



BANK FOR INTERNATIONAL SETTLEMENTS

Comments on Ocampo "Macroeconomic vulnerability and reform: Managing pro-cyclical capital flows"

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Major points of Ocampo's paper

- Capital flows are pro-cyclical and challenge monetary and financial stability.
- Fiscal policy should move toward surplus in upswing but often is instead pro-cyclic (“hand to mouth”).
- Monetary policy has a hard time leaning against capital-flow fuelled upswing without destabilising exchange rate.
- This leaves capital account restrictions and foreign exchange intervention to create room for monetary policy and to help limit the roll-over risk of foreign liabilities.
- More work needs to be done on macro-prudential regulation.



Several questions

- Are capital flows increasingly pro-cyclical and, if so, why?
- Does the ownership of the export sector matter for the ability to use fiscal policy? Is fiscal policy counter-cyclic in Asia?
- What challenges will monetary policy face with zero interest rates in the dollar and the yen?
- Are the costs of foreign exchange intervention in Asia lower than in Latin America?
- Can we conceive of macro-prudential regulation beyond LTVs, pro-cyclic capital ratios and forward-looking provisioning?

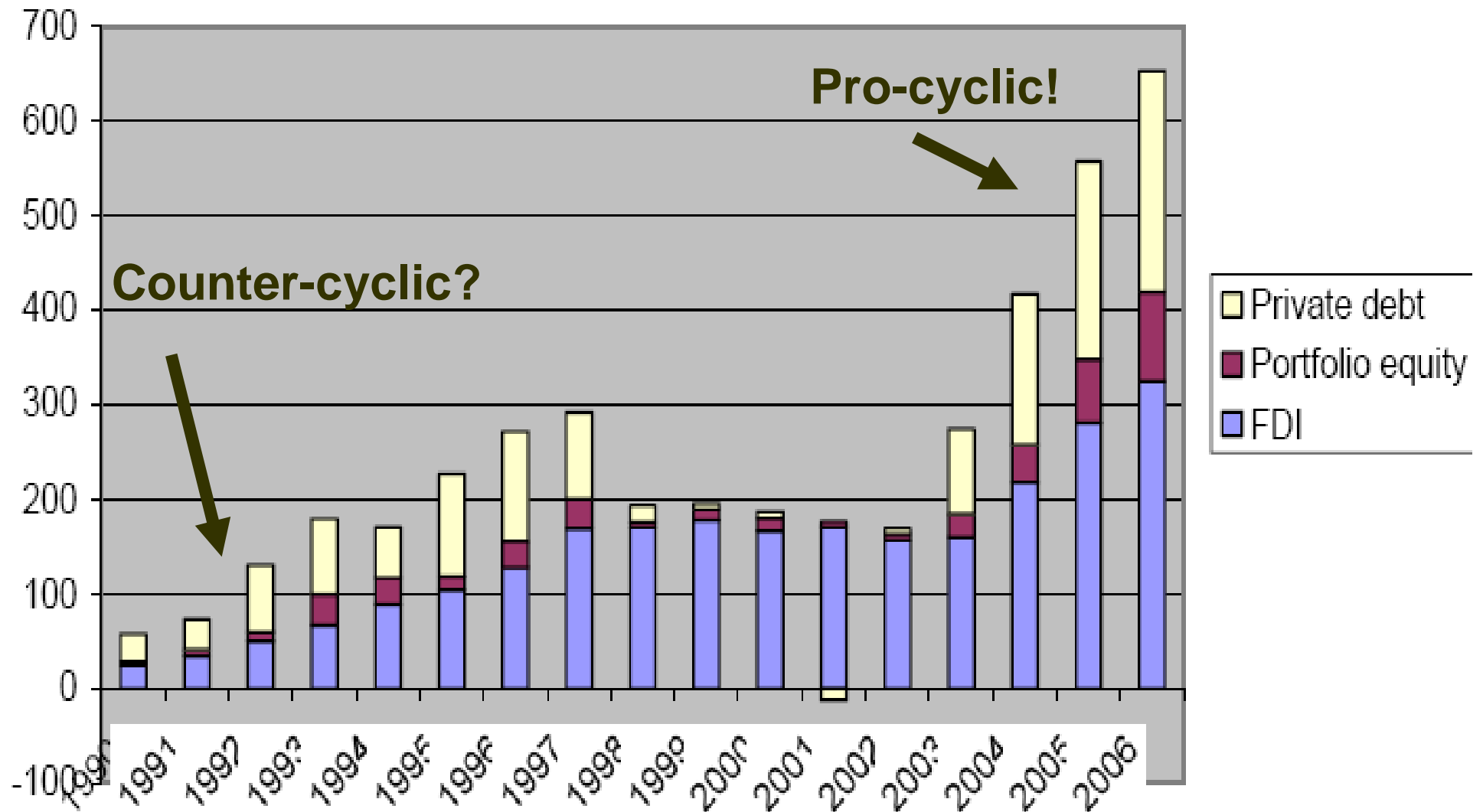


Are capital flows increasingly pro-cyclical and, if so, why?

- Kindleberger argued that mature creditor countries lend long-term abroad during slumps.
 - UK before 1913.
 - US in early 1990s?
- Kindleberger argued that immature creditors withdraw funds during slumps.
 - US 1930s.
 - Japan 1990s (but not Asia in early years).
- Why are global investors acting with less maturity?
 - They are more leveraged (US households too)?
 - US is leveraged investor?

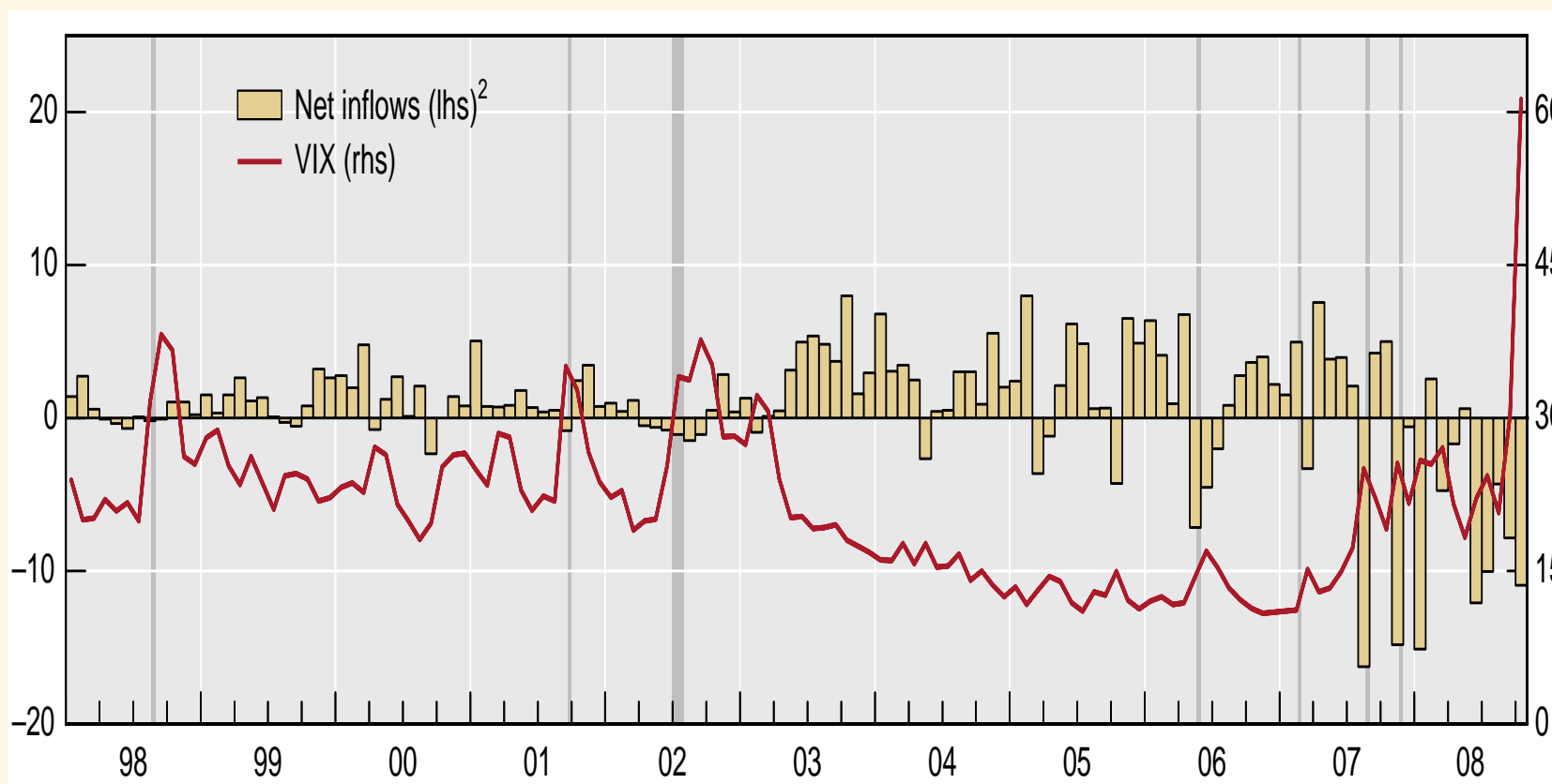


Private capital flows to developing countries





Global volatility and Asian net equity inflows





Does the ownership of the export sector matter for the ability to use fiscal policy?

Is fiscal policy counter-cyclic in Asia?

- Distinguish state-owned resource exporters (oil exporters, Chile) from private mines (So Africa, Australia) from smallholders (eg Thailand).
- In first case, state can keep boom revenues out of economy and save in sovereign wealth fund, stabilise investment.
- Harder for government to share in boom in latter 2 cases, leaving borrowing to finance intervention?



Does the ownership of the export sector matter for the ability to use fiscal policy? **Is fiscal policy counter-cyclic in Asia?**

- Ocampo suggests: “In East Asia, fiscal policies have been mixed, though rarely countercyclical”.
- Finding of China as acyclical vs Asian financial crisis response:
 - Test for post 1979 rather than 1960-2003?
 - Problem with growth figures?
- India?
- Korea shows countercyclic policy and is loosening.
- Thailand: 100 billion baht stimulus on the way.



What challenges will monetary policy face with zero interest rates in the dollar and the yen?

- Ocampo's argument implies that "parity" interest rates would be low in this scenario (unless depreciation expected).
- Is the emphasis on interest rates misplaced? Do equity flows matter more for Asia, and thus the performance of major stock markets rather than interest rates?
- Or will capital flows remain weak while US interest rates very low (procyclic)?
- Or will dilemma get worse with very low dollar rates?



Are the costs of foreign exchange intervention in Asia lower than in LatAm?

- Ocampo highlights “quasi-fiscal costs”.
- Asian inflation record and interest rates tend to be lower than in Latin America.
- As a result, much of the much larger Asian reserve accumulation occurred in places and at a time when the carrying cost was low or even negative.
- Will Asia, however, eventually pay?
 - Valuation losses have receded as an issue with dollar strength.
 - But could re-emerge even as low US dollar interest rates produce carrying costs.



Aside on reserve adequacy

- Ocampo: “A precautionary demand for international reserves that is proportional to total external liabilities”.
- Agree: In practice, reserves held against some fraction of equity holdings by non-residents (who give themselves a haircut on the way out the door).
- Agree: In practice reserves also held against bond market holdings of non-residents, eg Indonesia.
- Disagree: “External” ie cross-border. European banks have needed dollars for global consolidated positions—dollars borrowed in Hong Kong, London, New York.



Macro-prudential regulation beyond LTVs, pro-cyclic capital ratios and forward-looking provisioning?

- Worth learning from Asia?
 - Debt/ debt service limits in relation to income for credit card borrowing in Thailand.
 - Higher capital ratios for household debt when these were growing fast in India.
 - Tax deductibility of debt to foreign affiliates for foreign banks in Korea.
- Rule-based macro-prudential regulation, or discretion?