

Capital Flows, Exchange Rates, and Geopolitics

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Managing capital flows

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Outline

- Managing net capital flows: Global Imbalances
- Managing gross capital flows: Financial Stability Risk
- Managing new capital flows

Global Imbalances

Economists Group

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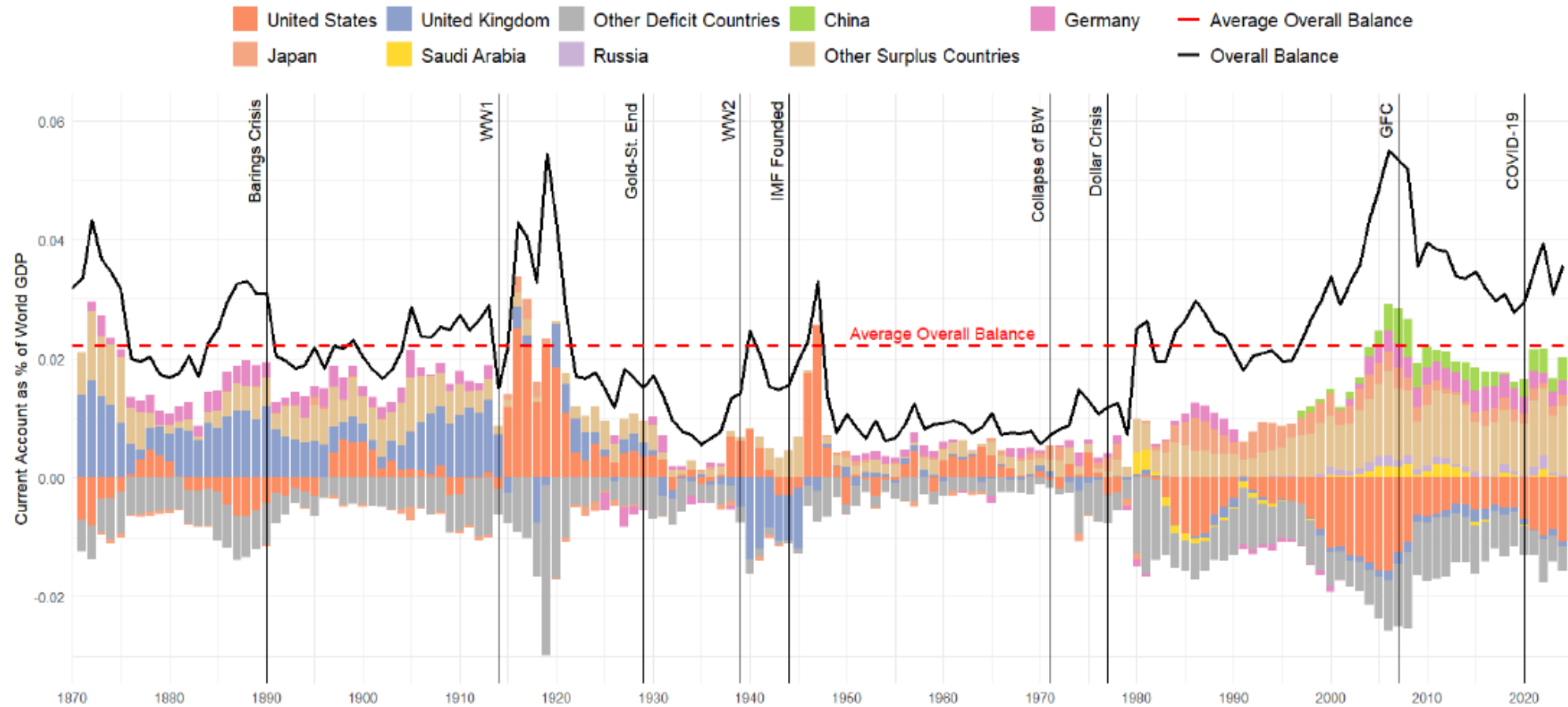
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Chart 1. Global current account imbalances today are well above the historical average

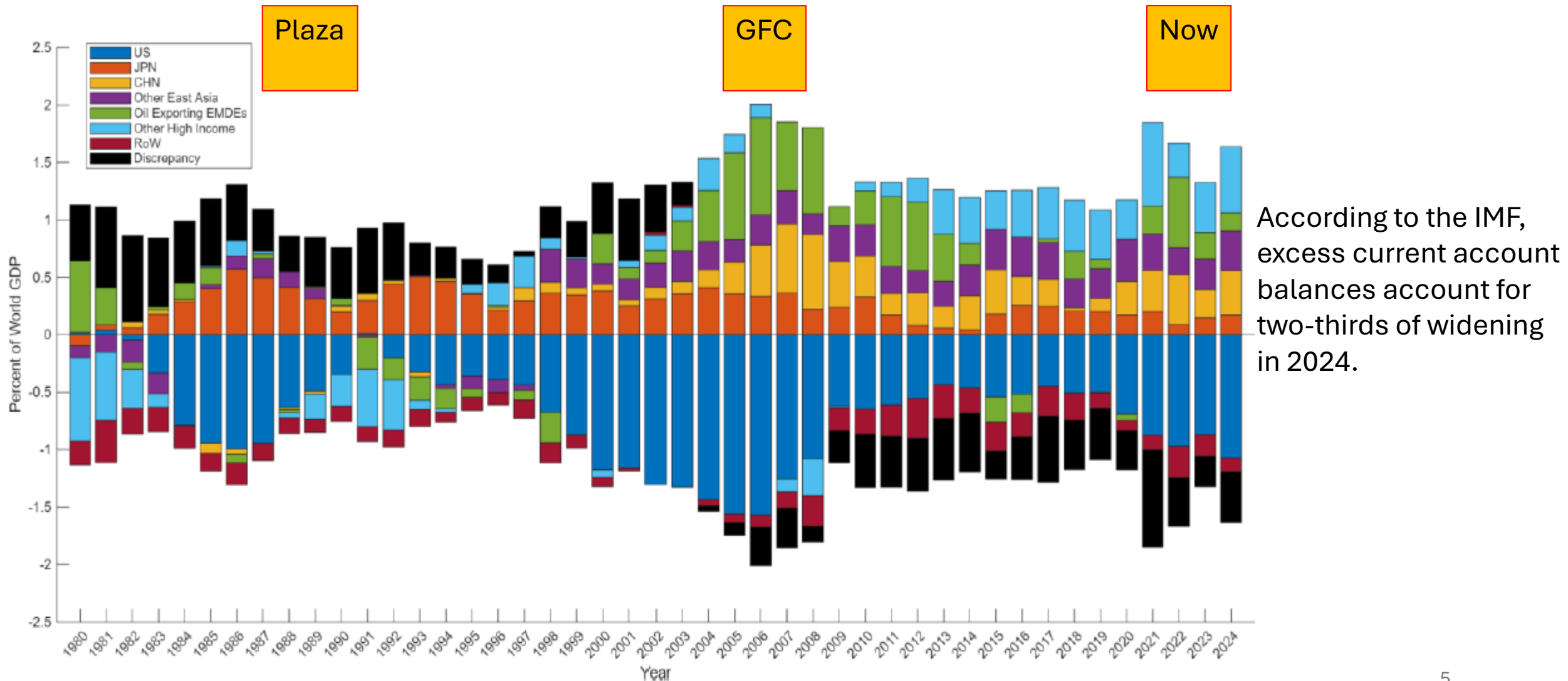
Current account as a percentage of world GDP, 1870-2024



Sources: Jordà-Schularick-Taylor (2017), IMF World Economic Outlook

Notes: Prior to 1980, the figure is based on a sample of 18 advanced economies from Jordà-Schularick-Taylor (2017). The overall balance is defined as the sum of the absolute value of current account surpluses and deficits.

Global imbalances threaten balanced growth and reciprocal trade



Global imbalances threaten balanced growth and reciprocal trade

- **G3** drove marked increase in 2024 current account balances after a long pre-pandemic decline
- US and China continued the divergence in 2025H1. China's surplus grew further in 2025H2.
- Imbalances below 2006 peak but trends in **China** (growing official surplus, measurement issues, RMB path) and **US** (non-energy goods and primary income balances) raise concerns
- NIIP positions have continued to widen; **US NIIP in uncharted negative territory** (-90% of GDP)

Global and Sectoral Imbalances are conceptually distinct

- **Global imbalances** have been associated with risks of **protectionism** (1985) and of **financial instability** (2007).
- **Negative spillovers on third countries (LatAm...).**

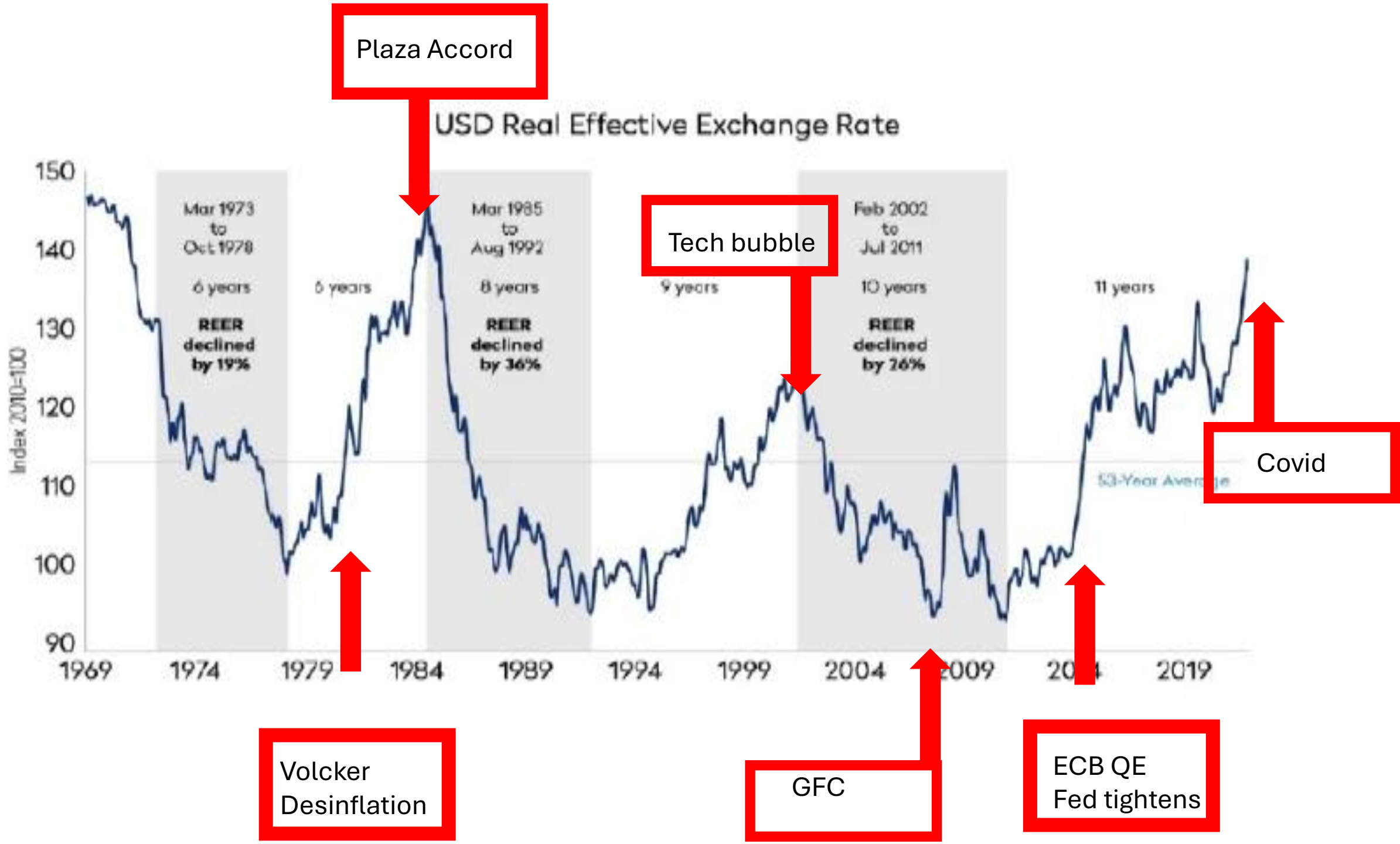
- **Sectoral imbalances** may also be associated with **protectionism, financial and security risks.**
- **They** sometimes come with **Non Market Practices** and **choke points.**

Causes of Global Imbalances

- Global imbalances are **macroeconomic** in nature.
- They are a consequence of **unbalanced growth models**.
- They reflect the **savings and investment** balance, shaped by macroeconomic policies.

Red Herrings

- **Tariffs**, unless extreme, do not close imbalances.
- **International currency** issuance does not necessarily imply current account deficits.
- **Exchange rates** do not have a causal role (they « clear the market »):
 - 1985 Plaza Accord. Dollar appreciation before.
 - 2007 Great Financial Crisis. Dollar depreciation before.



Lessons from the Plaza Accord (Takeo Hoshi – Paris Report)

Multilateral

Process built up over months of G5 deputy-level consultations. Japan was the most forthcoming party.

Process-oriented

Aim was to coordinate expectations and shift market sentiment — not to deliver a specific yen level or trade balance.

Protect orderly Trade

Goal was to defuse US protectionist pressure and protect the open trading system.

"Global imbalances are ultimately rooted in domestic economic structures and cannot be sustainably resolved through exchange-rate movements alone. The Accord was meant to buy time so that political tensions could be defused while gradual structural adjustments took place on both sides."

Lessons from the Plaza Accord

Misreading 1 : "don't end up like Japan"

The narrative (surplus country side)

- US pressure **forced** yen appreciation.
- Yen appreciation **destroyed Japanese competitiveness**.
- Result: the "**lost two decades**" of stagnation.
- Implication: yielding to external demands = **strategic suicide**. **Resist** exchange-rate or structural pressure.

Why this is wrong

- Japan's late 1980s were a **boom, not stagnation**. Asset prices surged after the Plaza.
- Stagnation began only **after the bubble burst** in the early 1990s.
- What hurt Japan was **excessive monetary easing** kept too long, **financial deregulation** gone wrong, and a **delayed banking-sector cleanup**.

None of the above is exchange-rate appreciation per se. *Japan's stagnation came from how Japan responded to the appreciation — not from the Plaza Accord itself.*

Lessons from the Plaza Accord

Misreading 2: "pressure works, set numerical targets"

The narrative (deficit country side)

- The Plaza moved the yen quickly → **US has the leverage.**
- Reinforced by 1986 Semiconductor Agreement: **20% foreign-share target** eventually reached.
- Trade policy turns from rules-based liberalisation to **outcome-oriented management.**

Why this is wrong

- The Plaza worked because **expectations turned**, not because the US dictated outcomes.
- Japan's trade surplus persisted even after the yen halved — exchange rates **alone don't close S – I gaps.**
- Outcome-based pressure **undermines the rules-based system** the Plaza was designed to preserve.
- Imbalances reflect **domestic structures**

Bottom line: *the two misreadings of the Plaza Accord turn structural adjustment into a zero-sum contest. The space for cooperative adjustment has narrowed precisely because each side is fighting the wrong battle.*

Lessons from the Plaza Accord

01

Monetary easing kept too long

BoJ cut its discount rate to 2.5% to offset yen appreciation; held it there until 1989. Asset bubbles inflated.
(Ueda, 1992.)

02

Lopsided financial deregulation

Corporate financing options expanded fast; saver-side and bank-business reform lagged. Banks lent to weaker borrowers backed by land collateral.

03

Delayed banking-sector cleanup

When the bubble burst in the early 1990s, problem loans were not resolved promptly. The credit crunch fed into the lost decade.

04

Failure to switch growth model

Catch-up via capital deepening + exports could not last. Japan needed innovation-based growth — and didn't pivot in time.
(Aghion et al., 2021.)

Lessons from the Plaza Accord

Core Claim

- U.S. and surplus countries (Japan → China) → **misinterpreted the Plaza Accord**
- These misreadings now **obstruct global adjustment**

What the Plaza Accord Did (1985)

- Coordinated **dollar depreciation** → **Eased U.S. political pressure**
- **Aimed at buying time for structural reform**

Misinterpretation in Japan and China

- Plaza Accord → stagnation

Misinterpretation in the U.S.

- Pressure → deliver outcomes

Today's Problem

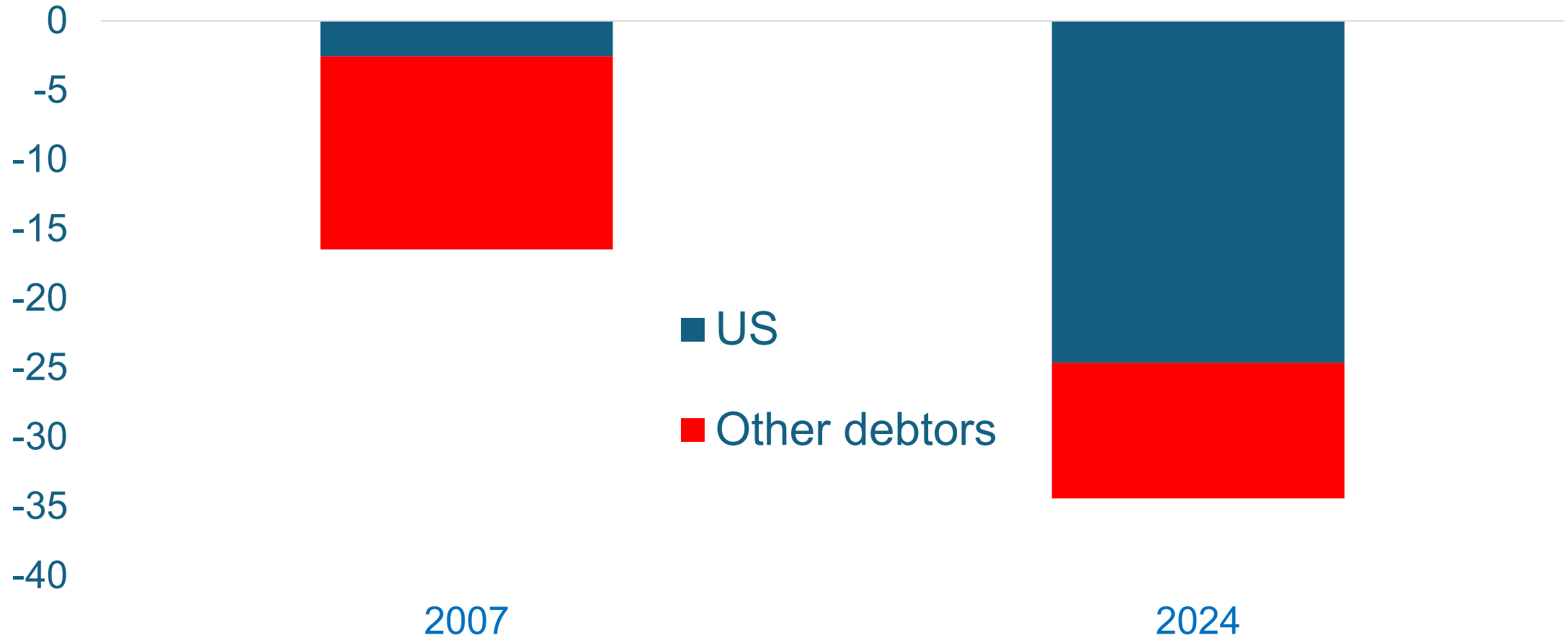
- China: **resists pressure**
 - U.S.: **demands results**
- **Mutual mistrust**

True Lesson

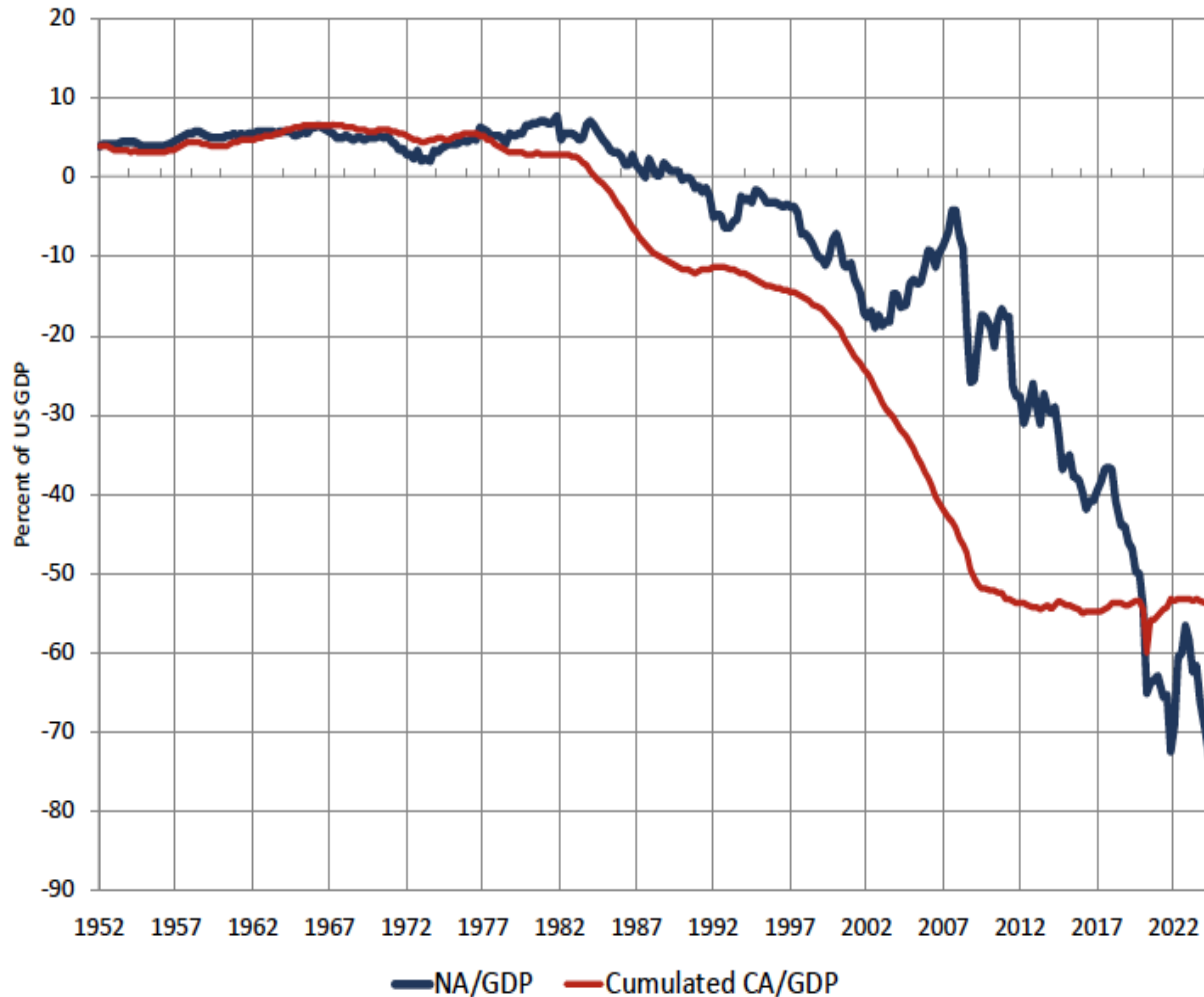
- Imbalances cannot be fixed by exchange rates alone or external pressure
- Require **(coordinated) structural adjustment**

Gross Flows: Financial Stability Risk

Net debtor positions in 2007 and 2024 (% world GDP)



US net foreign asset position 1952Q1-2024Q4



*Erosion excess returns
Lasting US equity overperformance

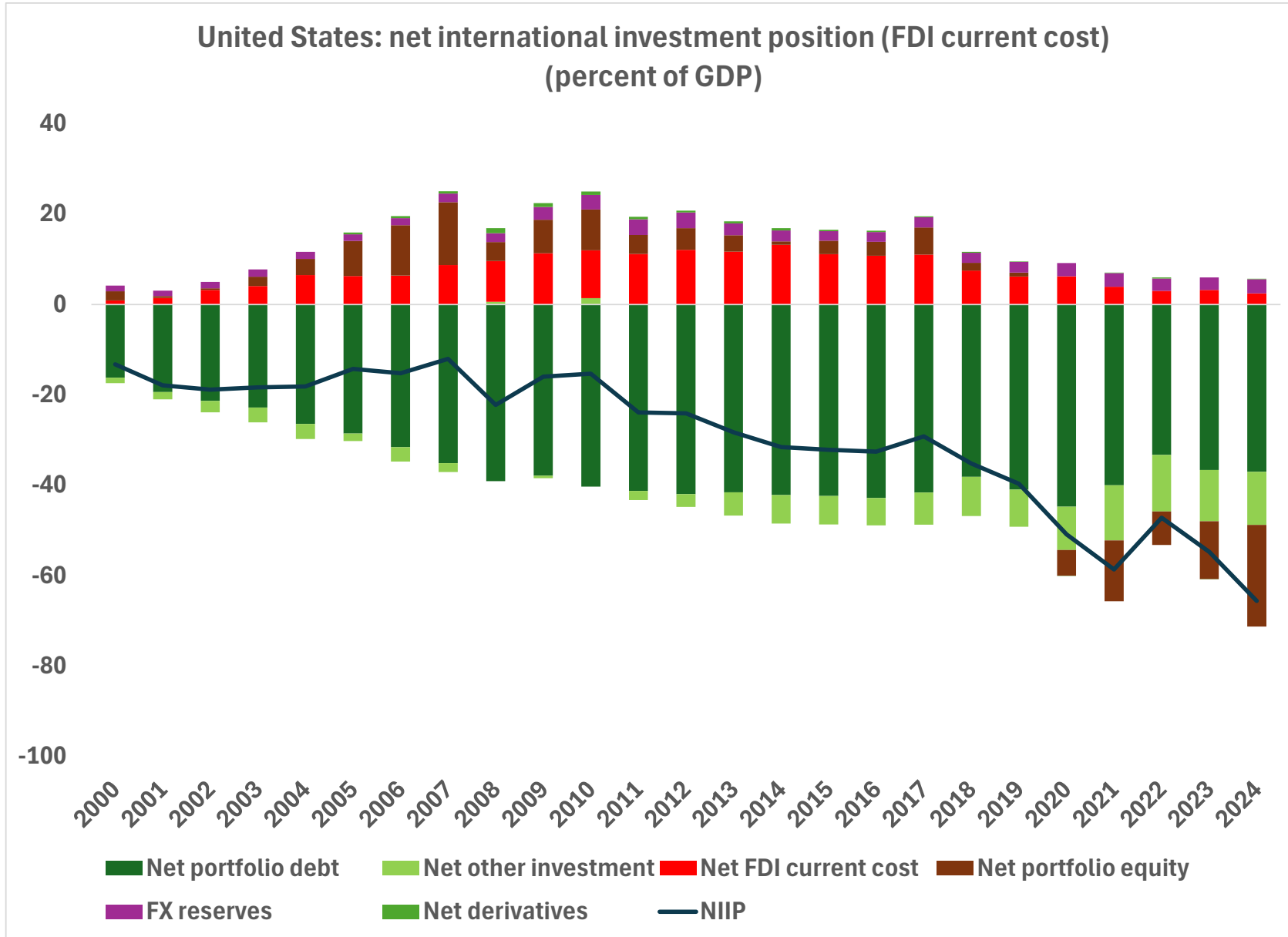
*Repeated « duty »:
GFC, Euro area,
Covid, Ukraine

*Public finances

Notes. Difference between NA/GDP and Cumulated CA/GDP represents cumulated Valuation Effects/GDP. *Source:* BEA, Federal Reserve, FRED and author's calculations.

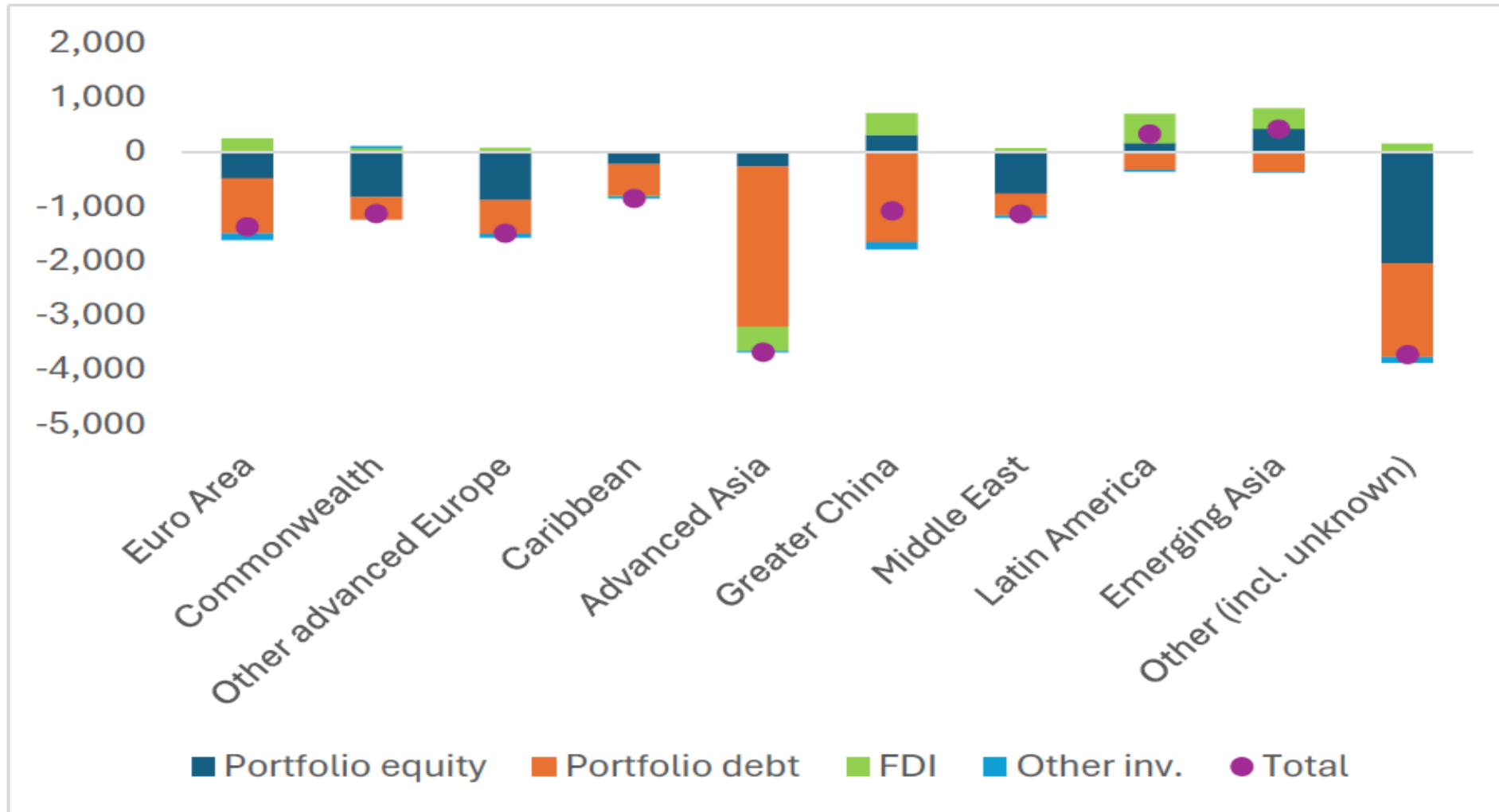
Source: Gourinchas Rey and Sauzet (2020)

US net IIP: short portfolio debt



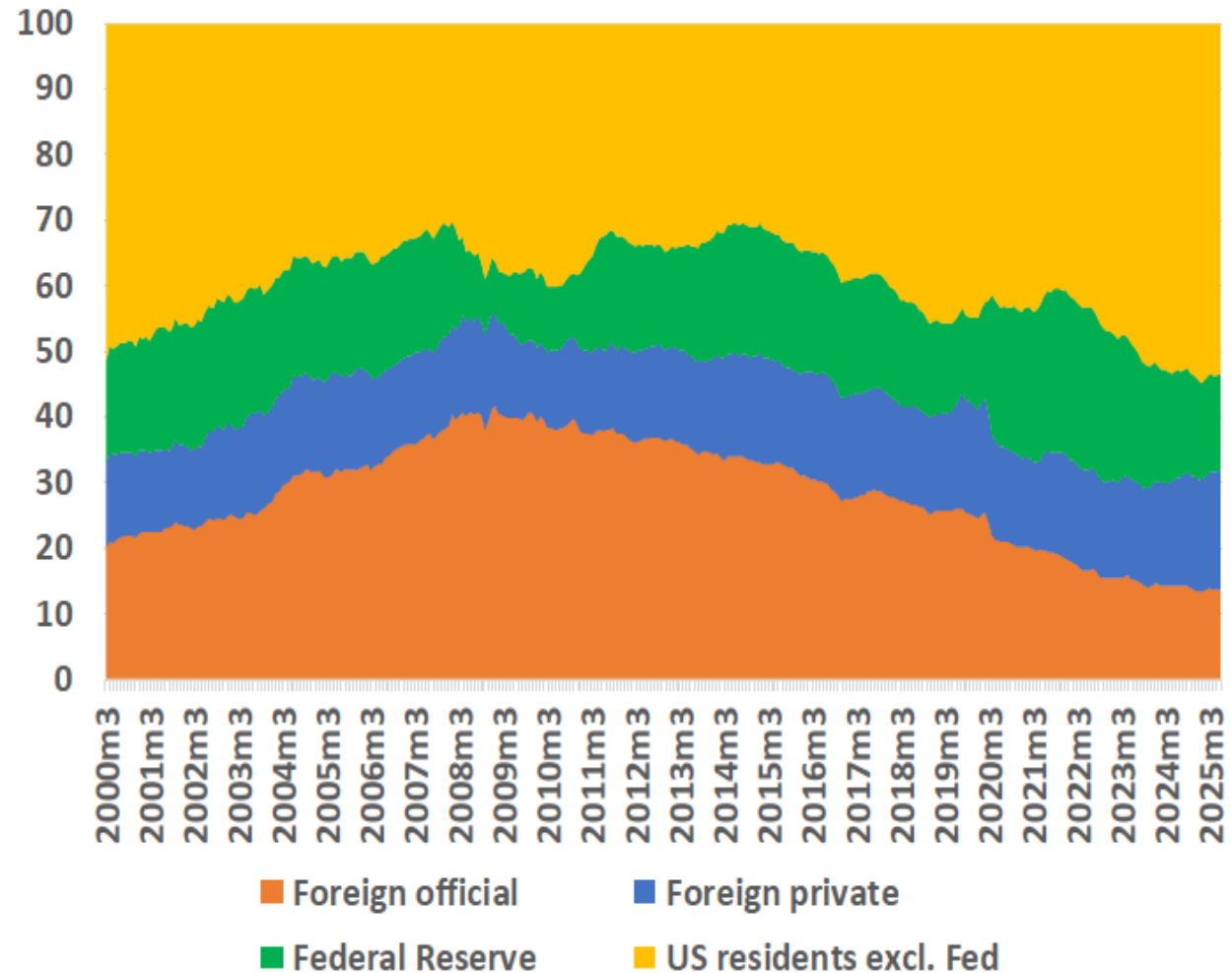
Source: Paris Report (Milesi-Ferretti)

US net IIP by region



Holders of U.S. Marketable Treasury Securities

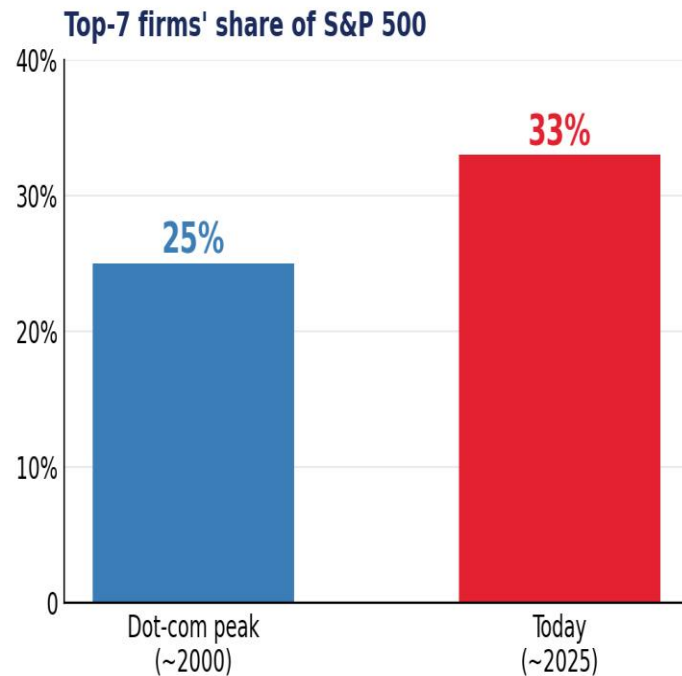
- There is a **large shift** in the pattern of **foreign holdings of USTs**.
- A **diminishing role** for **foreign official investors** who accounted for the lion's share in 2008.
- Offset by a **rising role** for **private investors**.



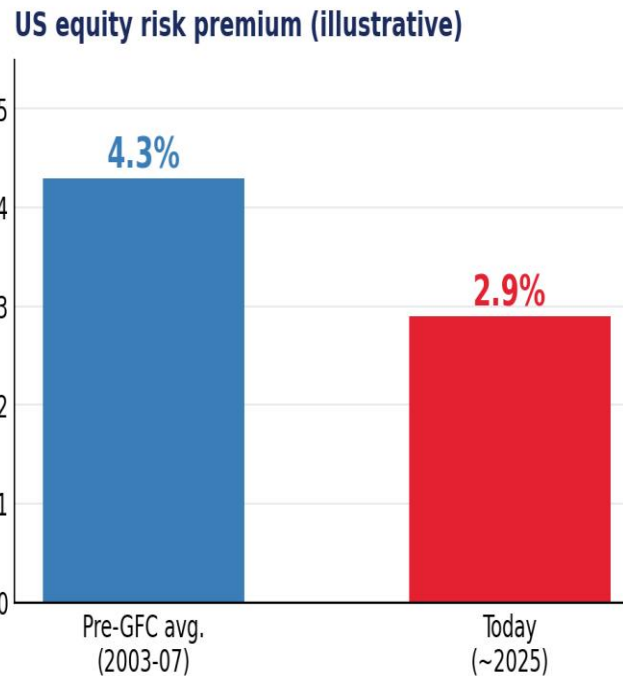
New vulnerabilities (Harr & Krogstrup- Paris Report)

Concentration up · risk premia down

Symptoms of the new private-savings-glut regime



Source: Harr & Krogstrup (2026); IMF GFSR (2025b); Federal Reserve (2025).



Source: Harr & Krogstrup (2026); IMF GFSR (2025b); BIS (2025a); De Cos (2025).

Concentration risk

"Magnificent Seven" \approx 33% of S&P 500; \sim 20% of global equities. Magnitude exceeds the dot-com peak (Herfindahl).

Compressed risk premia

Equity premia and credit spreads near historic lows; term premia closer to average — premia, not safe rates, absorb the new glut.

Leverage in safe markets

Hedge-fund "basis trades" using repo leverage; rising elasticity of demand for Treasuries \rightarrow spike risk if convenience yield slips.

Sectoral Imbalances : Financial Risk

- Increasing importance of **NBFIs**:
 - Improve **data on cross border exposures** of NBFIs and on the links between NBFIs and the banking sector (timely **FSB** work)
- Stress test interconnections: System Wide Exploratory Scenario (SWES)
- Enhancing **transparency on activities in offshore jurisdictions (NBFIs, cryptos)** and dealing with regulatory arbitrage (**FSB, BIS**).
- **Prudential policy** and international cooperation on **liquidity provision**.

New Flows

Internationalisation of Crypto Money Instruments

Native Tokens

Examples

Bitcoin, Ether

Market cap

\$1,400 bn

Trust basis

Algorithm (internal)

Intl prospects

Scalability limited

Stablecoins

Examples

Tether, Circle

Market cap

\$300 bn

Trust basis

Credibility of peg + “free ride” on
currency attributes (\$)

Intl prospects

Growing?

Tokenised Deposits

Examples

JPM Coin

Market cap

Nascent

Trust basis

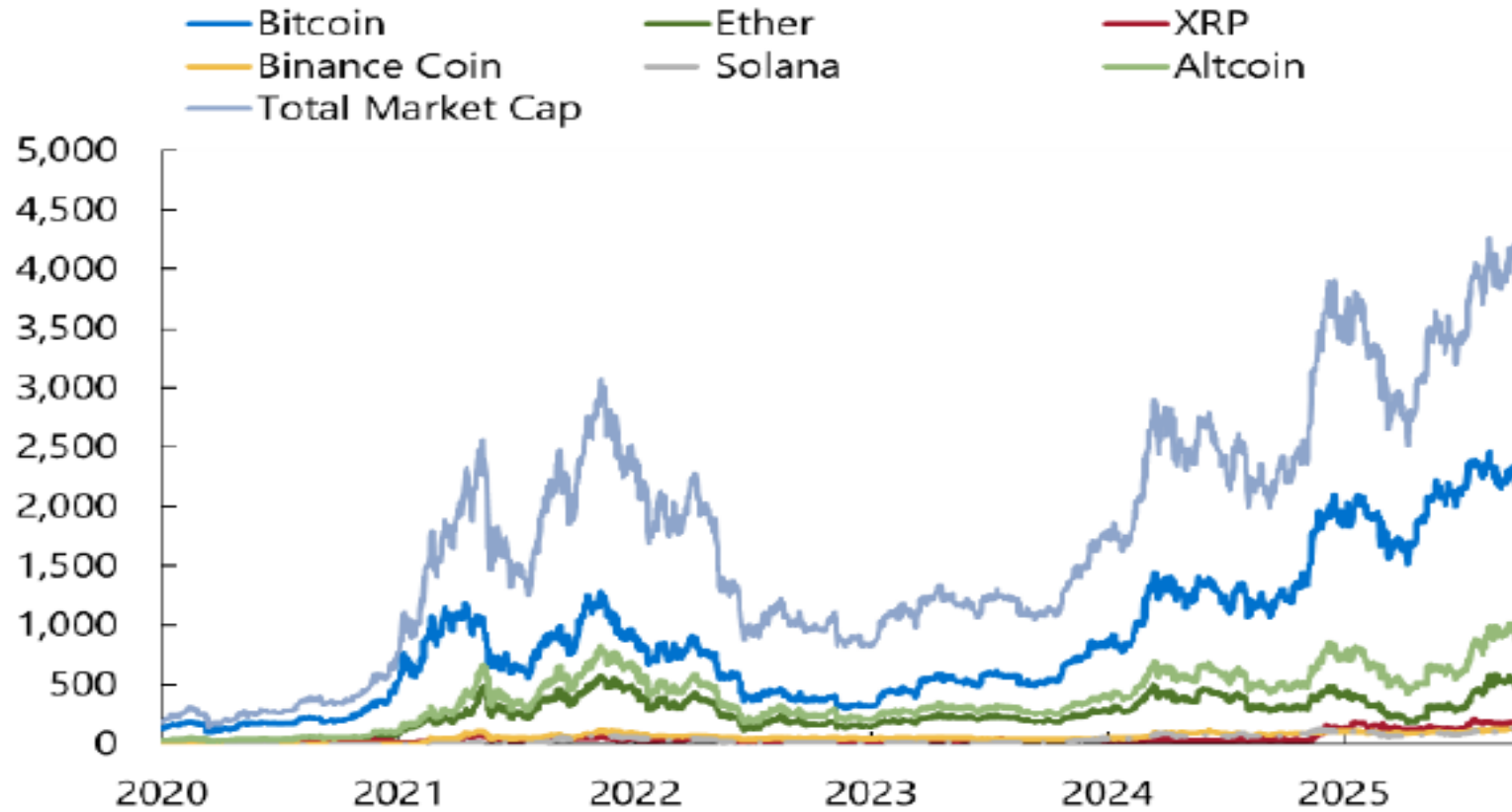
Regulated bank + Central bank

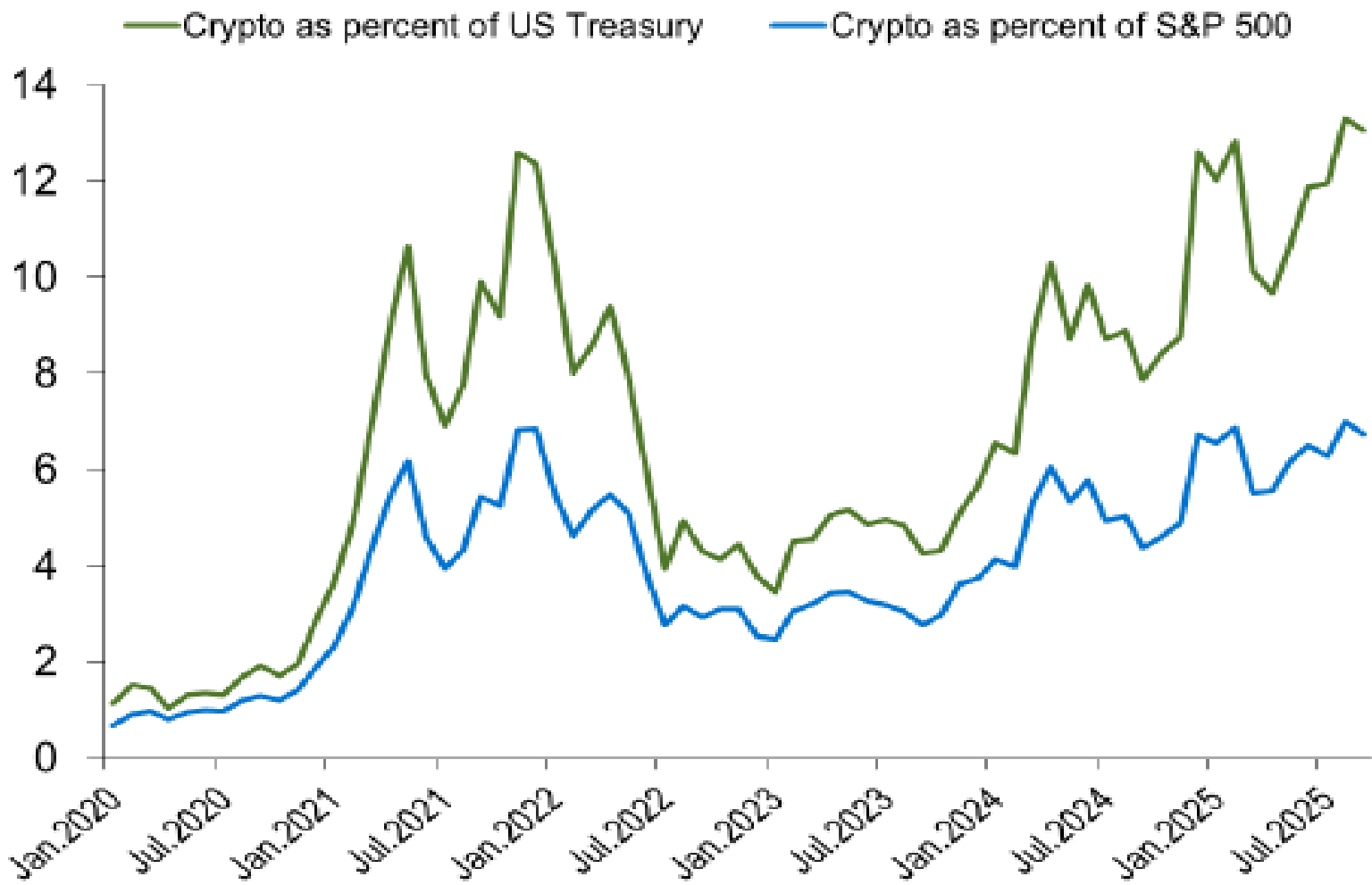
Intl prospects

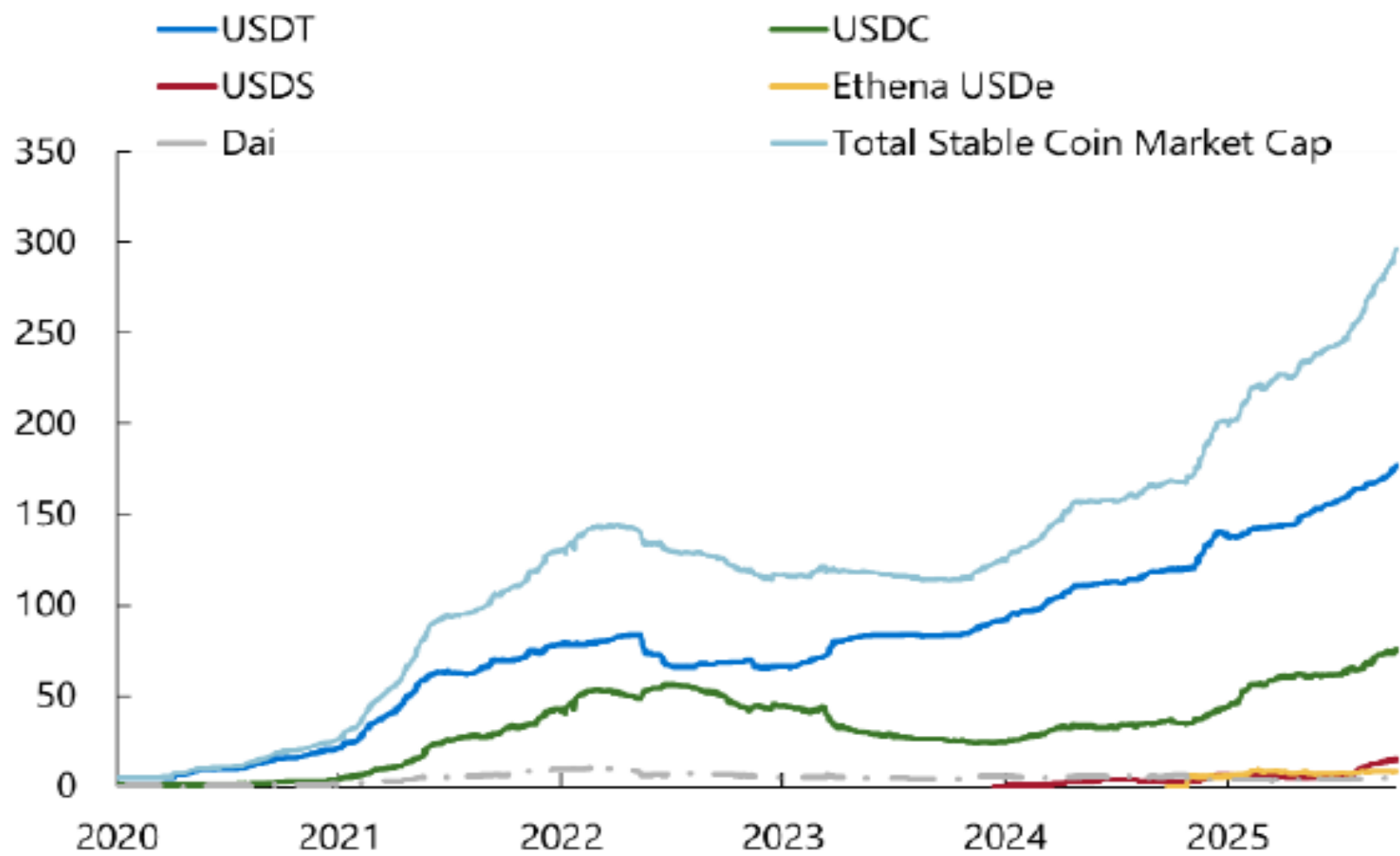
Nascent; design-dependent
(interoperability)

*Total crypto assets market cap surpassed
USD 4.2 trillion.*

1. Selected Crypto Assets Market Cap (in USD billions)







Stablecoins and Eurodollars: A Historical Parallel

What are Eurodollars?

USD deposits held outside the US, legally outside US jurisdiction but embedded in the dollar system. Today ~\$13 trillion. Important for global role of the dollar.

The parallel

Both are dollar claims outside the regulated US banking system, relying on par convertibility. Regulatory arbitrage (regulation Q) and desire not to touch US financial system drove creation of eurodollars (Soviet oil payments)

Key lesson

Eurodollar volumes only took off once the Fed's liquidity backstop was implicit. Stablecoins lack this — a fundamental fragility.

Critical differences

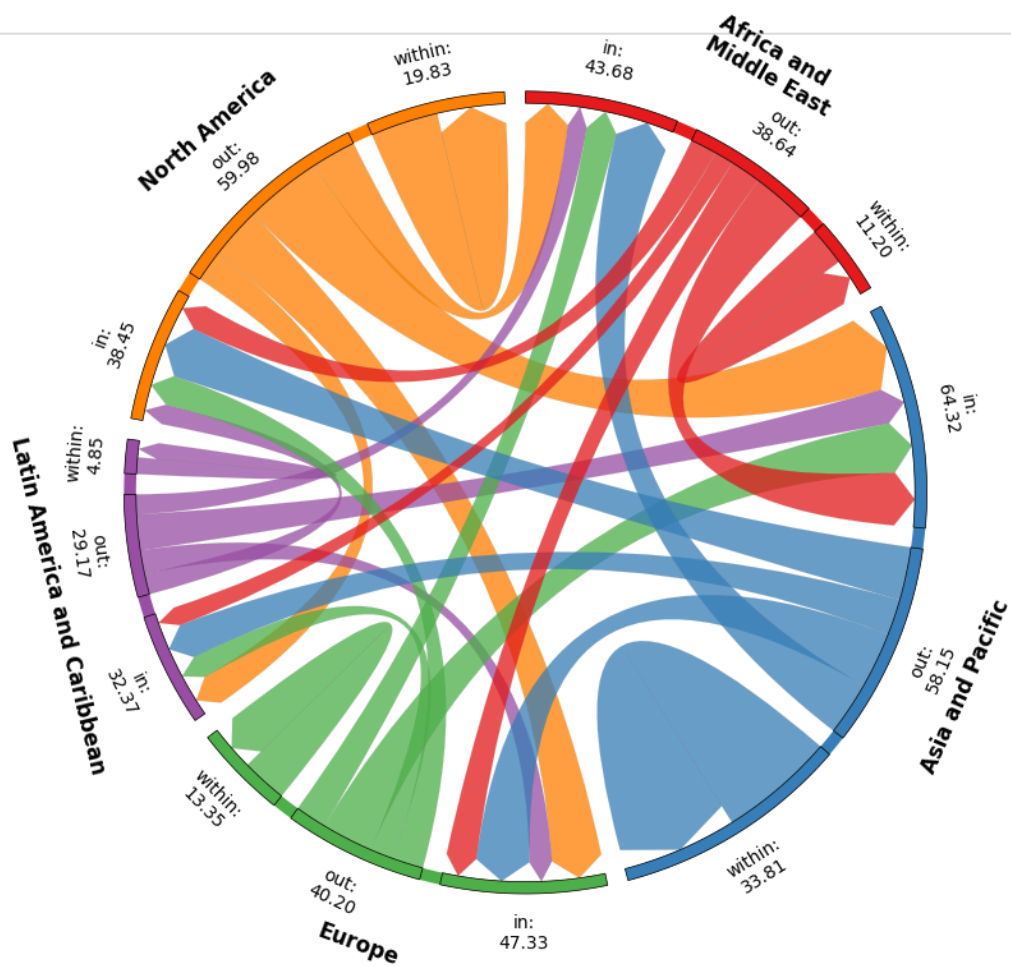
Stablecoins pay no direct interest and have no lender of last resort.

We Cannot Yet Measure Cross-Border Crypto Flows Precisely

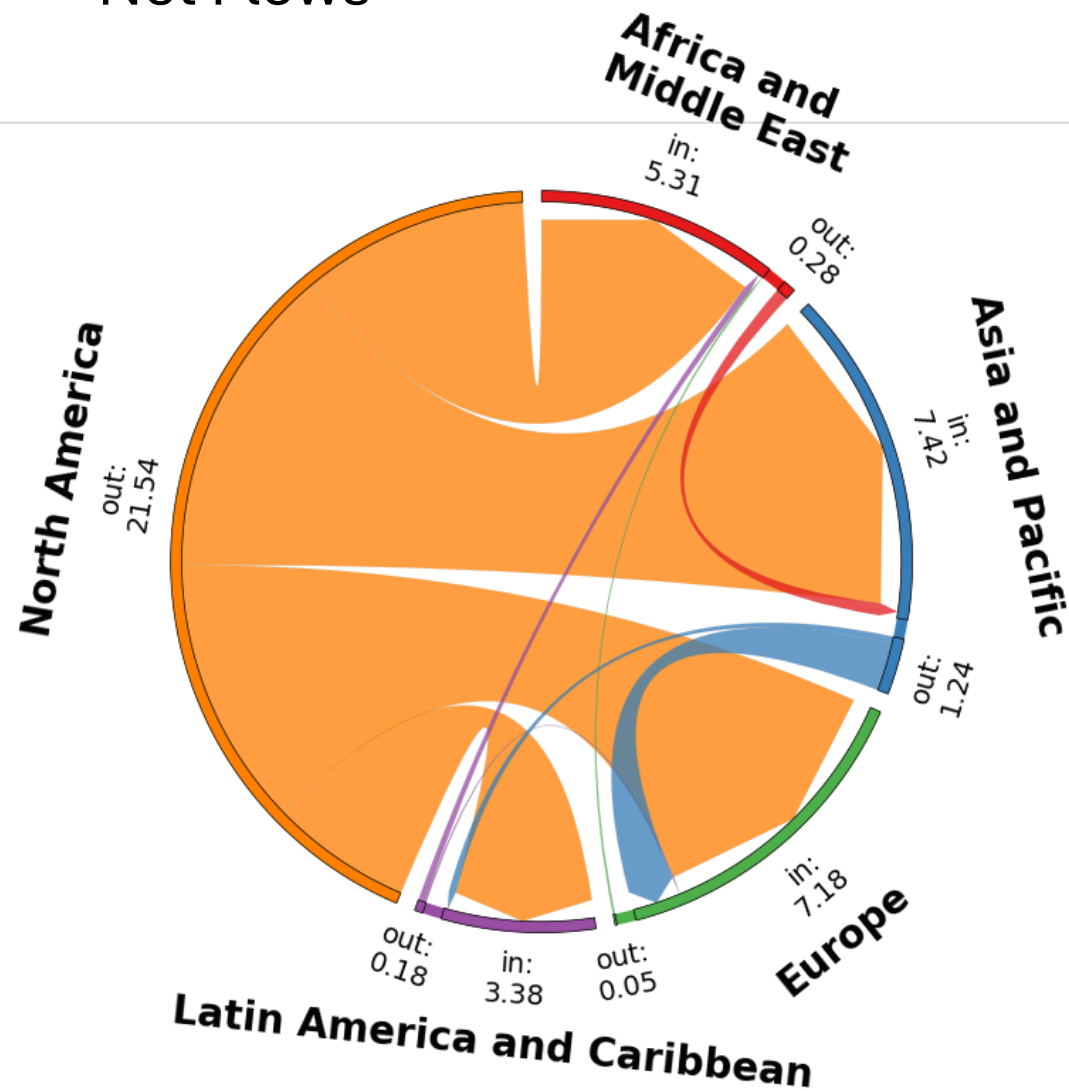
National accounts and BoP frameworks capture crypto flows poorly — wallet addresses do not reveal user jurisdiction.

- Chainanalysis: reconstruct residence using geography of web traffic into centralised exchanges — widely used but relies on strong assumptions (no VPNs, uniform transaction sizes)
- Reuter (2025): AI/ML on Ethereum self custodial wallets using linguistic signals, trading patterns — works without VPN assumption; but region-level only
- BIS Project Atlas: combines on-chain and off-chain data
- Asia-Pacific leads gross flows (\$160 bn); relative to GDP, Africa/Middle East (1.5%) and LatAm (1.4%) are highest
- Improving measurement should be a priority for policy makers — flows are becoming material

Gross Flows

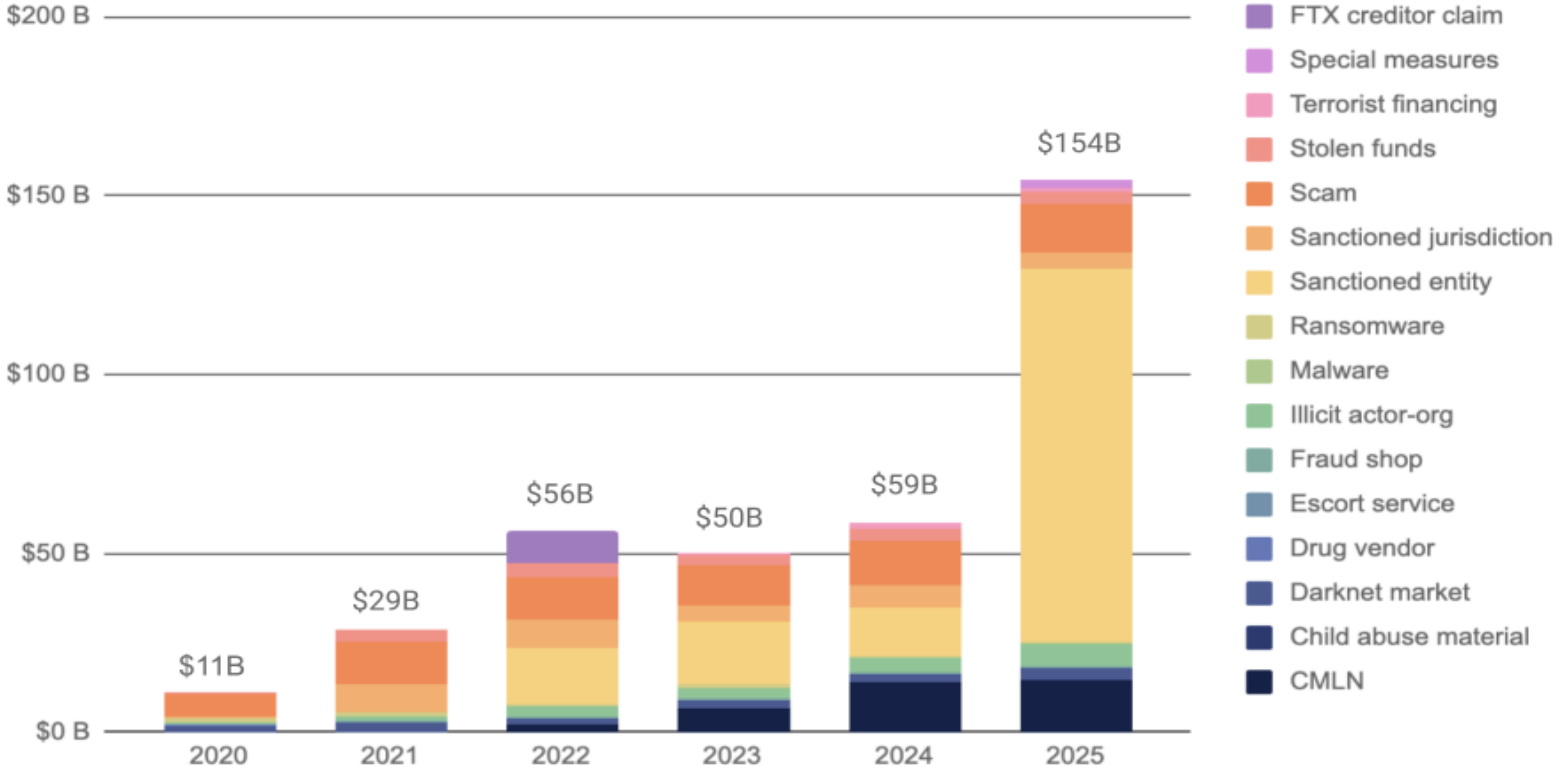


Net Flows



Illicit Finance

Total cryptocurrency value received by illicit addresses
2020-2025



© 2026 Chainalysis

\$154 bn

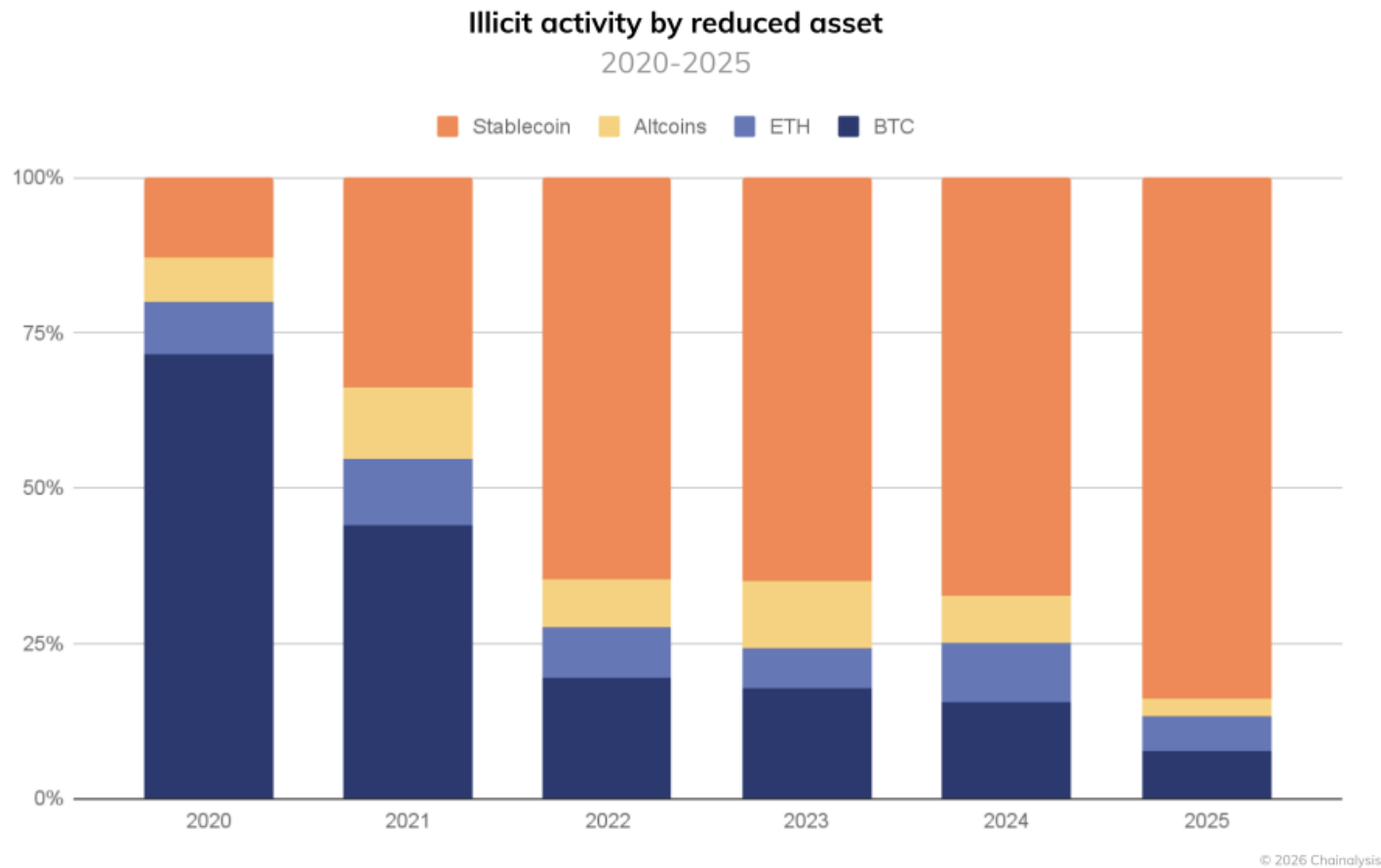
received by illicit crypto addresses in 2025

+162% year-over-year

\$104 bn from sanctioned entities

Source: Chainalysis Crypto Crime Report (2025).

New Tool for Illicit Finance



New Tool for Illicit Finance

- USD stablecoins increasingly replace Bitcoin for illegal cross-border flows — more liquid, easier to move
- 'Mixers' obscure the on-chain link between sender and recipient, potent with high-liquidity USDT
- Sanctions evasion: Russia A7A75 token ruble backed (\$90 bn transactions), North Korea (\$2 bn+), Iran (\$3 bn+)

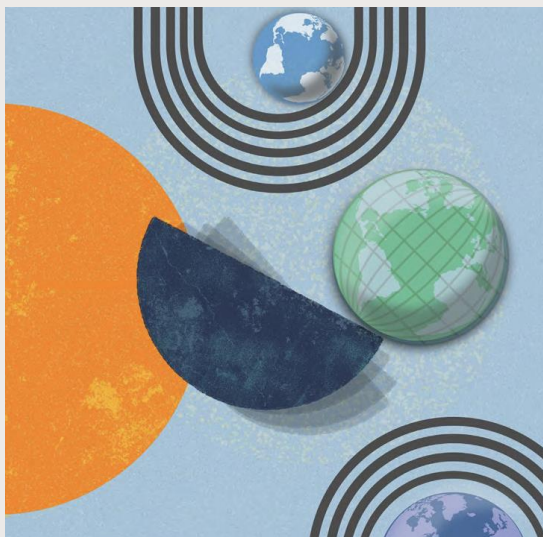
- Presentation based on **G7 Memo:**
<https://www.elysee.fr/en/G7evian/2026/03/30/g7-economists-memo-on-global-imbalances>

Background documents:

CEPR Bruegel Paris Report 4

<https://cepr.org/publications/books-and-reports/paris-report-4-new-global-imbalances>

- **CEPR Barcelona Report (Forth.)**



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