



CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

“International Financial Architecture: Challenges and the Private Sector Role”

Silvina Vatnick
President

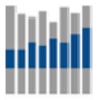
Center for Financial Stability (CEF)

“International Cooperation in Times of Global Crisis: Views from G20 countries”

New Delhi, 14-15 September, 2009

Agenda

- **The Crisis: Stylized Facts**
- **The G20 Agenda: Progress Made and Expected Outlook**
- **Challenges Ahead**
- **Moving Forward – A More Involved Private Sector**
- **Concluding Remarks**



CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

The Crisis: Stylized Facts (i)

- Nature of the crisis
 - ✓ Persistent global macroeconomic imbalances and liquidity;
 - ✓ Creation of highly sophisticated financial instruments (leveraged); excessive risk transfer with poor corporate governance;
 - ✓ Inadequate regulation and lax supervision;
 - ✓ Liquidity supply reversal in USA in July 2004.

The Crisis: Stylized Facts (ii)

Economic Growth (annual rate in %) Current Account Balance (in % of GDP)

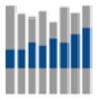
	2001-2005	2006-2008*	2001-2005	2006-2008
Argentina	2,3	7,9	3,6	1,7
Australia	3,2	2,2	-4,6	-5,5
Brazil	2,8	4,8	-0,3	-0,1
Canada	2,5	2,2	1,9	1,1
China	9,6	11,1	3,5	10,1
France	1,7	1,7	0,8	-1,6
Germany	0,6	2,4	2,8	7,0
India	6,5	8,6	0,4	-1,8
Indonesia	4,8	6,0	2,5	1,9
Italy	0,9	1,1	-0,9	-2,6
Japan	1,3	1,7	3,1	4,2
Mexico	1,9	3,4	-1,5	-0,7
Russia	6,1	7,5	9,8	7,3
Saudi Arabia	3,8	4,1	14,8	28,5
South Africa	3,9	4,8	-1,4	-7,2
South Korea	-	-	-	-
Turkey	4,7	5,0	-1,8	-6,1
United Kingdom	2,4	2,3	-2,0	-3,6
United States	2,3	2,1	-4,8	-5,3
Average	3,4	4,4	1,4	1,5
World	3,5	4,2		

- United States, UK, Australia, Italy, France, India, Mexico, Turkey, and South Africa have been net borrowers, among others.

- Argentina, Indonesia, China, Germany, Japan, Russia, Saudi Arabia, and Canada have been net lenders, among others.

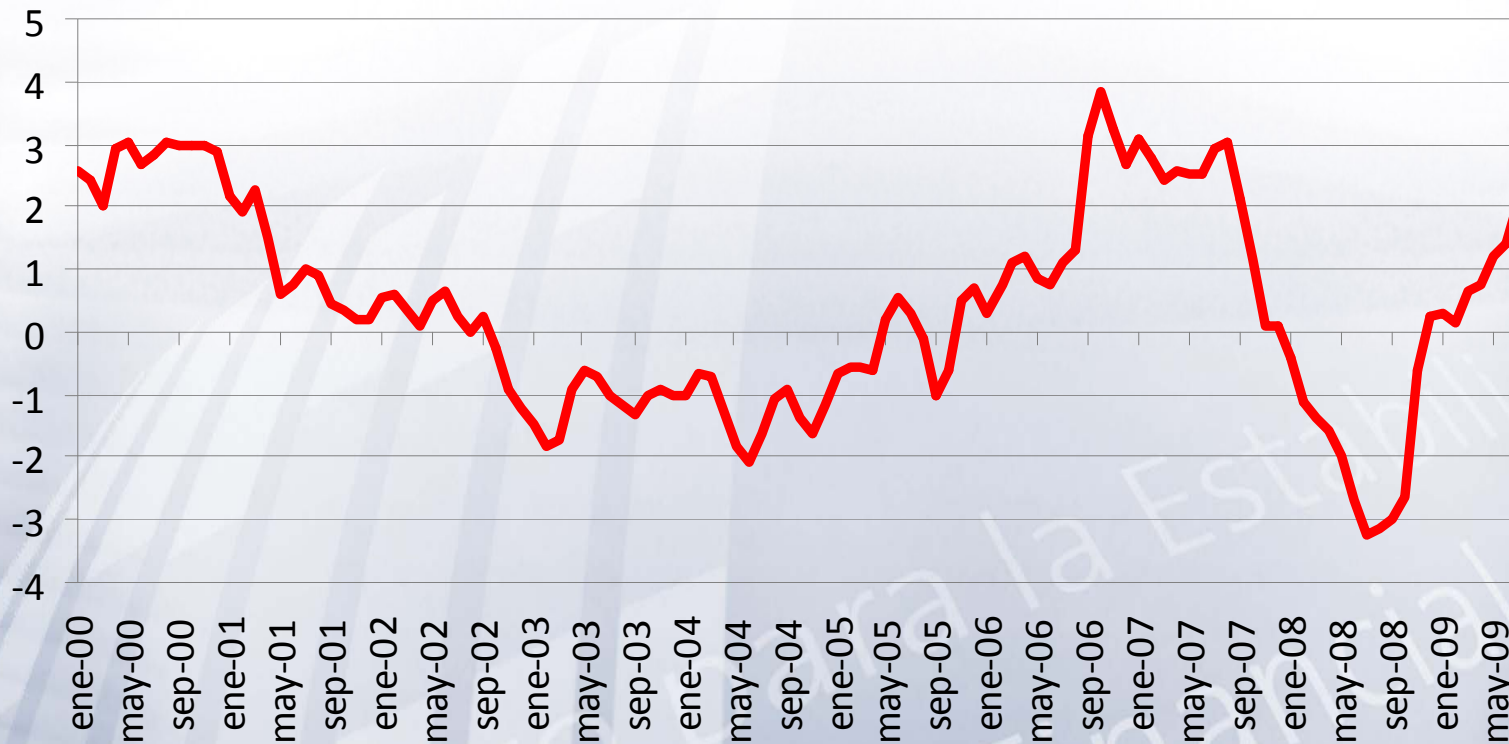
- (G7 and G20 economies represent, respectively, 47% and 80% of total global GDP.

SOURCE: IMF WEO



The Crisis: Stylized Facts (iii)

Fed Funds Rate in real terms
(in %, deflated by CPI)



SOURCE: Own estimates based on FED



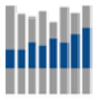
CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

The G20 Agenda: Progress Made and Expected Outlook (i)

G20 Communique's Objectives - London, April 2009

1. Restore confidence, economic growth and employment;
2. Fix the financial system and promote lending;
3. Strengthen financial regulation to foster such lending;
4. Capitalize and restructure international financial institutions to overcome this crisis and to prevent future ones;
5. Promote international trade and prevent protectionism;
6. Build sustainable economic growth with inclusion.



CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

The G20 Agenda: Progress Made and Expected Outlook (ii)

The new financial international architecture would include the revision/inclusion of:

- **Governance**
- **International Cooperation (government, corporate and civil society)**
- **Macro Prudential Issues**
- **Micro Prudential Issues**
 - ✓ Banks' consolidation
 - ✓ Capital requirements
 - ✓ Self-Regulation
 - ✓ Ratings
 - ✓ Internal risk models

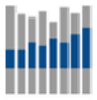


CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

Challenges Ahead (i)

- In the short run, fiscal and monetary stimulus are showing themselves effective for smoothing the crisis negative impact on output and employment; industrial production both in USA and Europe might have reached the bottom in the April-May period;
- Capital market's valuation seem to have reached a floor in USA last March;
- However, financial intermediation might still be a pending issue. Banks appetite for liquidity is still high;
- Real interest rates are becoming increasingly positive as deflation persists. (FED FUNDS from -4% to +2% in 12 months). Debtors' payment capacity becomes an issue (including liabilities of the public sector).

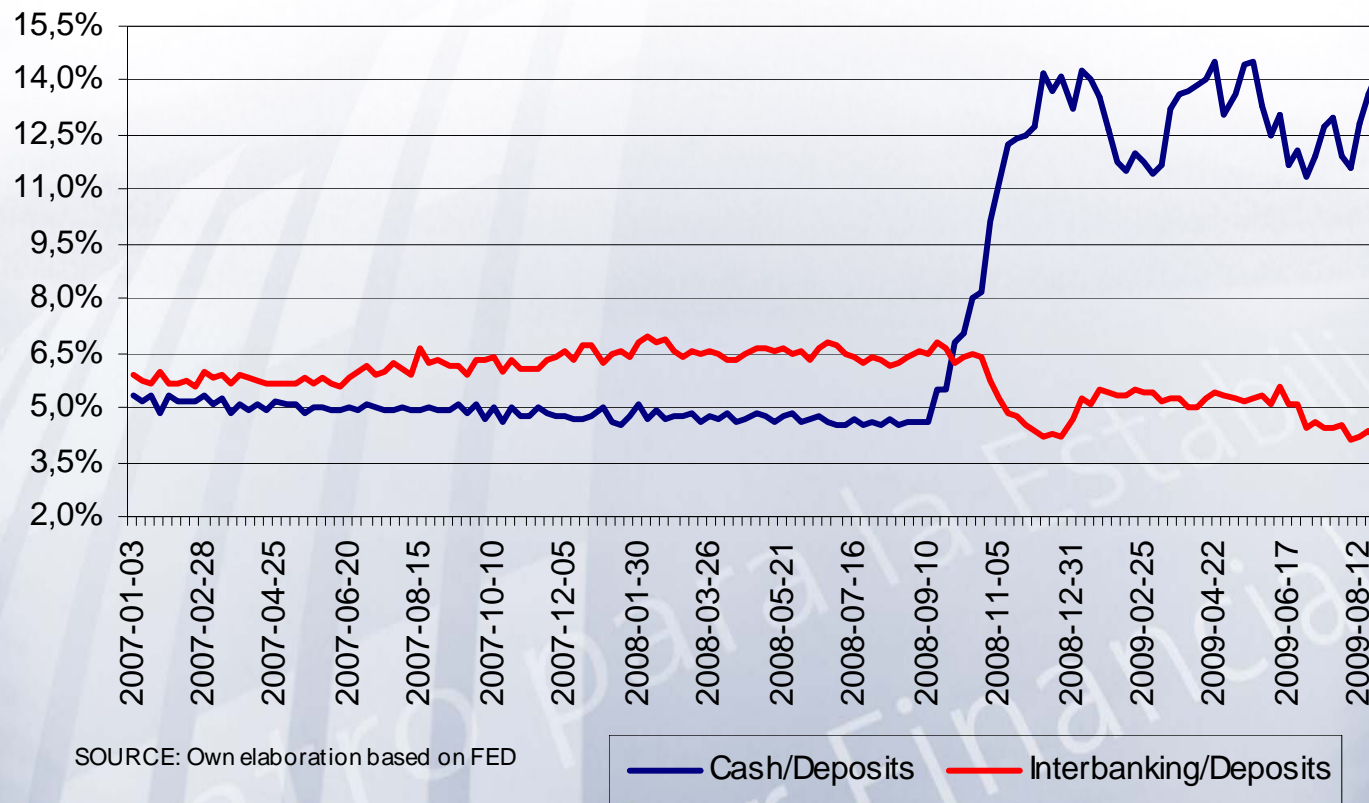


CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

Challenges Ahead (ii)

USA banks' liquidity - Restoration of financial intermediation
(in % of total deposits)



SOURCE: Own elaboration based on FED

— Cash/Deposits — Interbanking/Deposits

Challenges Ahead (iii)

- Cooperation, rules and standards adaptation and implementation for a more effective financial architecture including regulatory and surveillance issues represent a challenge in itself;
- Assuming those actions are effectively conceived, articulated and then implemented over time, structural weaknesses still continue to be key topics to be addressed to mitigate future crisis;
- Adjustment of macroeconomic imbalances represents a real concern in terms of world financial and economic stability;
- Private sector expenditure levels are being (imperfectly) substituted by public sector – indebtedness; financial system bailout represents just in the U.S u\$s 13 trillion (as of June 2009).
- Monetary stimulus is becoming also important and worrisome; over the period July 2008 – July 2009 the monetary base (including excess reserves) increased 88%, reaching 17% of GDP.

Challenges Ahead (iv)

Public Debt – as % of GDP

	United States	Germany	Spain	France	Italy	United Kingdom
Dec-07	66	65	36	64	104	44
Mar-09	75	70	53	72	109	61
Increase (in %)	14%	8%	47%	13%	5%	39%

SOURCE: Own estimates based on official data.

- Policies based on countercyclical public debt increases and positively sloped real interest rates become a critical issue considering mid-long term financial stability.
- Once financial intermediation is restored, re-absorption of liquidity would become a key topic. However, future inflationary pressures might be an alternative to alleviating fiscal burden.



CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

Moving Forward – A More Involved Private Sector (i)

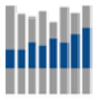
- The main goals of ongoing G20 coordination are to improve regulation/supervision for strengthening transparency, crisis management capacity and integrity, reducing risks through the financial system (leverage), and avoiding pro-cyclical economic and financial policies;
- FSB and IMF would work closely for the creation of macro early warnings; their implementation would become an adequate complement for monitoring financial (in) stability given the above mentioned structural constraints;
- However, typically those indicators do not reach a wide economic spectrum; in the future, surveillance would not have to be limited to the public sector; the private sector would also need a more comprehensive monitoring in order to contribute to the reduction of systemic risks.

Moving Forward – A More Involved Private Sector (ii)

- The corporate/civil society should take an active role moving forward. They could cooperate and complement those macro mechanisms by developing additional corporate tools;
- A proposal would be to develop indicators of corporate financial strength (e.g., balance sheets' stress testing in terms of interest rates and exchange rate movements) and vulnerabilities in a systemic approach, comprising aggregate micro data at sectoral/regional levels;
- Think tanks are well positioned to undertake the development of those tools and monitoring of the private sector;
- Also, a valid perspective to evaluate the degree to which implementation of corporate governance best practices occurs at the micro level is needed;
- The IFIs/standards setters are focused on country compliance with international standards. An initial effort to understand firm level compliance would be to undertake a pilot assessment of representative firms from 10 of the G-20 countries. Such an initiative should come from the private sector and civil society;
- Based on the results (merits) of the pilot project a more comprehensive assessment that includes a larger number of firms in more countries can be undertaken.

Concluding Remarks (i)

- Ideally, the G20 leaders at the Pittsburgh conference should focus on continued regulatory reforms, their implementation and effective exit strategies. Also should strongly encourage countries to create favorable conditions which encourage private investment by implementing best practice policies and standards;
- Assuming better rules and standards adaptation and implementation for a more effective financial architecture are implemented over time, structural weaknesses -adjustment of macroeconomic imbalances and unprecedented monetary stimulus- continue to be key topics to be addressed to mitigate the effects of future crisis. They also represent real concerns in terms of transitional exit strategies and world financial and economic stability;
- Effective government exit strategies from direct involvement in the financial system and key non-financial enterprises should include the reestablishment of a resilient private sector;
- A resilient private sector is also necessary to facilitate economic development/equitable growth with an enhanced commitment towards fiduciary obligations and accountability to stakeholders (not just management and majority shareholders);
- The market based model driven by responsible private investment and trade must be fixed, not abandoned;



CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

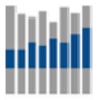
Concluding Remarks (ii)

- Think tanks could commit to:

(i) develop and implement corporate early warning indicators which would complement FSB and IFI's assessment of financial stability and

(ii) evaluate the degree to which implementation of corporate governance best practices occurs at the micro level.

- The promotion of ethical behavior and the encouragement of transparency for the private sector become key goals for moving ahead.



CEF

Centro para la Estabilidad Financiera
Center for Financial Stability

Thank you very much!

www.cefargentina.org