Economic spillovers and contagion

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Title: "Economic spillovers and contagion"

Lines:

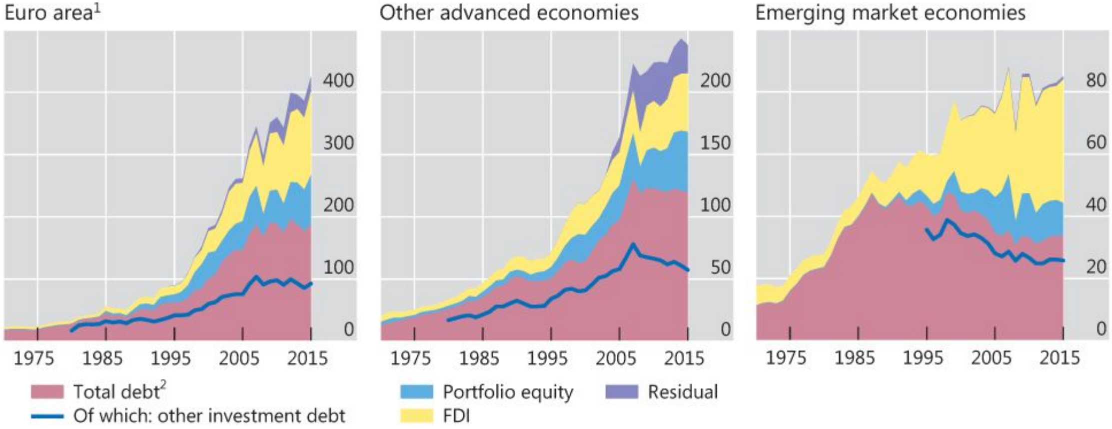
The world is becoming increasingly integrated. Looking at trends going back to the 1990s, we will discuss different avenues of spillovers of economic developments, shocks, and policies, both during "normal" times and during crises. We will talk about the following transmission channels: through capital flows, trade linkages, and labor mobility.

The world is increasingly interconnected: trade

… and capital flows

Different evolution of external positions in AEs and EMEs

Gross external liabilities as a percentage of GDP — Graph VI.4



The complete list of countries is available at http://www.bis.org/statistics/ar2017stats/ar87_c6.xlsx.

[1] The series for the euro area are constructed as sums of the respective series for individual countries; intra-euro area positions are not netted out. [2] For the time periods in which "other investment debt" is plotted, the difference between total debt and "other investment debt" is primarily "portfolio debt", although there is also a small unallocated debt residual.

Sources: Lane and Milesi-Ferretti (2017); BIS calculations.

Other avenues of globalization are harder to measure

- Economic migration
- Multinational companies
- Lengthening of global supply chains
- Trade in services (including through tourism)

But these are also increasing

Economic interconnectedness is generally good

- More efficient allocation of resources globally
- Specialization
- Gains from trade
- Access to global markets
- Access to global capital
- International risk-sharing

Economic interconnectedness can also spread adverse shocks across countries

- Specialization makes supply chains fragile
  - E.g. Fukushima
- Financial linkages transmit shocks and policy changes
  - Lehman
  - Taper Tantrum

Some countries have more impact than others

- Large economies
- Financial centers
- Key links in global value chains

Some countries are more vulnerable to external shocks

- Small economies
  - Domestic economy is small compared to reliance on global markets
- Open trade
- Open financial accounts
- Fixed exchange rate or another monetary policy anchor
  - Inflation targeting
- Indebted economies
- Economies with CA deficits

Sources of economic shocks and changes

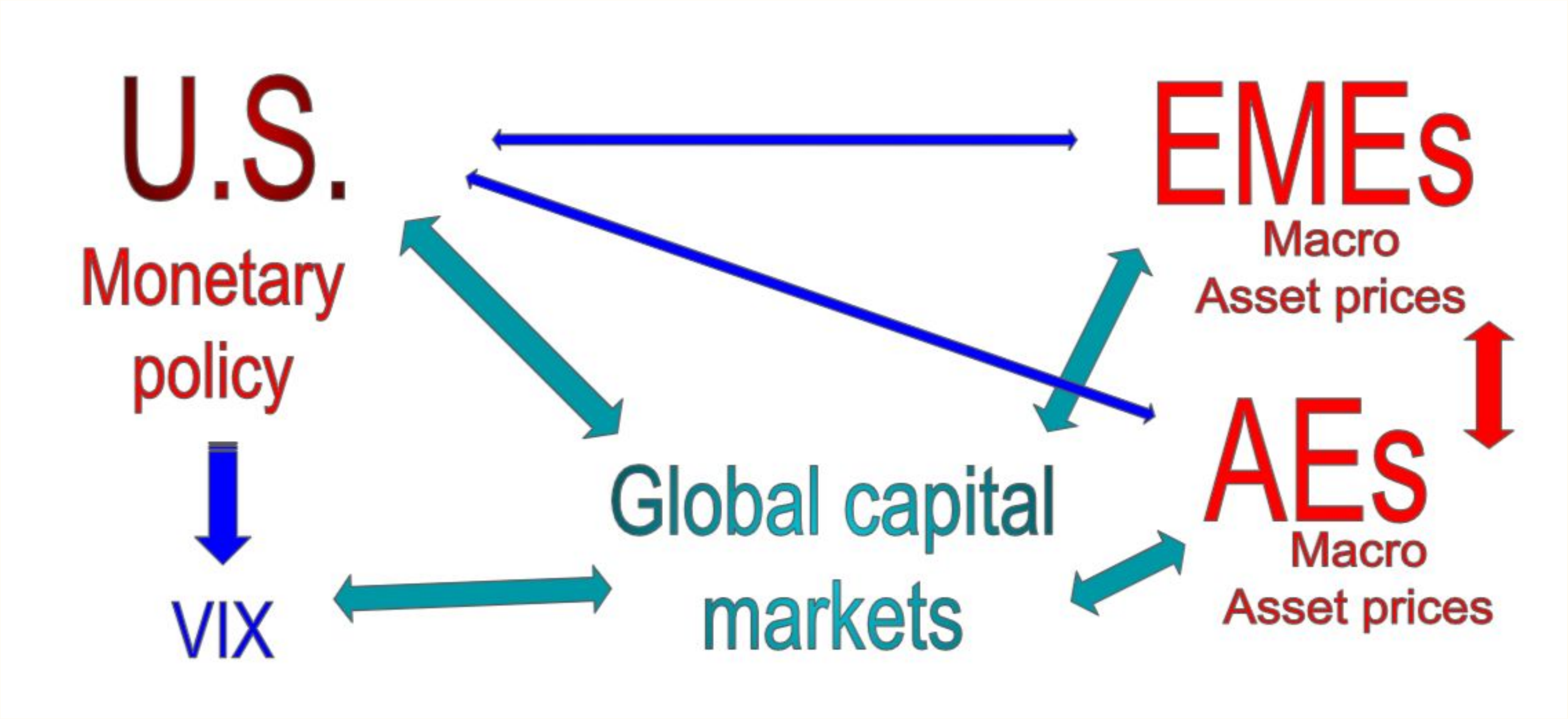
- External and exogenous
  - Pandemic
  - Natural disasters
- Specific markets
  - U.S. Subprime
- Specific policies
  - U.S. monetary policy
  - China-U.S. trade war
    - Affecting other countries, such as India

- Sudden
  - Example to the left
- Gradual
  - Industrialization or de-industrialization of large economies
  - Trade liberalization / specialization
  - Rise of offshore financial centers
  - Brexit
- Sudden * Gradual
  - China ER policies in the context of lengthening supply chains

Transmission channels are complex

- Trade in goods and services
  - Transmits real shocks
  - Transmits financial shocks
- Financial markets
  - Through capital flows (including bank lending)
  - Through asset prices
  - Through exchange rate fluctuations
- Multinational corporations
  - E.g. global banks
  - Car manufacturers

Example: U.S. monetary policy and global asset prices



Can vulnerable economies insulate themselves?

- Trade barriers are detrimental to growth
- Capital control only work if extreme (and are detrimental to growth)

Trends going forward (post-pandemic)

- Likely increasing globalization of trade and finance
- Likely growth of multinationals
- Increasing role of OFCs

Global shocks/problems and national policies

- High-impact economies do not generally internalize their impact in their policymaking
  - Fed swap lines an exception
- Some shocks/problems are inherently global
  - Pandemic
  - Climate change
  - Tax avoidance
- Little policy coordination and even less say for the EMEs
  - Global trade is the most advanced
  - G20 monetary policy meetings
  - Calls for global minimum corporate tax

A case for increased policy coordination

- Spillbacks are becoming more important
    - Taking into consideration spillovers is less and less altruistic
- Many countries are facing a similar set of problems due to pandemic, growing inequality, and climate change
    - High government debt
    - Need for equitable growth
    - Need for sustainable sources of growth
        - Including infrastructure upgrades