

Managing Capital Flows in a Globalized World: Policy Challenges

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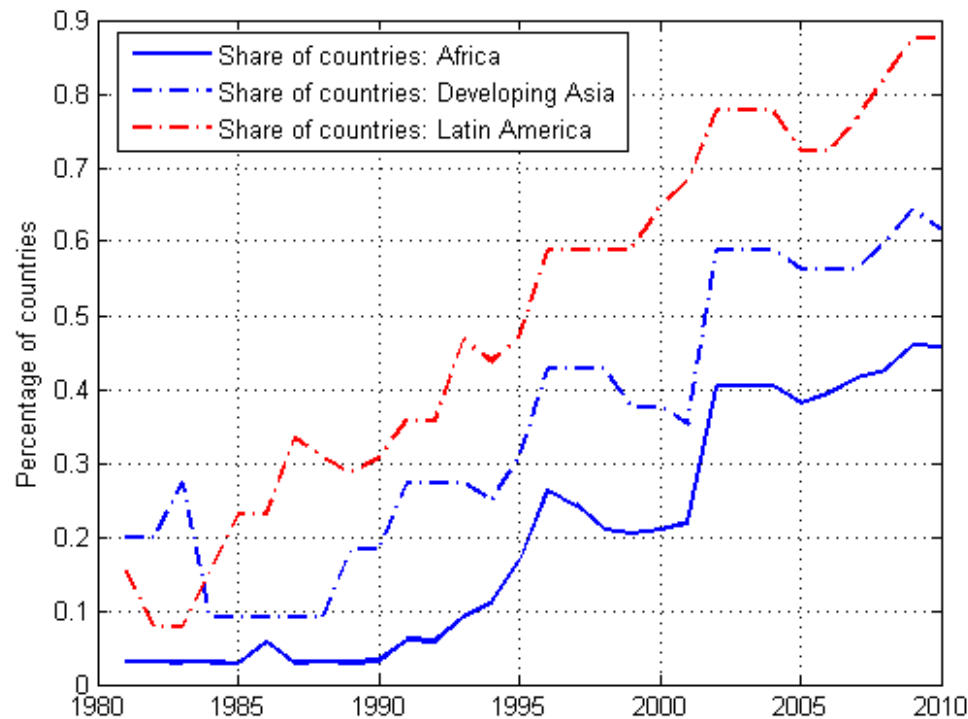
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Key Points

- Evolution of capital account liberalization
- Drivers of capital flows
- Credit ratings and bond spreads
- Policy Choices and Mundell's Trillema
- Policy responses to capital inflows

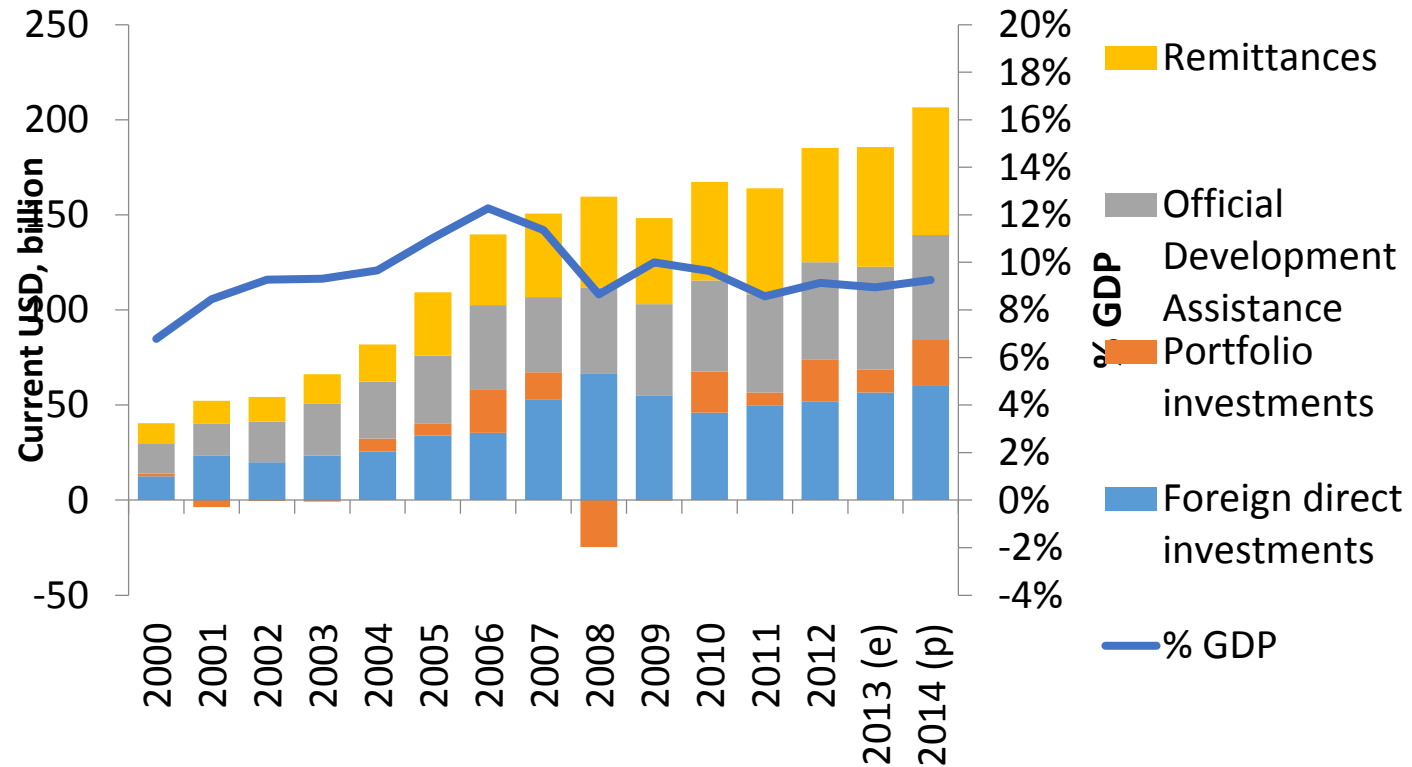
Evolution of Regional Share of Capital Account Liberalization

(Source: Ncube, Bicaba, Briziova(2015))



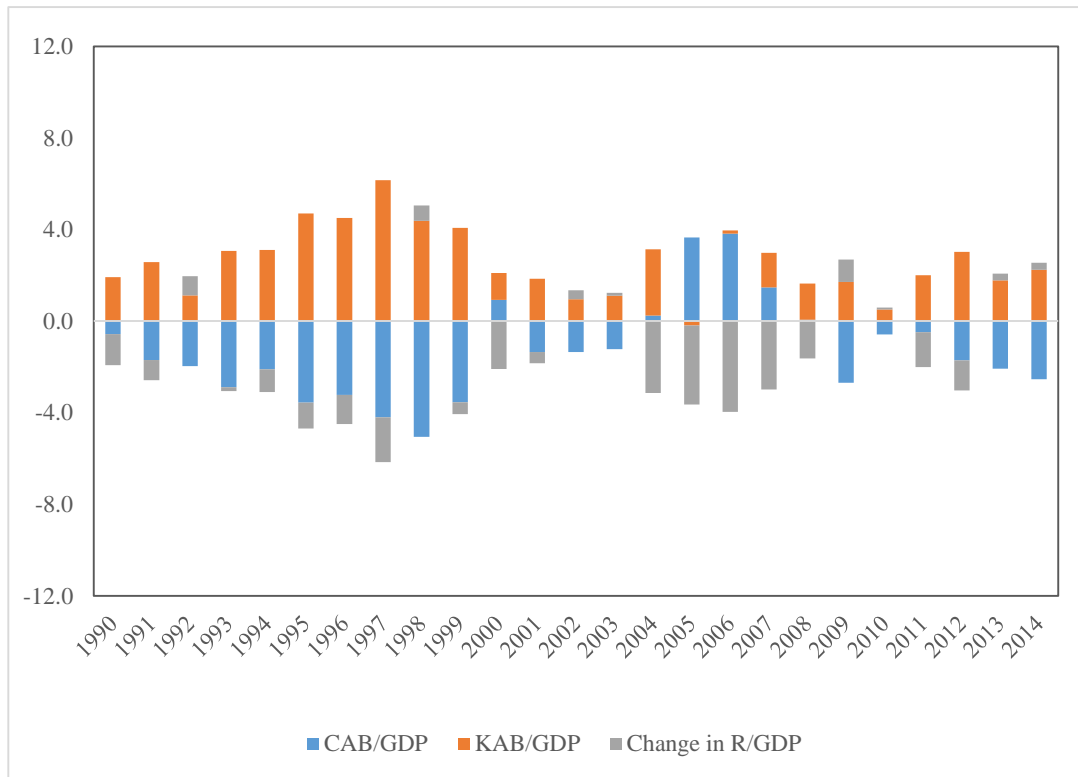
- Increasing capital account openness in both de facto(flows) and de jure(regulations) terms...in all regions
- Africa still lags other regions

Financial Flows to African Countries

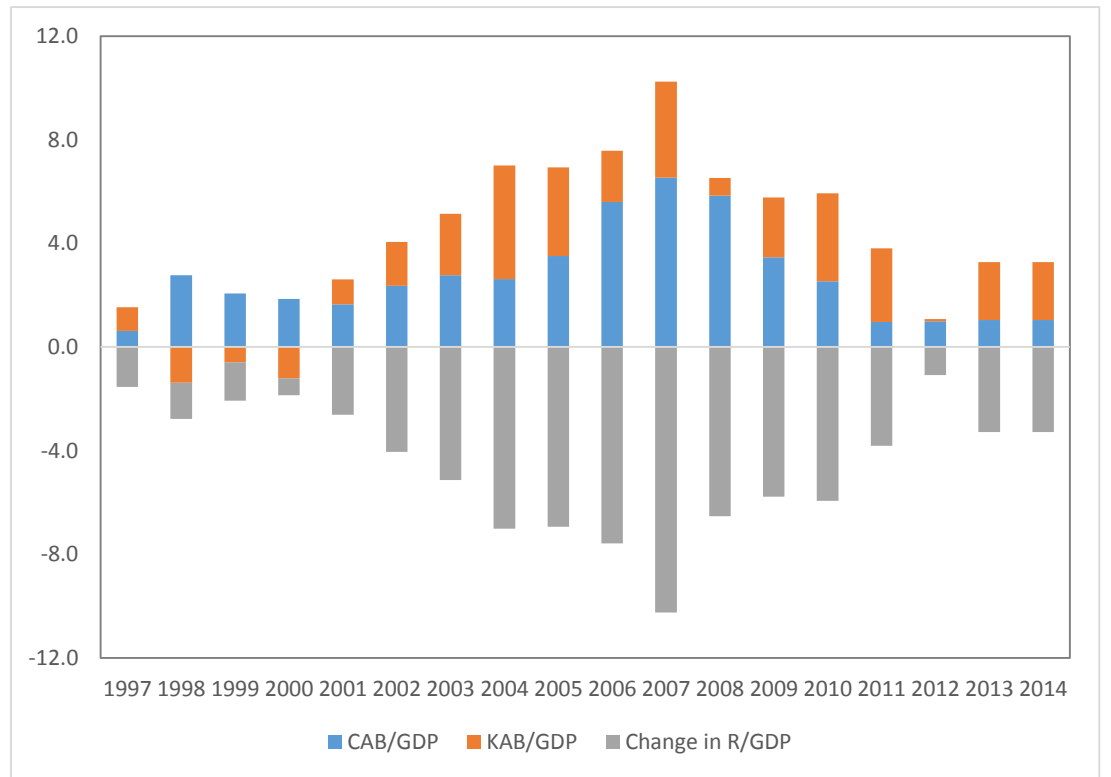


Capital Flows: Africa vs Asia

Africa

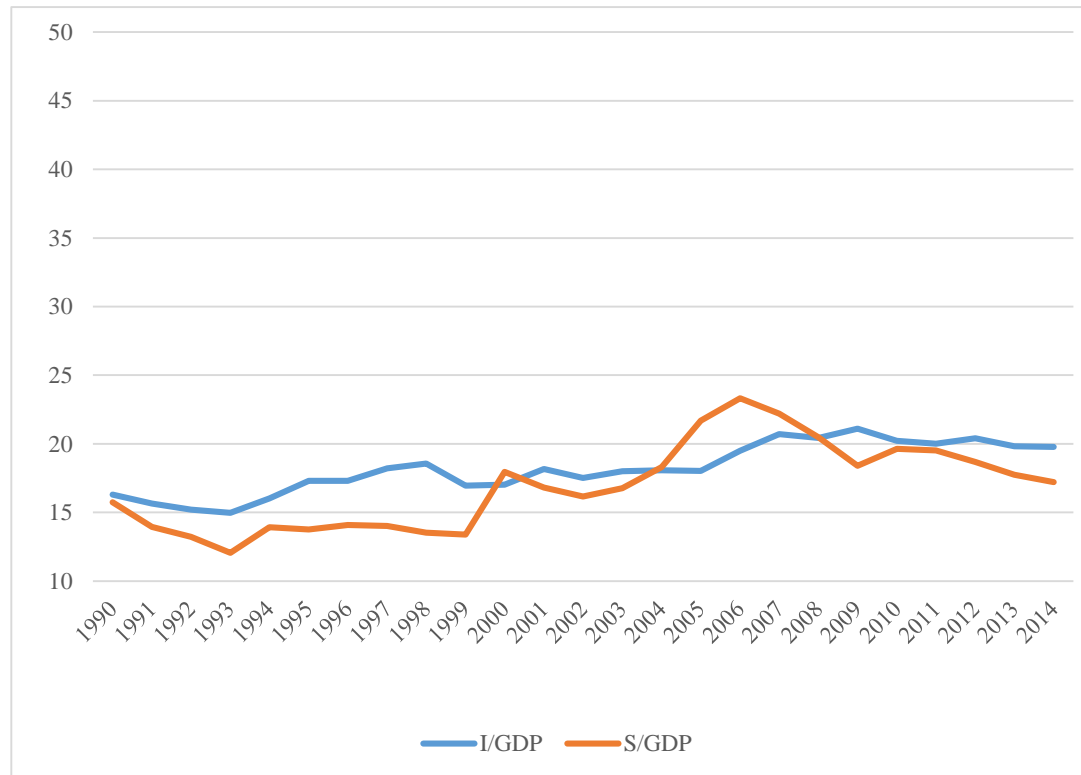


Asia

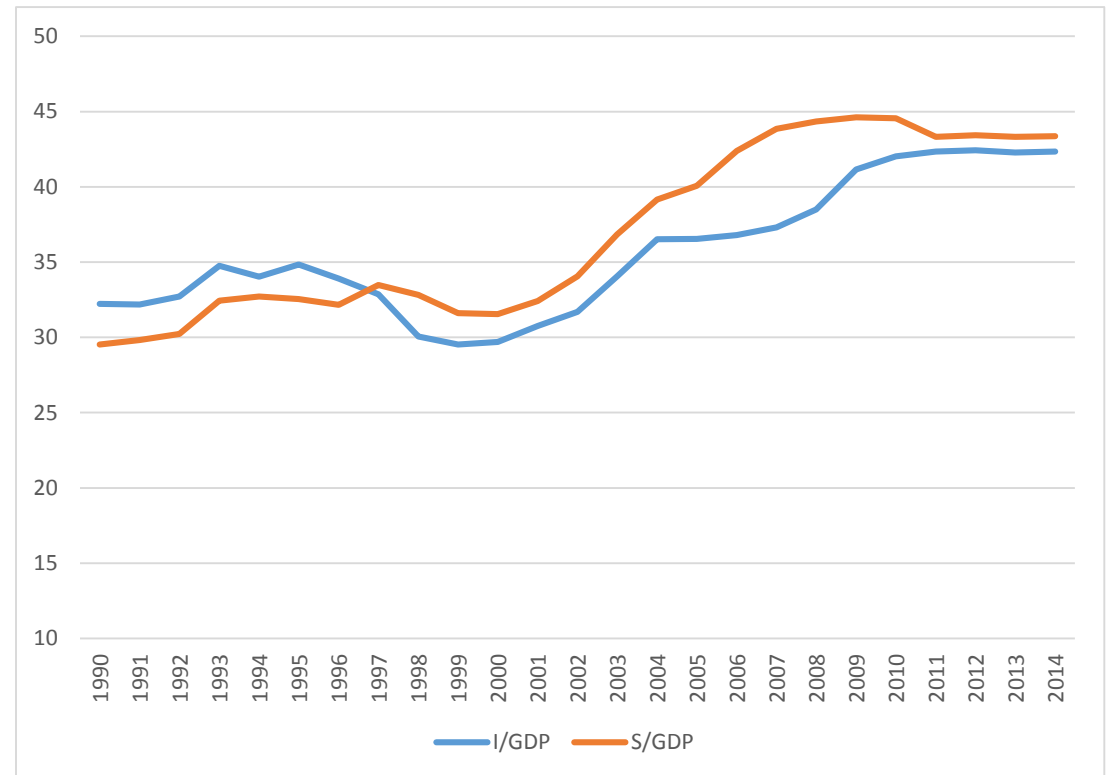


Savings-Investment Gap: Africa vs Asia

Africa



Asia



IMF Programs' Effect on Current Account Openness in Africa

(Using dummy for each type of IMF program within period of 5 months, for 3 years before and 3 years after the implementation of the program) EVENT

	Africa			Latin America			Developing Asia		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
SBA5[t-3,t+3]	-0.176***			-0.151***			-0.224***		
	(0.0180)			(0.0417)			(0.0470)		
PRGF5[t-3,t+3]		0.0848***			0.280***			0.106**	
		(0.0210)			(0.0624)			(0.0531)	
EFF5[t-3,t+3]			-0.148***			-0.133***			-0.0746
			(0.0298)			(0.0456)			(0.0618)
Observations	1,352	1,352	1,352	589	589	589	391	391	391
N	44	44	44	19	19	19	13	13	13
Fixed effects and constant	YES	YES	YES	YES	YES	YES	YES	YES	

Drivers of capital flows

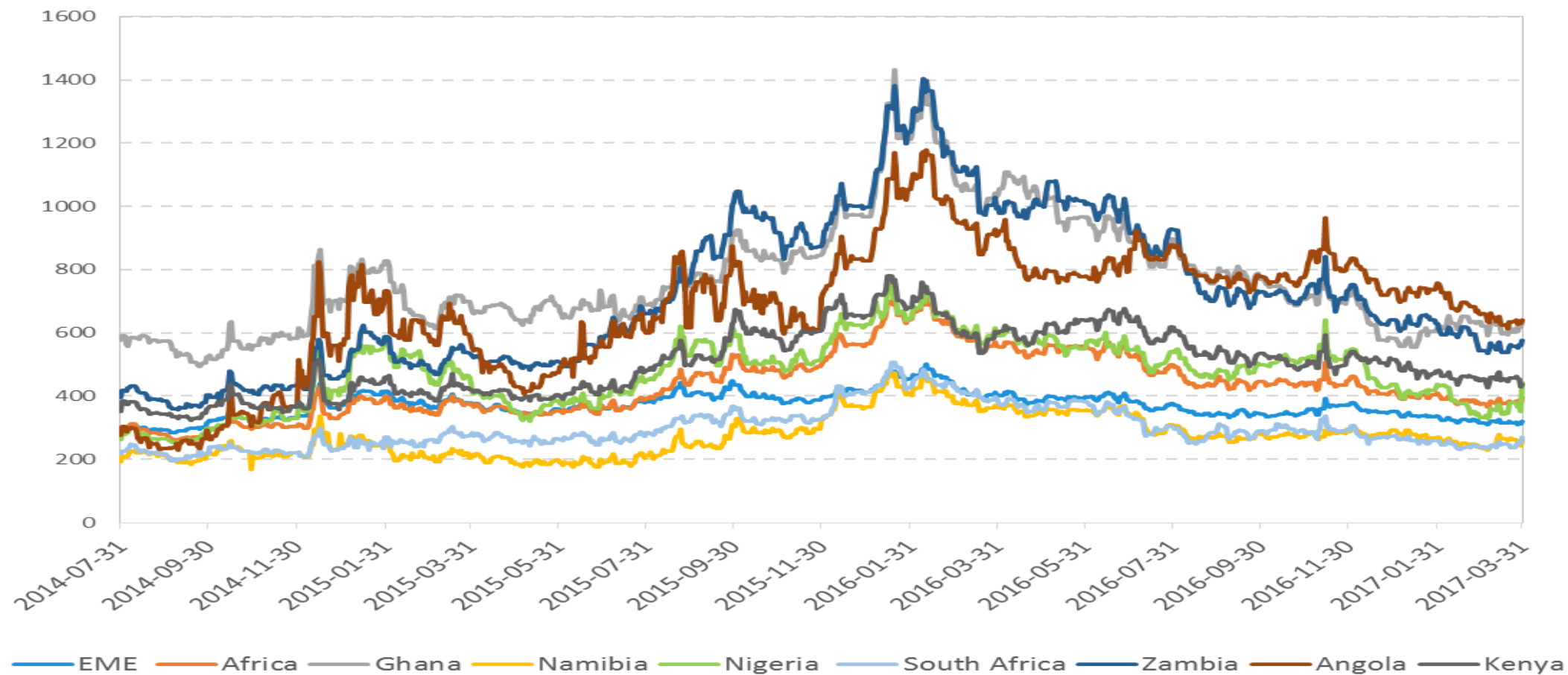
- Growth: GDP growth, GDP size
- Risk: Credit rating; Inflation differential; Current account; import cover ratio
- Liquidity: real interest rates; excess money supply;
- Institutional factors: Doing business indicators
- Valuation/Market Depth: PE Multiple; Yield differentials; market depth and liquidity
- Demographics: Population size
- Project opportunities for FDI: resources; infrastructure; manufacturing; services (private equity...)...IRR > 12%

Credit Ratings for selected African Countries

- Selected countries

Country	S & P		Moody's		Fitch	
	Credit Rating	Outlook	Credit Rating	Outlook	Credit Rating	Outlook
Angola	B	Negative	B1	Negative	B	Negative
CoteD' Ivoire	B	Not Rated	Ba3	Stable	B+	Stable
Congo Republic	B-	Stable	B3	Negative	CCC	Not Rated
DRC	B-	Negative	B3	Stable	B+	Not Rated
Ethiopia	B	Stable	B1	Stable	B	Stable
Gabon	Not Rated	Not Rated	B1	Negative	B	Negative
Ghana	B-	Stable	B3	Stable	B	Negative
Kenya	B+	Stable	B1	Stable	B+	Negative
Mozambique	SD	Negative	CAA3	Negative	Restrictive Default	Not Rated
Namibia	Not Rated	Not Rated	Baa3	Negative	BBB-	Negative
Nigeria	B	Stable	B1	Stable	B+	Negative
Rwanda	B	Stable	B2	Stable	B+	Stable
Senegal	B+	Stable	Ba3	Positive	Not Rated	Not Rated
South Africa	BB+	Negative	Baa2	Negative	BB+	Stable
Zambia	B	Negative	B3	Negative	B	Negative

African Bond Spreads for selected countries

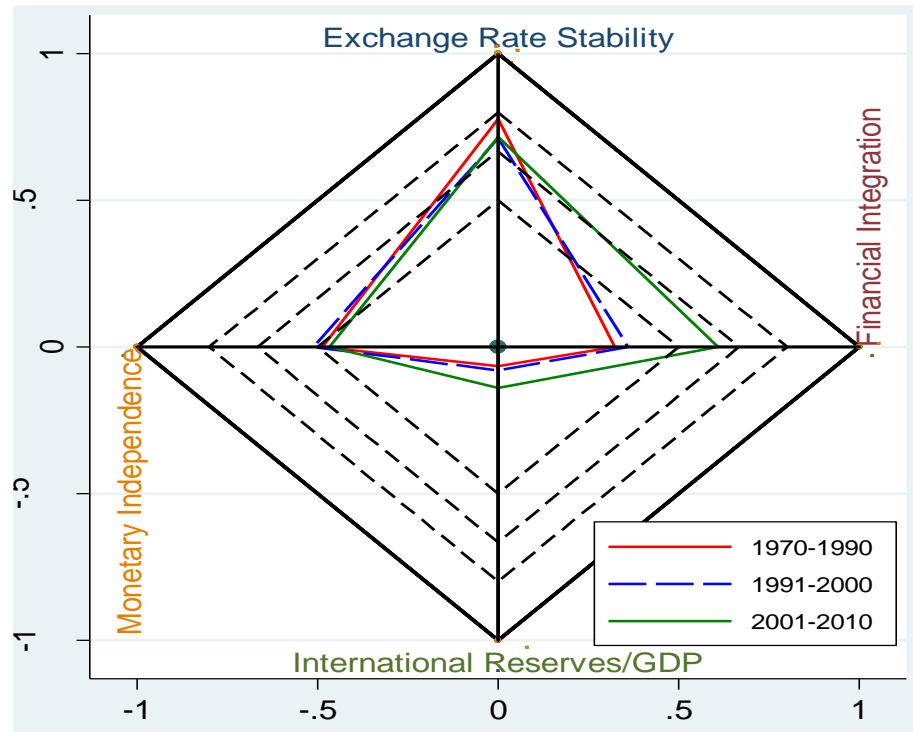


Policy Challenges and Mundell's Trilemma

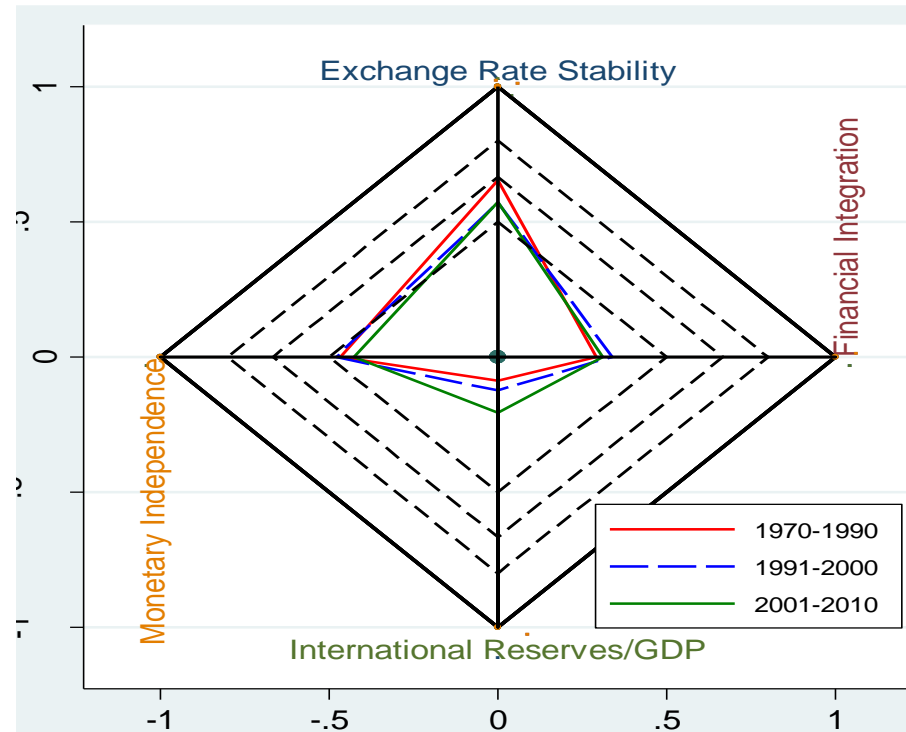
- Policy Objective: Choose Capital account policies (liberalization or controls) in order to maximize economic growth
- The policy choices are constrained by Mundell's trilemma(impossibility trinity)
- **Mundell's trilemma** posits that a country can achieve **two policy** objectives out of financial integration, exchange rate stability and monetary independence, **BUT NOT all three**
- The results for the period 1970-present show that Sub-Saharan Africa countries have pursued the policy combination of exchange rate stability and monetary independence, while lagging considerably in financial liberalization compared to other regions.

Evolution of Mundell's Trilemma: Africa vs Asia

Africa



Asia



Policy Responses to Capital Inflows

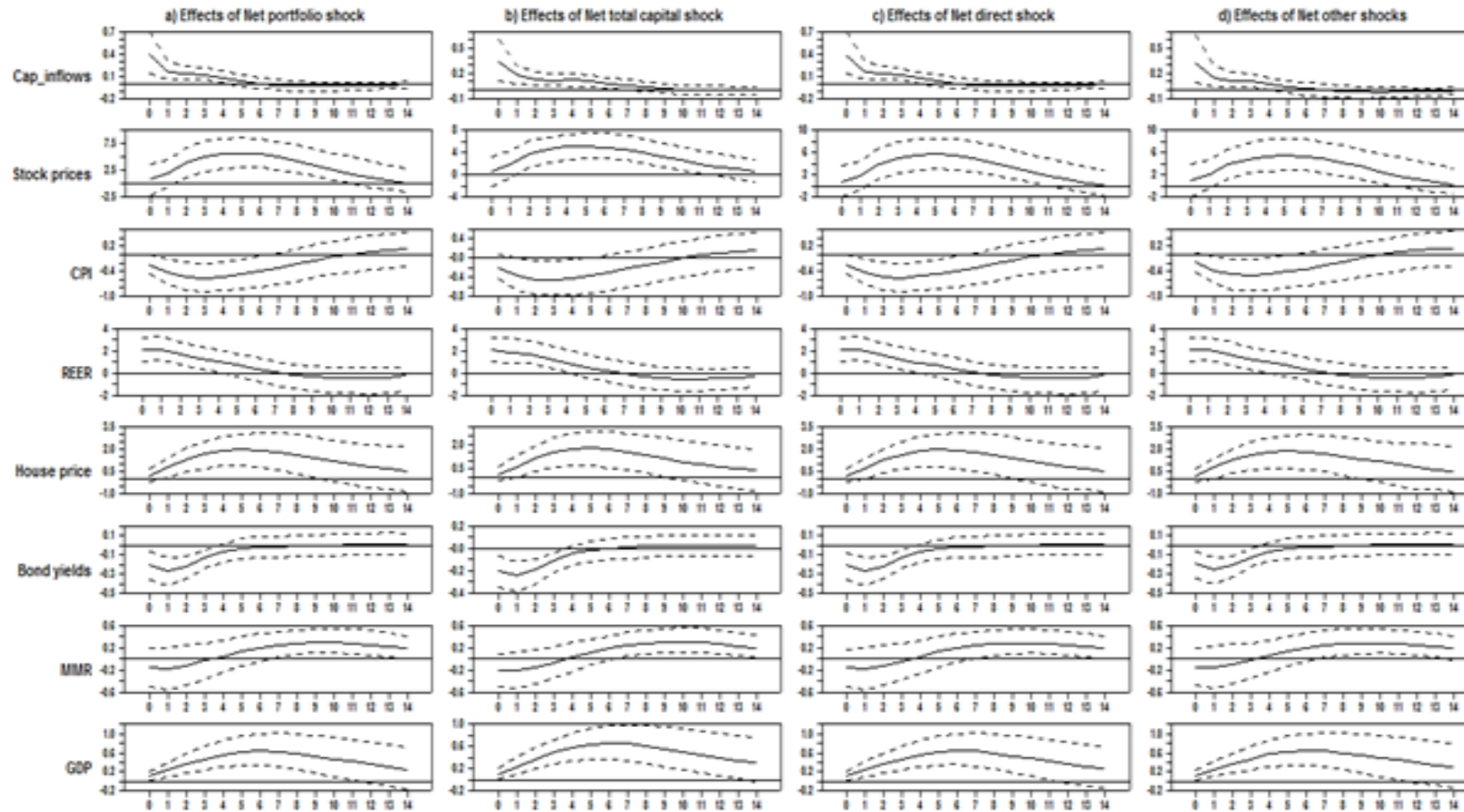
Macroeconomic responses

- Exchange rate appreciation
- Reserves accumulation
- Monetary policy: Interest rate cut
- Sterilization: to reduce money supply growth
- Fiscal policy tightening
- Impose capital controls, if all policies are exhausted

Prudential Responses

- Prudential regulation
- Linked to financial stability
- Impose capital controls (residency or FX-Currency related)
- Limit local lending in foreign currency; limit foreign purchase of securities by foreign residents; limit open foreign exchange positions; limits on foreign currency deposits

Shocks from Capital Inflows and their Effect(South Africa)...Impulse response functions



Policies for Controlling Capital Outflows

Individuals & institutions

- Annual limits on external remittances by individuals
- Limits foreign ownership of domestic stocks and debt securities (fungibility for dual listings)
- Restrictions on ownership of foreign stocks and debt securities for pension funds and other institutions
- Transactions taxes
- Administrative controls

Corporates

- Limits on external investments within regions and globally
- Limits on foreign stock exchange listings(or dual listings) of companies
- Limits on dividend remittances
- Limits on borrowings in foreign currency
- Structured trade finance transactions
- Administrative controls

Thank you