



# Coping with Capital Flows in Asia: Recent Experience

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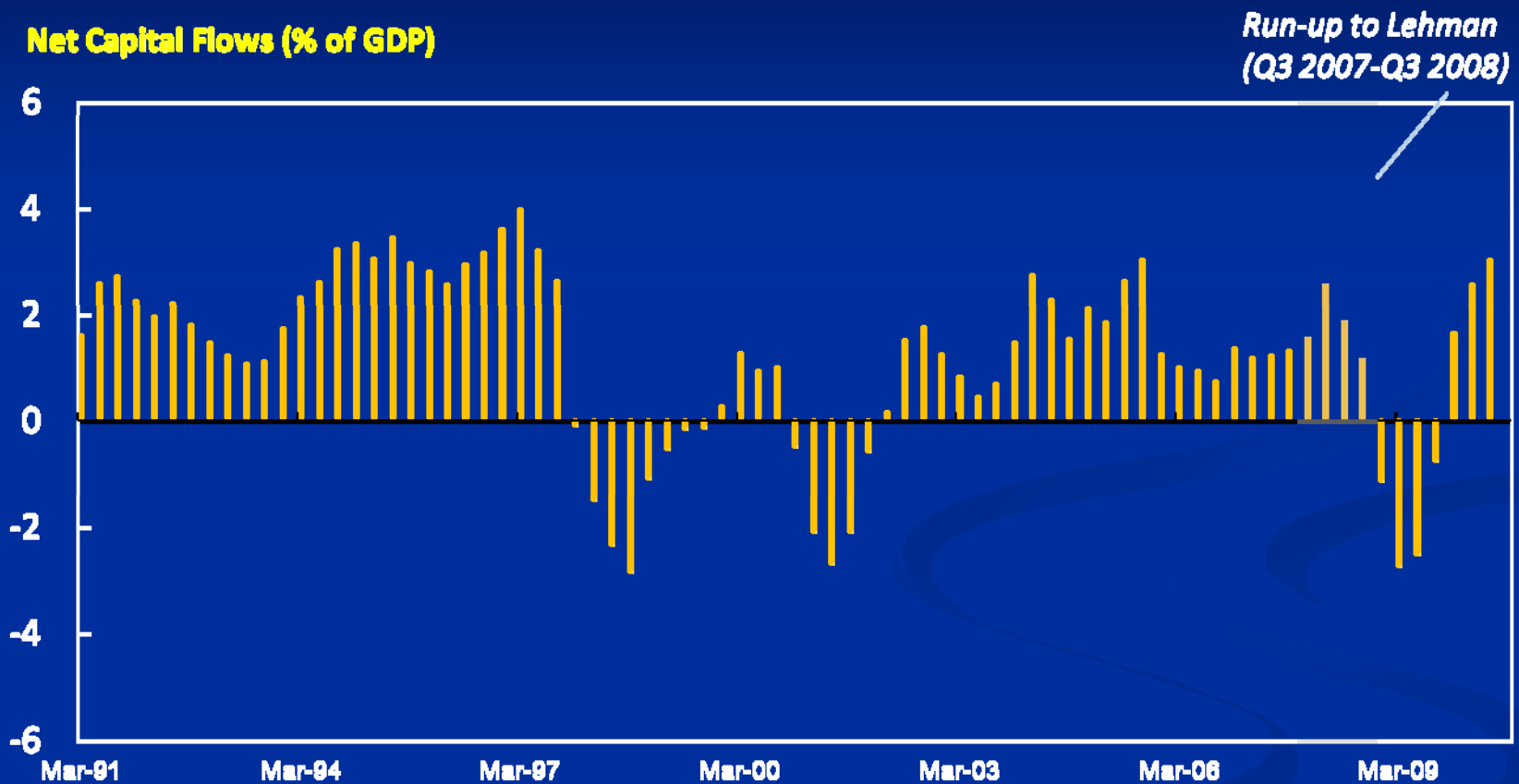
International Monetary Fund



## Outline of presentation

- Recent capital flows—an overview
- Recent macroeconomic policy responses in Asia
- How should a country respond to an inflow surge?
- Concluding remarks

# Capital flows to Asia rising rapidly, but not at all time highs yet

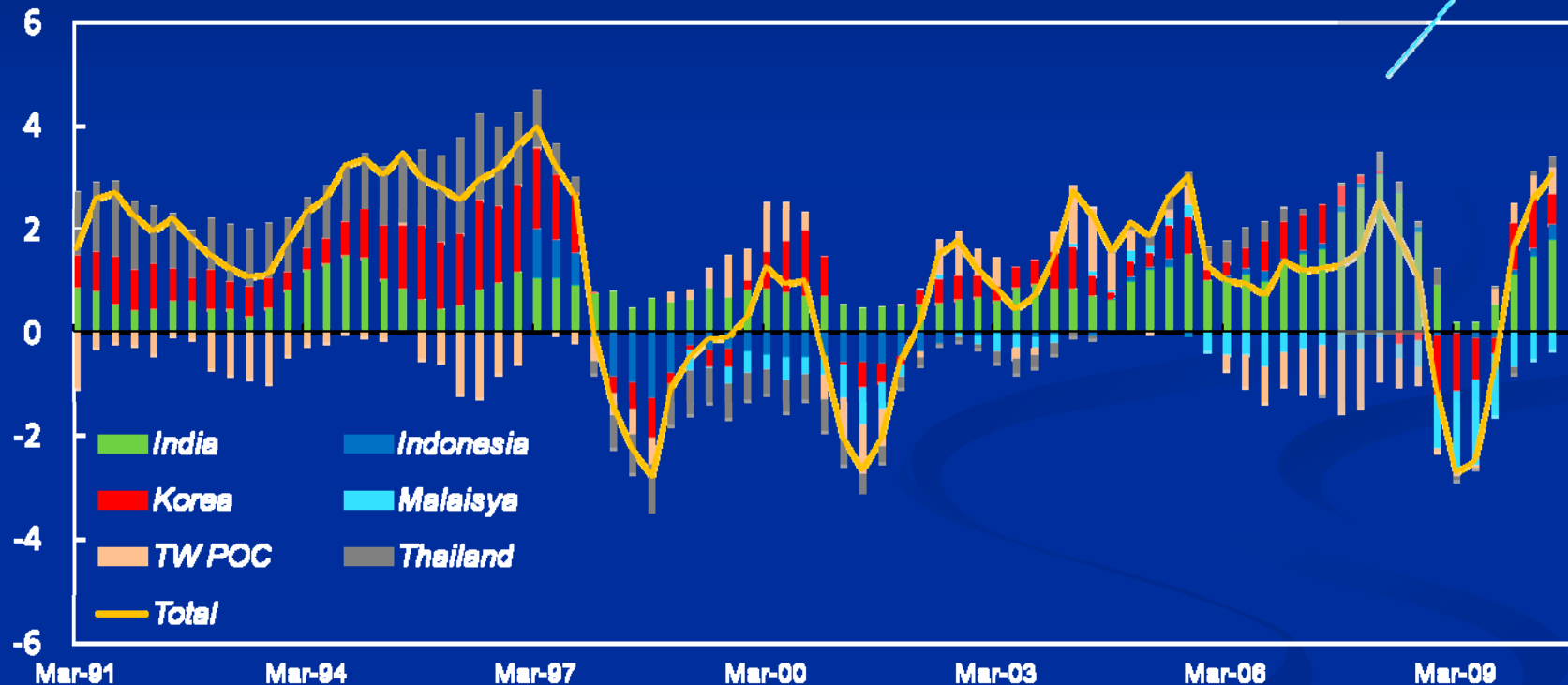


\* Data as presented are not strictly comparable across time, due to change in country composition . Showing India, Indonesia (Q1 1997-), Korea, Malaysia (Q1 1999-), Taiwan POC, Thailand.

# A rebound of capital inflows has varied among countries in Asia

Net Capital Flows (% of GDP)

Run-up to Lehman  
(Q3 2007-Q3 2008)

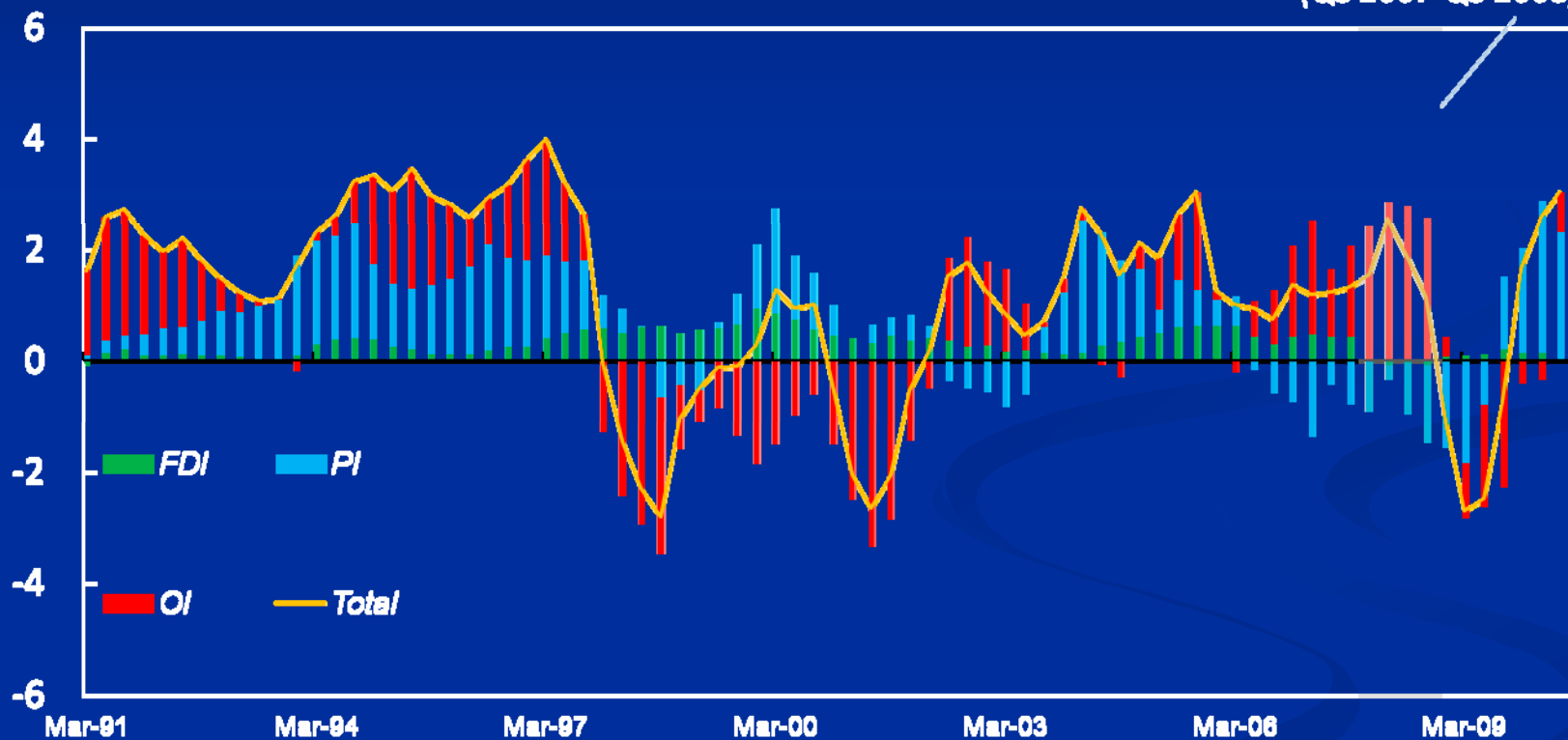


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# Portfolio inflows have dominated the recovery

Net Capital Flows (% of GDP)

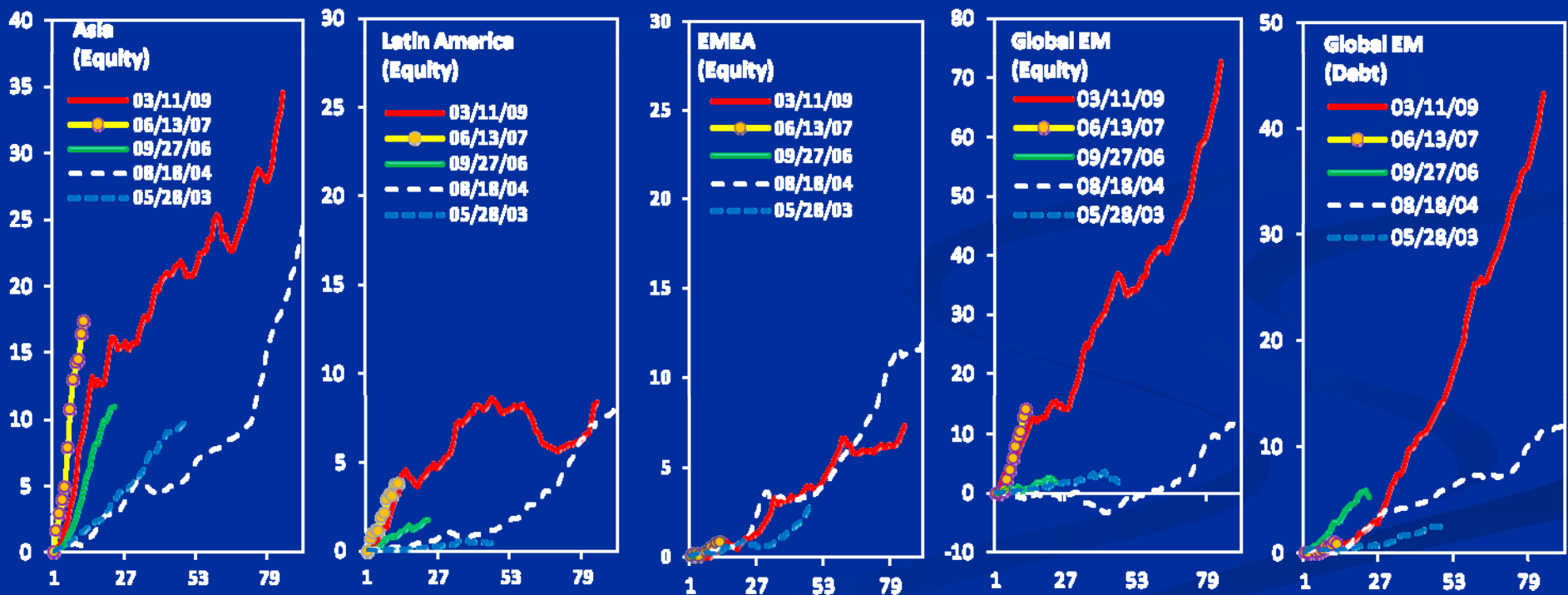
Run-up to Lehman  
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\* Data as presented are not strictly comparable across time, due to change in country composition. Showing India, Indonesia (Q1 1997-), Korea, Malaysia (Q1 1999-), Taiwan POC, Thailand.

# Asia is attracting the largest share of flows into EM mutual funds

Emerging Market Mutual Fund Flows by Region During Surges of Inflows 1/  
*(In billions of U.S. dollars)*

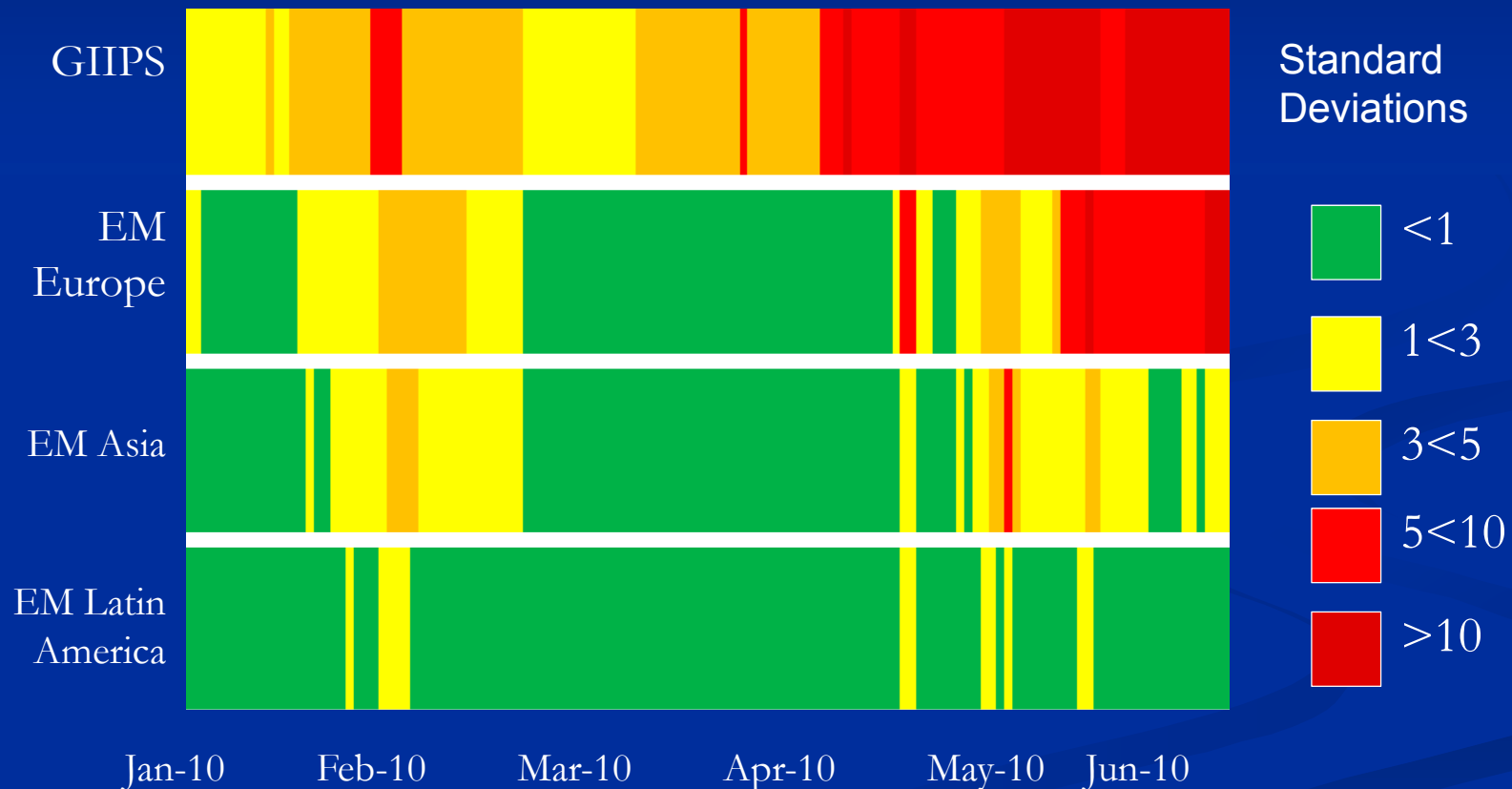


Sources: EPFR; and IMF staff estimates.

1/ "Surges" are identified loosely as periods during which inflows into Asian equity funds remain positive, ignoring short-lived interruptions. The horizontal axis denotes the number of weeks since the start of the surge.

# Asia has also been most resilient to the Europe-related turbulence

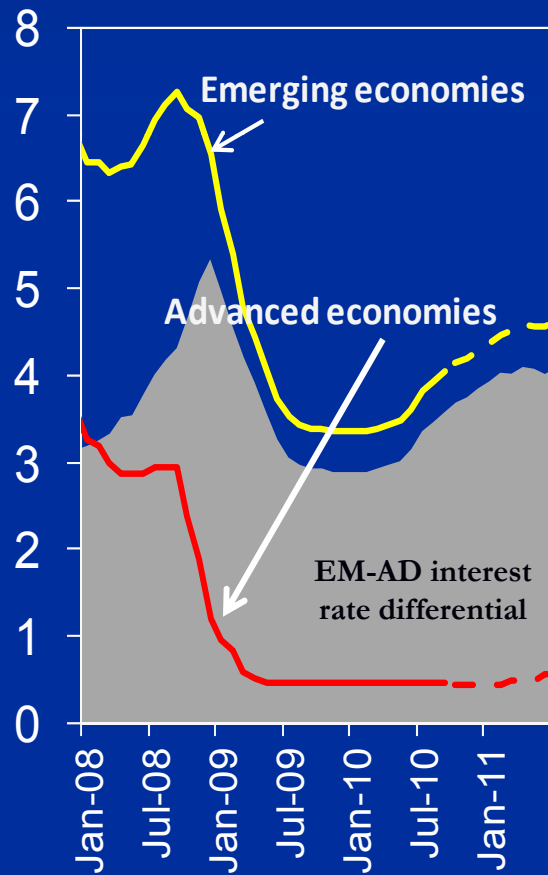
## GIIPS uncertainty: Impact on Sovereign CDS Spreads 1/



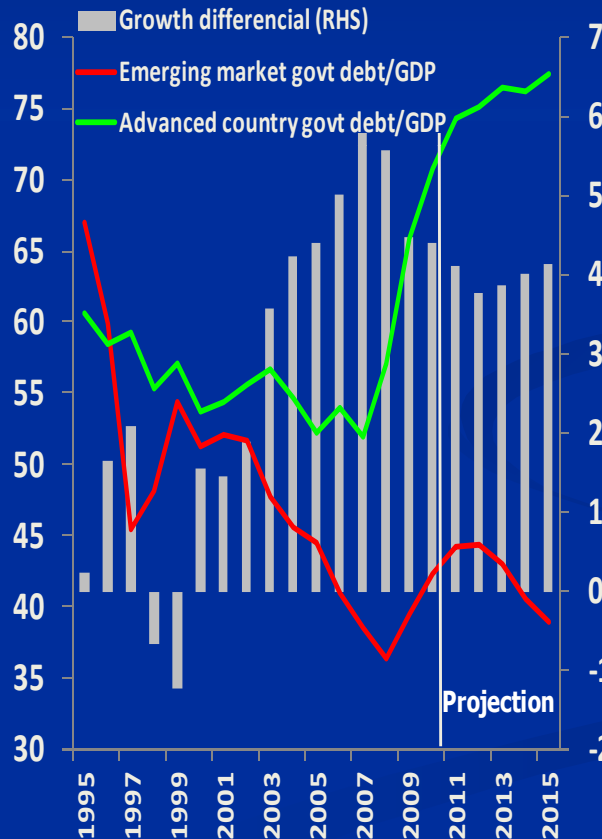
1/ Deviations from Q4 2009 averages are measured in standard deviations.

# Global liquidity and fundamentals driving flows toward emerging markets

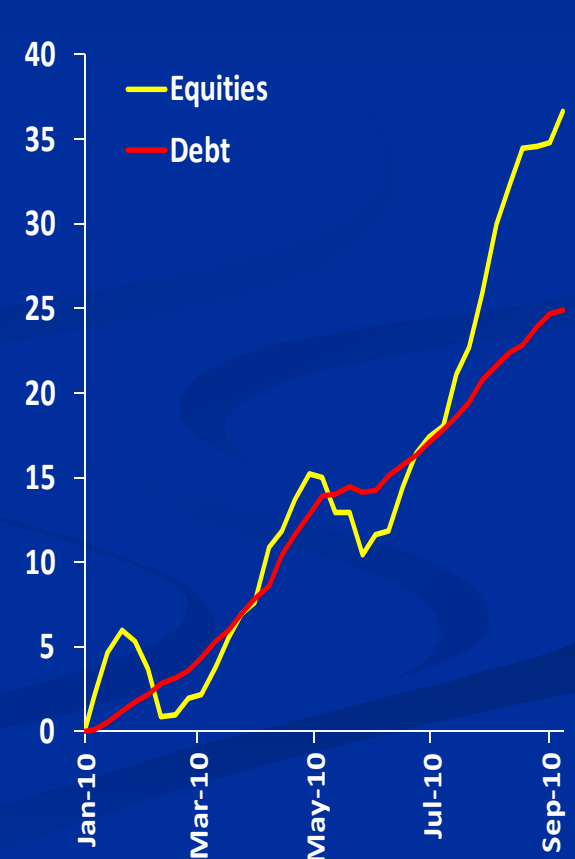
**Policy Rates  
(In percent)**



**Government Debt and Growth  
Differential (In percent)**



**Cumulative EM Mutual Fund Flows  
(In billions of U.S. dollars)**





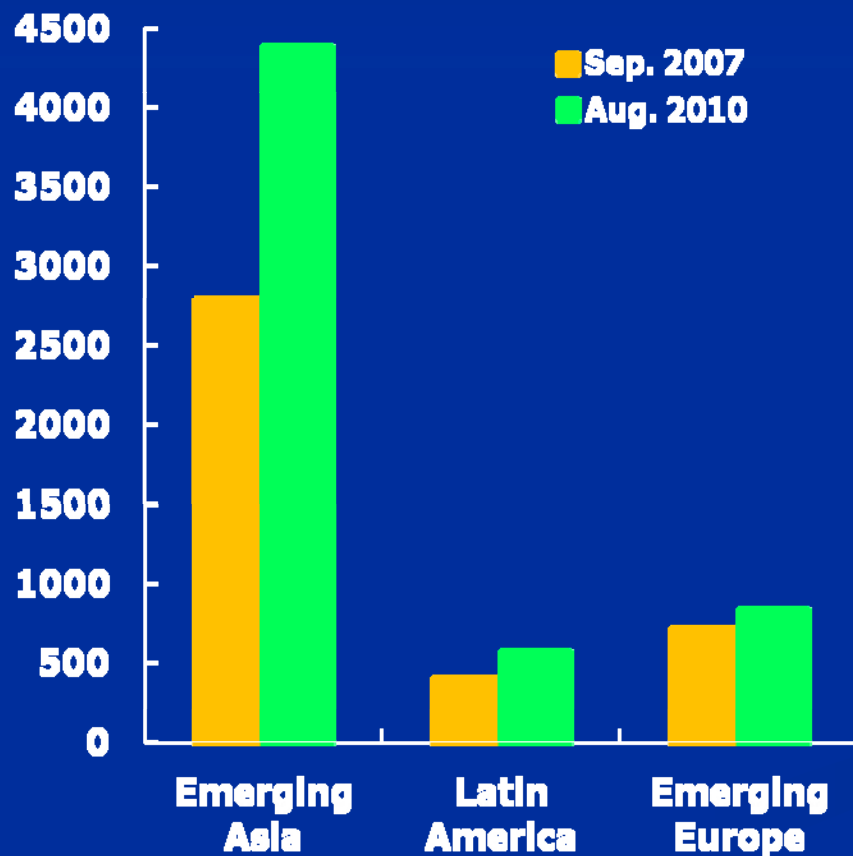
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# Reserve accumulation and currency appreciation have been the core policy response, but the policy mix differed by region

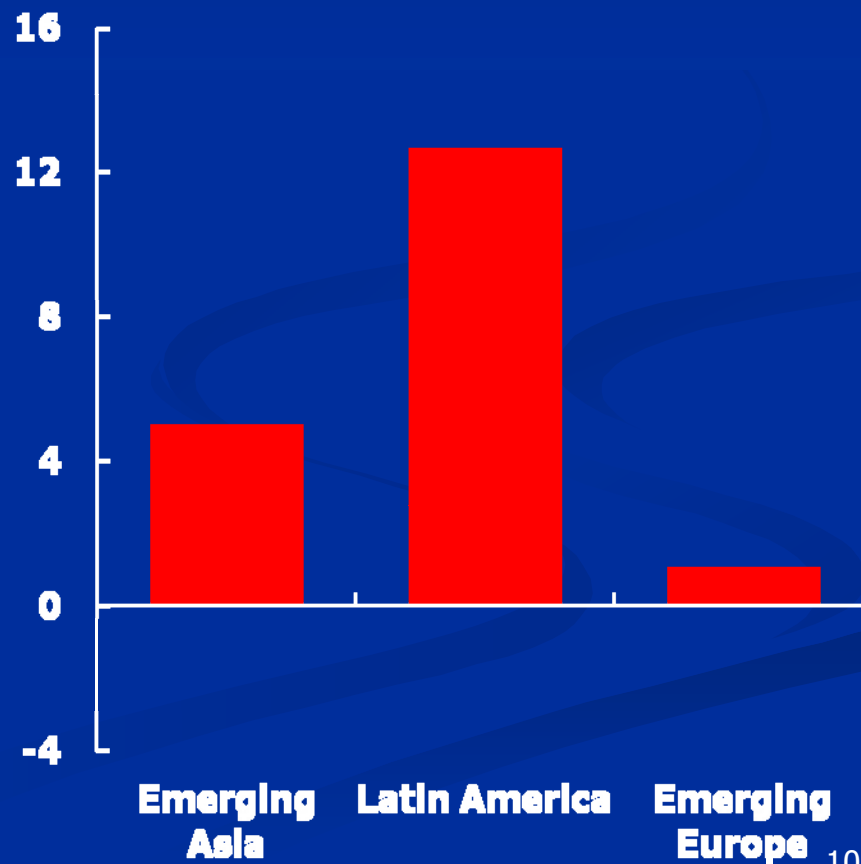
## Foreign Exchange Reserves

(In billions of US dollars)



## REER Change

(In percent; between September 2007 and August 2010; GDP weighted)



# Also, some substantial cross-country differences within Asia

## International Reserves and Exchange Rates

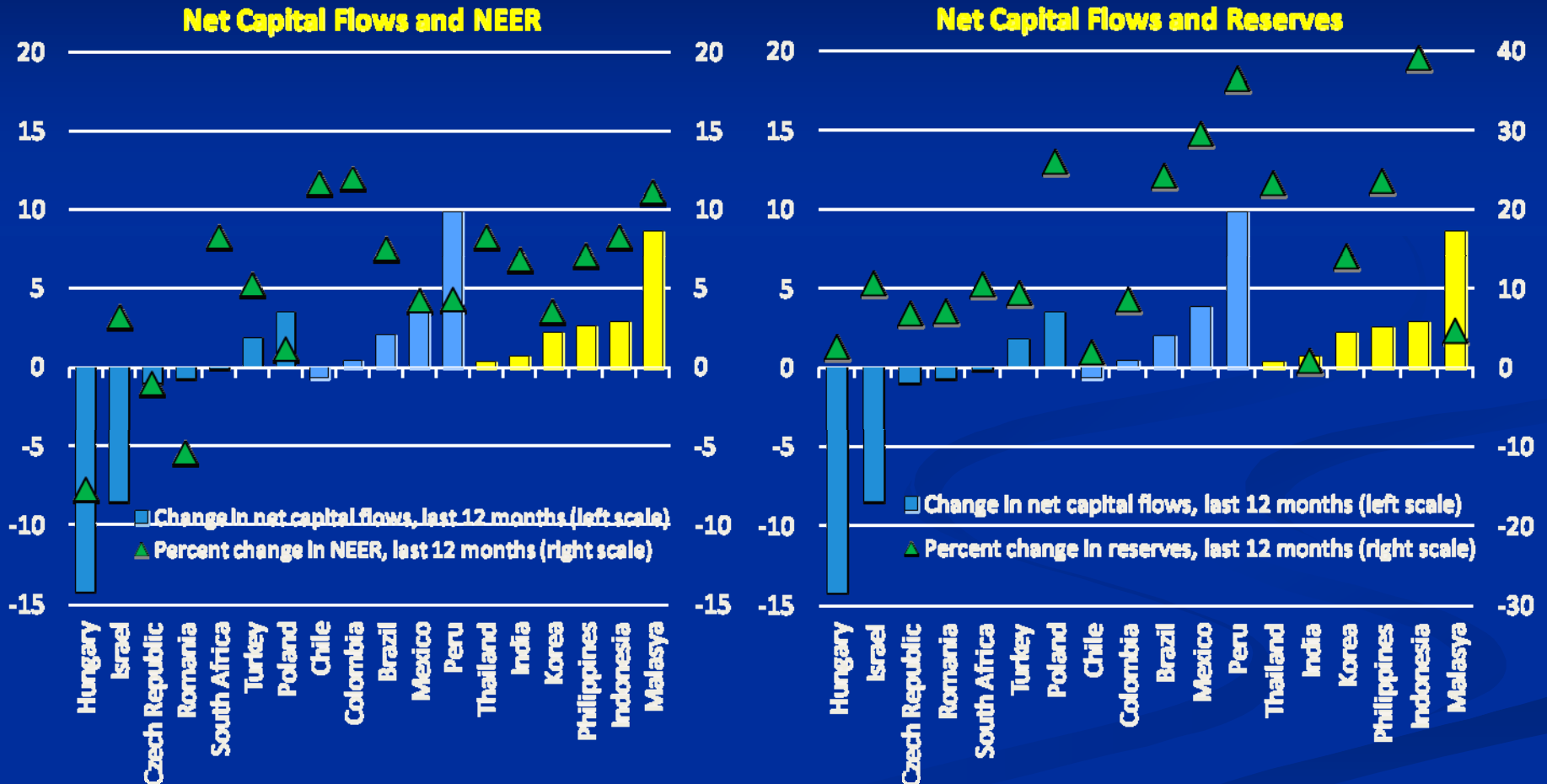
(August 2008 = 100)



Sources: IMF, *International Financial Statistics*; and staff estimates.

# Policy responses among emerging market countries only loosely related to strength of capital flows

## Change in Net Capital Flows, Exchange Rate Appreciation, and Reserve Accumulation 1/

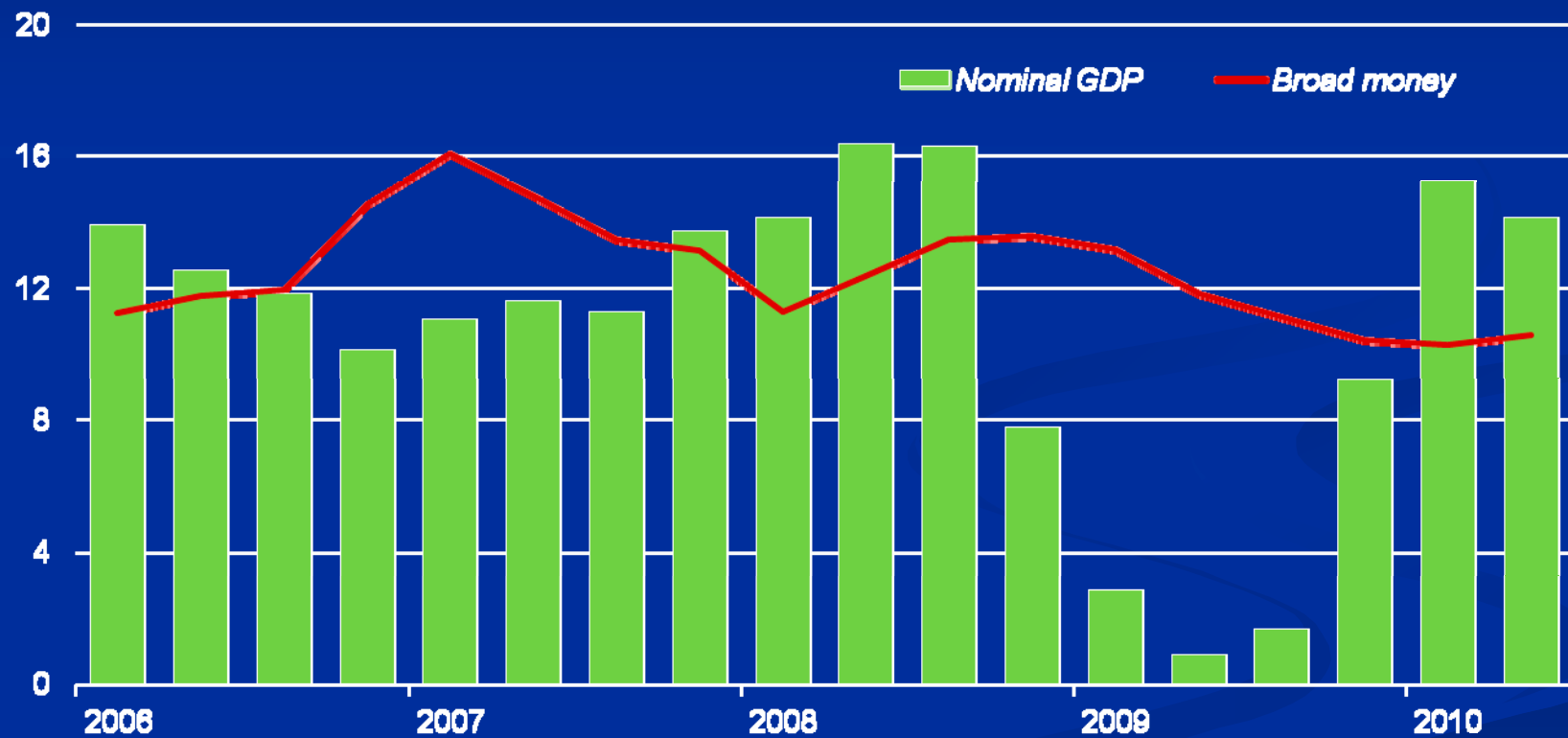


Sources: IMF, International Financial Statistics; and staff estimates.

1/ Net capital flows are a proxy of the balance of payments' financial account. This proxy is constructed as the difference between the change in international reserves and the trade balance. The charts show the change in net capital flows over the last twelve months (as of June 2010) over the previous twelve months as a percentage of GDP.

# Reserve accumulation does not appear to have led to excessive money creation

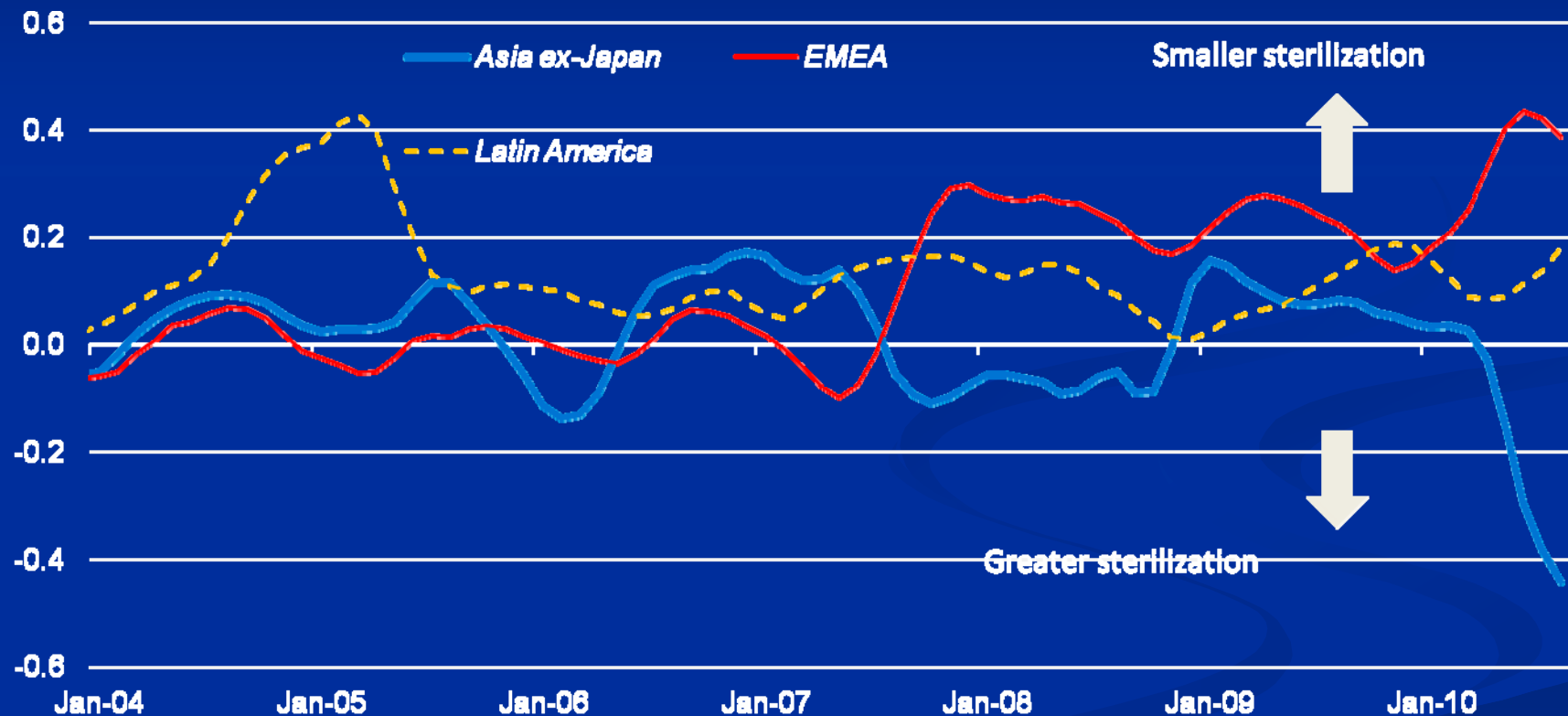
Emerging Asia's Nominal GDP and Broad Money Growth 1/  
(Year-on-year percent change)



1/Simple averages of annual growth rates for India, Indonesia, Korea, Malaysia, the Philippines, and Thailand.

# Sterilization has been broadly effective in controlling monetary expansion

Sensitivity of Money Supply to Central Bank Foreign Assets  
(Slope coefficient)



Sources: Haver Analytics; CEIC Data Company Ltd; IMF, *International Financial Statistics*; and staff estimates.

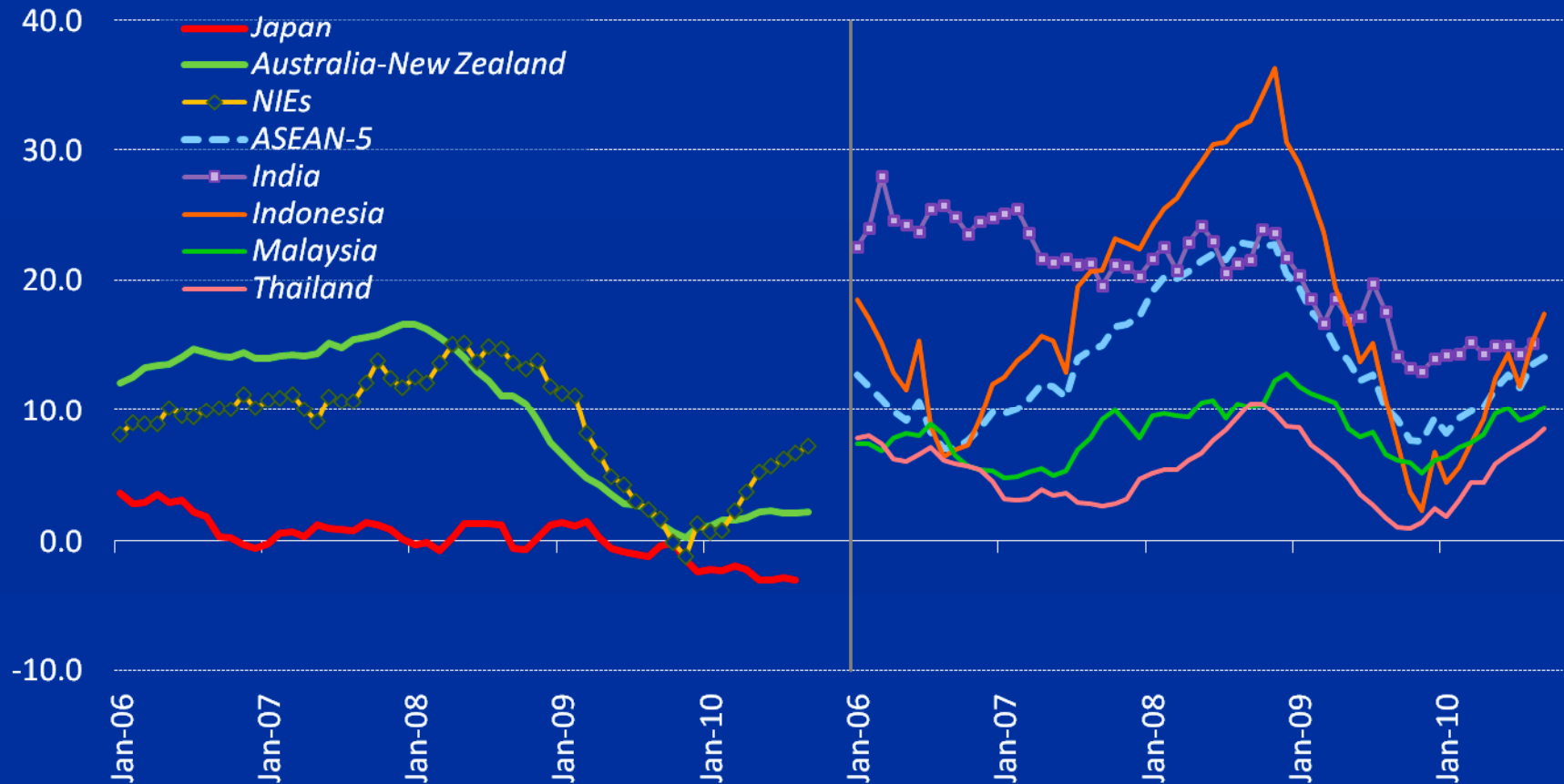
Note: Slope of 1-year rolling regression of year-on-year changes in M2 on those in central bank net foreign assets. Showing 3-month moving average (M2 growth = a + b NFA growth + u).

EMEA = Europe, the Middle East, and Africa.

# ...and credit growth remains in general moderate (so far)

## Credit to the Private Sector

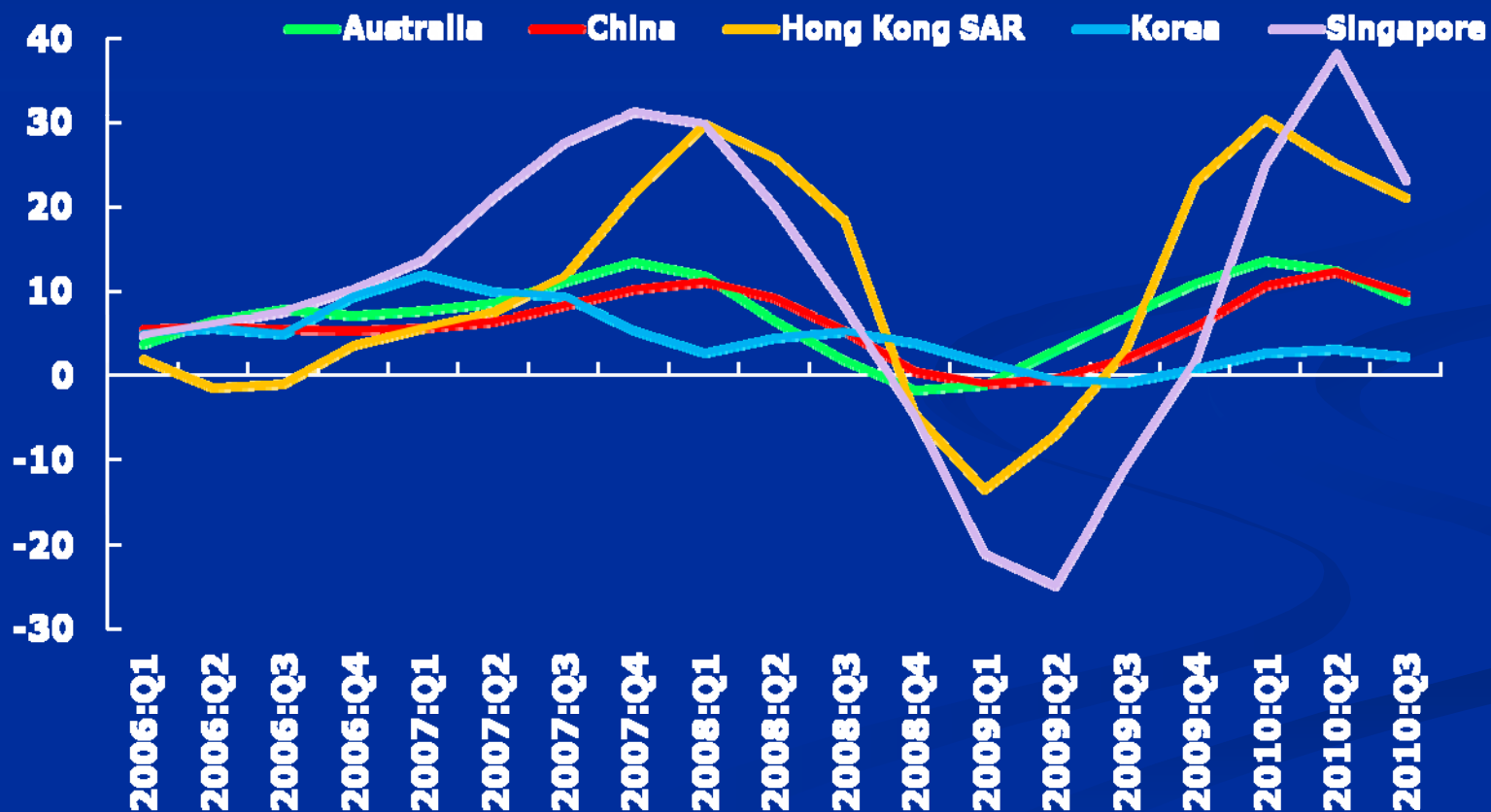
(annual percent change)



Sources: CEIC Data Company Ltd; and IMF staff calculations.

# However, some sign of price pressure has emerged in property markets in a few economies

**Selected Asia: Property Prices**  
(Year-on-year percent change)



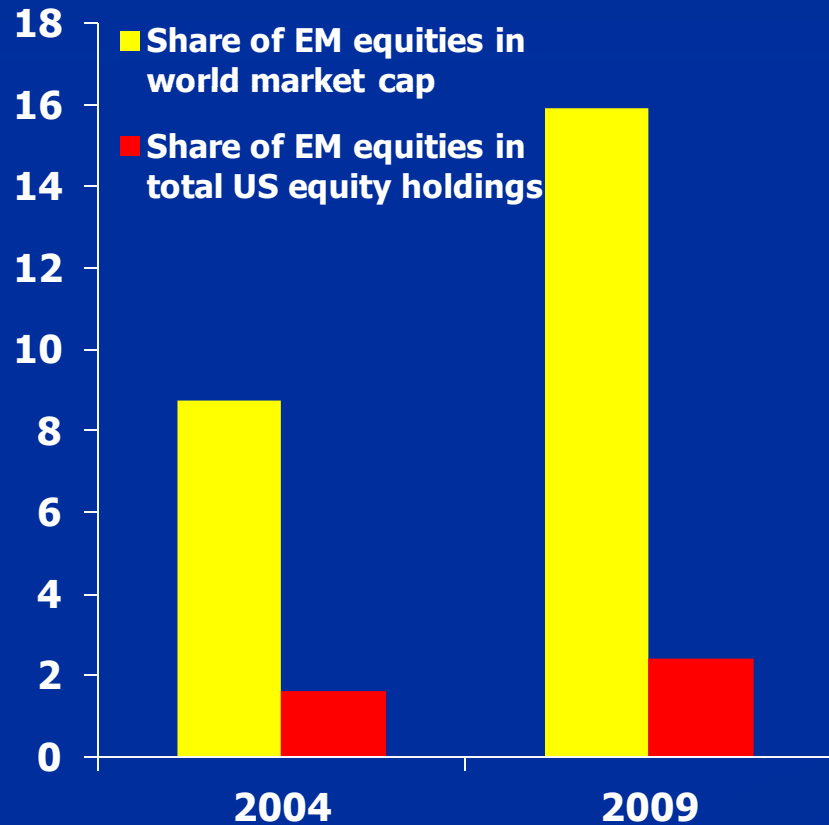


## Outline of presentation

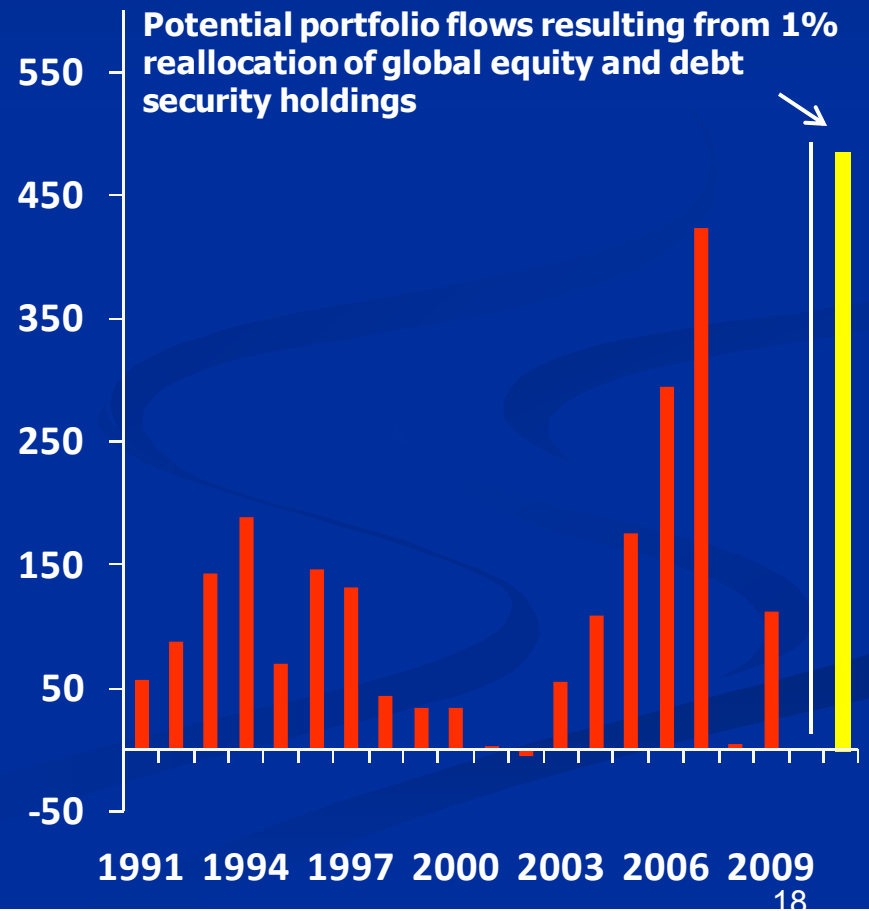
- Recent capital flows—an overview
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# Portfolio inflows to emerging economies could rise further...

## EM equities market capitalization and investor allocations (In percent)

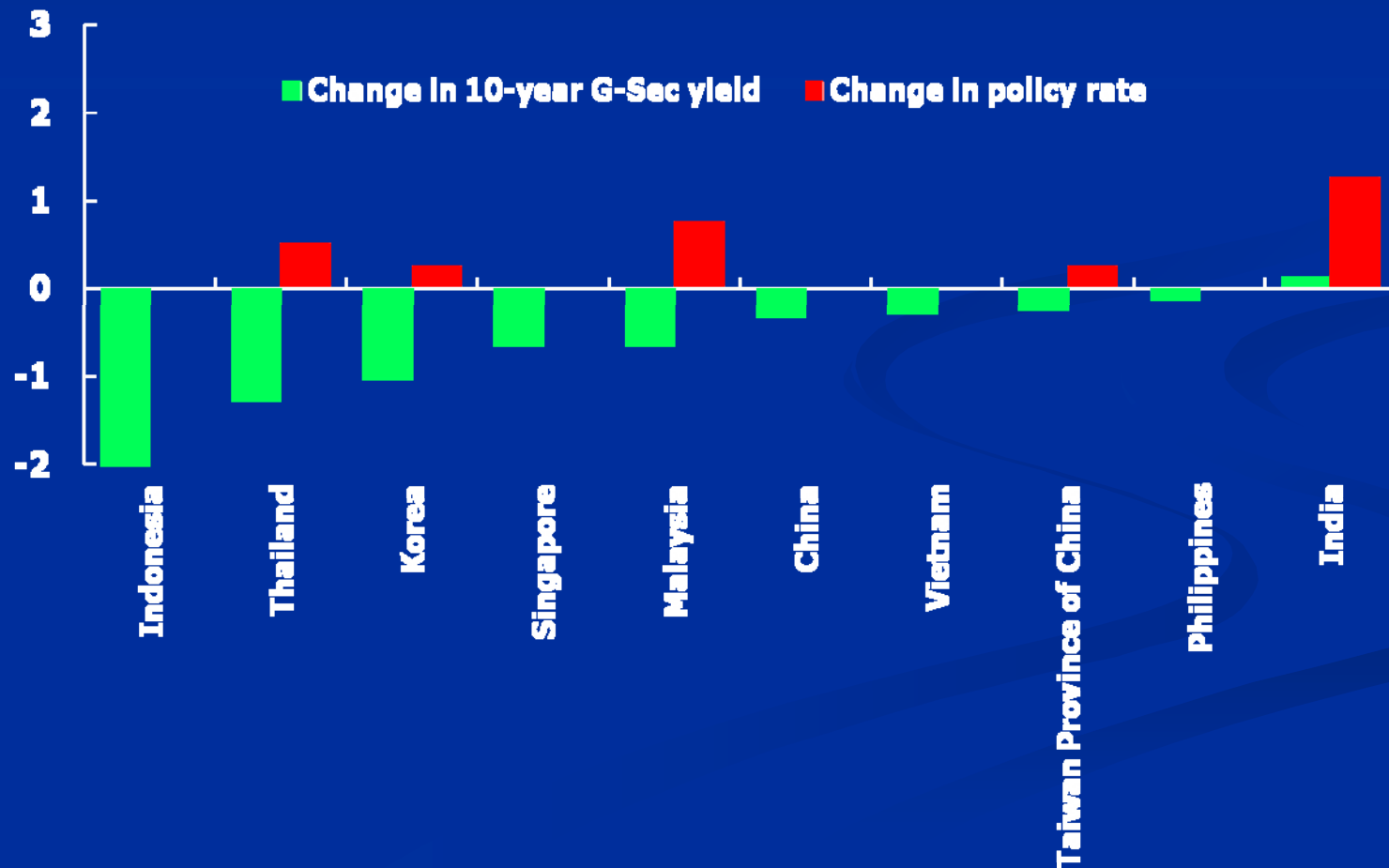


## Portfolio flows to emerging market and developing countries



and blunt the impact of monetary tightening on long-term rates and lead to financial instability

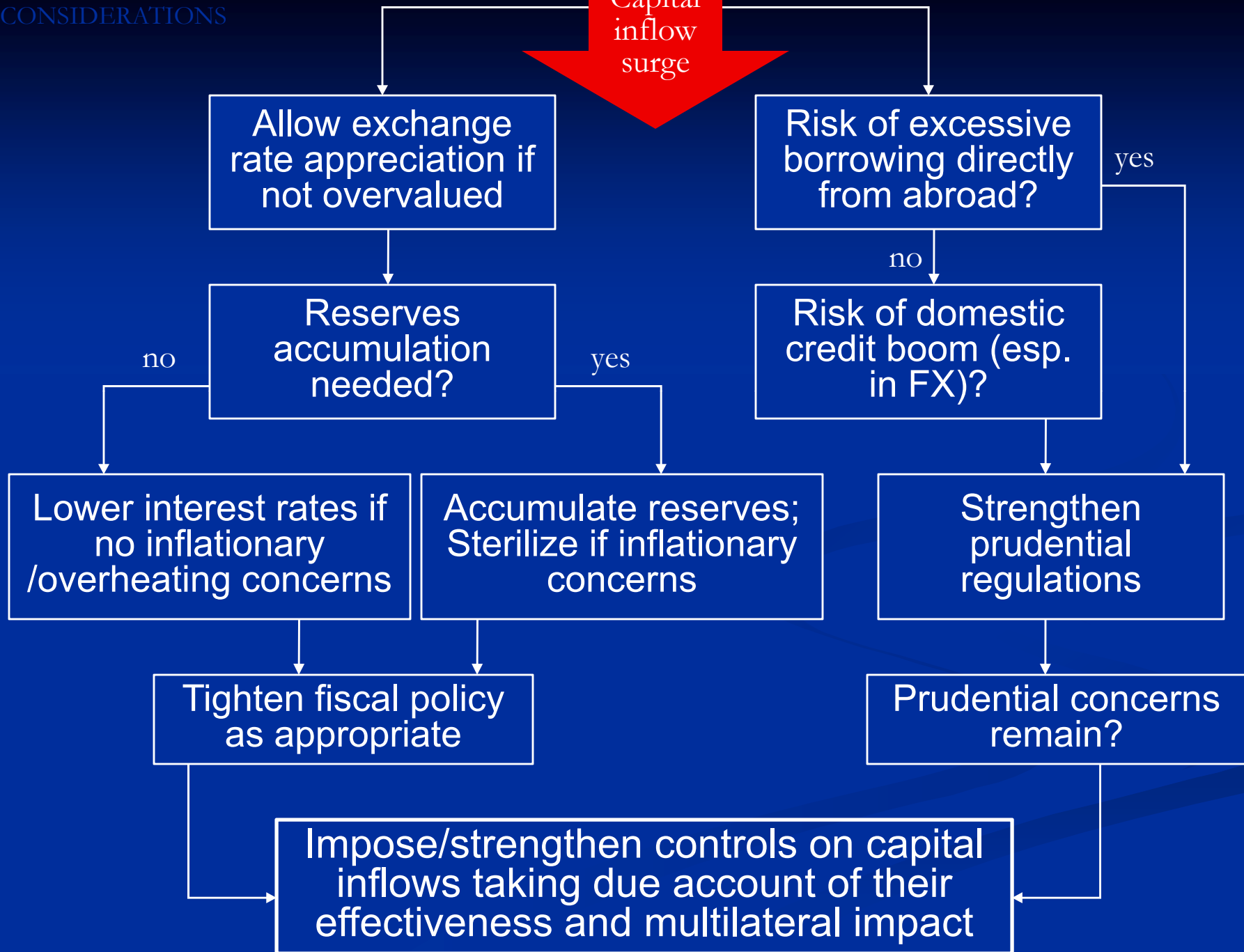
**Emerging Asia: Change in Interest Rates**  
*(In percentage points)*



MACRO Macroeconomic Considerations  
CONSIDERATIONS

Prudential Concerns  
PRUDENTIAL CONCERNS

Capital  
inflow  
surge



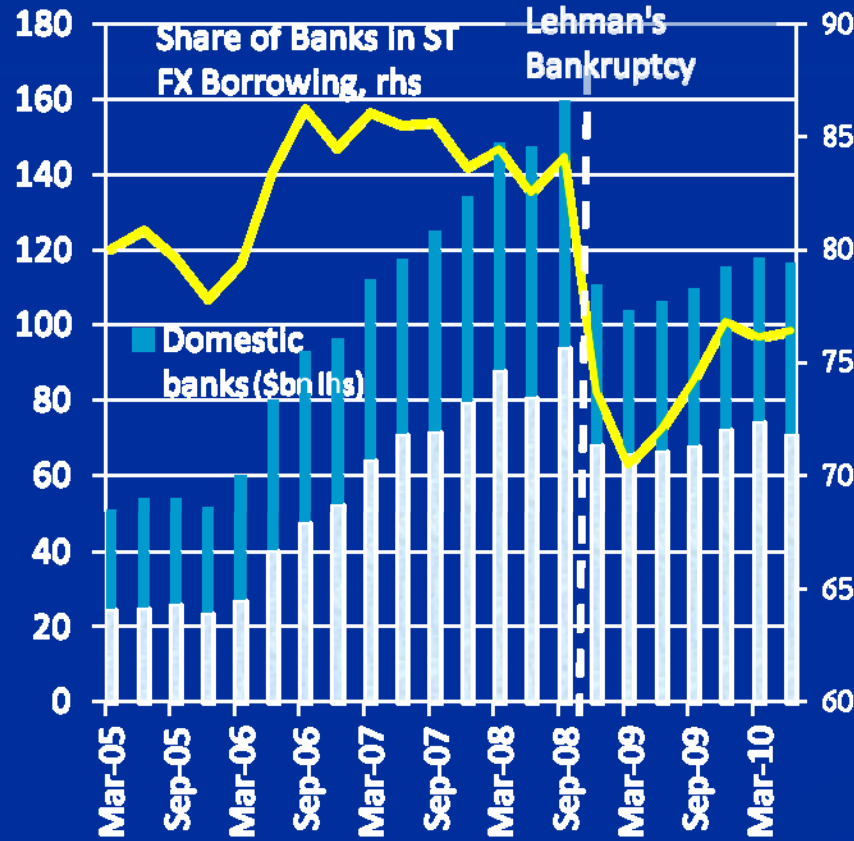
## Macro-prudential measures to extend the policy tool kit

Measures	Implemented in
Rein in short-term foreign currency borrowing by commercial banks	Korea
Lengthen maturity structure of central bank's external liabilities and make one-month certificate less liquid	Indonesia
Limits placed on foreign investors' access to time deposits	Taiwan Province of China
Liberalization of capital outflows	Thailand
Removal of tax exemptions for foreign investment in government bonds	Thailand
Direct tax on fixed income and equity inflows	Brazil

# Effectiveness of macro prudential measures to manage inflows has been mixed

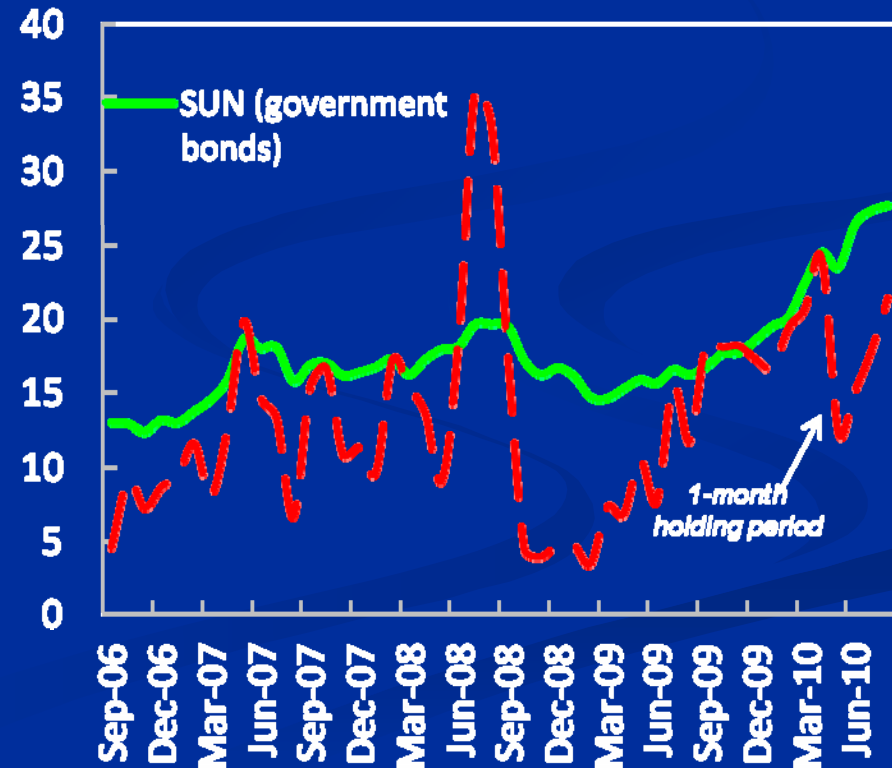
**Korea: banks' external debt has not returned pre-crisis levels**

**Indonesia: foreign ownership on the rise again.**



Source: CEIC

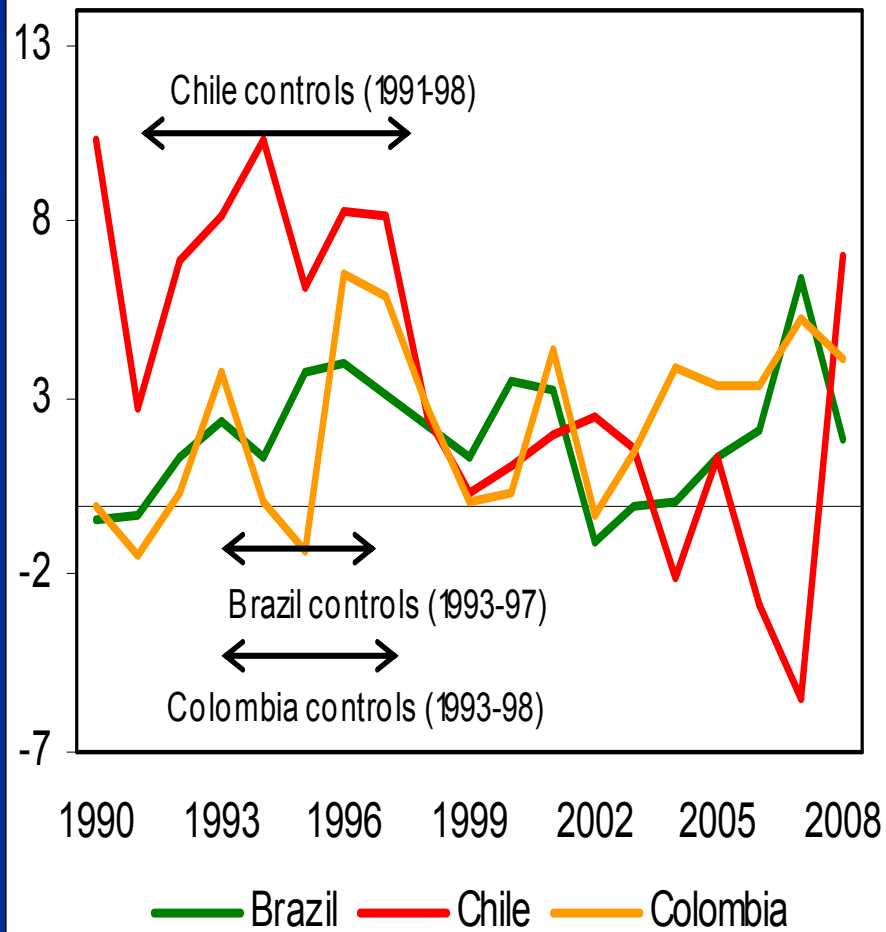
**Foreign Ownership (In percent total)**



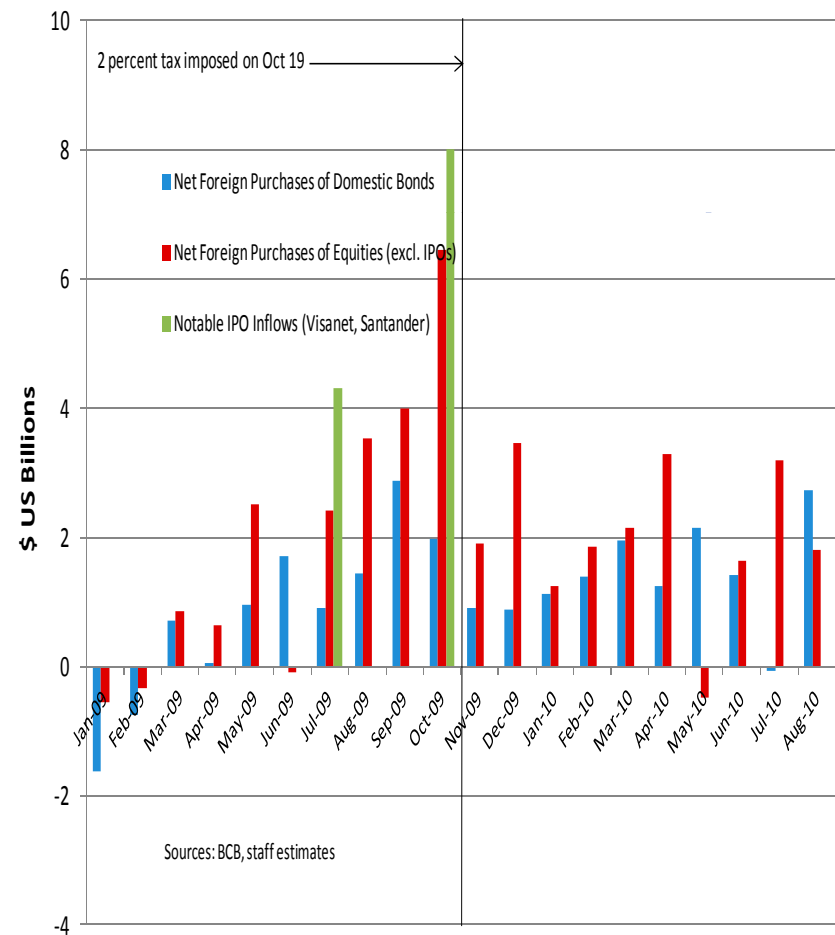
Source: Indonesian authorities.

# Use of direct capital controls to reduce inflows in Latin American countries

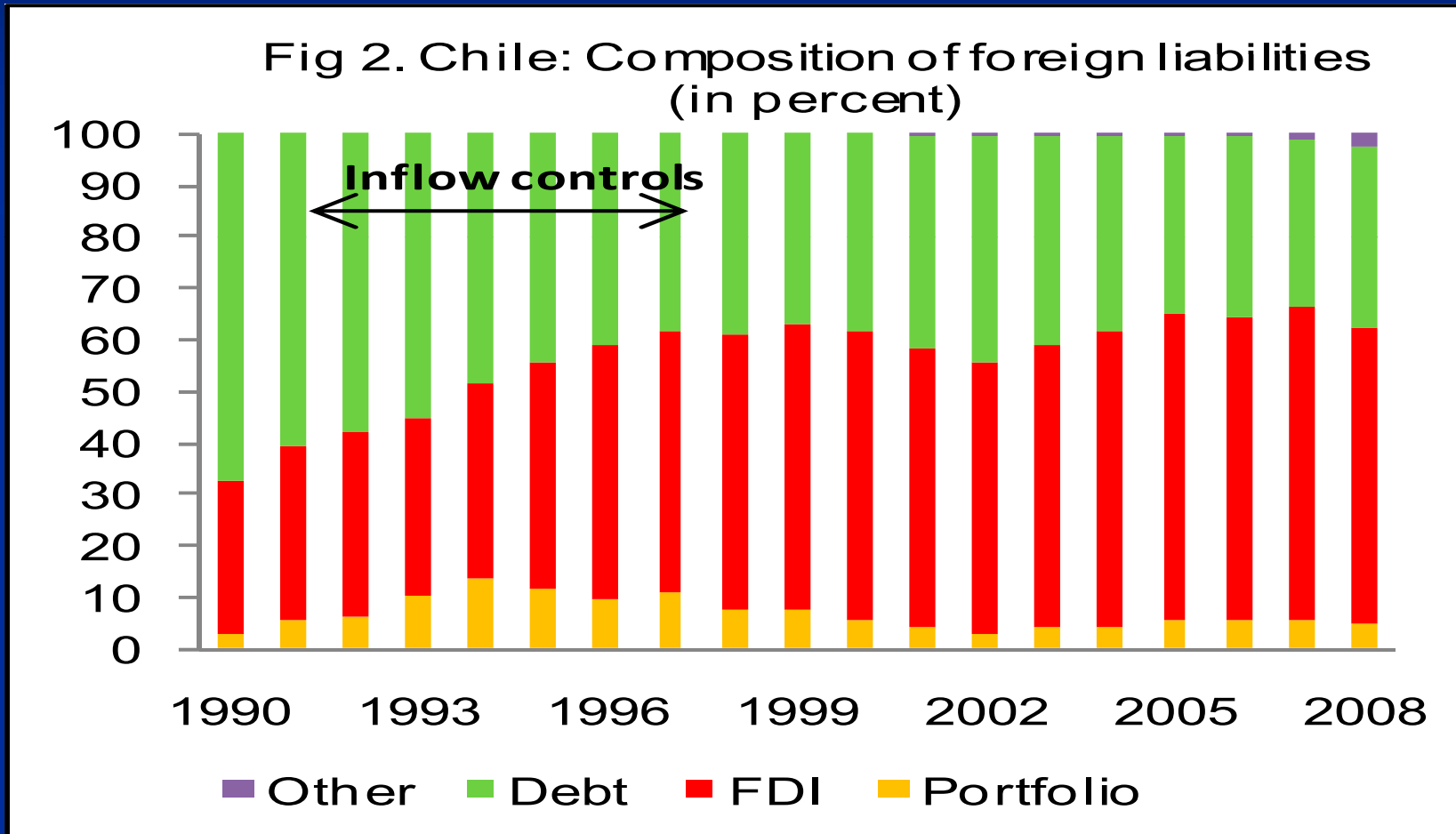
Fig 1. Net private financial flows (% of GDP)



Monthly Portfolio Capital Inflows Before and After IOF Imposition



...but stronger evidence linking controls to changes in the composition of inflows.





# Selected Asia: Measures to rein in real estate markets

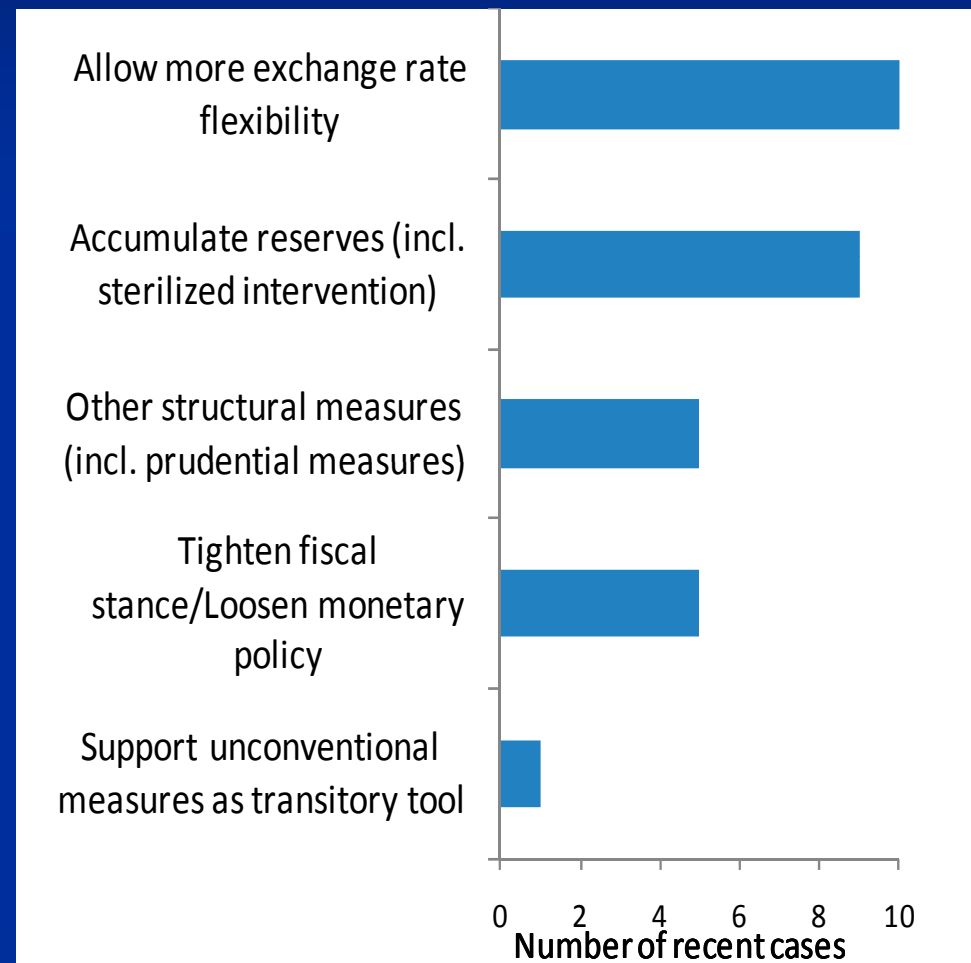
<b>Measures</b>	<b>Implemented in</b>
<b>Tighter ceilings on L-T-V ratios</b>	China, Hong Kong SAR, Singapore
<b>Higher stamp duties on resale of properties</b>	China, Hong Kong SAR, Singapore
<b>Higher risk weighting for real estate loans</b>	India
<b>Caps placed on loan amounts for non-luxury property</b>	Hong Kong SAR
<b>Increases in mortgage rates for second homes</b>	China
<b>Release of additional land for housing</b>	Singapore

# Recent IMF staff advice on capital inflows

## Measures taken

- Macroeconomic measures
  - Allow appreciation
  - Accumulate reserves
  - Allow/relax limits on outflows
- Unconventional measures
  - Reinstate or raise RR on FX deposits
  - Reinstate external borrowing limits
  - Impose tax on inflows
  - Strengthen macro-prudential rules

## IMF staff advice



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## Concluding remarks (1)

- Capital inflows fundamentally good: additional financing for productive investment, risk diversification, etc.
- But sudden surges could pose a risk to macroeconomic stability
- Macro-prudential/capital controls appropriate in specific circumstances:
  - Currency not undervalued
  - Further reserve accumulation undesirable
  - Inflation/overheating concerns
  - Limited scope for fiscal tightening
  - High risk of financial fragility

## Concluding remarks (2)

- Asia still has macroeconomic space for conventional response
- Macro-prudential measures have complimented macroeconomic policy response
- Macro-prudential/capital control measures are not a substitute for macroeconomic policy
- The relation between domestic macro prudential measures and conventional monetary policy needs to be studied further

END