



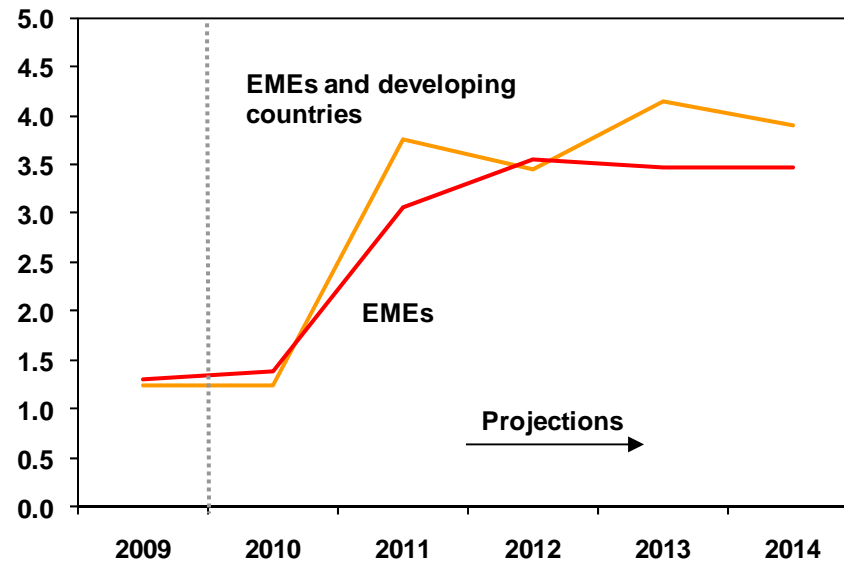
# Managing Procyclicality: The Case of Capital Inflows

*Remarks at Bank of Thailand International Symposium*

*Karl Habermeier  
International Monetary Fund  
October 15, 2010*

# Capital Flows Back on the Radar Screen

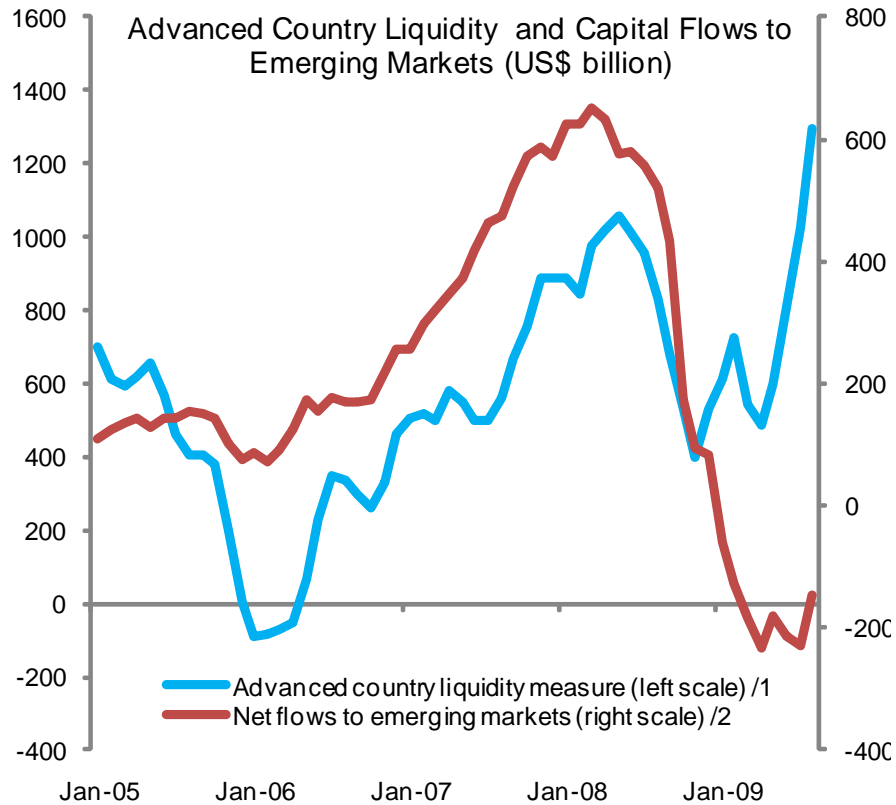
Net private capital inflows to EMEs (in percent of GDP)



Source: IMF's WEO database.

- Macroeconomic and prudential challenges
- Capital controls again in the news

# Capital inflows, a practical issue

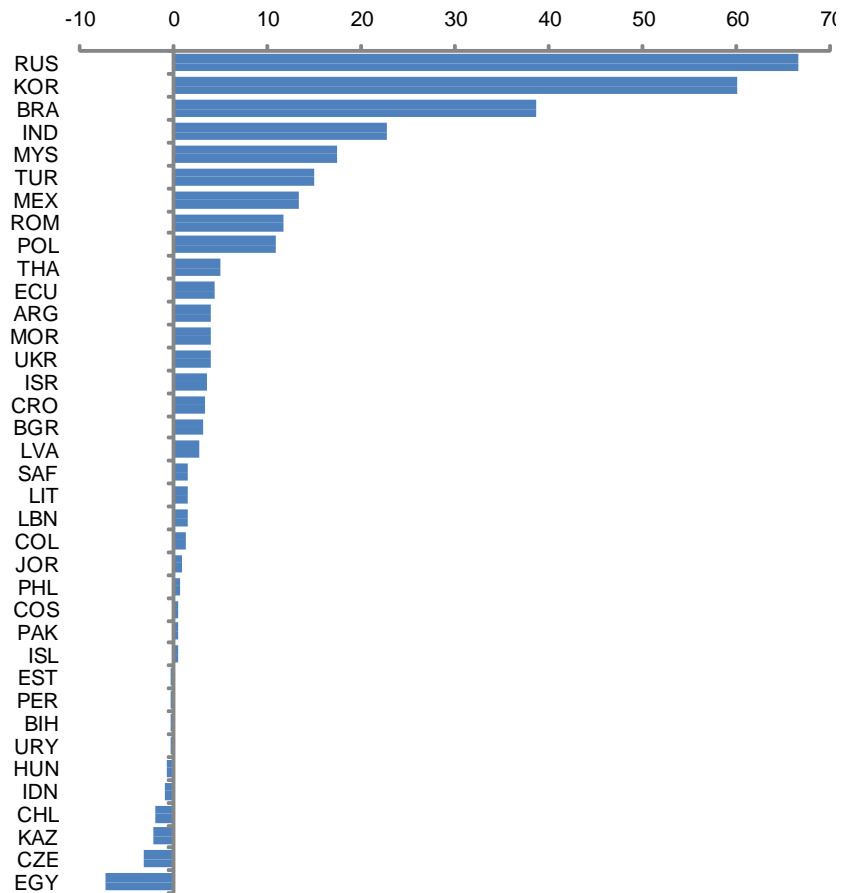


Source: International Financial Statistics, and IMF staff calculations

/1 Annual change in the three-month moving average of money base in Canada, the euro area, Japan, United States and the United Kingdom (expressed in US\$).

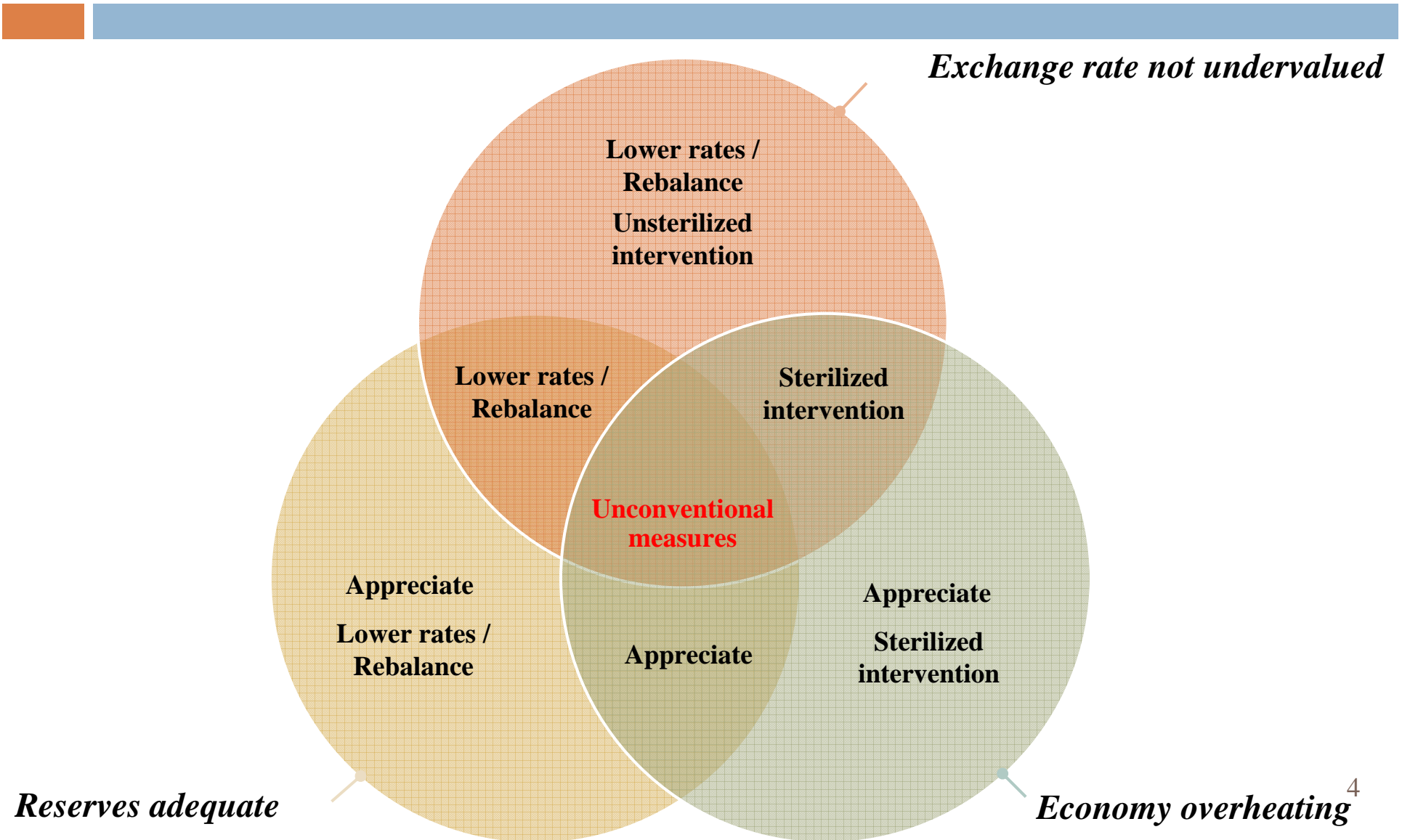
/2 Net capital flows to emerging and developing countries (twelve-month rolling windows). Net capital flows are measured from an index that is a proxy for the financial account balance. It is constructed as the difference between the change in reserves and the trade balance.

Recent Changes in Capital Flows 1/  
(latest six months vs previous six months, in \$ billion)



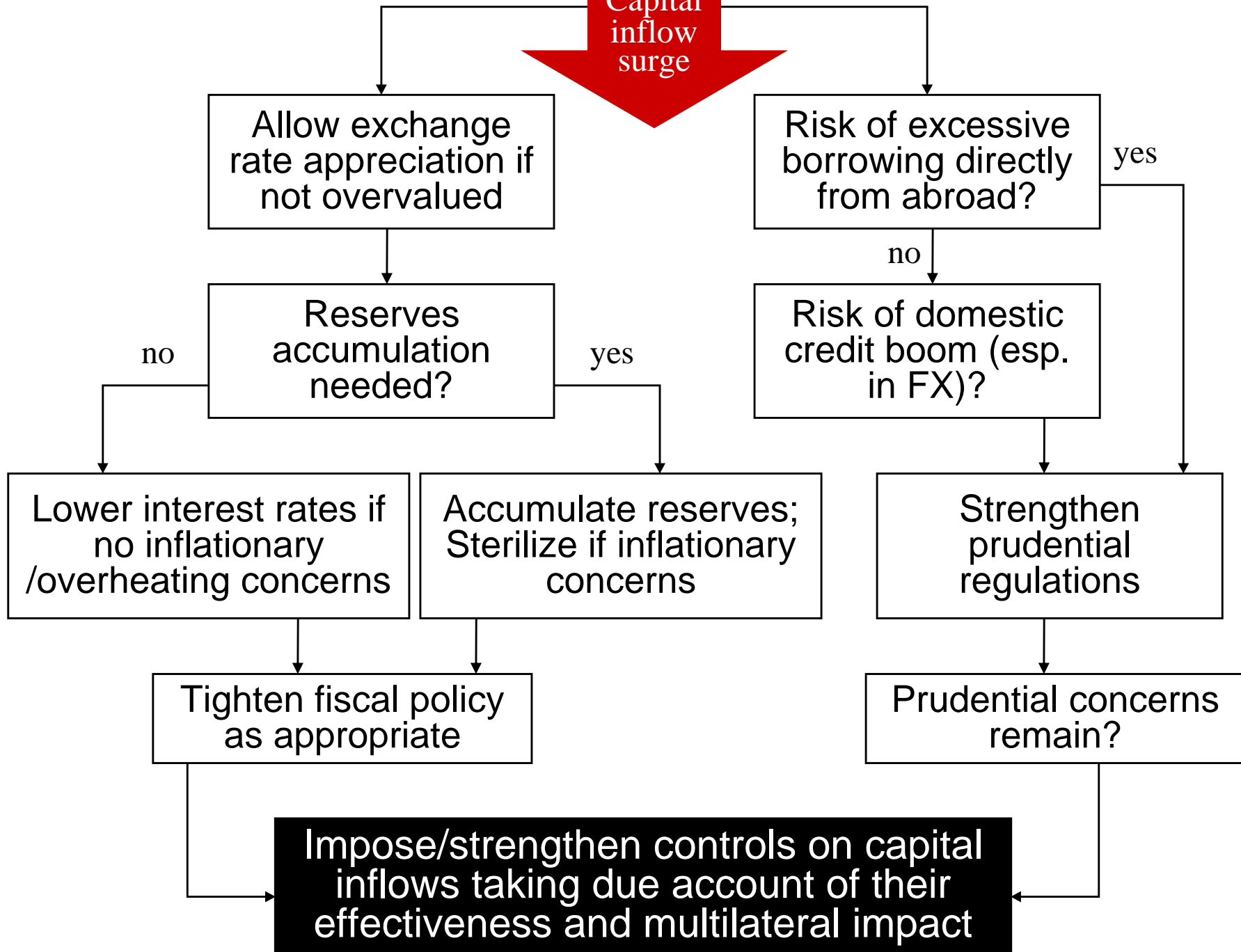
1/ Index is a proxy for the financial account balance. It is constructed as the difference between the change in reserves and the trade balance.

# Towards a consistent framework...



**Macroeconomic Considerations**

**Prudential Concerns**



**Macroeconomic Considerations**

**Prudential Concerns**



Allow exchange rate appreciation if not overvalued

Reserves accumulation needed?

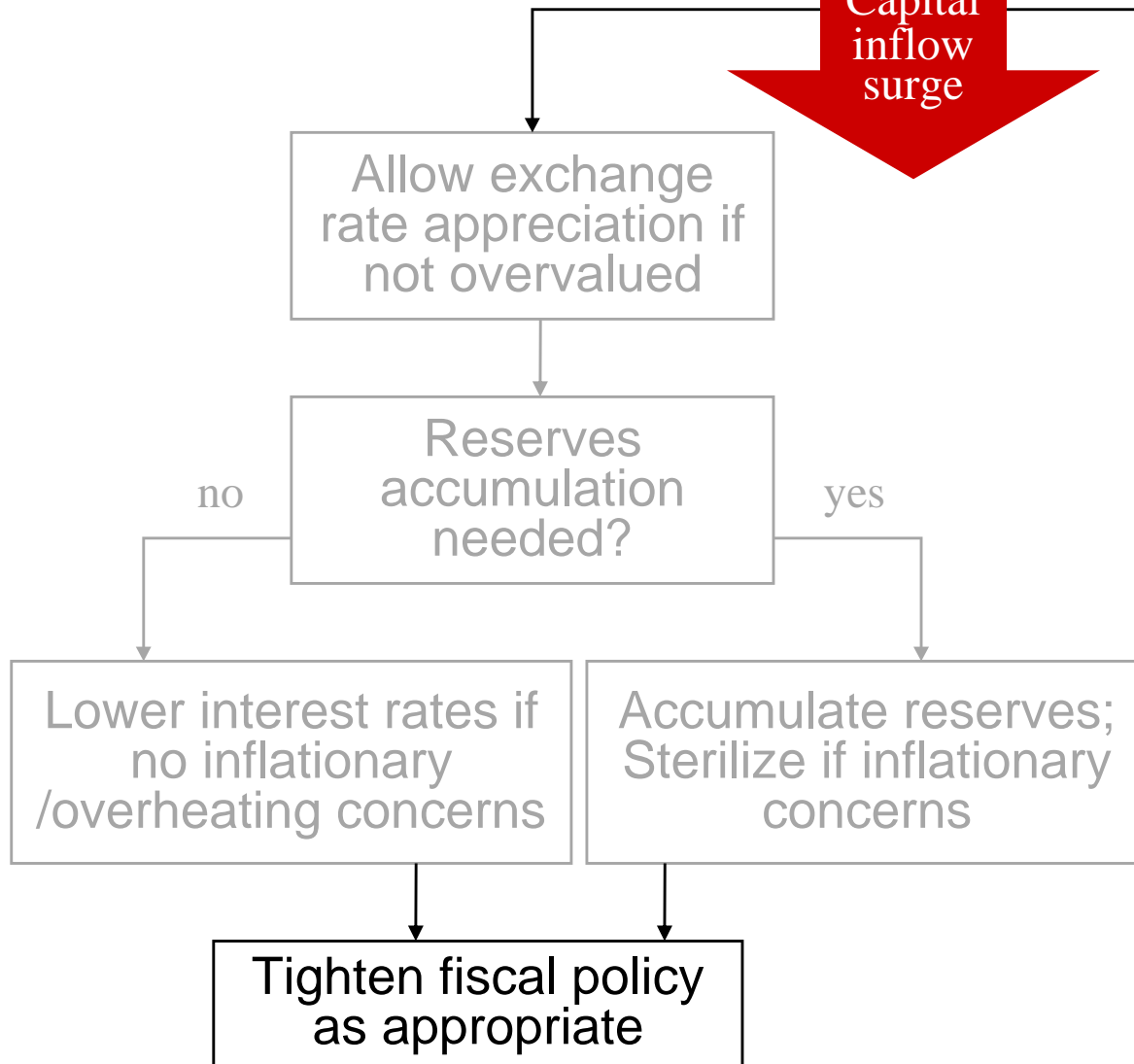
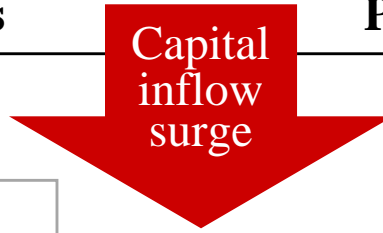
yes

Accumulate reserves;  
Sterilize if inflationary concerns



**Macroeconomic Considerations**

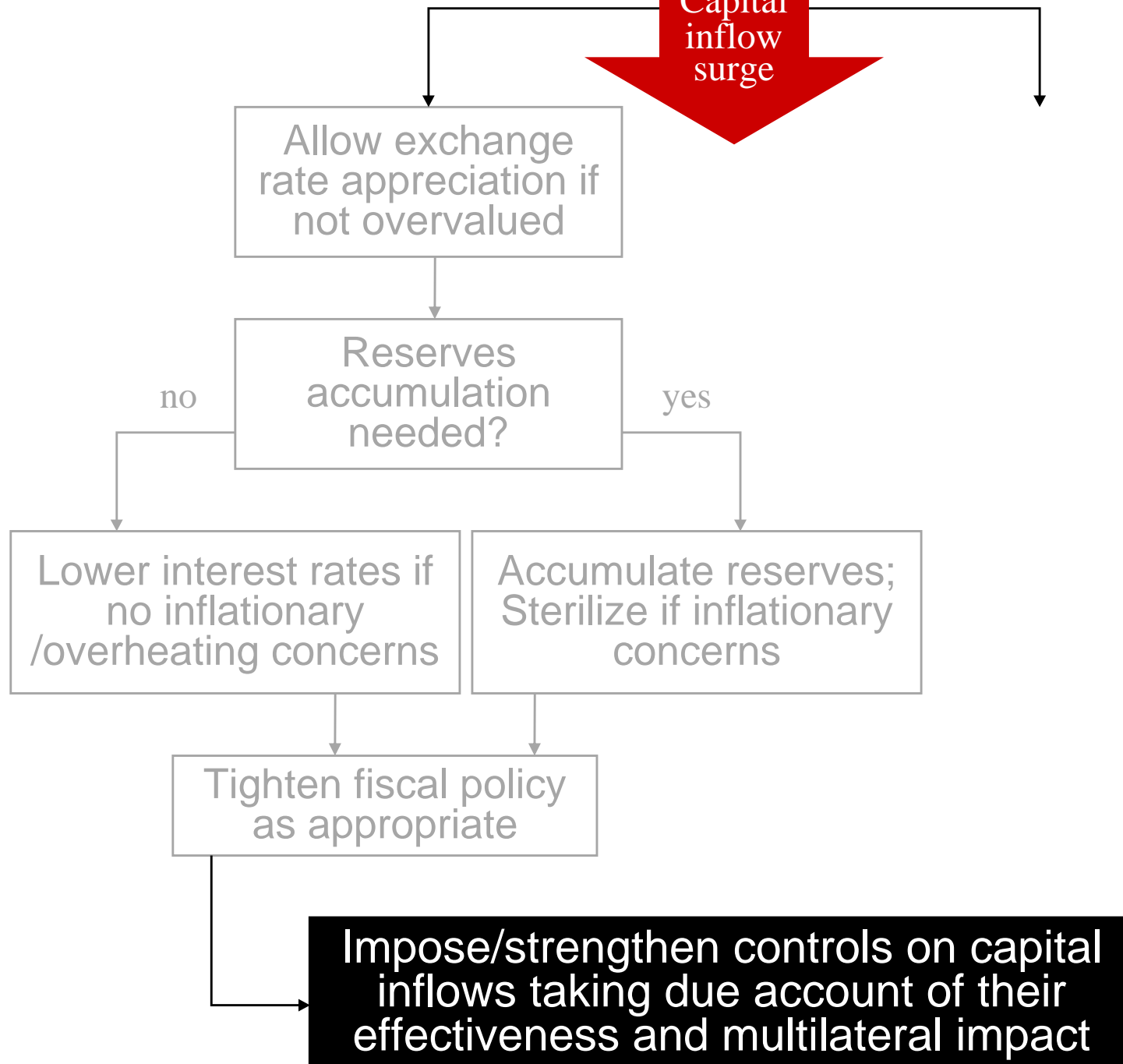
**Prudential Concerns**



**Macroeconomic Considerations**

**Prudential Concerns**

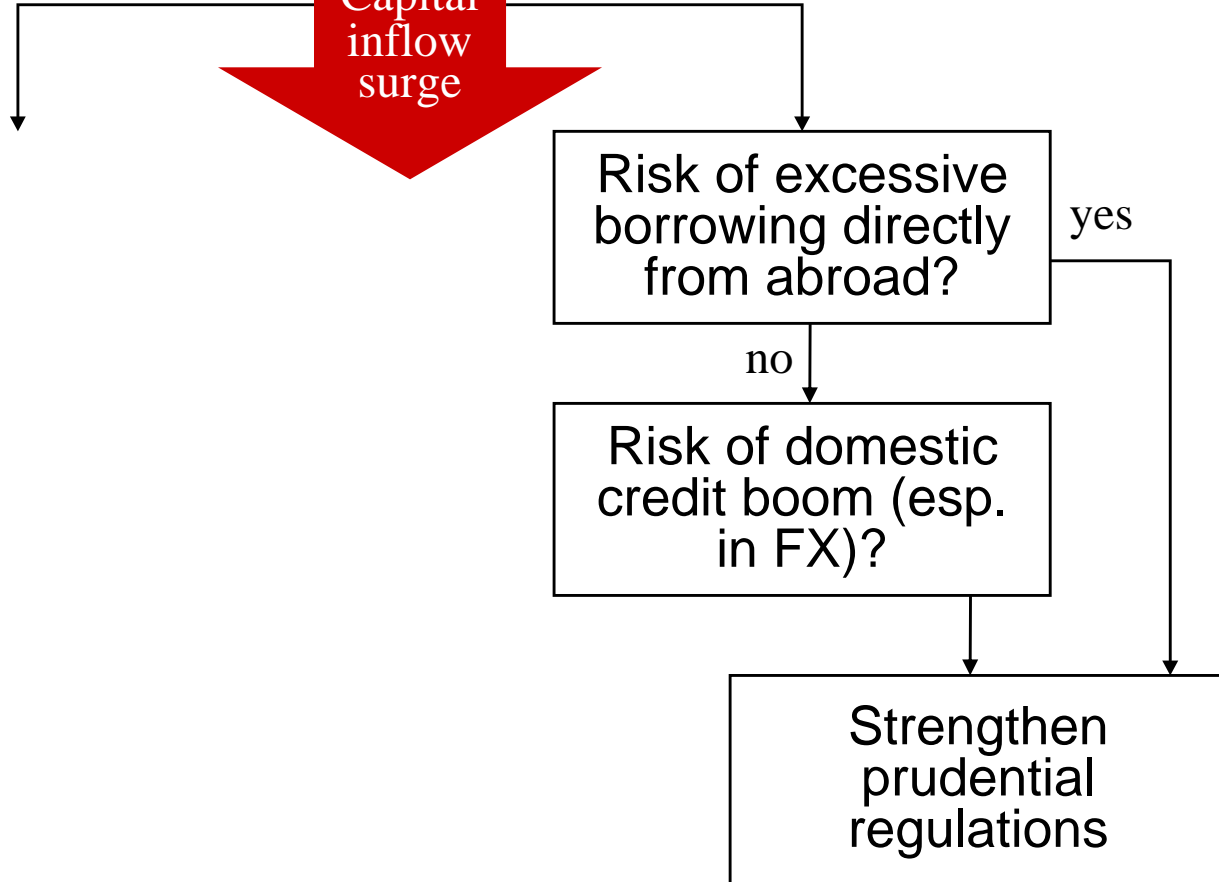
**Capital  
inflow  
surge**



**Macroeconomic Considerations**

**Prudential Concerns**

**Capital  
inflow  
surge**



**Macroeconomic Considerations**

**Prudential Concerns**



Risk of excessive borrowing directly from abroad?

yes

no

Risk of domestic credit boom (esp. in FX)?

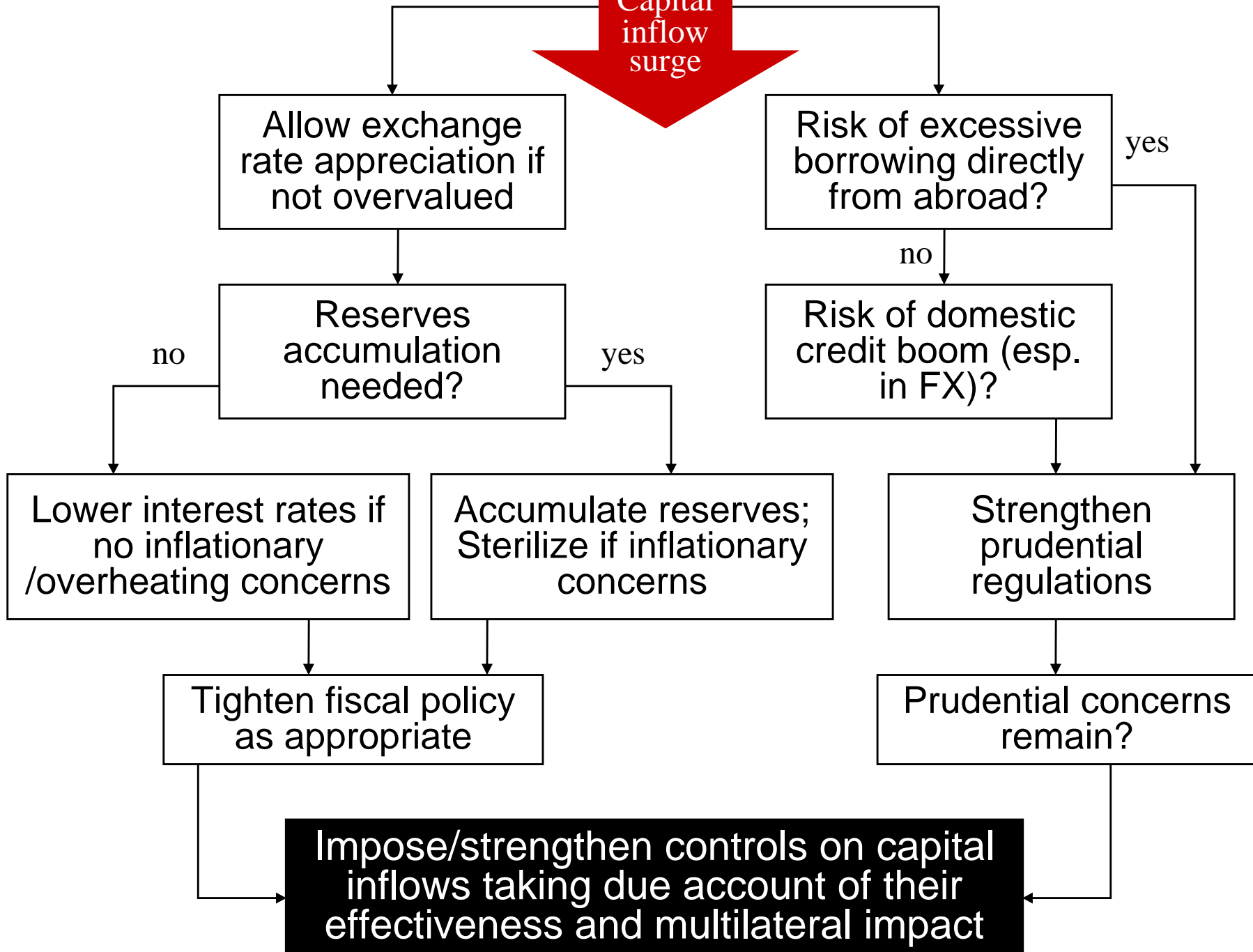
Strengthen prudential regulations

Prudential concerns remain?

**Impose/strengthen controls on capital inflows taking due account of their effectiveness and multilateral impact**

**Macroeconomic Considerations**

**Prudential Concerns**



# Which unconventional measure?

	Pros	Cons
Tax on inflows	<ul style="list-style-type: none"> <li>• Can broaden base and adjust rate</li> <li>• Use revenues to ease pain during bust</li> </ul>	<ul style="list-style-type: none"> <li>• Efficiency of tax collection agency</li> <li>• Transactions can move offshore</li> </ul>
URR	<ul style="list-style-type: none"> <li>• Similar to tax on inflows</li> </ul>	<ul style="list-style-type: none"> <li>• Less effective when funding costs low or coverage narrow</li> <li>• Monitoring compliance by NBFIs</li> <li>• Transactions can move offshore</li> </ul>
Use of prudential measures for cyclical purposes	<ul style="list-style-type: none"> <li>• Immediate impact on banks' activities</li> <li>• Can be adjusted</li> </ul>	<ul style="list-style-type: none"> <li>• Supervisory capacity</li> <li>• Limited to regulated institutions</li> <li>• Can divert transactions to non banks</li> </ul>

# Effectiveness of Inflow Controls— Key Variables



- Volume and composition of inflows
- Exchange rate level and volatility
- Domestic-foreign interest rate differentials

# Effectiveness of Inflow Controls— Conclusions



- Mixed results
- Sensitive to methodology
- Practical considerations in the effectiveness of controls
- Market participants' views

# Multilateral Implications of Controls



- Crowding out of better policies
- Contagion and “beggar-my-neighbor”
- Effect on global imbalances
  
- Also: prudential policies

# Multilateral Governance of Capital Movements

- Trade and current transactions: long-standing frameworks
- Capital controls: OECD, EU, GATS limited in country coverage or scope
- Attempt to amend Fund Articles in 1990s
- Global framework for imposition of controls may be useful (Fund mandate paper)