BANK FOR INTERNATIONAL SETTLEMENTS

Towards a New Bretton-Woods?

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Introduction: current practices

- current efforts to peg to the dollar
- the basic Dooley, Folkerts-Landau, Garber thesis: mutual convenience
- but counterarguments are not hard to make
- current practices are neither desirable nor sustainable

Global implications of current practices (1)

- asymmetrically low policy rates in the industrial world, together with financial innovation
- have supported spending but aggravated domestic financial imbalances
- asymmetric resistance to rising exchange rates implies looser monetary policy in emerging market economies

Global implications of current practices (2)

- the world is awash in liquidity
- the expected costs of disorderly market adjustments are rising
- this is not desirable

Are current practices sustainable?

- private sector cross-border flows dwarf public sector flows
- private sector dollar inflows need not continue
- public sector portfolios are already long-dollar
- the “dollar block” is shrinking and oil revenues rising
- this provides a backdrop of dollar vulnerability

Why vendor financing suits creditors

- imports “stability”
- export-led growth strategy
- reserves as insurance and collateral
- helps avoid currency appreciation and deflation
- other domestic advantages

And why it suits debtors

- cheaper imports raise US living standards
- a sharp dollar decline could raise inflation/ interest rates and lead to recession
- higher rates and recession could lead to lower asset prices and a still deeper recession
- and recession would encourage protectionism

But also raises concerns for creditors

- Asia is importing inflation and domestic imbalances
- can China emulate Japan on a much larger scale?
- the insurance and collateral arguments are wrong or overblown
- resisting supply-driven deflations could cause problems
- other domestic disadvantages

As well as for debtors

- capital inflows impede trade adjustment in two ways: a stronger dollar and more domestic absorption
- lower bond rates aggravate domestic financial imbalances
- short-term gain for long-term pain

Conclusions and policy implications

- neither desirable nor sustainable
- Already seeing tighter US monetary policy and rising Asian exchange rates
- but many risks still remain
- a more comprehensive policy response could help mitigate these risks