

POLICY PANEL 3

Is policy intervention required more than in the past?

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The system has been rewired

1

Portfolio flows at the center stage in driving financial conditions.

2

Sovereign debt outgrows private credit.

3

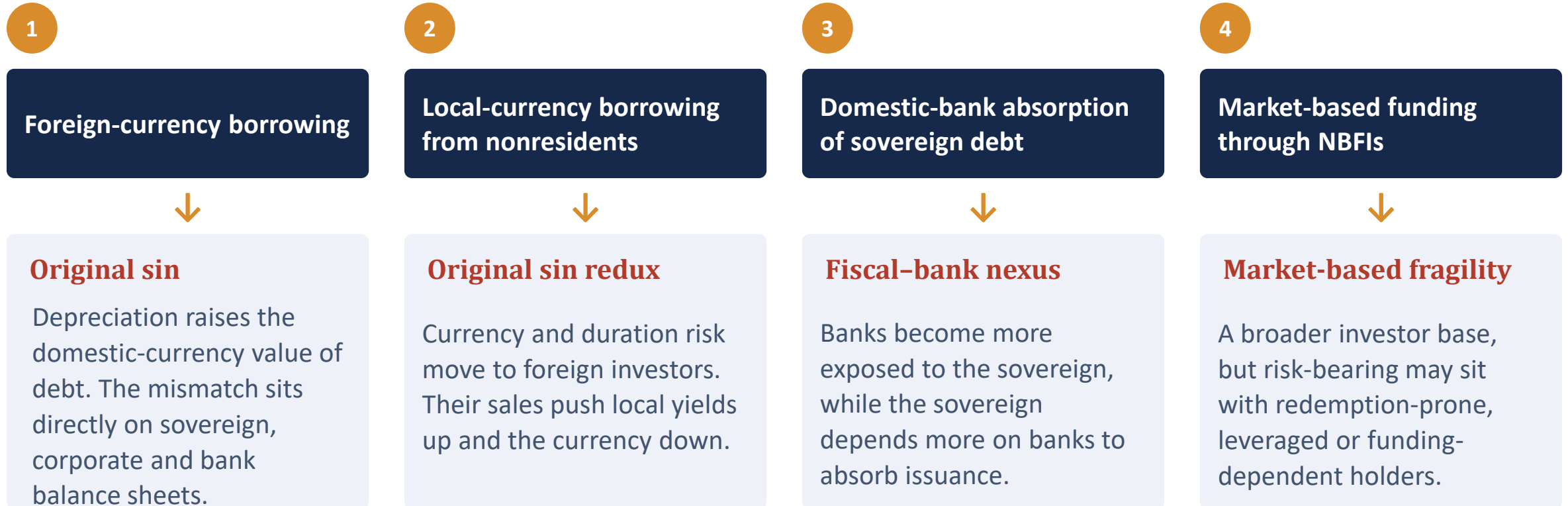
Nonresident NBFIs in EME markets and portfolio investments.

NBFIs can improve market liquidity and absorb risk in normal times.

During stress, they become **consumers of liquidity rather than providers of liquidity.**

Risk does not disappear — it reallocates it

Each financing choice moves risk somewhere else in the financial system.



The policy problem is to identify where the risk has moved — and whether the system can absorb it in stress.

Policy must follow where the risk sits

WHERE RISK SITS

- 1 Foreign-currency debt
- 2 Local-currency debt held by foreigners
- 3 Domestic-bank absorption of public debt
- 4 NBFi and market-based funding

POLICY MUST ADDRESS

- Currency mismatch, FX liquidity, reserve buffers
- Foreign investor base, hedging, market depth, dealer capacity
- Sovereign concentration, fiscal credibility, bank–sovereign feedback
- Leverage, liquidity mismatch, margins, repo and FX-swap intermediation

IS POLICY INTERVENTION REQUIRED MORE THAN IN THE PAST?

The system has reconfigured.

WHAT HAS CHANGED

- **Intermediation:** banks → NBFIs + capital markets
- **Dollar demand:** via FX swaps + Treasury futures
- **Fragility:** concentrated bank balance sheets → leveraged, market-based layers

WHAT HAS NOT CHANGED

- **Dollar centrality** (60% of reserves, 86% of FX trades)
- **Backstop:** still the Federal Reserve
- **Dealer banks** at the centre of market functioning
- **No credible safe-asset substitute**

Takeaway: A quiet domestic market is not evidence of a resilient one. With nonresident holders and dollar-funded banks, vulnerabilities can accumulate offshore and arrive all at once.