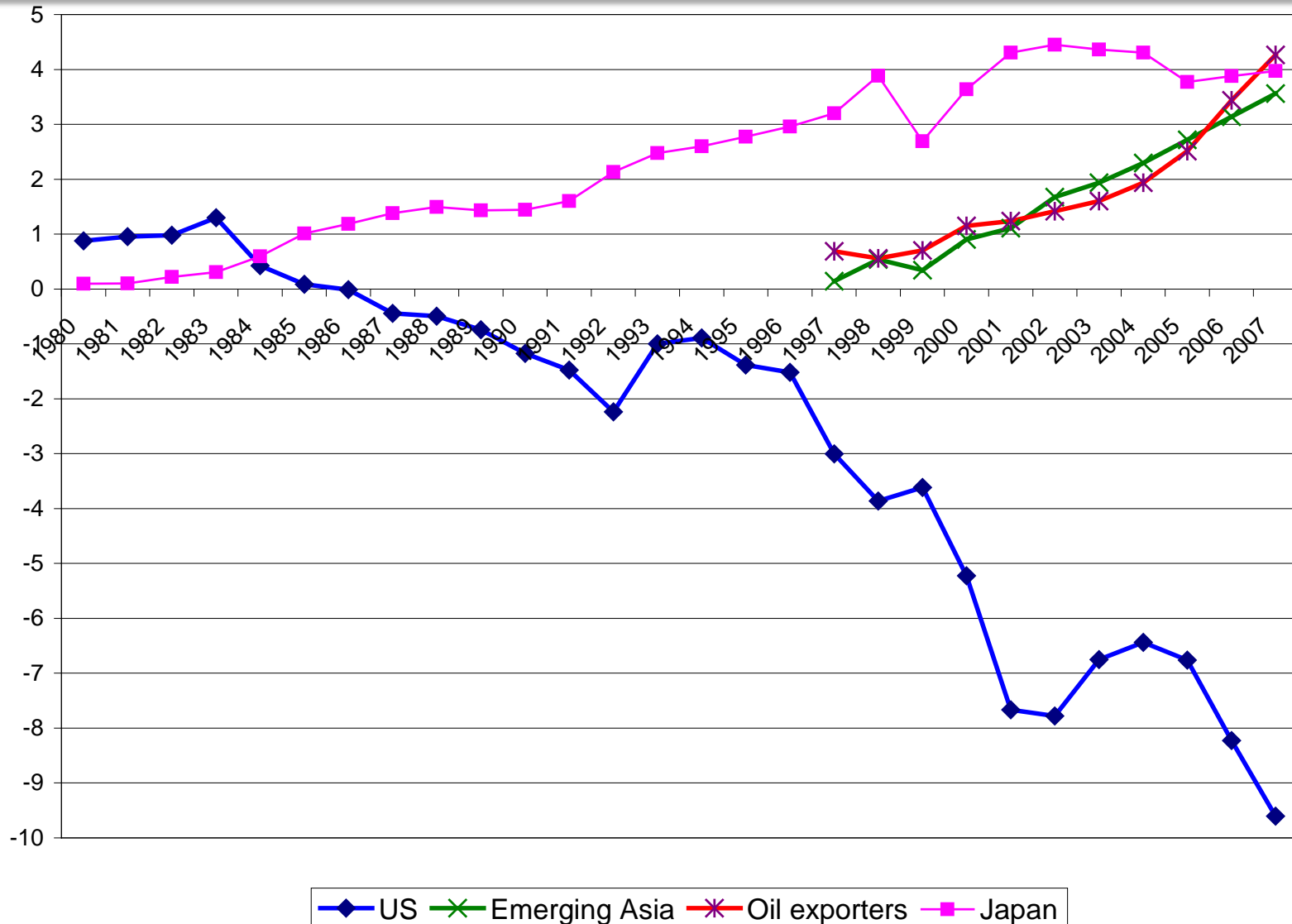


The global imbalances phenomenon

1. Large secular decline in NFA of the U.S.
(persistent trade and current account deficits)
2. U.S. portfolio: risky assets leveraged on debt
3. Build up of foreign reserves in EMs (less financially developed)
4. Low interest rates in the U.S., high financing costs in EMs
5. Growing credit and leverage ratios of U.S. households and government



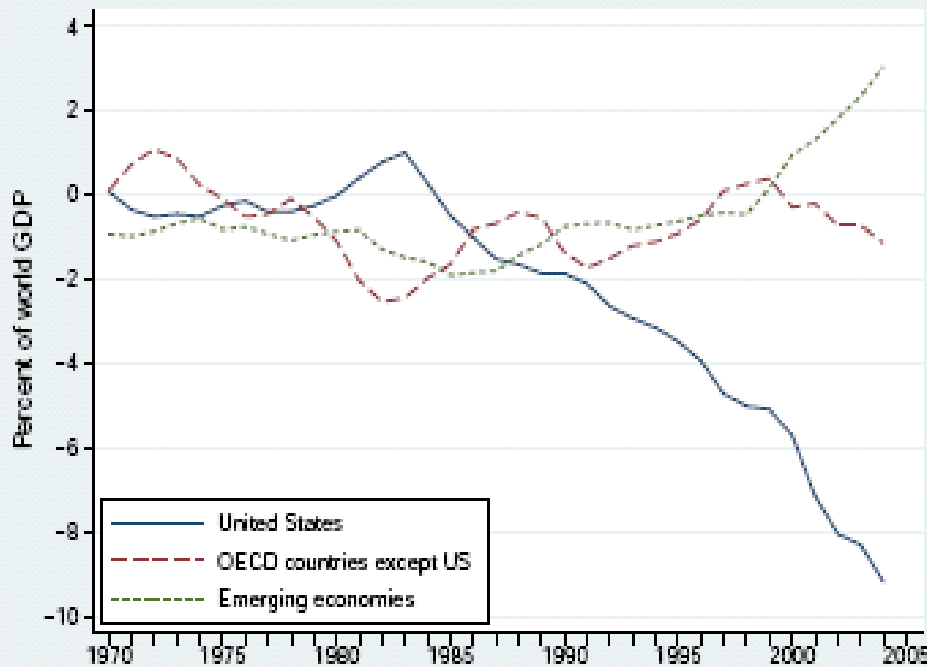
NFA positions as a share of world GDP



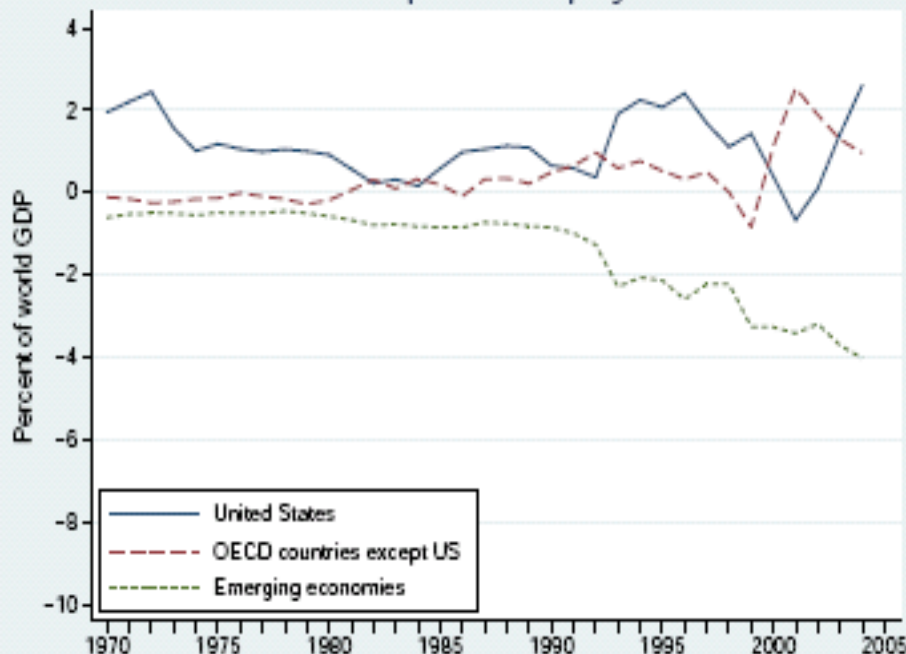


Portfolio structure of NFA positions

A - NFA in debt and international reserves

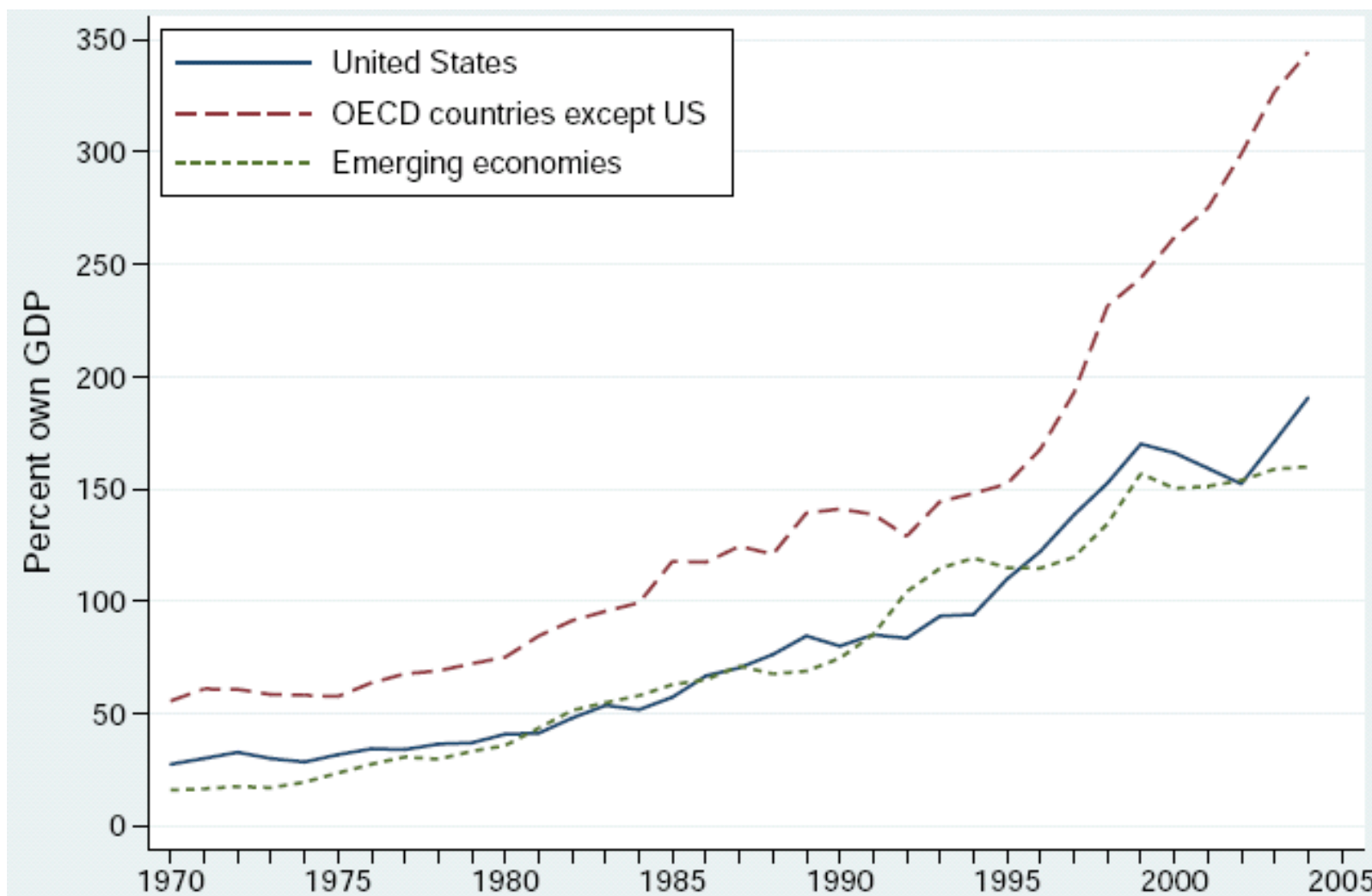


B - NFA in portfolio equity and FDI



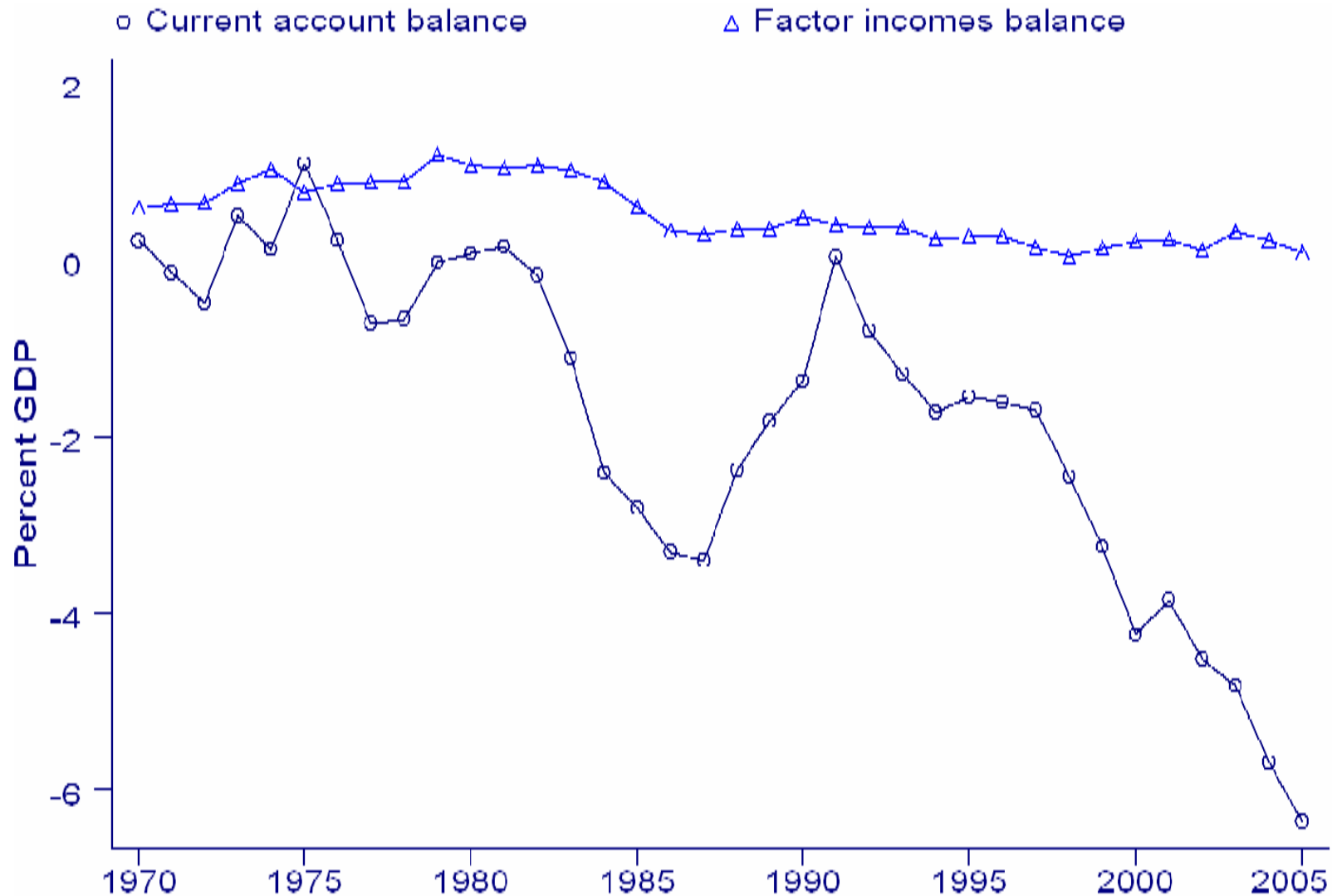


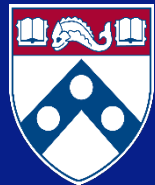
Gross stocks of foreign assets & liabilities



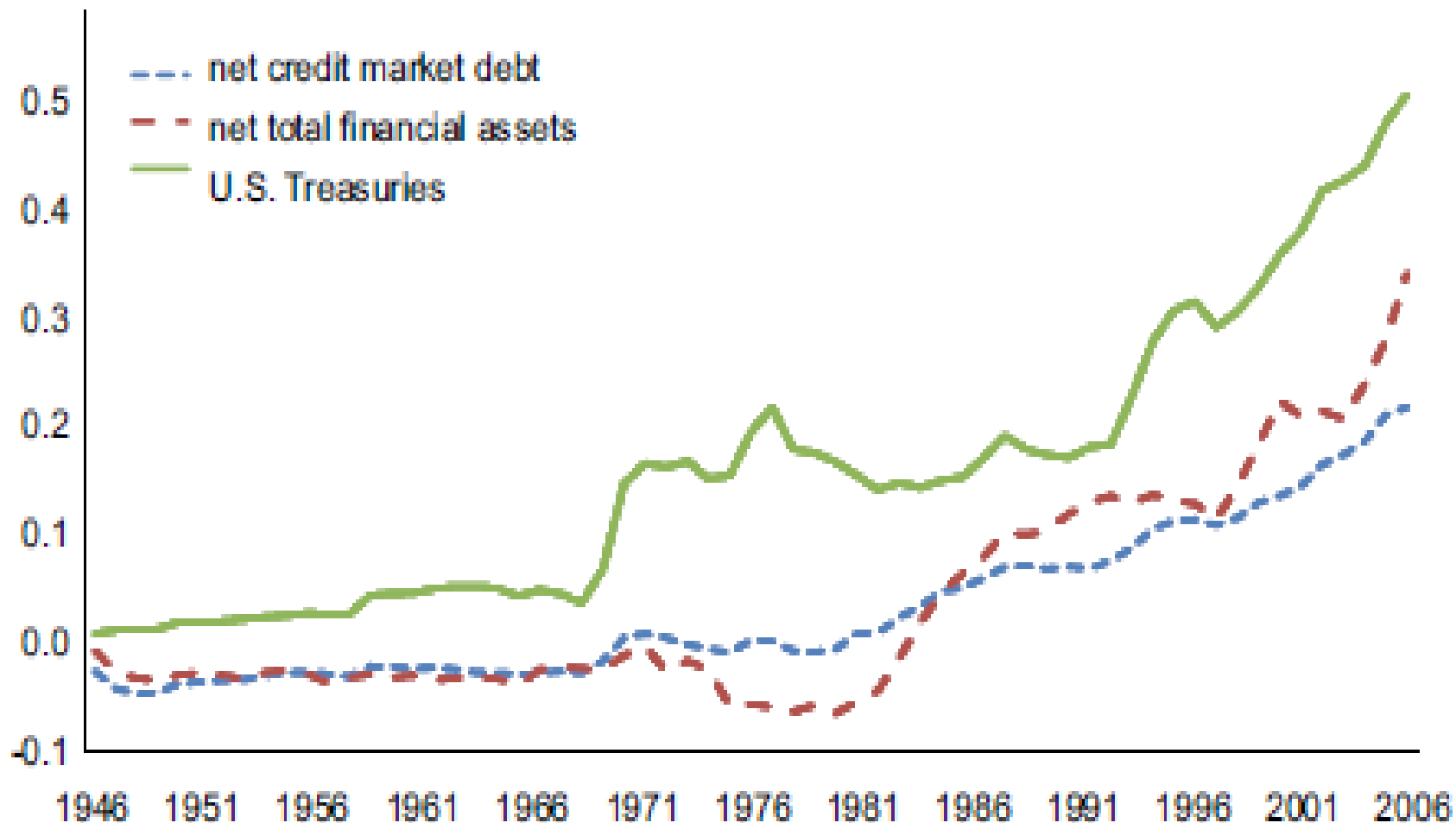


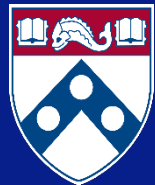
U.S. current account & net factor payments



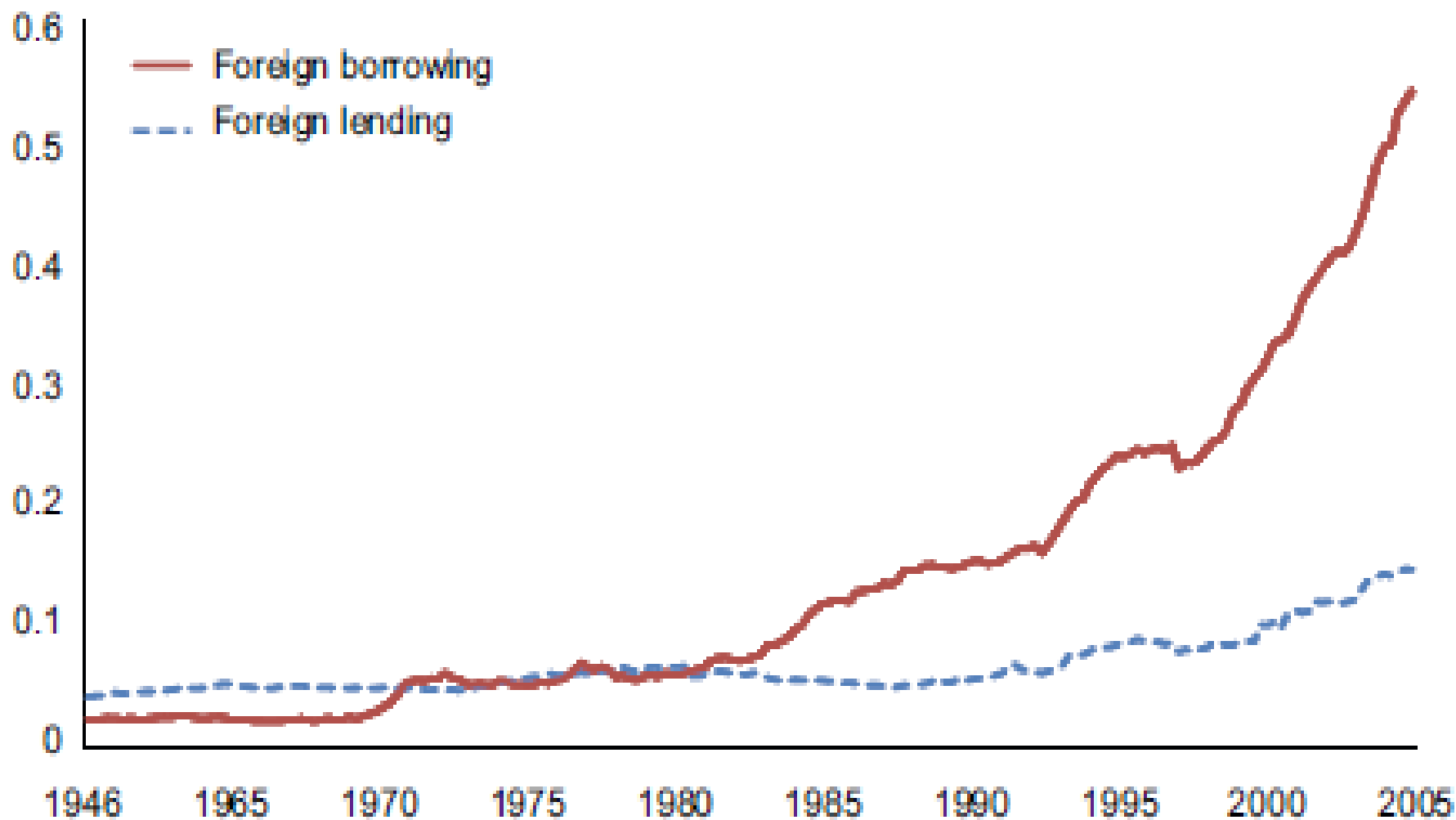


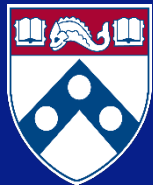
Ratio of Net U.S. Credit Assets Held by Rest of the World to Net U.S. Credit Assets of Domestic Nonfinancial Sector





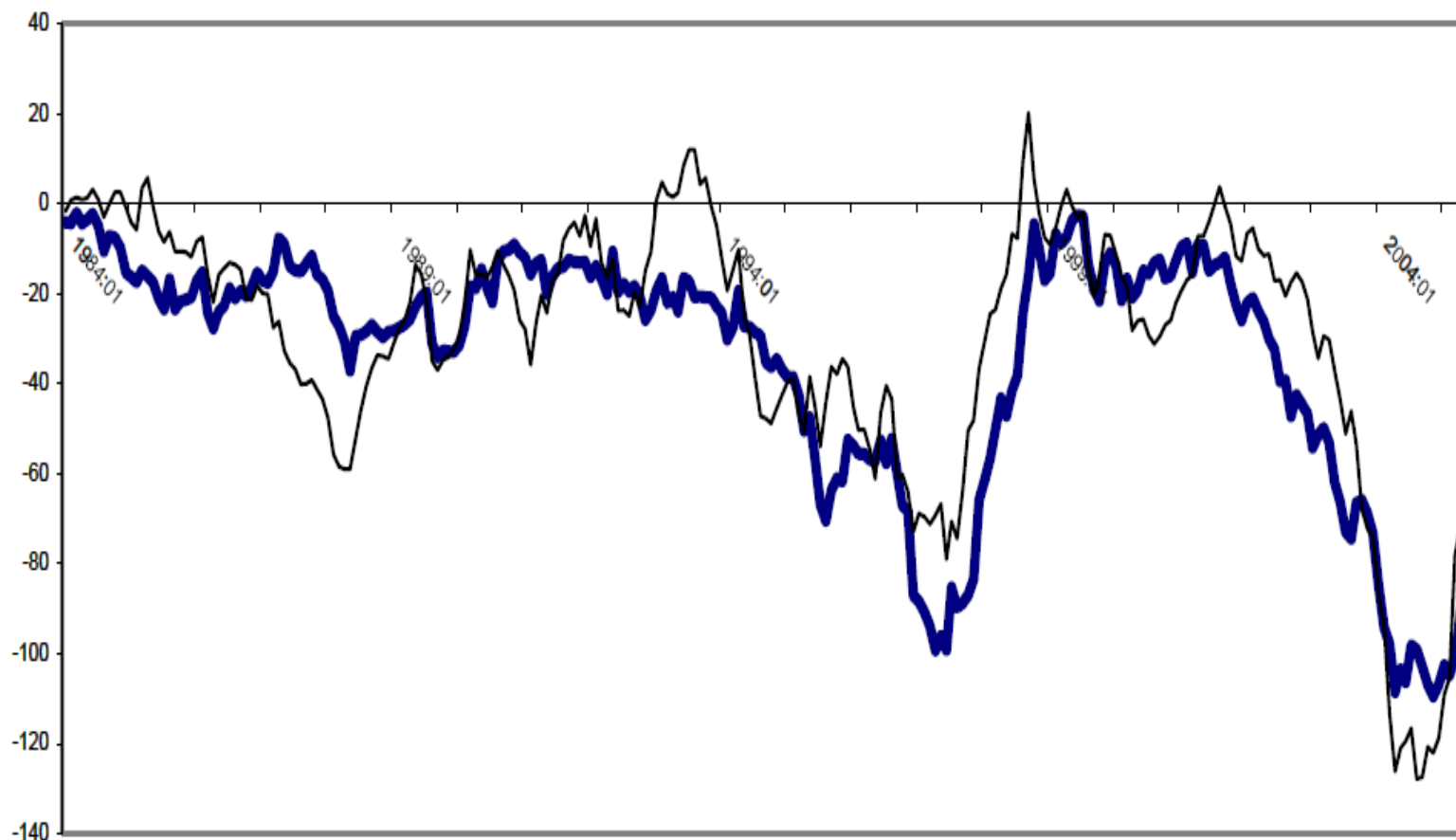
U.S. Foreign credit market borrowing and lending (percent of GDP)





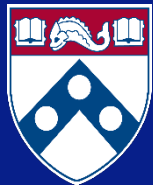
Interest rate effect of foreign U.S T-bill purchases

(basis points for 10-year T-bills, Warnock & Warnock (2006) models)



$$i_{t,10} = a + b\pi_{t+10}^e + (1-b)ff_t + c(\pi_{t+1}^e - \pi_{t+10}^e) + d(rp_t) + e(y_{t+1}^e) + f(deficit_{t-1}) + g(foreign_t) + \varepsilon_t$$

where π_{t+10}^e and π_{t+1}^e are 10-year- and 1-year-ahead inflation expectations; ff_t is the federal funds rate; rp_t is an interest rate risk premium; y_{t+1}^e is expected real GDP growth over the next year; $deficit_{t-1}$ is the structural budget deficit (scaled by lagged GDP); and $foreign_t$ is 12-month foreign official flows into U.S.



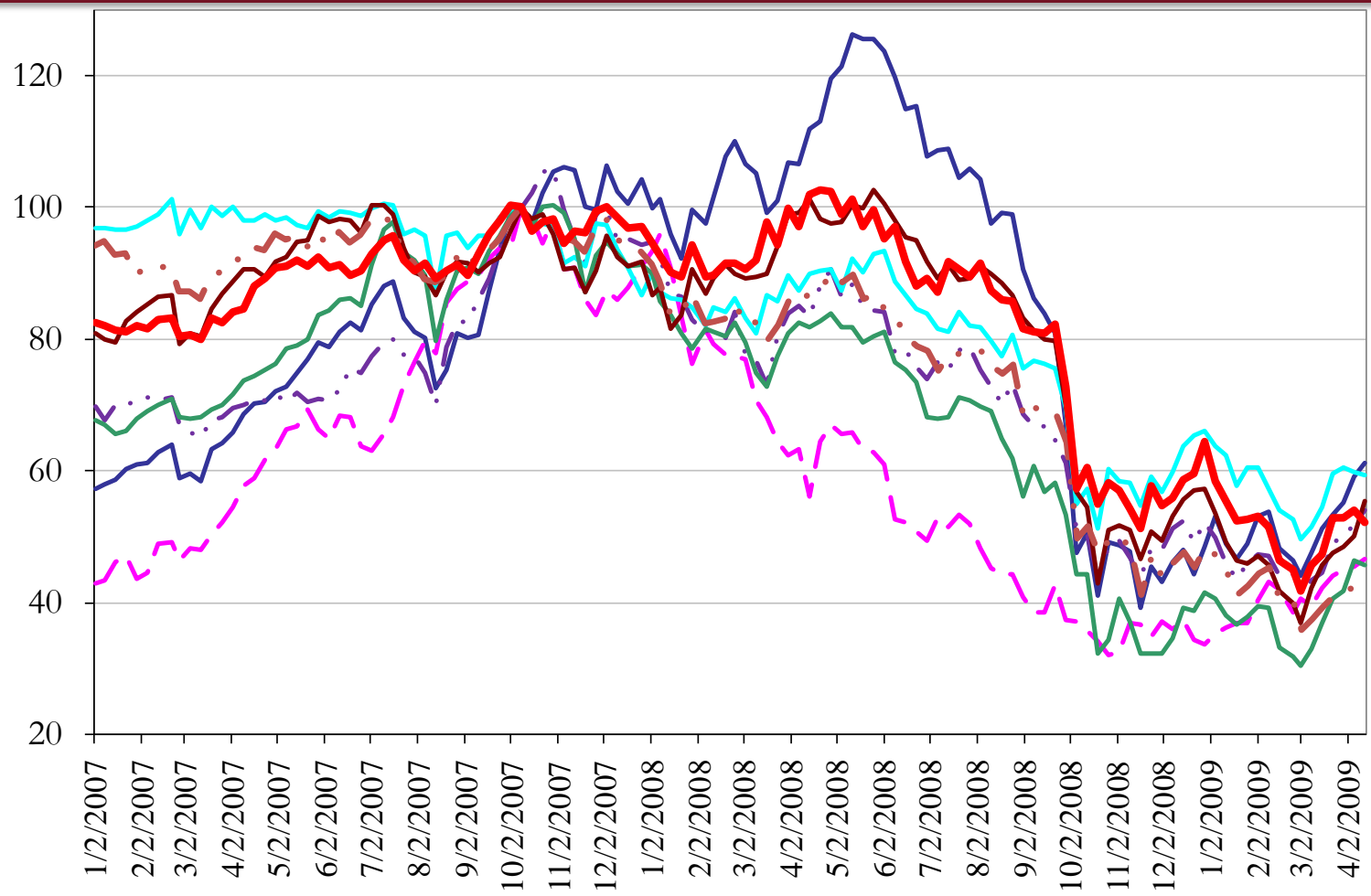
The surge in reserves: A New Mercantilism?

	Country	Year of Sudden Stop	Change in reserves
	Hong Kong	1998	34.69
	Korea	1997	16.23
	Malaysia	1997	14.36
	Thailand	1997	13.17
	Uruguay	2002	12.87
	Indonesia	1997	12.17
	Philippines	1997	10.65
	Russia	1998	9.41
	Turkey	2001	7.90
	Peru	1998	7.41
	Pakistan	1998	6.61
	Argentina II	2001	6.51
	Argentina I	1994	5.42
	Chile	1998	3.57
	Brazil	1998	3.30
	Colombia	1998	2.97
	Mexico	1994	2.65
	Ecuador	1999	-3.46
	<i>Median</i>		7.66
	<i>Median Asian Countries</i>		13.17
Change in mean reserves/GDP ratio (SS year to 2004)- (1985 to year of SS)			



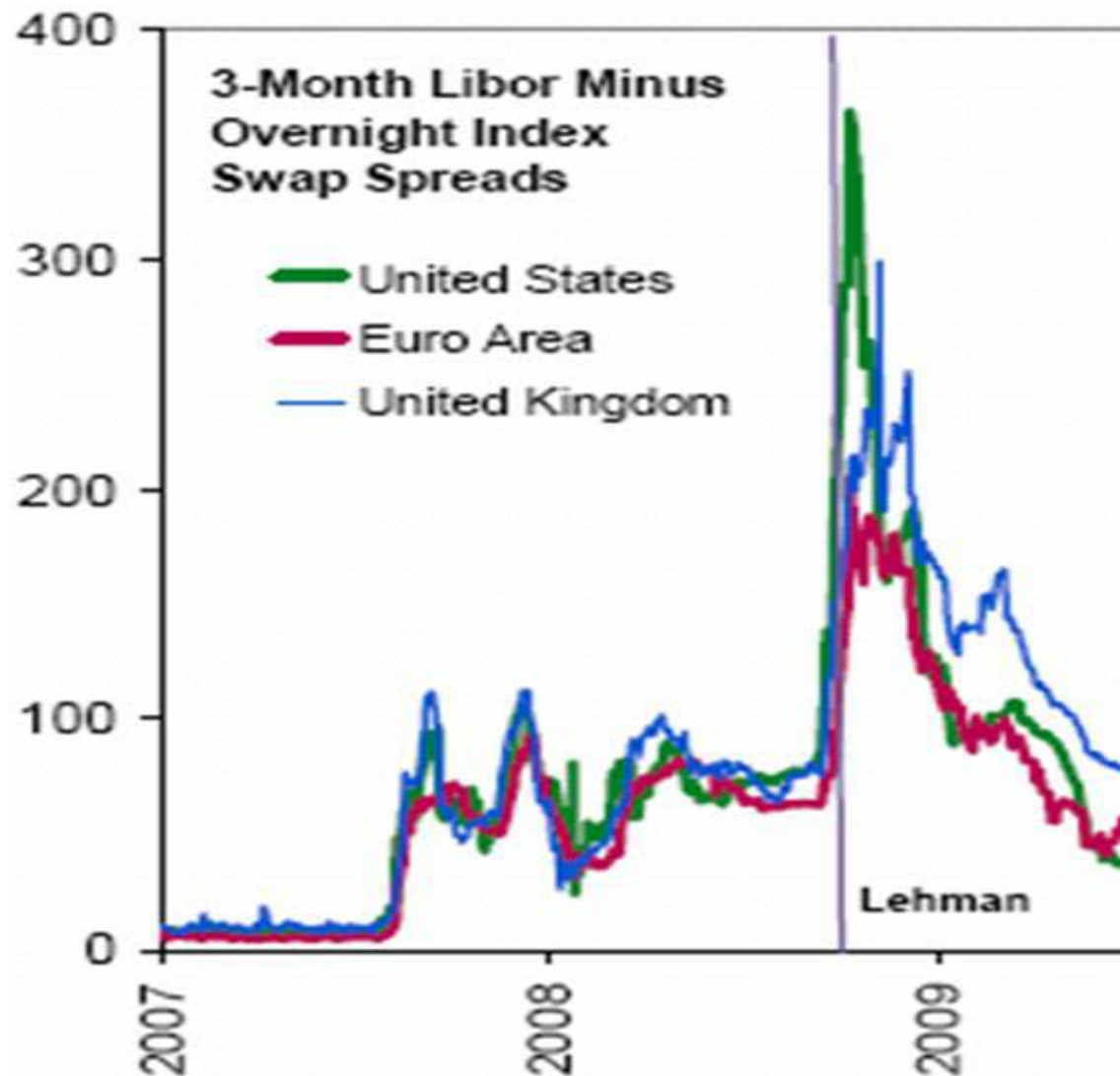
The 2008 Global Stock Market Crash

(indexes re-based at Dow Jones maximum)



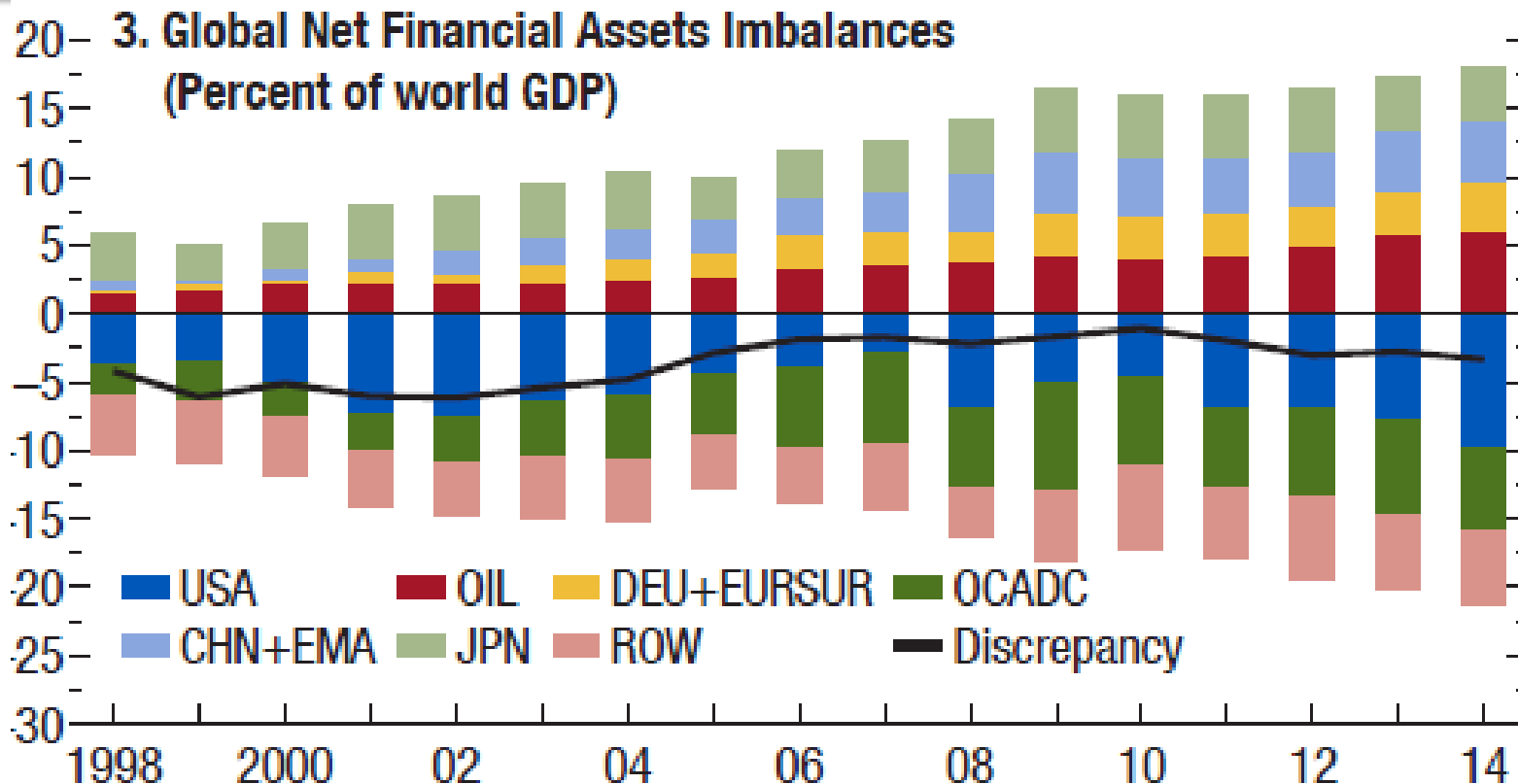


Bank spreads surged globally

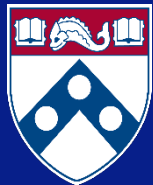




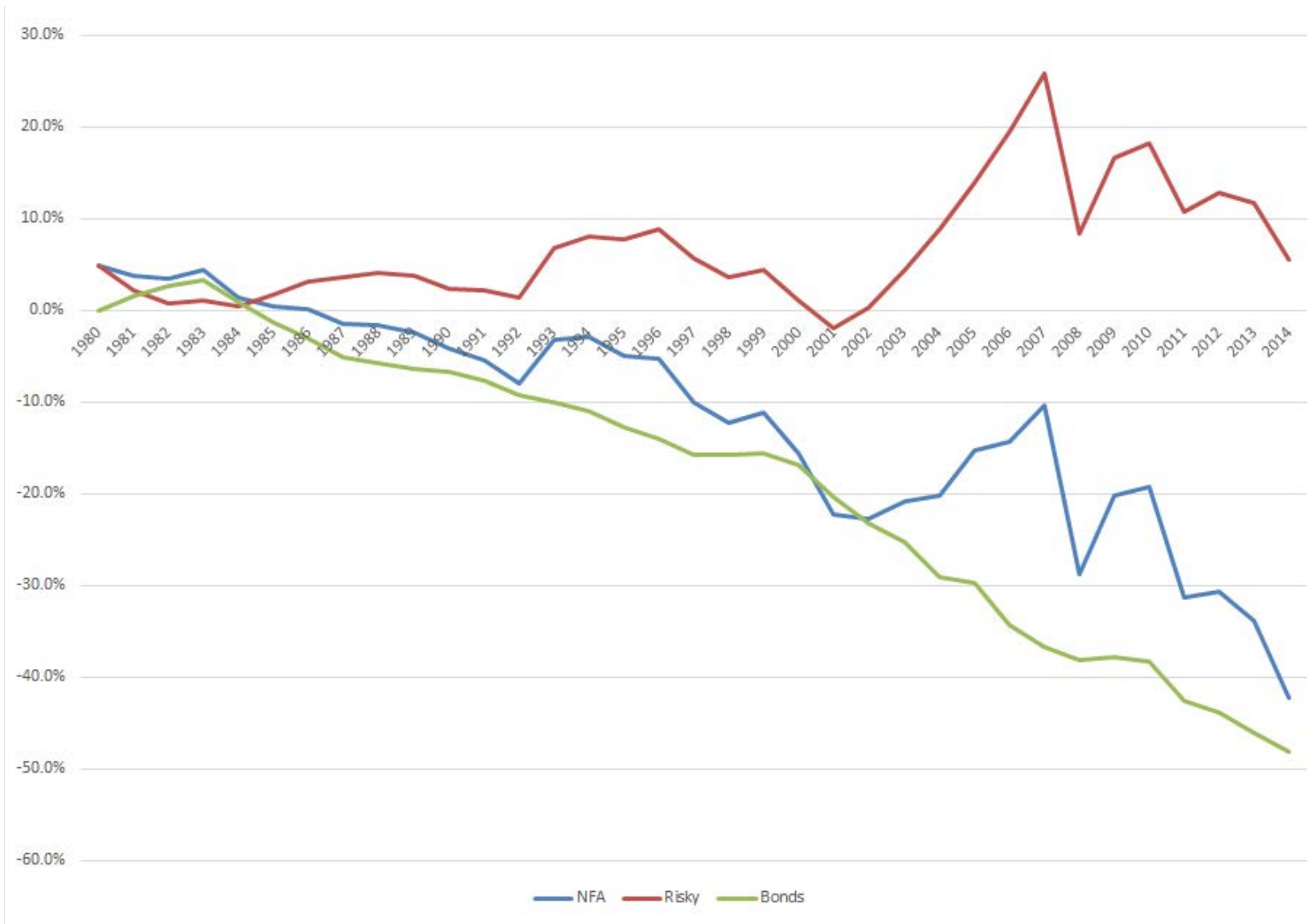
Global imbalances persist

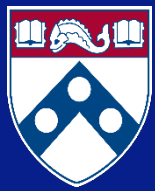


Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. CHN+EMA = China and emerging Asia (Hong Kong SAR, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan Province of China, Thailand); DEU+EURSUR = Germany and other European advanced surplus economies (Austria, Denmark, Luxembourg, Netherlands, Sweden, Switzerland); OCADC = other European countries with precrisis current account deficits (Greece, Ireland, Italy, Portugal, Spain, United Kingdom, WEO group of emerging and developing Europe); OIL = Norway and WEO group of emerging market and developing economy fuel exporters; ROW = rest of the world.

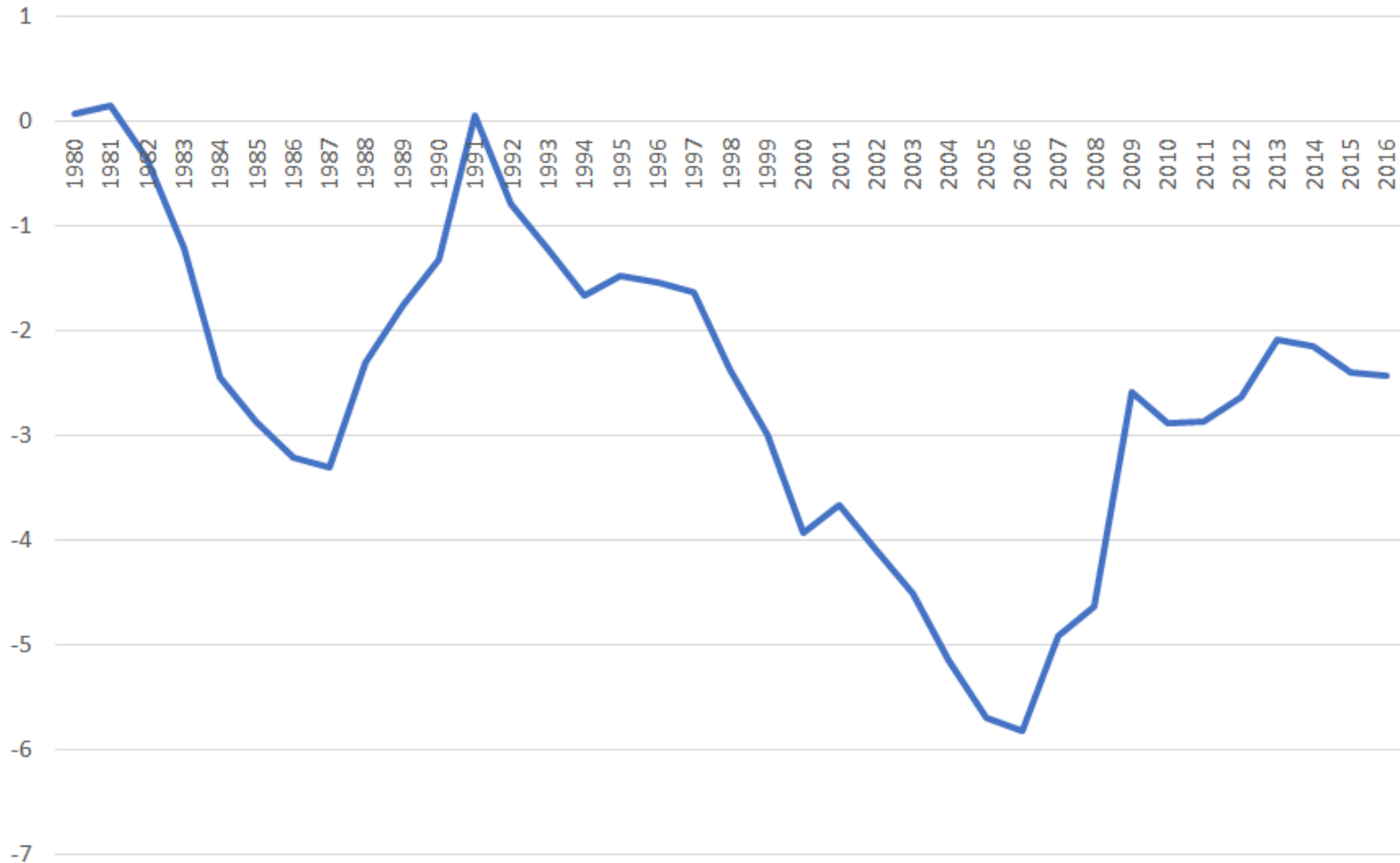


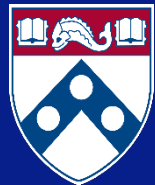
U.S. Net external positions through 2014





U.S. Current Account Deficits Persist





Financial globalization: reality check

- Expectations: Improved risk sharing, enhanced financial intermediation, efficient allocation of capital, increased growth, reduced volatility ... increased social welfare
- Realities: Weak evidence of improved risk sharing, convergence in FD, or faster growth, reduced long-run volatility. Risk of financial crises, global imbalances
- *Realizing the gains of FG requires development of domestic institutions & financial markets!* (Mishkin (2008), Rajan & Zingales (2003), Obstfeld & Taylor (2004))
 - ...but how do we get there? (sequencing v. Rajan-Zingales)