

- Comments on “ Managing Capital Flows: Some Considerations Based on the Fund’s Institutional View ”

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# Too much finance?

- After the global financial crisis, there has been rethinking in many areas.
- Nonlinear effects of financial development
  - Financial development and growth
  - Financial development and stability

# Too much financial liberalization?

- IMF's view on financial liberalization has been changed.
- Before GFC
  - Financial liberalization can have more benefits than costs
  - The costs can be minimized by sound macroeconomic policies and deeper financial development

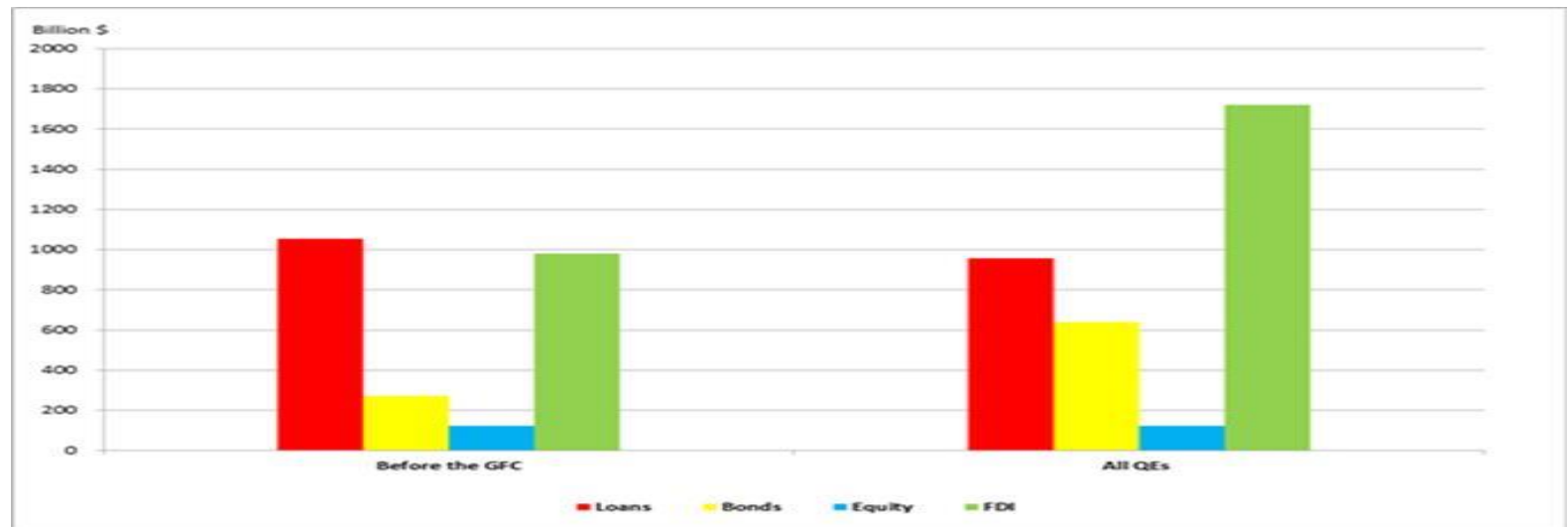
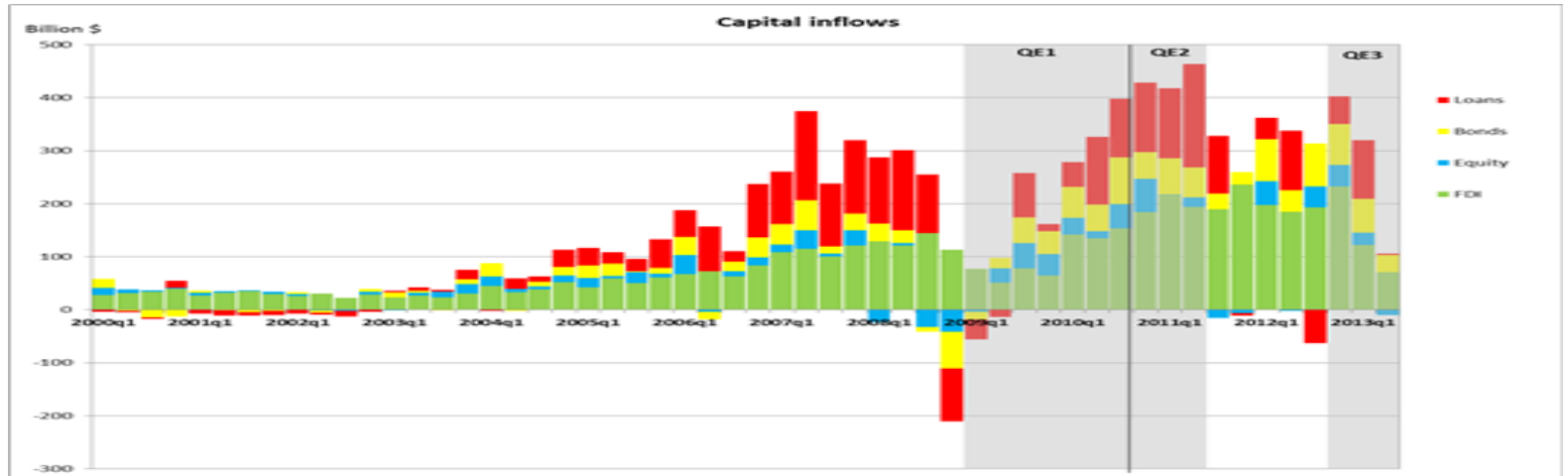
# Too much financial liberalization?

- After GFC – IMF’s institutional view
  - Liberalization needs to be well planned, timed, and sequenced in order to ensure that its benefits outweigh the cost
  - In certain circumstances, capital flow management measures can be useful. They should not, however, substitute for warranted macroeconomic adjustment.

## Three Comments

- (1) Recent Developments of Capital Flows
- (2) Taper Tantrum and Capital Flows
- (3) Capital Controls vs. Macroprudential Policies

# (1) Recent Developments of Capital Flows



# (1) Recent Developments of Capital Flows

- Total capital flows into developing countries during QEs are comparable to those before Global Financial Crisis.
- While bank-led flows – i.e. loans – dominated before GFC, they shrank and other flows – i.e. bonds, and FDI – rose after the crisis.

## (2) Taper Tantrum and Capital Flows

- Since substantial QE reversal (or increase in interest rate in the U.S.) has yet started, it is not easy to assess its impact.
- In May 2013, then the Fed Chairman Ben Bernanke's unexpected tapering talk has triggered a sharp exchange rate depreciation in some emerging economies.



# Factors Associated with Exchange Rate Depreciation during Taper Tantrum

Dependent Variable	Percent Change in Nominal exchange rate							
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Increase in Current Account Deficit, 2010-12	0.023*** [0.005]	0.023*** [0.005]	0.024*** [0.005]	0.023*** [0.006]	0.025*** [0.006]	0.024*** [0.006]	0.026*** [0.006]	0.025*** [0.006]
Average annual %Change in Real Exchange Rate, 2009-2012	-0.537*** [0.116]	-0.504*** [0.115]	-0.479*** [0.114]	-0.466*** [0.119]	-0.543*** [0.116]	-0.511*** [0.117]	-0.489*** [0.115]	-0.476*** [0.120]
Increase in Credit to GDP ratio, 2009-2012	0.097** [0.040]	0.108*** [0.040]	0.083* [0.041]	0.099** [0.043]	0.099** [0.040]	0.109*** [0.040]	0.085** [0.042]	0.102** [0.043]
Log of Average Inflows of Bond, Equity, Loans 2010-2012	0.438* [0.257]	0.442* [0.250]	0.224 [0.304]	0.549** [0.272]	0.507* [0.269]	0.481* [0.262]	0.297 [0.314]	0.621** [0.283]
Reserves/M2, 2012	3.321 [2.428]	3.556 [2.226]	2.451 [2.377]	3.133 [2.461]	3.327 [2.434]	3.613 [2.247]	2.557 [2.383]	3.231 [2.468]
Real GDP 2012, percent Change	0.031 [0.163]				0.049 [0.165]			
Inflation (CPI), 2012		0.164* [0.094]				0.153 [0.097]		
Exchange Rate Regime, 2012			0.949** [0.463]				0.941** [0.464]	
Rule of Law, 2012				-0.085 [0.689]				0.007 [0.697]
Asia					-1.299 [1.470]	-0.785 [1.442]	-1.393 [1.488]	-1.452 [1.572]
R <sup>2</sup>	0.691	0.718	0.677	0.647	0.696	0.72	0.683	0.653
Observations	51	50	52	52	51	50	52	52

Source: Park and Shin (2015)

- Economic fundamentals such as foreign reserves, GDP growth, and government budget deficit did not affect exchange rate depreciation during QE taper tantrum. (an exception was inflation): Eichengreen and Gupta (2013)
- Domestic credit expansion and actual capital flows have a significant effect: Park and Shin (2015)
- Countries receiving capital flows in the form of bank loans and equity are particularly vulnerable.

# Different types of capital flows

Dependent Variable	Percent Change in Nominal exchange rate			
	[1]	[2]	[3]	[4]
Increase in Current Account Deficit, 2010-12	0.018*** [0.006]	0.017*** [0.005]	0.024*** [0.005]	0.019*** [0.005]
Average annual %Change in Real Exchange Rate, 2009-2012	-0.714*** [0.135]	-0.755*** [0.125]	-0.708*** [0.137]	-0.673*** [0.129]
Increase in Credit to GDP ratio, 2009-2012	0.048 [0.041]	0.041 [0.039]	0.077* [0.041]	0.076* [0.038]
Log of Portfolio Liability 2011	-0.217 [0.240]	-0.209 [0.196]	-0.099 [0.236]	-0.027 [0.185]
Reserves/M2, 2012	4.855** [2.261]	4.428** [2.085]	4.445* [2.326]	5.766** [2.158]
Inflation(CPI) 2012	0.172 [0.113]	0.146 [0.101]	0.224** [0.109]	0.196* [0.103]
Capital Flows during QE (Loans)	0.316 [0.370]	0.655*** [0.202]		
Capital Flows during QE (Bonds)	0.079 [0.261]		0.343 [0.245]	
Capital Flows during QE (Equity)	0.447 [0.353]			0.797*** [0.265]
R <sup>2</sup>	0.821	0.812	0.771	0.807
Observations	44	46	46	44

### (3) Capital Controls vs. Macroprudential Policies

- Two types of capital flow management measures.
  - (1) Capital controls: Restrictions on cross-border financial activity that discriminate based on residency
  - (2) Macroprudential measures: Regulation on cross-border or foreign-currency exposure and lending without discriminating based on residency.

# Are CFMs effective?

- Most papers have found little or mixed evidence of capital controls, but there is stronger evidence that they can significantly affect the composition of capital flows and specific measures of financial vulnerability. (Forbes et al. (2015))
- The empirical evidence on the effectiveness of macroprudential measures is scant (Blanchard et al. (2013))
- Macroprudential regulations appear to be more effective than capital controls in improving financial stability (Forbes et al. (2015)).

# CFMs and Taper Tantrum

Dependent Variable	Percent Change in Nominal exchange rate				
	[1]	[2]	[3]	[4]	[5]
Increase in Current Account Deficit, 2010-12	0.018*** [0.006]	0.018*** [0.006]	0.018*** [0.006]	0.018*** [0.006]	0.018*** [0.006]
Average annual %Change in Real Exchange Rate, 2009-2012	-0.746*** [0.124]	-0.751*** [0.131]	-0.721*** [0.128]	-0.765*** [0.126]	-0.743*** [0.125]
Increase in Credit to GDP ratio, 2009-2012	0.040 [0.038]	0.038 [0.041]	0.062 [0.038]	0.034 [0.040]	0.050 [0.039]
Log of Portfolio Liability, 2011	-0.335 [0.222]	-0.345 [0.232]	-0.151 [0.211]	-0.349 [0.232]	-0.199 [0.211]
Reserves/M2, 2012	3.820* [2.090]	3.845* [2.186]	4.700** [2.143]	3.049 [2.050]	3.075 [2.080]
Inflation (CPI), 2012	0.184* [0.099]	0.185* [0.103]	0.174* [0.101]	0.180* [0.102]	0.176* [0.103]
Capital Flows (QE1)		0.157 [0.364]	0.396*** [0.137]		
Capital Flows (QE2)		0.390 [0.735]		0.677*** [0.206]	
Capital Flows (QE3)		0.132 [0.368]			0.540*** [0.187]
Capital Flows (QE1~ QE3)	0.219*** [0.061]				
Macroprudential	-0.192 [0.949]	-0.055 [1.140]	-0.624 [0.887]	0.004 [0.992]	-1.014 [0.924]
Capital Controls (Outflows)	-1.542 [1.123]	-1.569 [1.193]	-1.502 [1.146]	-1.584 [1.160]	-1.103 [1.177]
Capital Controls (Inflows)	-0.584 [1.317]	-0.631 [1.372]	-0.308 [1.355]	-0.544 [1.365]	-0.167 [1.363]
R <sup>2</sup>	0.837	0.837	0.821	0.816	0.801
Observations	44	44	46	46	48

- The coefficients of *macroprudential measures*, and *capital controls (inflows and outflows)* are all negative, but no coefficient is statistically significant.
- It would be better to use the macroprudential policies as preemptive measures.
- They should be used in limiting the appreciation of the real exchange rate and restraining domestic credit expansion when a country experiences capital inflows.
- Shin and Bruno (2013): Korea's case

## Conclusion

- It is an interesting presentation.
- After a country receives excessive capital inflows, policies are limited.
- Preemptive macroprudential measures seem to be more promising than direct capital controls.
- More analyses are needed on the effectiveness of CFMs.