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International Financial Integration in a Changing Policy Context – the End of an Era?

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International financial integration has faced major changes and challenges since the 2008-09 global financial crisis. The crisis triggered a persistent contraction in international capital flows. Regulatory reforms and new macro-prudential frameworks have been reshaping international finance since the crisis. Financial flows are also affected by the unwinding of ultra-accommodative post-crisis monetary policies in advanced economies. Finally, protectionist attitudes have been on the rise, since the financial crisis, and already shape the agenda of a number of governments in advanced economies.

This special issue of the *Journal of International Money and Finance* consists of thirteen papers that provide new perspectives on key issues facing international financial integration. All papers were presented at a conference held at the European Commission in Brussels on March 1-2, 2018, organized by the *Journal of International Money and Finance*, the European Commission, CEPR, Tilburg University, Université Libre de Bruxelles, University of British Columbia, University of Southern California, and University of Wisconsin.

The first paper, by *Geert Bekaert* and *Arnaud Mehl* proposes a measure of international *equity* market integration based on the global correlation of stock returns. The authors argue that equity market integration has *not* declined after the Great Recession. The authors also provide empirical evidence consistent with the classical monetary policy trilemma, during the recent era of globalized capital markets.

The next three papers focus on international banking. *Isabel Schnabel* and *Christian Seckinger* provide an empirical analysis of the macroeconomic effects of European banking integration**.** The study finds that foreign bank presence in a given country significantly raises local GDP growth. That effect was markedly higher during the financial crisis than in normal times. This suggests that the post-crisis contraction of cross-country banking in Europe has generated significant output losses.

Robert McCauley, Agustín Bénétrix, Patrick McGuire and *Goetz von Peter* study financial de-globalization using BIS consolidated banking statistics organized by banks' *nationality*. The authors show that the post-crisis worldwide decline in cross-country banking was driven by European banks and their foreign branches and subsidiaries. Banks headquartered outside Europe continued to expand their global activities. The authors conclude that banking de-globalisation "is neither broad-based nor a trend".

Sangyup Choi and *Davide Furceri* provide an empirical study of the effect of country-specific macroeconomic/financial uncertainty shocks on cross-border banking. A rise in uncertainty in a given country is shown to trigger a fall in banking inflows and outflows, but the country's net cross-border banking position increases. Also, the share of cross-border bank lending in total bank lending increases, suggesting a portfolio rebalancing mechanism.

The next seven papers analyze the dynamics of global current accounts. *Hiro Ito* and *Robert McCauley* provide a currency view of global imbalances. The authors divide countries into currency zones according to the correlation of their currencies, and they construct current accounts for the main currency zones. The dollar zone current account has been close to balance, since the global financial crisis. The elevation of the renminbi to key currency status would worsen the dollar zone's current account.

Massimo Giovannini, Stefan Hohberger, Robert Kollmann, Marco Ratto, Werner Roeger and *Lukas Vogel* quantify the drivers of the persistent post-crisis improvement of Euro Area (EA) and US current accounts. Using an estimated dynamic general equilibrium model, the authors highlight the key contributions of the post-crisis commodity prices collapse, and of emerging market aggregate demand shocks, for the EA and US post-crisis current account reversals.

Beatrice Scheubel, Livio Stracca and *Cédric Tille* identify episodes of large capital flows to emerging markets driven by global conditions, and assess the efficacy of widely used policy tools for managing capital flows. The study finds that these macro-prudential tools have relatively modest effects, and that they mainly operate as a deterrent to destabilizing financial flows.

Scott Davis and *Andrei Zlate* document empirically that a monetary policy tightening in advanced economies triggers a contraction in net capital flows to emerging economies. The capital flows response is mitigated by an endogenous monetary policy tightening in emerging economies. That monetary policy reaction depends on the exchange rate regime and on capital account openness.

Andreas Fischer, Henrike Groeger, Philip Sauré and *Pinar Yeşin* highlight an anomaly in official current account statistics: retained earnings on portfolio equity holdings are *not* included in those statistics (while FDI retained earnings are recorded). The authors construct corrected current account series that include retaimed earnings on portfolio equity. The correction alters the current account adjustment, especially for financial centers.

Jonas Heipertz, Romain Rancière and *Natacha Valla* trace the evolution of domestic and external portfolios, at a sectoral level, for France. The authors also present an estimated model of balance-sheet contagion that reveals the key role of domestic and foreign security cross-holdings, for the transmission of real and financial shocks.

Alessandro Turrini and *Stefan Zeugner* estimate country-specific benchmarks for Net International Investment Positions (NIIP) of advanced and emerging economies. Two criteria are used in defining the benchmarks: consistency with economic fundamentals and prudence against the risk of external crises. Gaps between actual and benchmark NIIP help predict subsequent NIIP changes better than actual NIIP levels.

The remaining papers in this special issue study the effect of global *trade* developments for international finance. *Johannes Brumm, Georgios Georgiadis, Johannes Gräb* and *Fabian Trottner* concentrate on the rise in cross-border production networks. Using data for a panel

of advanced and emerging countries, the authors show that, for an individual country, stronger global value chain participation is associated with larger current account balances.

Jesper Lindé and *Andrea Pescatori* quantify the effects of protectionist trade policies using a New Keynesian model. The authors highlight the role of trade policy uncertainty and of the structure of global financial markets for the transmission of protectionist shocks. Model simulations suggest that the macroeconomic costs of a trade war can be substantial.