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Global Liquidity Is Having a Major Impact on Financial Stability and Economic Growth, Says Bank of Canada Governor Mark Carney

LONDON, United Kingdom—Large, abrupt fluctuations in global liquidity are having a major impact on global financial stability and economic growth, Bank of Canada Governor Mark Carney said today in a speech to the Canada-United Kingdom Chamber of Commerce. "Over the medium term, the continuation of such extreme liquidity cycles could ultimately threaten open capital markets and a free trading system if not better addressed," he warned**.**

Governor Carney described overall global liquidity conditions as the result of complex interactions among several factors, including macroeconomic policies (such as the monetary policy stance and exchange rate regime), microprudential regulations (such as capital and liquidity rules), financial market innovation and risk appetite.

Over the past five years, global liquidity has swung wildly from an "exuberant surge" to a "severe retreat" to a renewed flow of liquidity in response to massive monetary and fiscal policy stimulus, the Governor said. "Now the cycle is again turning. The ongoing deleveraging of the European banking system is reducing global liquidity."

The volatility of global liquidity, its intense procyclicality, and its impact on local and global economies all underscore the "value of the structural and cyclical policies that can dampen these cycles and channel the flows to their most productive uses," the Governor said.

The International Monetary Fund is playing an important role in the peripheral country programs, which could be expanded through further conventional, conditional lending, if required, Governor Carney said. Central banks remain best placed to address future surges and shortages in global liquidity. However, he stressed that "there is a premium on improved oversight and regulations that reduce the procyclicality of global liquidity and make the system more resilient."

Once it is fully implemented, the G-20's financial reform agenda will dampen global private liquidity cycles, the Governor said. "Measures that increase the resilience of financial institutions, such as the new Basel III capital and liquidity standards, will reduce the probability and frequency of a sudden liquidity shock. Measures that reduce the procyclicality of the financial system will help stabilise global liquidity flows."