Core Model and Data Sources

Model Structure:

Sectors:

Stocks:

IIP

private sector debt

domestic asset prices

Transactions:

Cross-border credit as a proxy for international liquidity

Gourinchas and Obstfeld (2012) and Schularick and Taylor (2012).

Acharya, V.V., Schnabl, P., 2010. Do global banks spread global imbalances? Asset-backed commercial paper during the financial crisis of 2007–09. IMF Economic Review 58 (1), 37–73

Gourinchas, P.-O., Obstfeld, M., 2012. Stories of the twentieth century for the twenty-first. American Economic Journal: Macroeconomics 4 (1).

Schularick, M., Taylor, A. M., 2012. Credit booms gone bust: monetary policy, leverage cycles, and financial crises, 1870–2008. American Economic Review 102.

. In credit booms, asset values rise, improving balance sheets and facilitating the further expansion of credit. As a result, subsequent collapses are all the more traumatic. (The carry trade involves similar dynamics.) A capital inflow episode likewise may strengthen financial sector assets and even the NIIP in the receiving country in a way that pushes domestic borrowing beyond the point of true sustainability. This often sets the stage for a disorderly collapse later on. In diagnosing such situations, it is essential to keep the underlying credit flows in clear view Journal of International Money and Finance 31 (2012) 469–480 p 479

Adrian, Tobias and Hyun Song Shin (2010) ìLiquidity and Leverage,îJournal of Financial Intermediation, 19, 418-437

ESA 2010 p20

The **International Investment Position (IIP)** – effectively, the international balance sheet – is a *stock* account that shows at a given point in time:

The value of financial assets of residents of an economy that are claims on non-residents or are gold bullion held as reserve assets

The value of liabilities of residents of an economy to non-residents.

The **Balance of Payments (BoP)** is a *flow* statement that summarizes economic transactions between residents and non-residents during a specific time period. It consists of:

The **Current Account,** which further breaks down as shown below. The current account balance shows the difference between the sum of exports and income receivable and the sum of imports and income payable (exports and imports refer to both goods and services, while income refers to both primary and secondary income).

The **Goods and Services Account** which shows transactions in goods and services between residents and non-residents

The **Primary Income Account** which shows amounts payable and receivable in return for providing labour, financial resources, or non-produced non-financial assets to non-residents.

The **Secondary Income Account** which shows redistribution of income between residents and non-residents such as foreign aid.

The **Capital Account** records acquisitions and disposals of non-produced non-financial assets, such as land sold to embassies and sales of leases and licenses, as well as capital transfers, that is, the provision of resources for capital purposes by one party without anything of economic value being supplied as a direct return to that party.

The **Financial Account** shows net acquisition and disposal of financial assets and liabilities.

The sum of the balances on the current and capital accounts represents the net lending (surplus) or net borrowing (deficit) by the economy with the rest of the world which is equal to the net balance on the financial account. The financial account measures how the net lending and borrowing with non-residents is financed. The financial account

plus the ‘**other changes’** account explain the change in the IIP between the beginning and end of each period.

The **Other Changes in Financial Assets and Liabilities Accounts** reconcile the balance of payments and IIP for a specific period, by showing changes due to economic events other than transactions between residents and non-residents such as valuation changes or destruction of assets.