Department of Finance Canada | Ministère des Finances Canada

Capital Flows and Potential Roles for Policy:

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Canada

Global economic and financial context of capital flow management issue

- **Capital flow management on/off agenda since 1990s:**
  - Most recently, Global Financial Crisis and aftermath.
- **With emergence of a global economic and financial system:**
  - Capital flows have become much larger, more volatile, faster and with more diverse sources (e.g., EMEs) and destinations (e.g., Africa).
- **Managing capital flows more complex:**
  - Rapidly changing nature of global financial markets;
  - Larger numbers of sovereign and private borrowers/issuers of credit; and,
  - Seismic policy changes—large-scale QE, uneven recoveries, etc.

Canadian experience with capital flows

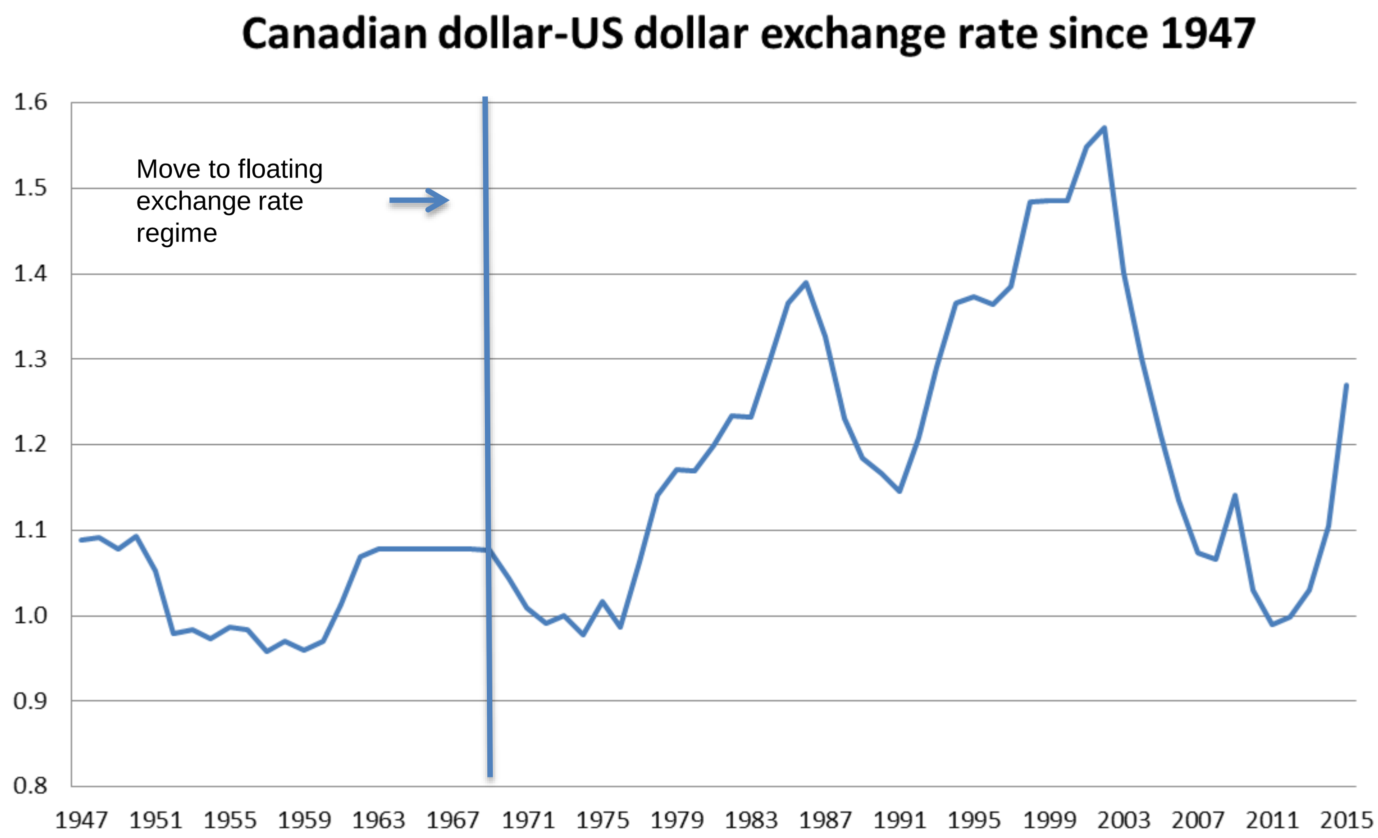
❑ The Canadian experience

- Driven by our own unique situation and "initial conditions":
  - Political & currency union of 13 provinces and territories with differing economic structures, resource endowments and degrees of integration with global economy.
- Practical policy necessities involved in pursuing growth and macroeconomic stability in a medium-sized open economy.

❑ Policy approach:

- Exchange rate as buffer versus changes in US/global growth, commodity prices, etc.
- Risks mitigated by capacity for debt issuance in domestic currency.
- Adjustment to global economic forces within stable macroeconomic and micro- and macro-prudential framework, rather than targeting capital flows.

Canada's long history with a floating exchange rate regime



Canadian experience with capital flows: Macro-prudential tools in Canada

- **Countercyclical Capital Buffer (CCB)**
  - Follows from Basel III regulatory reforms;
  - Under authority of Superintendent of Financial Institutions;
  - The CCB has never been employed.
- **Government-Backed Mortgage Insurance Tools**
  - Aimed at reducing housing market imbalances and protecting buyers and lenders;
  - Measures include: loan-to-value limits; caps on total and gross-debt-service ratios; and limits on amortization lengths;
  - Under the authority of the Minister of Finance.

Canadian experience with capital flows: Macro-prudential tools in Canada

Governance:

- **Institutionally Independent Model**
  - Allows financial oversight authorities to remain accountable towards their respective mandates;
  - Matters are discussed through a financial stability advisory committee; and,
  - Preliminary work is underway to conduct a review of the domestic framework and policy strategies.

Canadian views on capital flow management measures (CFMs)

- **Every country faces unique challenges and opportunities:**
  - Complexities involved in managing a modern, market-based and globally-integrated economy in the 21st Century;
  - Small and medium-sized open economies have fewer macroeconomic options than largest economies (policy-takers v policy-makers);
  - Full range of policies needs to be considered.

- **Canadian view thus broadly in line with IMF institutional view:**
  - Coping with capital flows begins with sound macro policies; but,
  - Certain circumstances in which CFMs can complement (but not replace) sound and adaptive macro policies.

Capital Flow Management Measures: Bottom Lines

- **CFMs an issue for all countries:**
  - Particularly small and medium-sized open economies.
- **CFMs can complement but not replace sound macro policies:**
  - CFMs should be timely, targeted and transparent.
- **Need to strike appropriate balance:**
  - Small and medium-sized economies need flexibility to cope with surges in capital inflows or outflows; but,
  - Policymakers must avoid devolution of global economy into patchwork of capital flow free v capital restricted zones.
- **CFMs issue ongoing—no universally-accepted "mantra", and will need to be informed by:**
  - Ongoing country experiences;
  - IMF stock-taking exercise; and,
  - G20 IFA Working Group under Korean and French leadership

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