

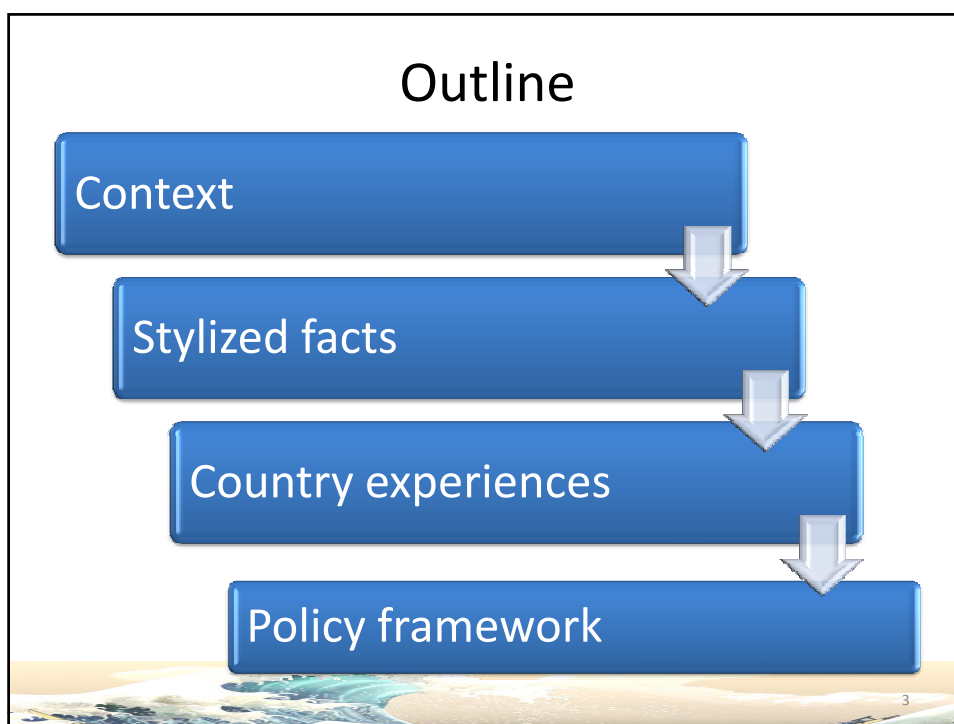
Recent Experiences in Managing Capital Inflows: Cross-Cutting Themes and Possible Policy Framework

Outreach Mission
April 2011

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Context

Context

- Many countries facing capital inflow surges, posing macroeconomic and financial stability challenges in some cases
- Policy responses have varied across countries, in part due to differences between countries and nature of capital inflows
- Need for a conceptual framework to weigh different policy choices
- Part of broader and ongoing work agenda on cross-border flows

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Context

Objectives

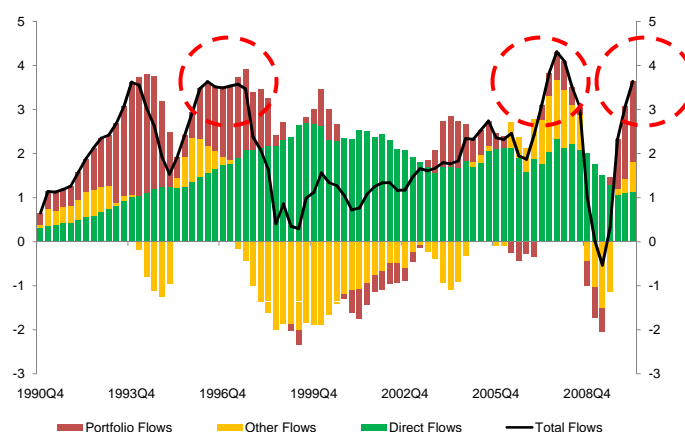
- Provide stylized facts about capital flows
- Review country experience with capital inflows and policy responses
- Develop a policy framework for managing capital inflows
- Offer a menu of policy options to respond to capital inflows under various circumstances

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Stylized Facts

Capital flows to EMs close to all-time high

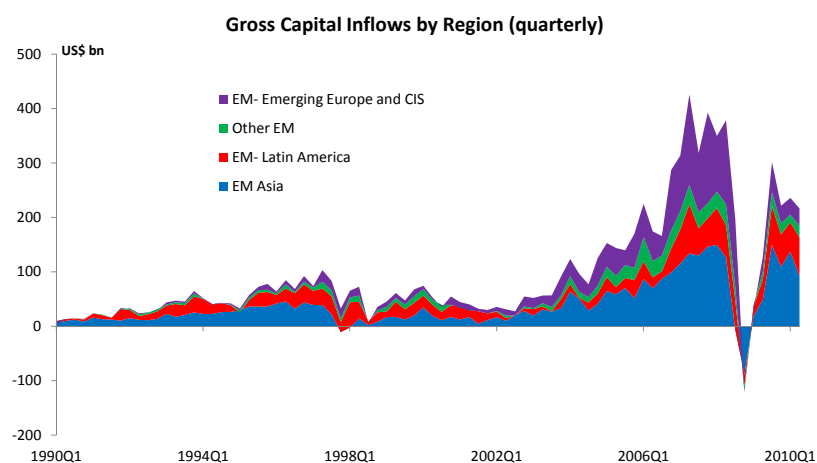
Net Inflows - All EM countries
(Percent of GDP)



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Stylized Facts

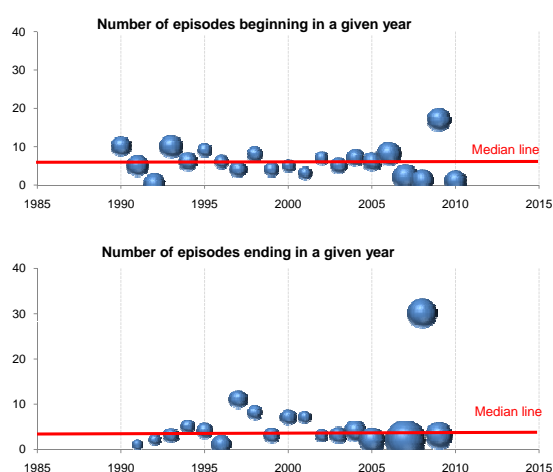
Latin America and Asia are leading the pack



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Stylized Facts

Inflow episodes start at different times but often end together



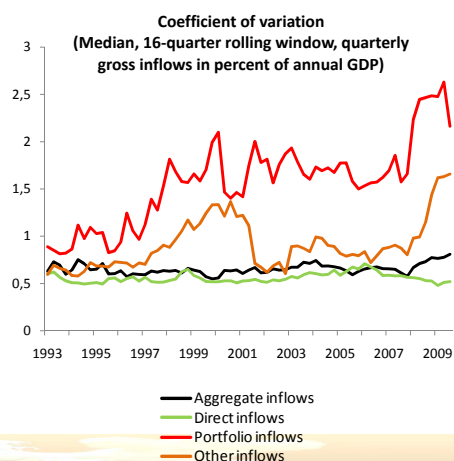
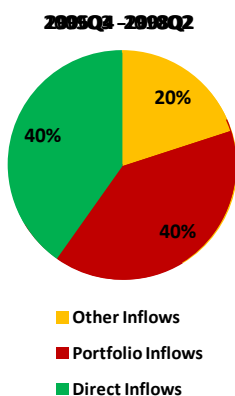
Size of the bubble corresponding to the number of countries with an exchange rate market pressure index larger than the 75th percentile of the whole sample.

Size of the bubble corresponding to previous year's total inflows into EMs.

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Stylized Facts

Portfolio flows dominant this time round and more volatile historically



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Stylized Facts

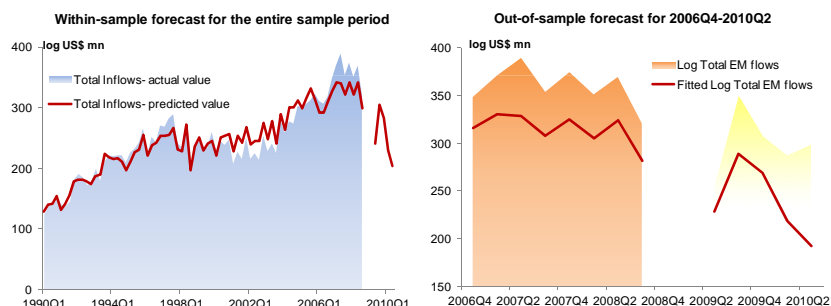
Push and pull factors that explain flows

	Cyclical	Structural
Push	<ul style="list-style-type: none"> - Low US interest rates - Low global risk aversion - Strained AE balance sheets 	<ul style="list-style-type: none"> - International portfolio diversification - Low AE potential growth

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Stylized Facts

Capital flows to EMs reflect a combination of push and pull factors

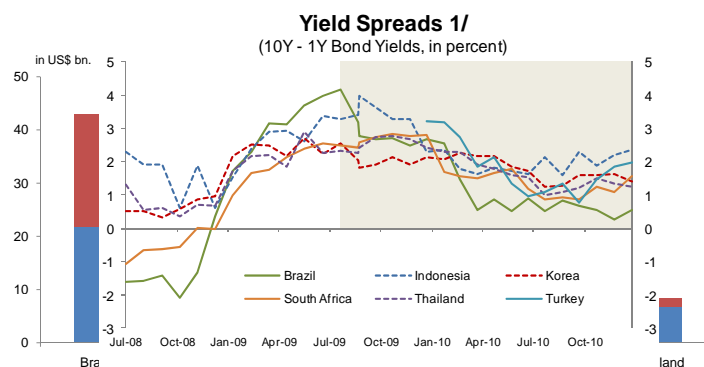


- Push factors
 - U.S. interest rate
 - Global risk aversion
- Pull factors
 - Growth potential
 - Market size
 - Openness
 - Other country-specific factors

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Country Experiences

EMs share common features in terms of inflows and their impact










Source: Bloomberg.
1/ Shaded area represents most recent wave of capital inflows.

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Country Experiences

Selected Countries: Macro Conditions

	Magnitude of Net Inflows Average in the last wave of inflows (Percent of GDP)	Composition of Net Inflows Red = Portfolio flows, Orange = Other flows, Green = FDI	Inflation Percent y/y, average of last 6 months	Real Credit Growth Percent y/y, average of last 6 months
Brazil	6.2		5.0	12.9
Indonesia	2.6		6.2	9.2
Korea	1.9		3.3	0.4
Peru	5.9		2.1	9.3
South Africa	6.6		3.6	-0.1
Thailand	5.0		3.1	4.3
Turkey	6.9		7.9	21.4

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Country Experiences

Selected Countries: Policy Responses

	Currency Appreciation Percent change in the NEER from the trough since the crisis	Reserve Increase Increase in percent of GDP from the trough since the crisis	Monetary Policy Change in policy rates in the recent wave	Fiscal Policy Change in cyclically adjusted fiscal stance between 2009-10	CFMs
Brazil	38.4	6.0	↑	↔	Yes
Indonesia	19.4	7.4	↑	↔	Yes
Korea	17.5	10.7	↑	↔	Yes
Peru	5.6	9.0	↑	↔	Yes
South Africa	41.4	2.6	↓	↔	No
Thailand	9.3	22.3	↑	↔	Yes
Turkey	6.5	1.7	↓	↔	Yes

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Key Elements of Framework

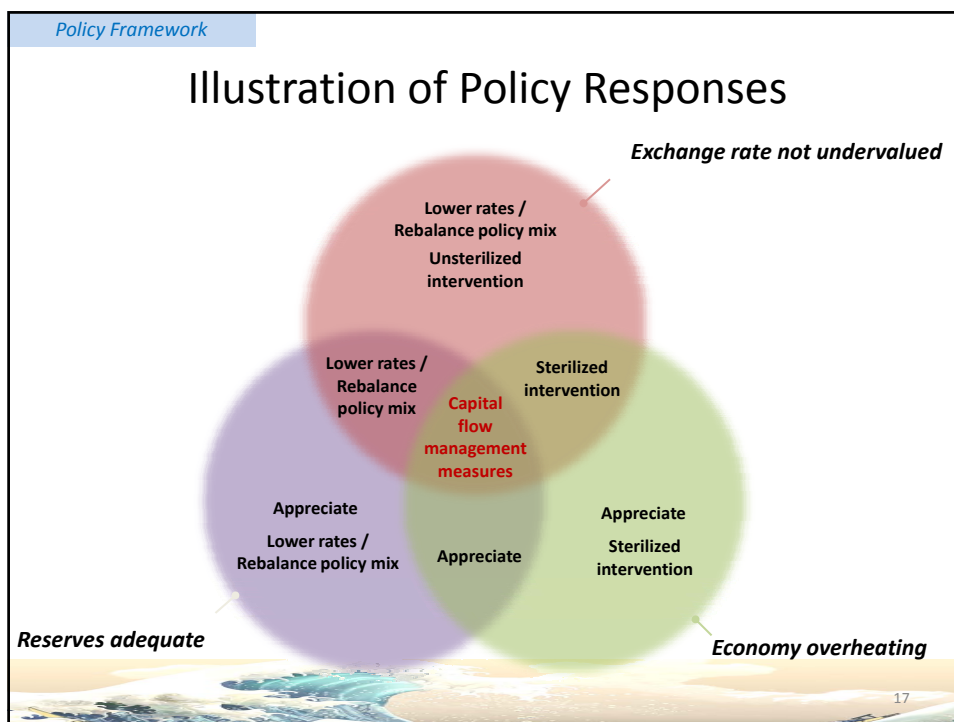
- Policy responses depend on country circumstances
- Prudential and structural measures to strengthen capacity to absorb capital flows always encouraged
- No substitutes for right macroeconomic policies
- Capital flow management measures (CFMs), including taxes, certain prudential measures, and capital controls, are part of policy toolkit
- CFMs could help address macro and financial stability risks related to inflows under certain circumstances

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Appropriate Macro Policy Responses

- Allow exchange rate to appreciate when it is undervalued
- Accumulate reserves to adequate prudential levels
- Rebalance monetary/fiscal policy mix
 - *Lower policy rates consistent with inflation objectives and when overheating not a concern*
 - *Tighten fiscal policy if procyclical*

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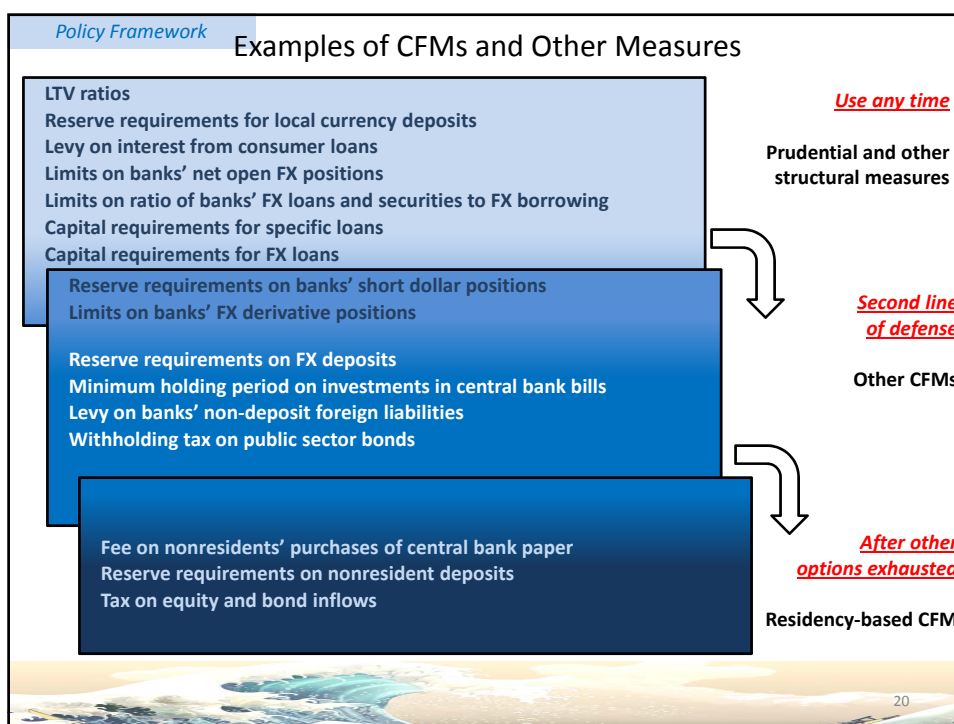
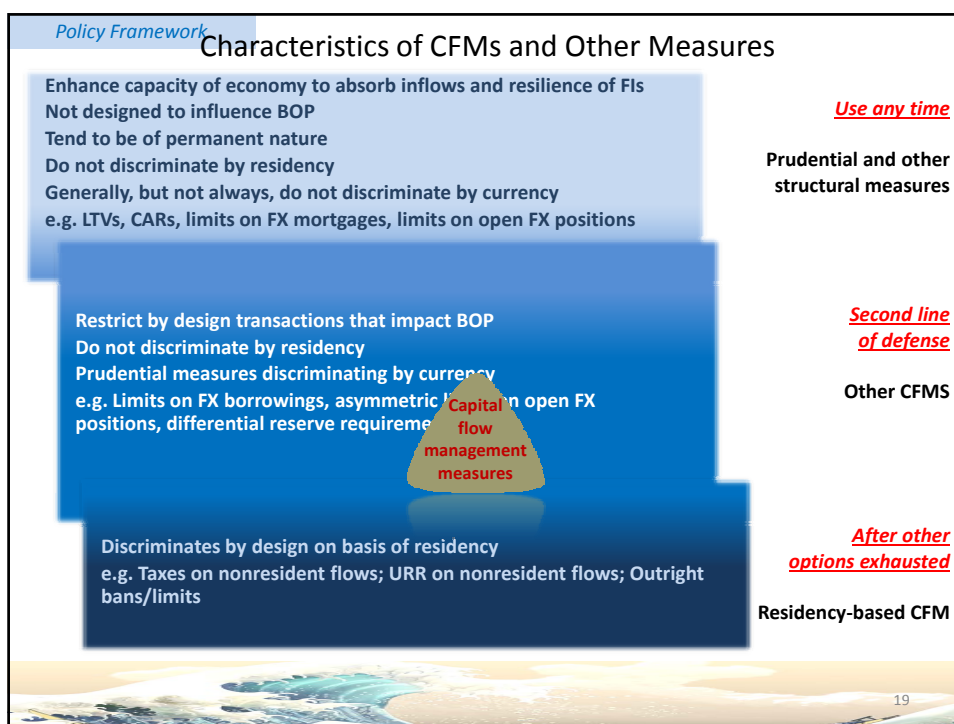
Policy Framework

CFMs appropriate under certain circumstances

- CFMs: Measures designed to influence capital inflows
- Appropriate macro conditions are in place
 - *Exchange rate is not undervalued*
 - *Reserves are more than adequate*
 - *Overheating/inflation concerns preclude monetary easing*
 - *Fiscal policy is not procyclical*
- Could complement fiscal tightening plans that are already in place

Capital flow management measures

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Some Considerations in Design and Implementation of CFMs

- Non-residency-based CFMs generally preferable
- Intensity should match specific macroeconomic or financial stability concerns in question
- Withdrawn when risks recede
- Maximize efficiency and minimize costs/distortions
- Depend on country-specific circumstances (e.g. administrative and regulatory capacity)

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Application of Framework

- **Key objective:** Develop a framework to help countries manage large capital inflows
- **Intended use of framework**
 - Inform policy advice to all members in a consistent, evenhanded, and predictable way
 - Give due regard to country-specific circumstances and external setting
 - Adapt framework based on experience
 - Other elements of agenda on capital flows
 - Together: help sharpen surveillance

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Ongoing and Next Steps

- Further analysis of effects of source countries' policies, including upcoming spillover reports
- Multilateral effects of macroprudential policies and CFMs
- Capital outflows and capital account liberalization

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For further information:

www.imf.org

www.imf.org/external/np/pp/eng/2011/021411a.pdf

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