Myths and Dangers for Emerging Markets

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I will talk about …

1. Clear and present dangers
2. Risks overstated
3. Risks deliberately ignored
4. Risks not fully recognised
5. … and democracies’ real big problem
So let’s see how many imagined and real elephants in the room are around…
1. Clear and present danger: prospects of a global trade war

- Large welfare losses on all sides on the longer term. **No** real winners
- But: easy short-term wins for populists, particularly in the US (by virtue of size) - elsewhere too. In this sense Pdt Trump is sadly right

**Resist!**
2. Risks overstated: fears about QE unwinding

- Lessons have been learnt from 2013 “taper tantrum” by central banks and markets
- No central bank is rushing – first (real) mover’s disadvantage
  - US – likes weak $
  - BoE – Brexit
  - BoJ - slow
  - ECB – biggest risk as most independent (no fiscal authority) but has large current account surplus
  - AD central banks are stiff scared - EMs just need to play it safe
- Pas de panic!
Risks overstated: cryptocurrency

- CCs are a form of private money that have long history
- But also qualitatively different: lack of dominant central authority - itself weak with long history of inflation – maybe be not an issue thanks to solid technological benefits & assurances
- CCs challenge status quo of both commercial banks and the central bank – why is competition and disruptive innovation a bad thing when we like it elsewhere?
- Do not over-regulate – not a real elephant!
3. Risks deliberately ignored

- Post crisis financial regulation has not reduced big systemic risks:
  - Capital and liquidity improvements at bank level will not help at the system level if crisis hits
  - Too-big-to-fail problem is NOT resolved; bank concentration risk has increased
  - No real approach to network/connectivity risk
Elephant #1 in the room: bank size

Sometimes, even if I stand in the middle of the room, no one acknowledges me.
4. Risks not fully recognised: China’s bloated financial sector

*New research by Cerutti & Zhou, IMF*

China has by far the biggest banking sector

Though most is domestic, external claims are rapidly rising

*Sources: Cerutti & Zhou: The Chinese banking system, VoxEU, February 2018; BIS, ECB, IMF*

*Source: BIS, External claims, 2017 Q2*
Elephant #2 in the room: China risk

• While external financial linkages are most systemic in EMs and DEs, some of it is quasi-aid
• The real issue is the financial contagion of any major shock in the domestic system to *advanced economies*: see the Shanghai stock exchange “shock” in early 2016
• No reserves is enough to mitigate fallout
• Cleaning up and transforming China’s giant banking sector is a global concern - and interest
5. Democracies “real elephant”: inequality

The most powerful chart of the last decade:
Globalisation as an Elephant. @BrankoMilan

Figure 4. Change in real income between 1988 and 2008 at various percentiles of global income distribution (calculated in 2005 international dollars)
THANK YOU!