

International Financial Architecture

1. Broader definition – not just monetary and exchange rate arrangements but also banking regulation and IFRS.
2. IMF quotas: general consensus.

Contd.

3. Issues not under discussion.

⇒ Dollars status as sole reserve currency;

⇒ SDR as an alternative;

⇒ The need for managed exchange rates.

4. Possibility of a chaotic dollar fall triggered by, say, oil pricing, and affecting its status as principal reserve currency cannot be ruled out.

Contd.

5. Floating currencies (Euro, Yen) perhaps cannot sustain further appreciation without risking recession.
6. Sharp dollar fall would also trigger steepening of the dollar yield curve – and affect economic recovery in the U.S.

SDR as Reserve Currency?

1. The Chinese have talked about it – so has the U.N. Commission.
2. If existing dollar reserves are to be converted to SDRs, who will take the exchange risk?
3. A Grand Bargain?
 - ⇒ Yuan appreciation; and
 - ⇒ Fluctuation bands for G4 currencies (\$,€,¥,CNY)

Contd.

4. If G20 wants to limit commodity price volatility by limiting speculation, case for limiting exchange rate volatility is as strong – even without the reserve currency issue.
5. *"What economic function did the exchange rate changes among these islands of stability fulfil? Except for stuffing gift socks of hedge funds, the answer is none."* -- Nobel Laureate Robert Mundell, in an article in Wall Street Journal
6. *Do we need a Bretton Woods II?*

Banking Regulation

1. **Present model : private profits, public losses.**
2. **Capital for liquidity/interest risk needed. But rationalisation and increasing of capital ratios alone may not solve problem.**
3. **One possible solution:**
 - ⇒ **Deposit taking institutions to engage in narrow banking; and**
 - ⇒ **All trades between narrow banks and riskier institutions to be through exchanges.**

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India's CBLO market is a very successful exchange traded "call money" market.

4. Derivatives:

- ⇒ Plain vanilla only exchange traded (G20 pushing for this);
- ⇒ OTC transactions on fully collateralised, MTM margin basis?

Too many companies in China, Korea, Indonesia, India and other countries have suffered large losses – and banks have mismanaged credit risks.

IFRS

1. **MTM of liabilities?**
2. **MTM of loan book?**
3. **Hedge effectiveness of cash flow hedges.**