Seminário Internacional

Desafios e Oportunidades para a Integração Financeira e Monetária na Região

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Analysing the Integration of the Brazilian Financial Markets: Towards a Mercosur Vision

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Overview

- **Research**
- **Development in Emerging Market Economies**
- **Emerging Market Economy Currency Internationalisation**
- **Lessons from European Integration**
- **The Vision: Mercosur's Virtuous Currency Internationalisation**
- **Report Policy Proposals**

Disclaimer: These ideas are not those of the BCB, or the UKFCO

Research

- Currency internationalisation *can* bring benefits
- Risks with international currency internationalisation: vulnerability and procyclicality
- The damage can be negative effect on longterm growth prospects and credibility of strong and stable economy
- The stronger and more stable the economy is the greater the greater the ambition and benefits from Currency Internationalisation can be.
- Currency internationalisation (and financial integration) is *virtuous* when it is *complementary* to a broader growth strategy.
- The risks are particularly great for developing/emerging market economies: international monetary asymmetries
- Therefore, Emerging Market/Developing Economy Currency Internationalisation (and financial integration) has to be subordinated to a broader vulnerability-reducing development strategy.

Development in Emerging Market Economies

- China: Export-oriented industrialisation strategy; dependency on energy and commodities imports; global mass demand for exports. Financial integration strategy, including Currency Internationalisation (*proactive*), supports development strategy.
- South Africa: Economy centred on extractive industries, without clear development strategy. Dependent on commodity exports. Embraced financial integration, including Currency Internationalisation (*full*).
- Brazil: Growth strategy focusing on mix of extractivism, industrialisation and growth of domestic demand, but primarisation as growing dependency on Chinese demand for commodities. Cautious Currency Internationalisation (*reactive*).

Lessons:

a) longterm development for EMEs is plausible when vulnerability is minimised

b) Yet, inevitable (inter)dependence

Emerging Market Economy Currency Internationalisation

- South Africa's Full Currency Internationalisation: *Not* Complementary
- Brazil's Reactive Currency Internationalisation: Asupportive of development (ultimately *not* complementary).
- China's Proactive Currency Internationalisation: development- and trade-led CI (*potentially* complementary).

Lessons learnt:

a) If unsupportive of a vulnerability-reducing development strategy, it becomes destabilising, which damages credibility of currency.

b) Currency Internationalisation designed to support a development strategy which reduces vulnerability over time we call *virtuous*.

c) Vulnerability could be reduced if development and virtuous currency internationalisation take place in cooperation with trusted others.

Lessons from European Integration

- Idea of shared development through industrial-functional and trade integration enabled by close cooperation and funding of infrastructure and joint market.
- European integration contributed to European golden years.
- "Full" regional currency internationalisation (EMU) *followed* uneven financial integration.
- Insufficient and improper macroeconomic convergence, banking regulation and political integration, despite some solidarity, were exposed in Eurozone crisis by financial market scrutiny.
- Regional currency internationalisation (incl. monetary integration) amplified these weaknesses.

Lessons:

- European facilitation of industrial-functional and trade integration was successful in supporting regional development.
- Monetary Union amongst sovereigns is almost certainly a recipe for disaster.
- Financial integration does not resolve underlying weaknesses in the economy, regional or national, political or social.

Vision: Mercosur's Virtuous Currency Internationalisation

- Mercosur should develop a strategy for regional currency internationalisation centred on the use of local currencies.
- This must be designed *proactively* so as to support a shared vulnerability-reducing development strategy, which must be primary.
- The development strategy should focus on:

a) industrial-functional and trade integration

b) enabled by funding of infrastructure, research and innovation, redistributive development of skills and demand, market defragmentation and macroeconomic convergence.

- Mercosur currency internationalisation/monetary cooperation must be *trade-led and incentivise commitment*.
- Tailored financial integration can support integration process, but it cannot resolve underlying weaknesses in the economy, regional or national, political or social. It must include prudential measures.

Report Policy Proposals

1. Develop and extend regional payment, clearing, and settlement mechanisms
2. Commission a Study to Analyze the Risks and Opportunities of a more elaborate system of bilateral swap agreements
3. Enhance collaboration, macroeconomic and regulatory coordination, and harmonization between central banks and regulatory agencies
4. Commission a study of the costs and benefits of introducing regional currency derivatives to hedge regional exchange rate risk
5. Special credit lines mediated through specifically assigned dealer banks could enhance offshore settlement in local currency
6. Maintain countercyclical macro-prudential measures as part of the macroeconomic toolkit
7. Support the establishment of regional funding currency in the long term

Dr. Annina Kaltenbrunner will elaborate and add to this in her presentation.