

Fragmentation of Global Trade and Finance

BCC 13th Annual Conference

Challenges from Higher Uncertainties

Introduction

- For decades growth in international trade led to financial integration and greater interdependence between countries and regions.
- Trade has been an important part of the developing world's economic progress. According to the World Bank, between 1990 and 2017, global GDP nearly tripled-- developing countries share of exports approximately doubled from 16% to 30% while poverty plummeted from 36% to 9%.

Introduction

- Developments in geopolitical tensions, economic nationalism and technological rivalries are leading us away from a global, rules-based system towards a fragmentation of trade and finance along geopolitical and regional lines.
- These effects are not only manifested in changes and fragmentation in trade but also reflected in fragmentation of the financing of trade and the international financial system.

Factors influencing Financial Fragmentation

- Heightened security and geopolitical rivalries have not only led to restrictions on technology availability, trade disputes, tariffs and pressure to de-risk global supply lines. These concerns have also spilled over the financing of trade and the international financial system.
- The increased use of financial sanctions and regulations governing the flow of capital have increased the desire for some to call for alternatives to the US\$-centric international financial system, including efforts to develop alternative payments and financial systems.
- Advances have been at the global, regional and national levels to develop such payments and financial systems that are outside the US\$ financial infrastructure.

Global initiatives-example

- An example on the global level could be the multi-CBDC payment platform, Mbridge, developed and tested as a prototype by the BIS. This was done in cooperation with key partners from the HKMA, PBoC, Bank of Thailand and the CB of UAE plus 25 observers from central banks and MLI's.
- In addition to being outside the US\$ sphere, such infrastructure hopes to be more efficient with using Blockchain technology with cheaper and faster execution.

Regional initiatives-example

- The BRIC block is also developing infrastructure to circumvent US\$ dominated infrastructure. A new multi-lateral institution, the New Development Bank (NDB) is in operation and a Contingent Reserve Arrangement (CRA) has been created but yet to be activated.

National initiatives-example

- In addition to global and regional alternatives, financial statecraft is moving forward with regional or currency specific infrastructure being established such as CIPS (Cross-Border Interbank Payment System) to facilitate RMB-denominated payments outside SWIFT.

Possible implications of Financial Fragmentation-

- Major risks associated with these trends
 - Establishment of parallel systems or the technology required to successfully operate such systems implies a future of competing blocks and generates new vulnerabilities.
 - Opportunity costs associated with not refining current systems, For example, instead of developing a global CBDC system for wide-spread interoperability, we could see regional blocks for with little or no interoperability
 - Self-reinforcing trend where the velocity of fragmentation increases as systems and trade are pulled apart by geopolitical alliances.

The role of US\$ as the Global Reserve Currency

- Despite efforts to construct alternatives as discussed, the US\$ remains in this role.
- Increasingly, questions are aired if it can continue to satisfy some of the characteristics one might consider hallmarks of a global reserve currency:
 - Global acceptance
 - Economic strength and stability of the issuer
 - Liquidity
 - Stability and reliability as a store of value.

The role of US\$ as the Global Reserve Currency

- Global acceptance-The US dollar is still most widely accepted but trade policies could impact its near universal use
- Economic strength and stability of the issuer- So far, the case for US exceptionalism remains largely intact.
 - Questions around funding the growing deficits are centered on the adjustments in borrowing costs necessary vs the underlying financeability of the deficits.
 - However, the US has entered a time where debt service costs are such that, for example, they exceed spending for US defense.
 - The US could enter an era where fiscal space is narrowed.

The role of US\$ as the Global Reserve Currency

- Liquidity
 - While there have been some concerns over short, technically driven liquidity gaps but the The US Treasury market remains the most liquid market available to investors.
 - The questions for investors remain, “What are the alternatives for hyper-liquid investments and for central banks specifically around reserve management?”
- Stability and reliability as a store of value.
 - The US dollar is down roughly 10% vs major currencies this year but such fluctuations have always occurred.
 - Questions today revolve around the aims of the Administration to strike a balance between maintaining the strategic advantages of remaining the world's serve currency vs moving towards a weaker US Dollar to promote commerce and exports.