Capital Flow Management in Asia-Pacific

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The IMF's Institutional View

➢ **Basic premise:** capital flows are generally desirable, as they can bring significant benefits to countries

➢ **But:** flows often volatile ➔ macro challenges and financial stability risks

➢ **Capital flow liberalization should be well-planned, timed, and sequenced**

  ➢ Not presumed as appropriate goal for all countries at all times

➢ **Capital Flow Management Measures (CFMs) useful in some circumstances** (part of policy toolkit)

  ➢ But should not be used to avoid warranted macroeconomic adjustment

Considerations for Capital Flow Liberalization

Stable Macroeconomic and Financial Conditions
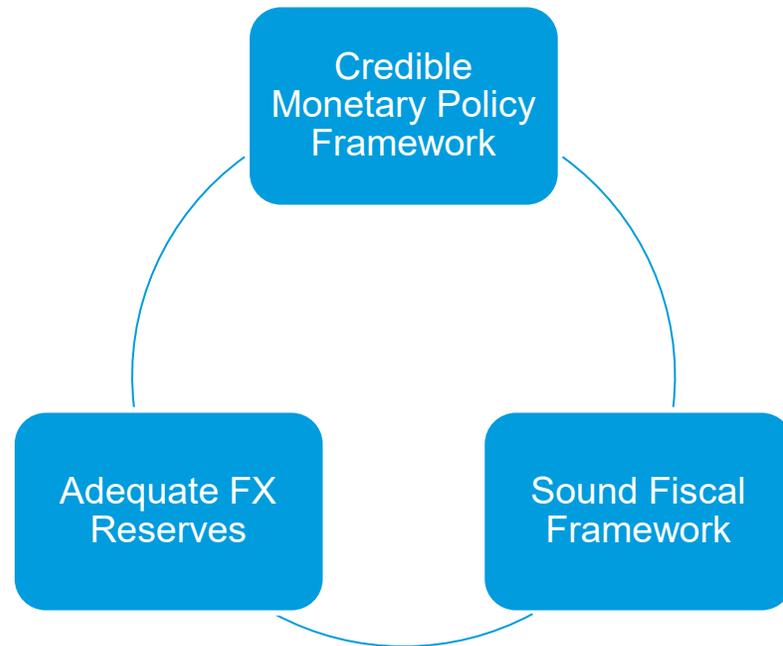
Financial Sector Readiness

Credible Monetary Policy Framework

Adequate FX Reserves

Sound Fiscal Framework

Sound Balance Sheets

Strong Regulation and Supervision

Strong Governance and Risk Management
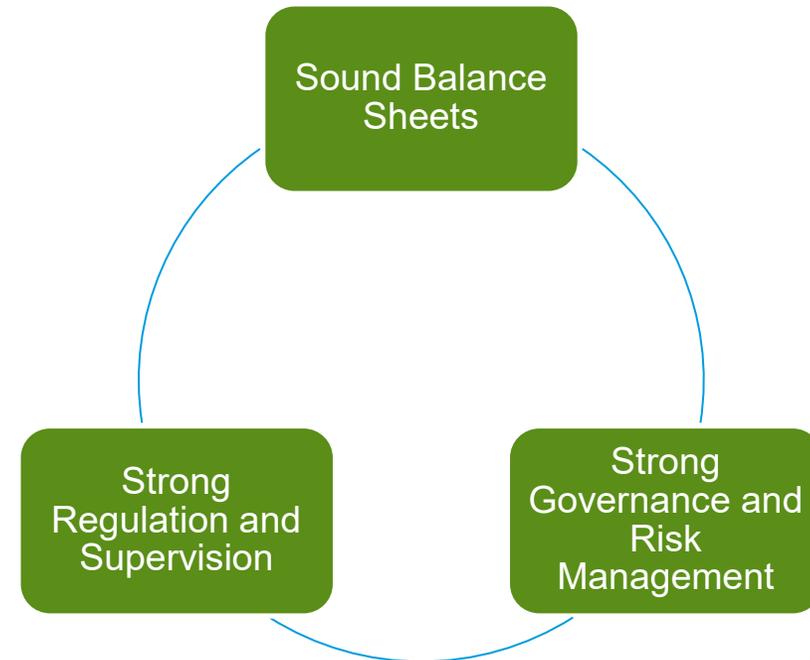
Where conditions are not fully met: any opening up should be gradual and careful

CFMs to Manage Volatile Capital Flows

➢ How **CFMs can help**:

  ➢ During inflow surges: to reduce macroeconomic risks associated with overvaluation and overheating and financial stability risks (CFM/MPMs).

  ➢ May limit risks from large **outflows** in **crisis** or imminent crisis (part of broader package)

➢ **CFMs only appropriate in limited circumstances** and should be **temporary**

  ➢ Should not substitute for warranted macroeconomic adjustment

  ➢ CFMs during surges should not for be used to influence exchange rate for unfair competitive advantage

  ➢ Should consider longer-term side effects

  ➢ Should be removed after surge/after crisis subsides (CFM/MPMs)

Policies to Manage Capital Inflow Surges

Exchange rate overvalued

Lower rates/ Intervene

Lower rates

Intervene +Sterilize

CFMs

Appreciate/ Lower rates

Appreciate

Appreciate/ Intervene +Sterilize
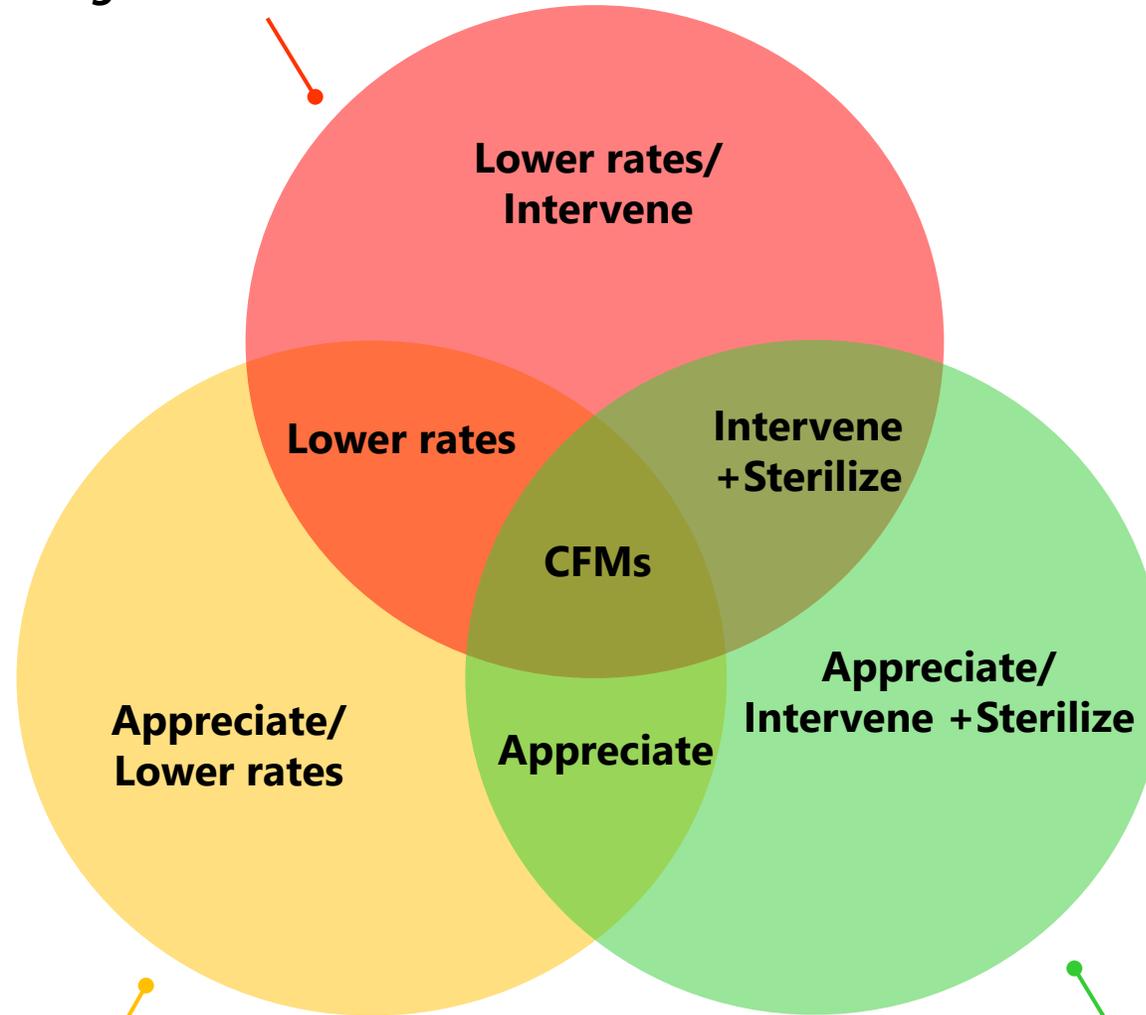
Reserves adequate

Economy overheating

The diagram does not prescribe or take a view on the appropriate combination of the three policies- only on circumstances under which each might be appropriate.

Policies to Manage Disruptive Outflows
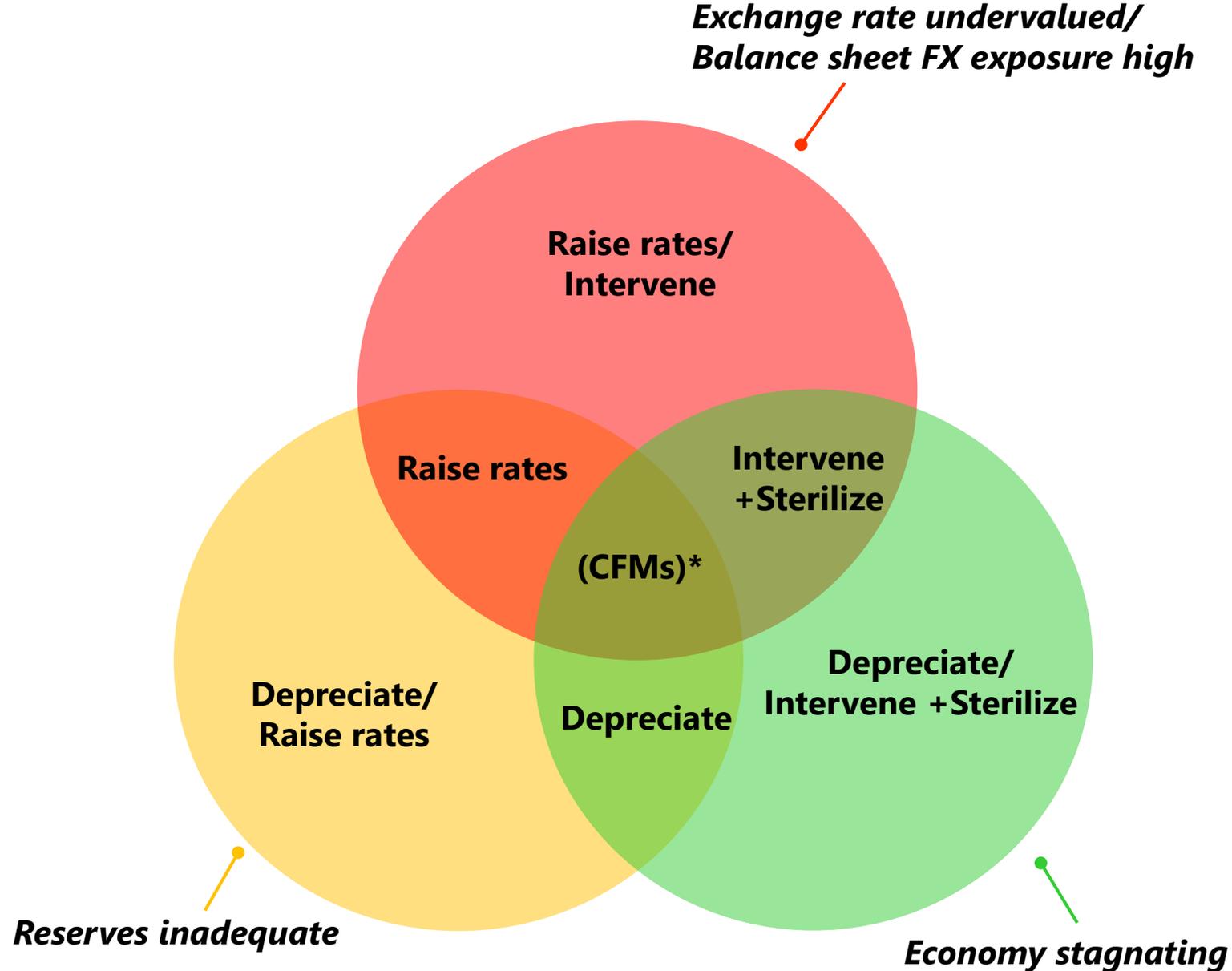
Exchange rate undervalued/
Balance sheet FX exposure high

Raise rates/
Intervene

Raise rates

Intervene
+Sterilize

(CFMs)*

Depreciate/
Raise rates

Depreciate

Depreciate/
Intervene +Sterilize

Reserves inadequate

Economy stagnating

The diagram does not prescribe or take a view on the appropriate combination of the three policies-only on circumstances under which each might be appropriate.

* In cases of **limited policy flexibility**, as represented by the intersection of the three circles, alternative options, including official financing (e.g., UFR) and, in crisis or imminent crisis, introducing temporary outflow CFMs and/or easing existing inflow CFMs can be useful to support, but not substitute for, the needed macroeconomic adjustment.

Other Cases for CFMs

➤ **Pre-emptive CFM/MPMs** outside of surges: manage capital flow volatility and prevent buildup of systemic financial risks in normal times. Conditions:

  ➢ Elevated financial stability risk associated with FX mismatch

  ➢ CFM/MPMs are needed to contain the risk (i.e., macro adjustment or MPMs not enough)

  ➢ CFM/MPMs should not help maintain or exacerbate a stronger-than-warranted external position

  ➢ Keep CFM/MPMs temporary and targeted (remove when risks subside)

➤ **Special Cases**

  ➢ CFMs governed by separate **international standards** (Basel, FATF, international tax cooperation standards)

  ➢ CFMs imposed for reasons of **national or international security** (mainly FDI-related)

Asian Financial Accounts Have Opened Over Time (1)

De Jure Capital Account Openness (Normalized Chinn-Ito index)
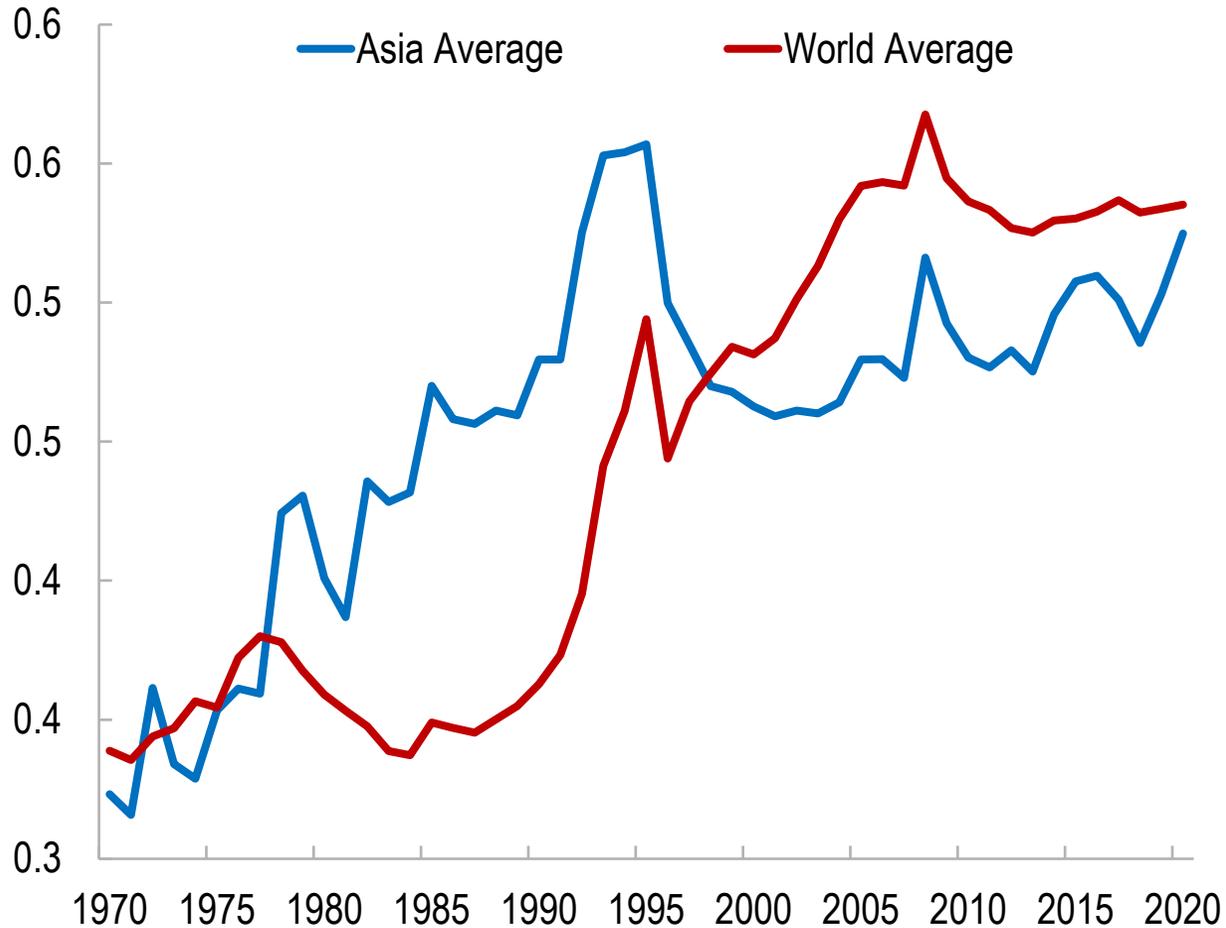
Sources: Chinn, Menzie D. and Hiro Ito (2006), and IMF staff calculations.

De Jure Capital Account Openness in 2020 (Normalized Chinn-Ito index)
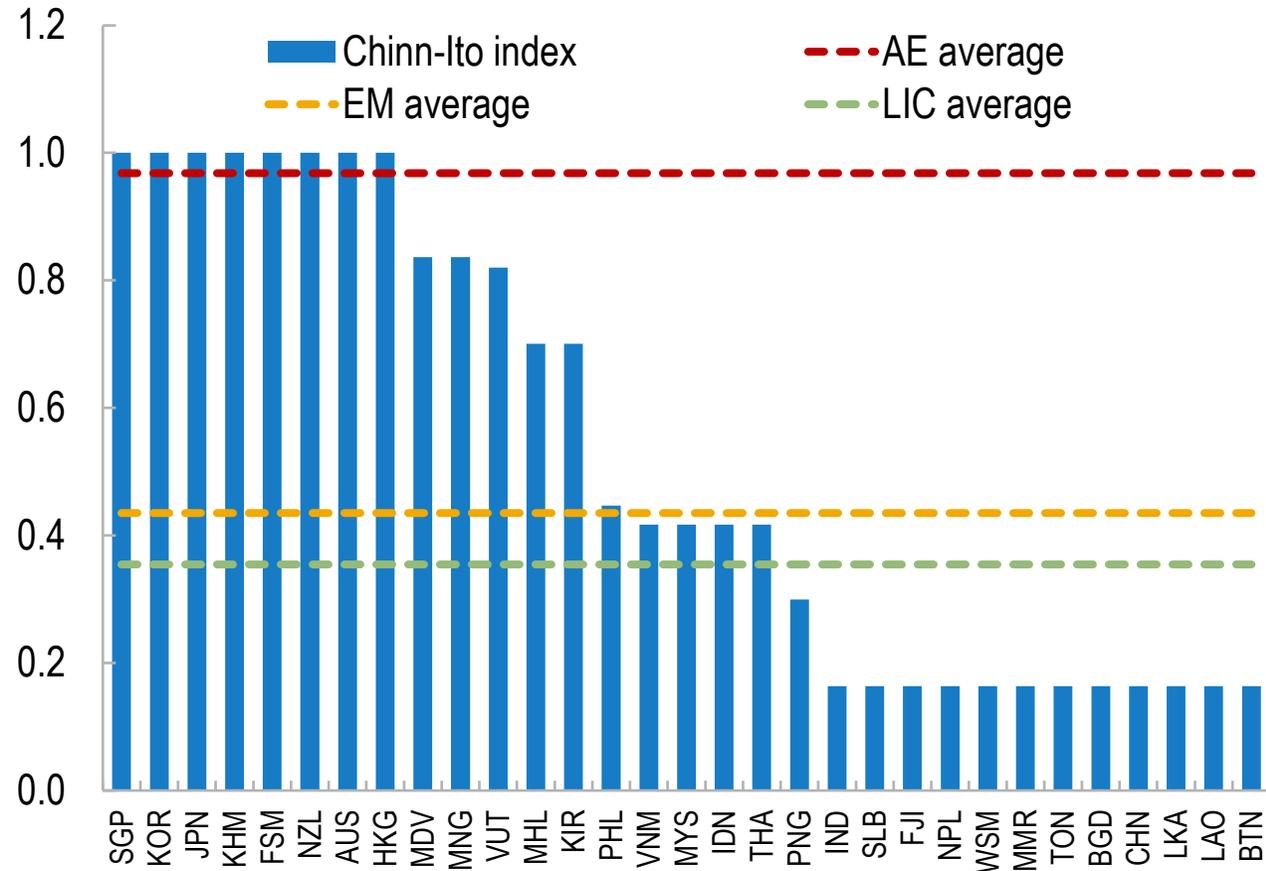
Sources: Chinn, Menzie D. and Hiro Ito (2006), and IMF staff calculations.

Asian Financial Accounts Have Opened Over Time (2)

De Facto Capital Account Openness in Asia (In percent of GDP)

Legend:
- Portfolio Equity Asset (red)
- Portfolio Equity Liability (pink)
- FDI Asset (green)
- FDI Liability (light green)
- Debt Asset (dark blue)
- Debt Liability (light blue)
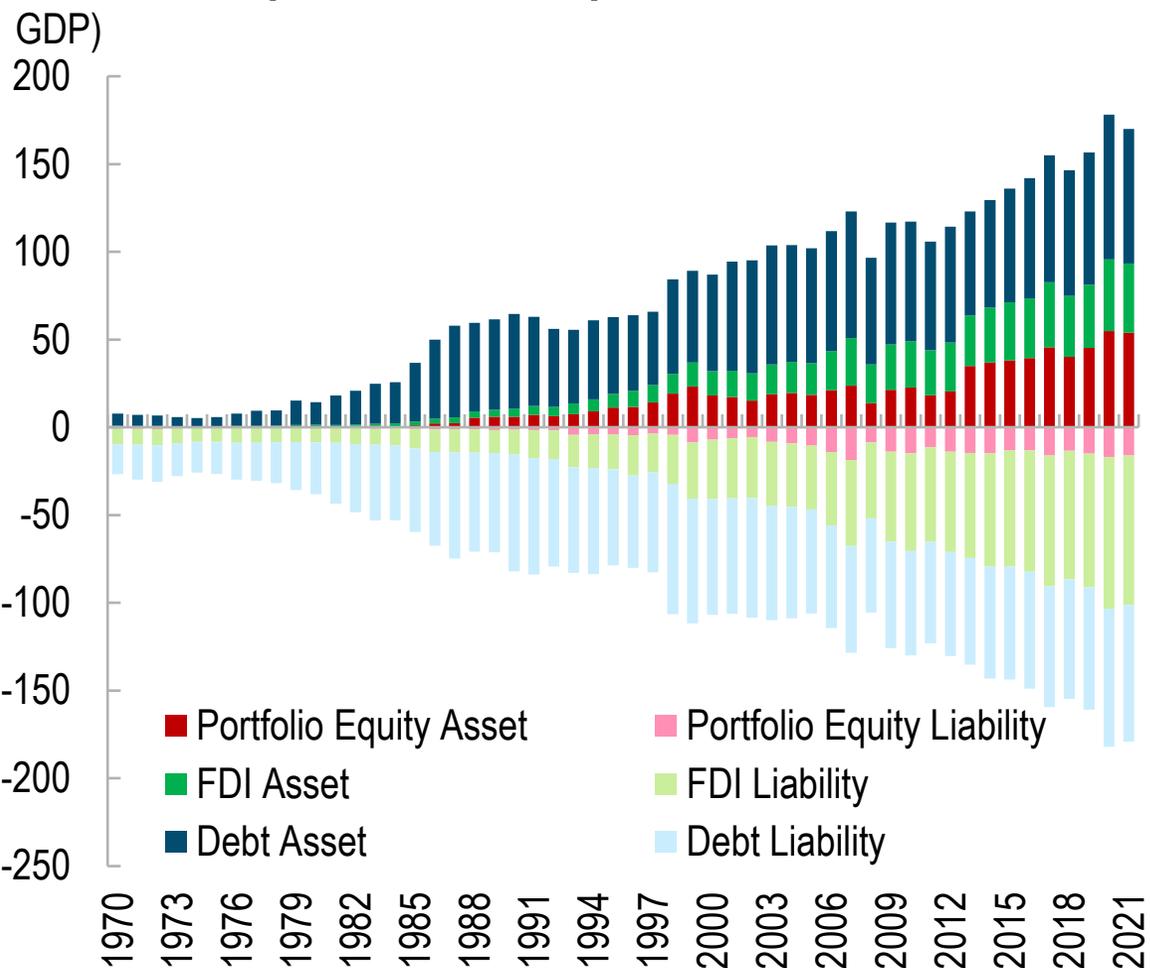
Sources: Lane, Philip R. and Gian Maria Milesi-Ferretti (2018), and IMF staff calculations.

De Facto Capital Account Openness in 2021 (In percent of GDP)

Legend:
- Portfolio Equity Asset (red)
- Portfolio Equity Liability (pink)
- FDI Asset (green)
- FDI Liability (light green)
- Debt Asset (dark blue)
- Debt Liability (light blue)

Countries: Taiwan POC, Japan, Australia, Malaysia, Korea, New Zealand, Thailand, Cambodia, Philippines, China (mainland), Vietnam, Indonesia, Mongolia, Maldives, India, Laos, Myanmar, Bhutan, Sri Lanka, Nepal, Bangladesh, APD average, AE average, EM average, LIC average

Sources: Lane, Philip R. and Gian Maria Milesi-Ferretti (2018)
Note: financial centers (HKG, SGP, LUX), Brunei and Pacific Island countries excluded from the calculations

Capital Flows to Asia Have Been Volatile

Net Capital Inflow to Asia (in billions 2005 USD)
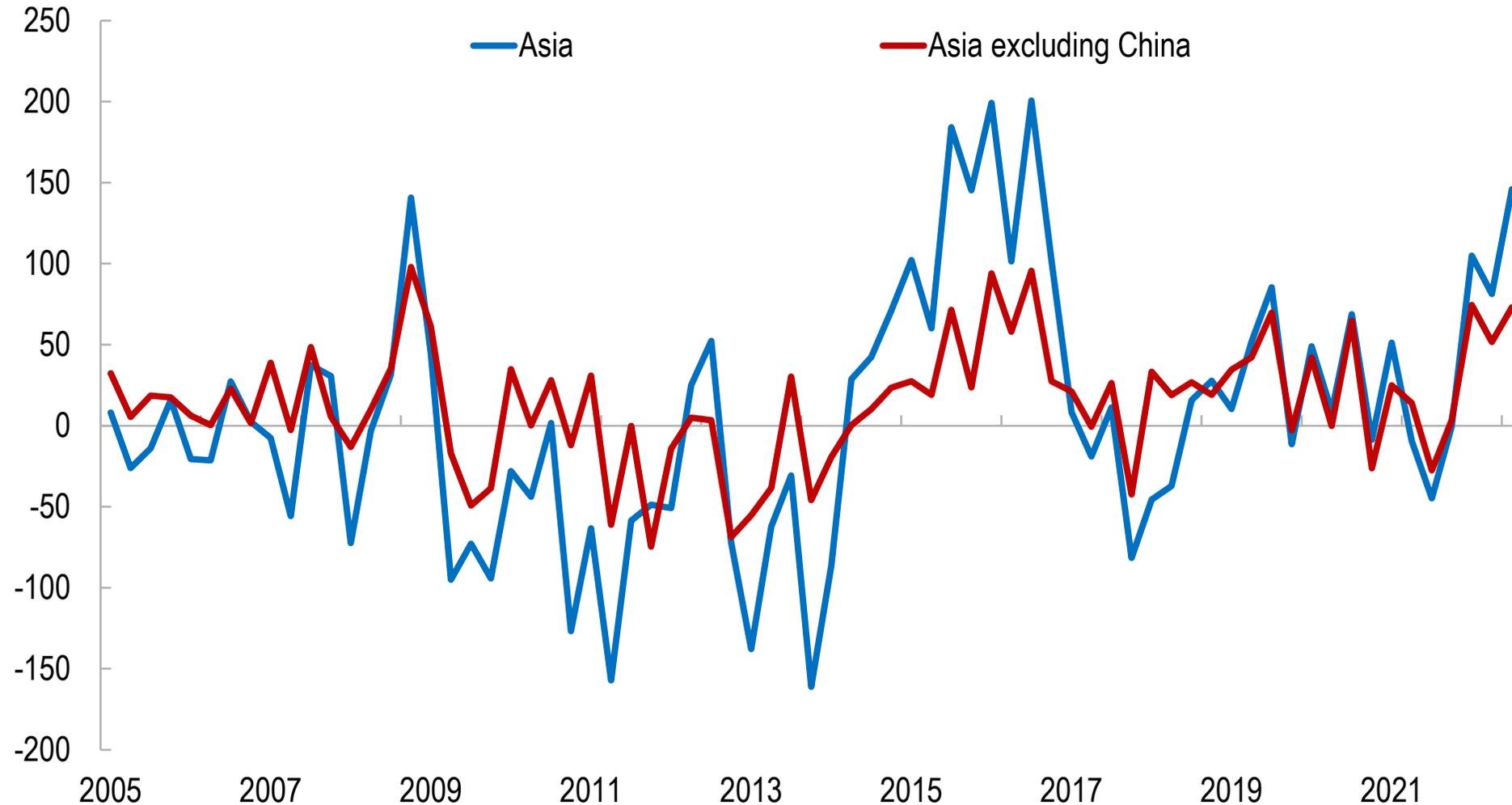
Source: IMF Balance of Payment data; and Haver Analytics.

CFMs Have Been Employed Frequently in Asia

Type of CFMs used in Asia 2012-2021*
(number of measures per type)
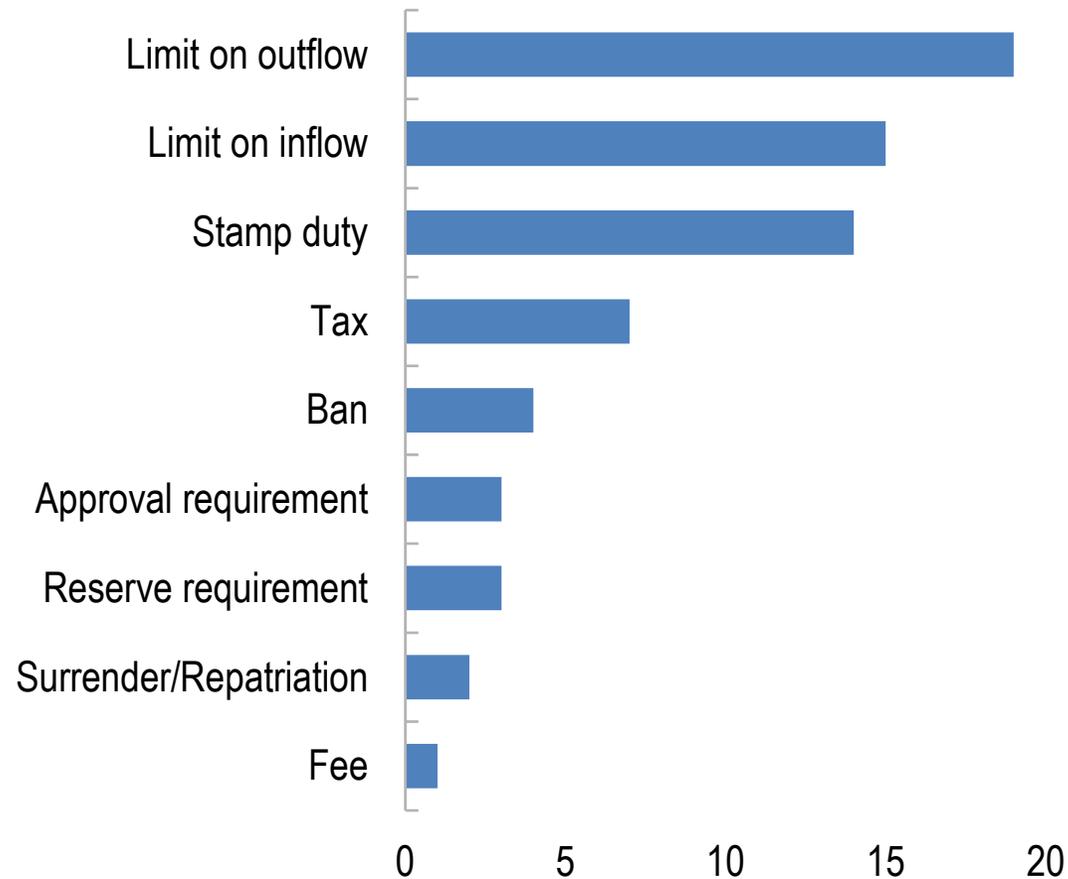
Sources: IMF 2021 Taxonomy of CFMs.
Note: * number of CFMs active or changed between 2012-2021

Net use of CFMs in selected Asian economies*
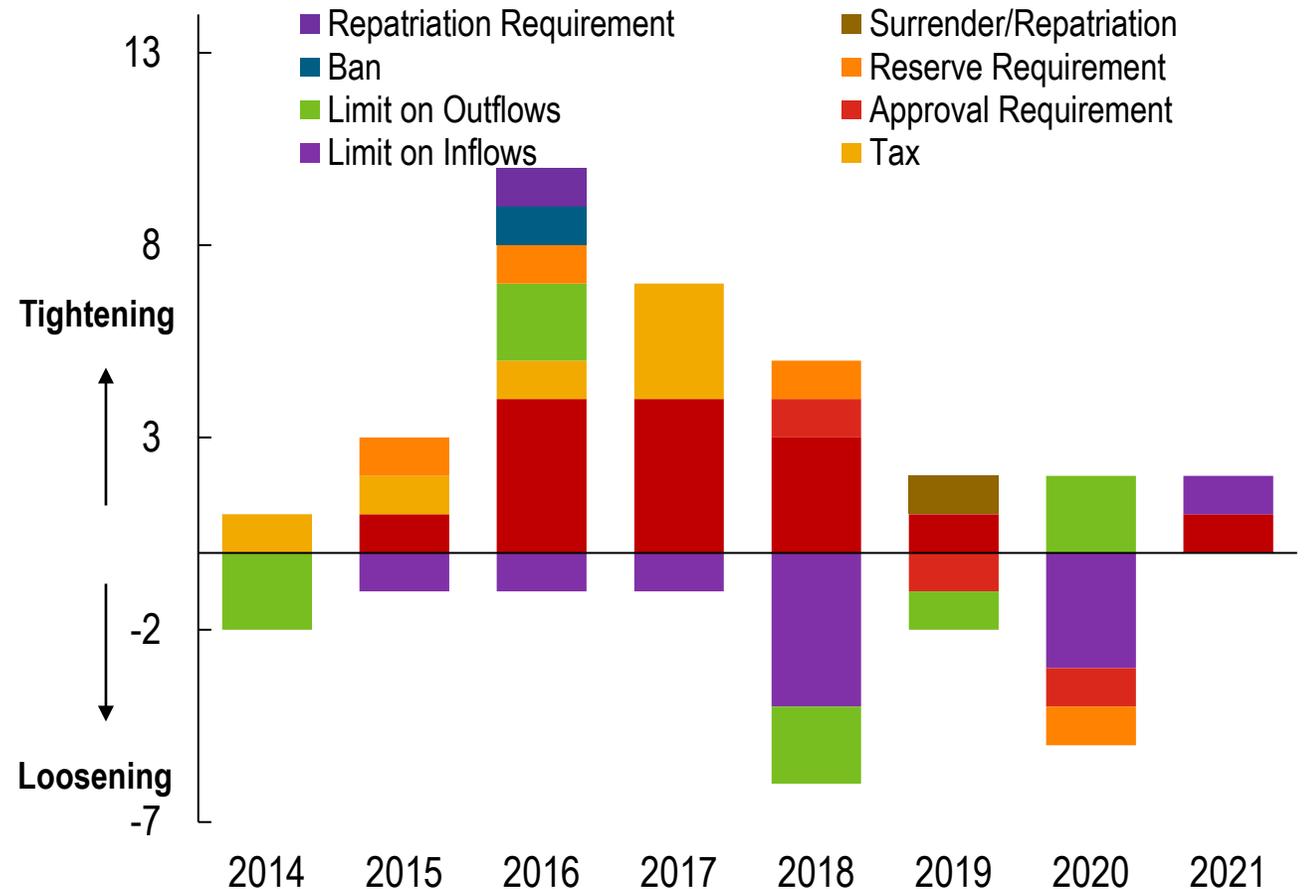
Source: IMF 2021 Taxonomy of CFMs.
Note: * number of new introduction, tightening and easing of CFM policies each year

Takeaways and Key Question

➤ **Capital flows:** generally desirable but not under all circumstances or at all times

➤ **Capital flow liberalization:** should be carefully planned, timed, and sequenced

➤ **CFMs:** can be useful under some circumstances but should not substitute for necessary macroeconomic adjustment

➤ **Financial account openness in Asia**: gradual trend toward more openness

 ➤ Degree of openness generally differs with income level

➤ **Asian CFMs**: countries have used a broad toolkit of CFMs

 ➤ During surges of volatile capital flows but often also outside of surges

Key question: What are the implications of digital assets/central bank digital currencies for capital flow management?