

Lessons from GFC for Management and Liberalization of Capital Flows in Asia

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This draws largely on Chapter 1 of the forthcoming book,
Managing Capital Flows: Search for a Framework,
edited by Masahiro Kawai and Mario B. Lamberte

Outline

1. Introduction
2. Economic characteristics of Asian economies
3. Openness of the economies
4. Patterns of capital flows
5. Impacts of capital inflows
6. Policy responses of Asian economies
7. Policy issues

1. Introduction

- Types of risks arising from surges in capital inflows:
 - macroeconomic risks
 - financial instability
 - sudden and massive capital flow reversal
- Asian economies experienced surges in capital inflows up until the onset of the global financial and economic crisis
- With the global economic turmoil subsiding, there are signs that capital of a largely short-term nature is returning to Asia in a significant way raising serious concern among policymakers in the region
- following Brazil's move, Taipei,China has recently imposed capital controls to limit speculative capital inflows
- These recent developments suggest that managing capital inflows remains an important policy issue for many emerging market economies

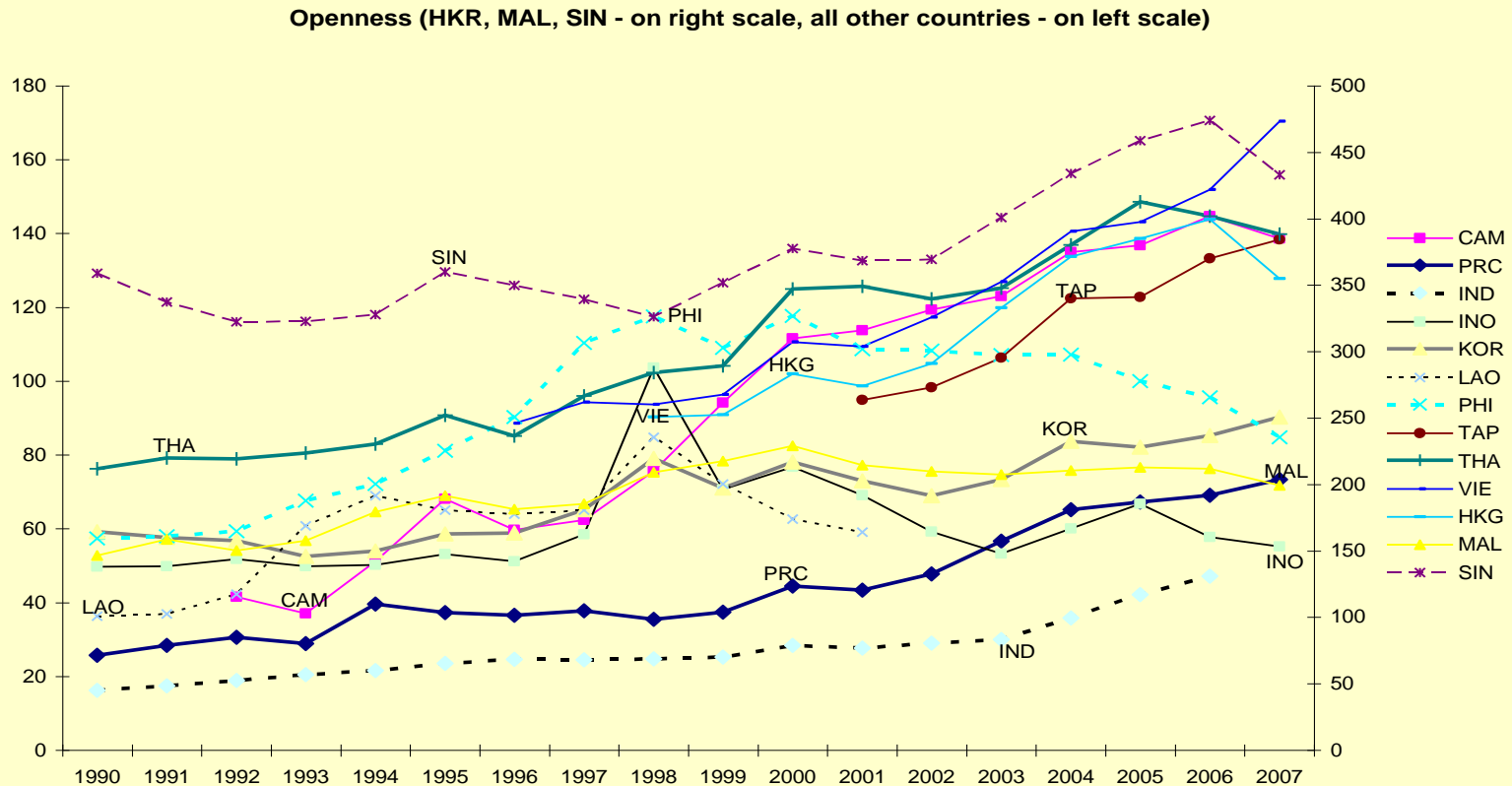
2. Some economic characteristics of emerging Asian economies...

Economies	GDP Growth (in %)			Current Account (as % of GDP)			Investment Ratio (as % of GDP)		
	1990-1996	2000-2007	2008	1990-1996	2000-2007	2008	1990-1996	2000-2007	2008
	Cambodia (CAM)	5.8	9.5	6.7	-5.0	-4.1	-10.2	10.8	18.5
China, People's Republic (PRC)	10.7	10.1	9.0	1.1	4.8	9.8	31.2	38.9	42.0
Hong Kong, China (HKG)	4.6	5.3	2.4		9.3	14.2	28.2	22.5	19.7
India (IND)	5.8	7.3	6.7	-1.3	-0.1	-3.0	22.6	27.6	34.8
Indonesia (INO)	7.5	5.0	6.1	-2.5	2.8	0.1	27.9	21.5	27.6
Korea (KOR)	7.9	5.2	2.2	-1.6	1.8	-0.7	37.3	29.0	29.3
Lao PDR (LAO)	6.5	6.7	7.8	-14.3	-2.3	0.0		28.5	0.0
Malaysia (MAL)	9.5	5.6	4.6	-5.5	11.8	17.6	38.7	22.5	19.6
Myanmar (MYA)	5.5	8.0	0.0	-0.6	0.0	0.0	13.2	0.0	0.0
Philippines (PHI)	2.8	5.0	3.8	-4.0	0.9	2.3	22.4	16.6	14.8
Singapore (SIN)	8.8	6.0	1.1	12.4	17.6	14.9	34.5	25.1	28.5
Taipei,China (TAP)	6.9	4.1	0.1		7.1	6.4		20.3	21.2
Thailand (THA)	8.6	5.0	2.9	-7.0	2.9	0.0	40.4	25.3	27.3
Viet Nam (VIE)	7.9	7.6	6.2	-8.4	-1.8	-11.8	20.2	32.4	36.0

Source: IFS, WDI, national statistics

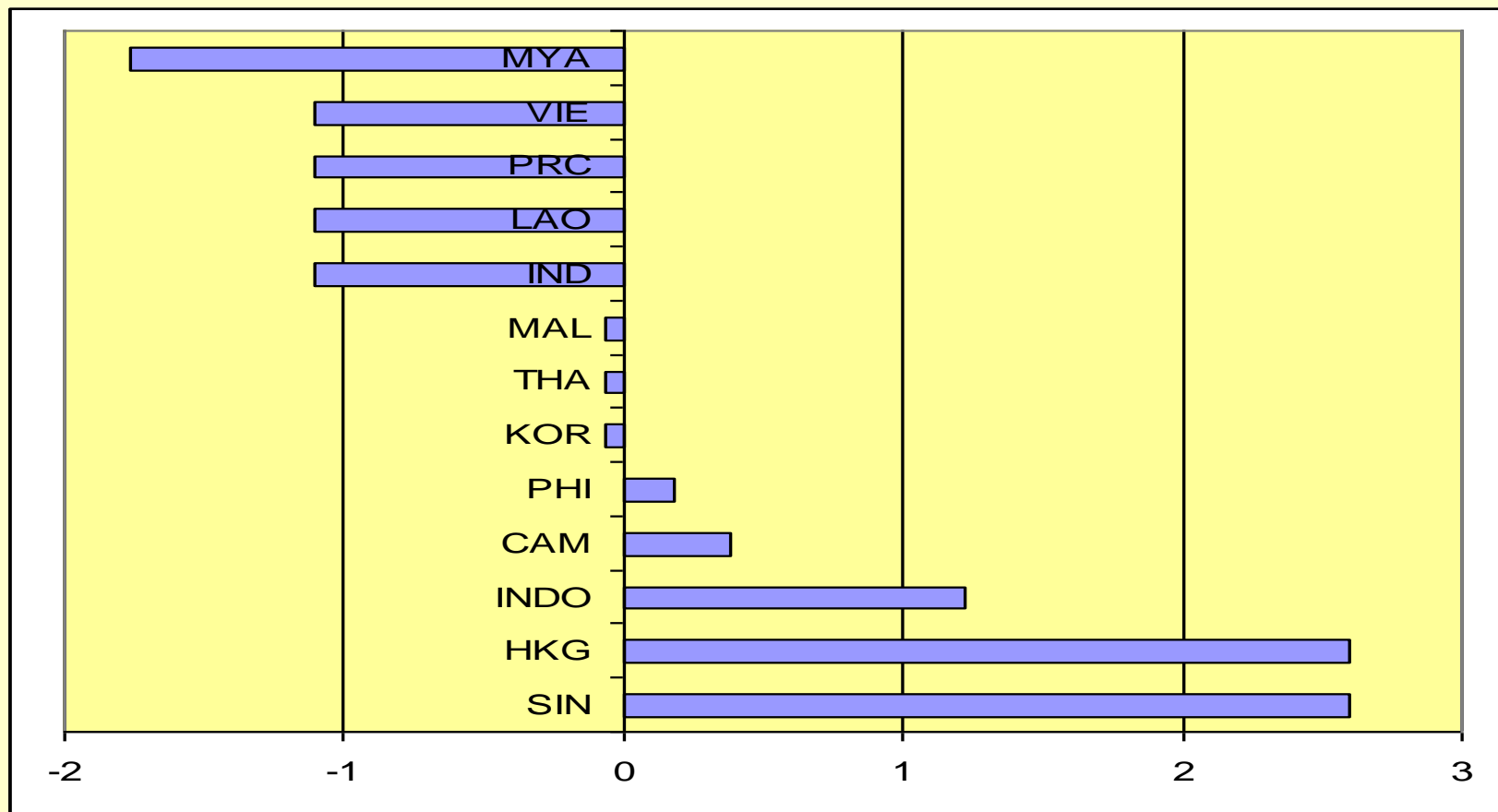
3a. Openness of the Asian Economies: Trade in Goods and Services

Figure 1. Ratio of Total Exports and Imports of Goods and Services to GDP (%)



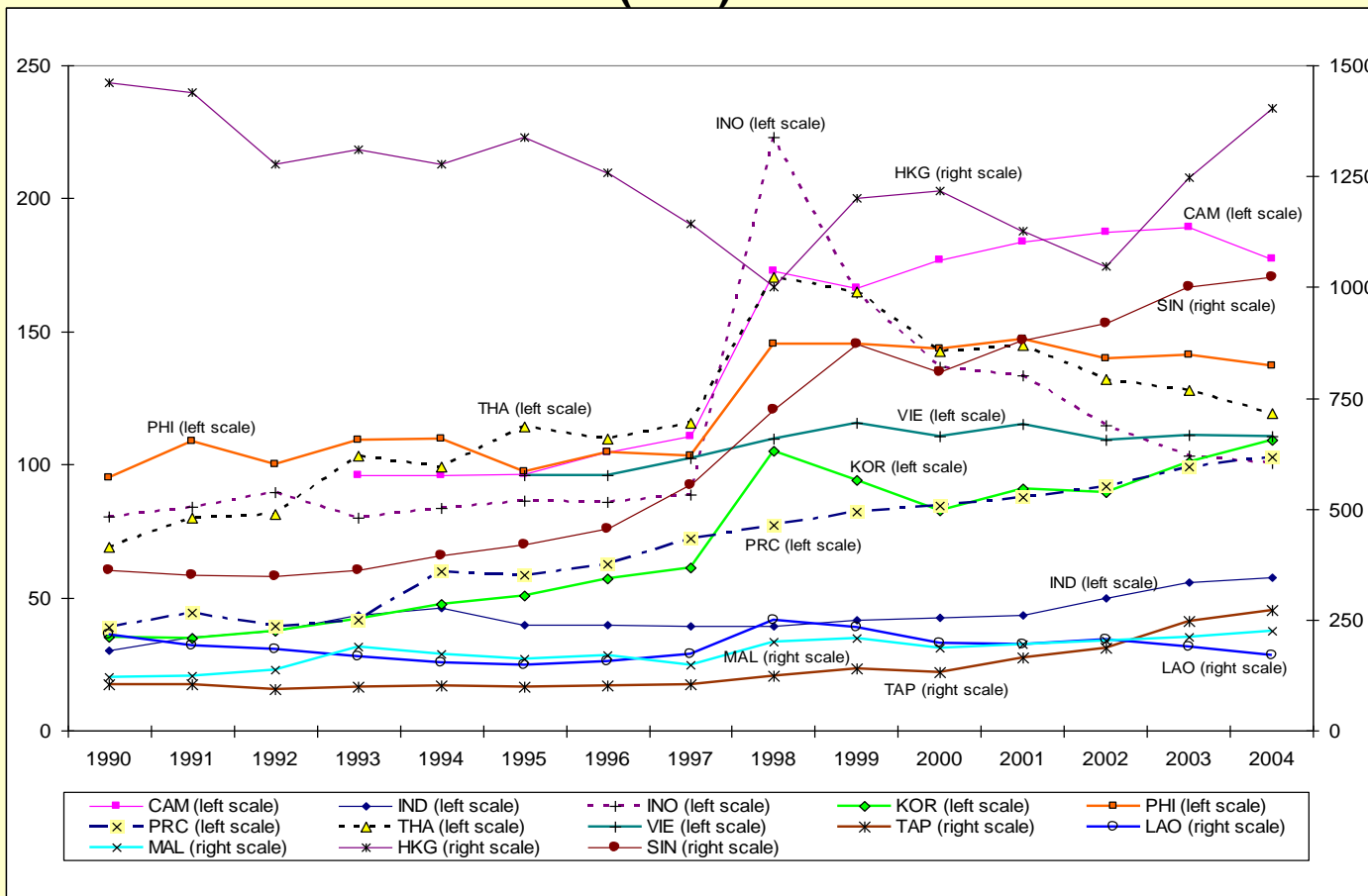
3b. Openness of the Capital Account

Figure 2. Degree of Openness of the Capital Account: *de jure*
(Chinn-Ito Index)



Capital Account Openness: de facto

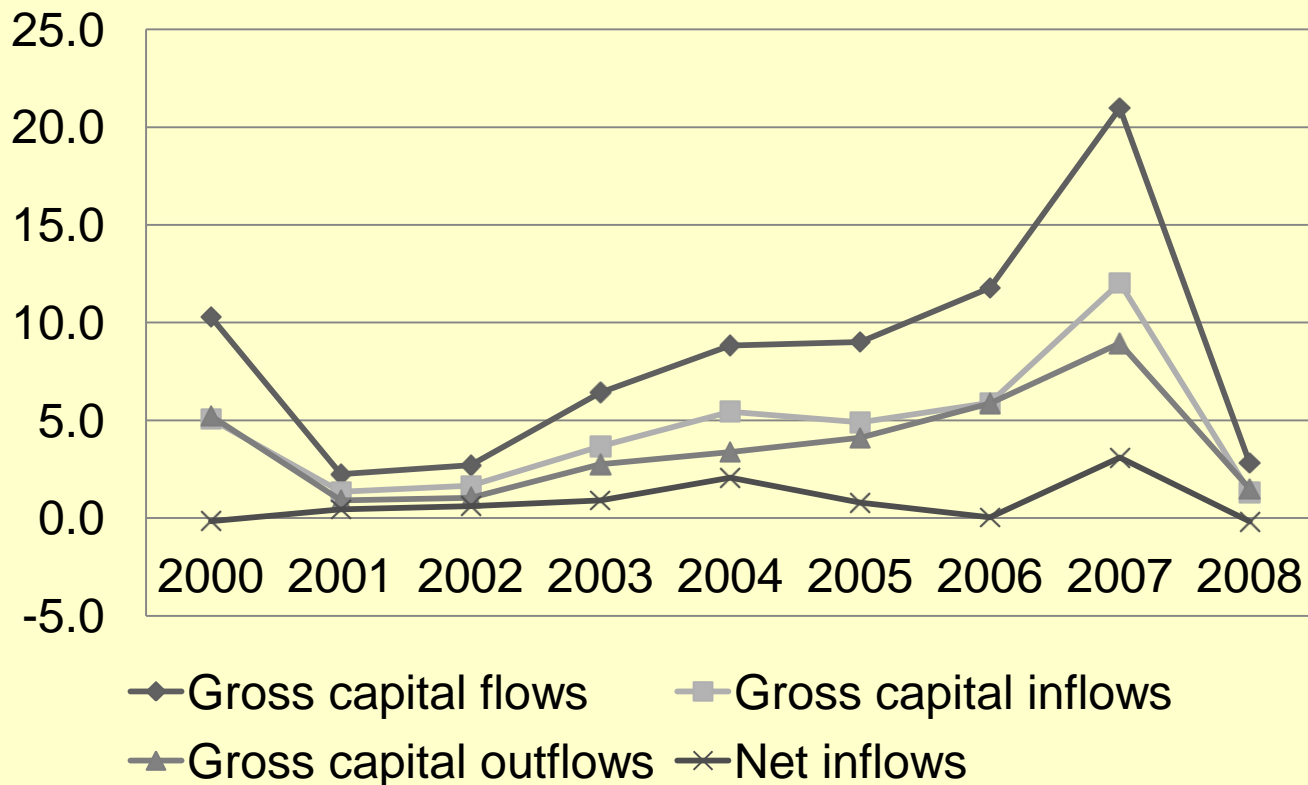
Ratio of Total Stock of Assets and Liabilities to GDP (In %)



4. Patterns of Capital Flows

- Capital inflows increasing since 2001, but dropped sharply in 2008
 - although share of FDI has remained high, however, share of portfolio has been increasing fast
 - bank financing rose sharply in 2007-08 with Korea accounting for two-thirds of the total
- Capital outflows also increasing up until 2008, led by PRC, Singapore and Korea
 - Portfolio investment outflows have the largest share
- As a whole, capital flows in Asia has become increasingly symmetric

Capital Flows: Emerging Asian Economies, % of GDP



Capital Flows in Emerging Market Economies: a Comparison

Capital Flows in Emerging Asia, 2000-2008 (in billion US\$)

	2000-2007	2008
Gross Flows	4743.1	237.2
<i>in % of GDP</i>	10.0	2.8
Gross Inflows	2624.1	111.2
<i>in % of GDP</i>	5.5	1.3
Gross Outflows	2119.0	126.0
<i>in % of GDP</i>	4.5	1.5
Net Inflows	505.1	-14.8
<i>in % of GDP</i>	1.1	-0.2

Capital Flows in Emerging Latin America 2000-2008 (in billion US\$)

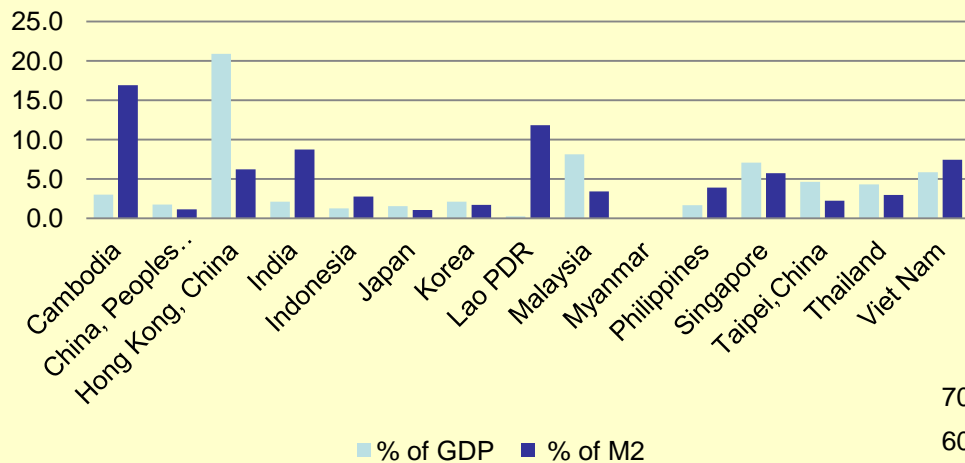
	2000-2007	2008
Gross Flows	677.3	159.2
<i>in % of GDP</i>	6.9	6.6
Gross Inflows	351.6	80.2
<i>in % of GDP</i>	3.6	3.3
Gross Outflows	325.7	79.0
<i>in % of GDP</i>	3.3	3.3
Net Inflows	25.9	1.2
<i>in % of GDP</i>	0.3	0.0

Capital Flows in Emerging Europe, 2000-2008 (in billion US\$)

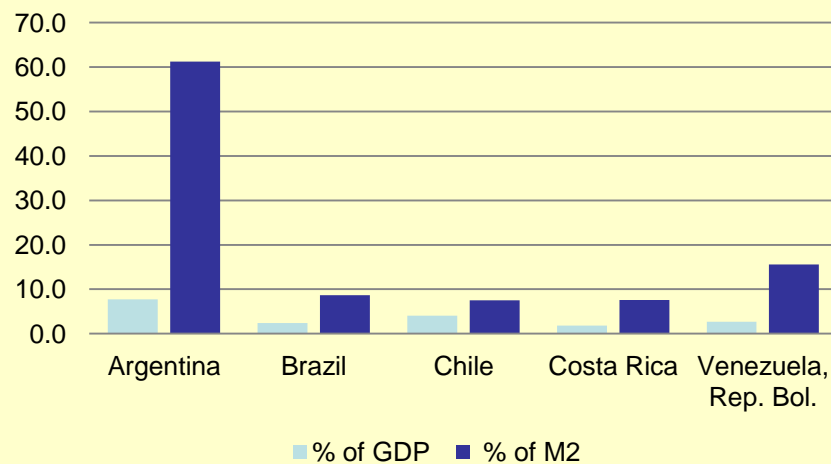
	2000-2007	2008
Gross Flows	789.1	182.0
<i>in % of GDP</i>	18.7	17.3
Gross Inflows	553.0	139.2
<i>in % of GDP</i>	13.1	13.2
Gross Outflows	236.1	42.8
<i>in % of GDP</i>	5.6	4.1
Net Inflows	316.8	96.4
<i>in % of GDP</i>	7.5	9.2

Volatility of net flows is generally high and varies greatly across countries..

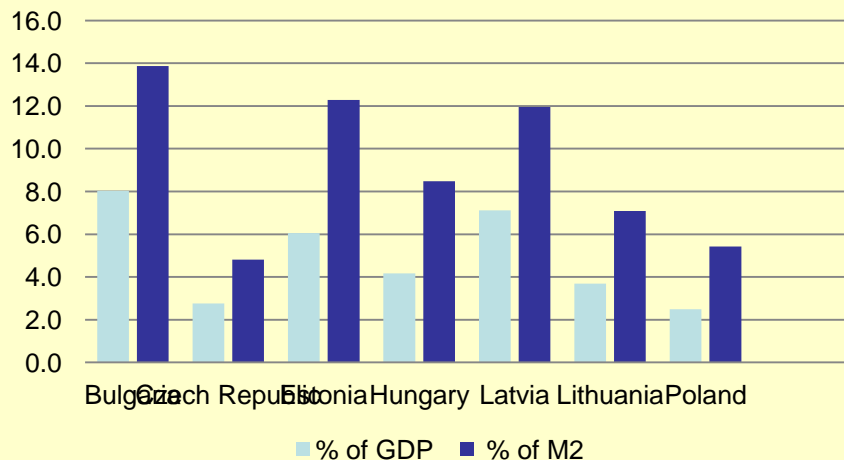
East Asian Economies



Latin America



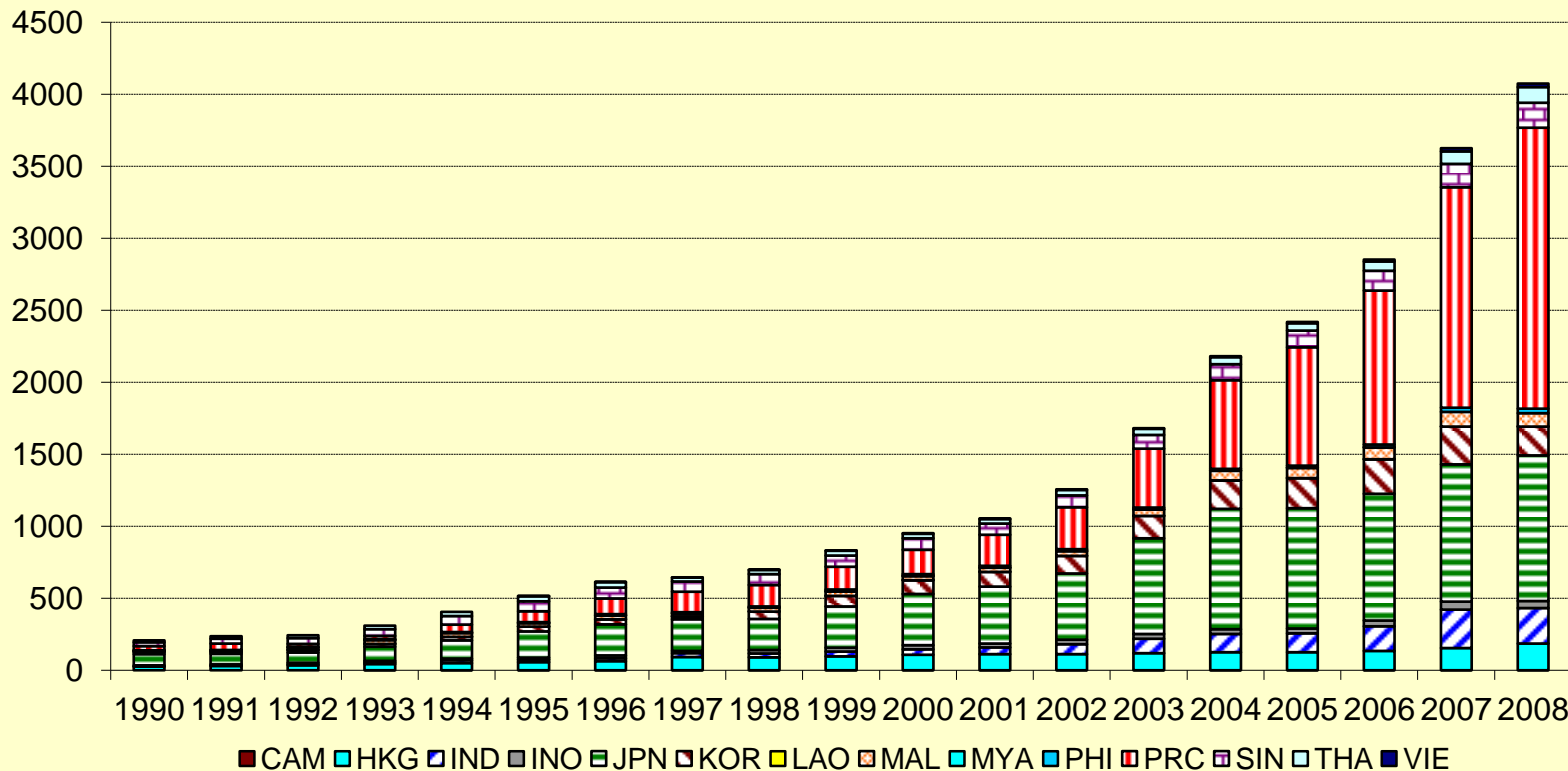
Central and Eastern Europe



5. Impact of Capital Flows

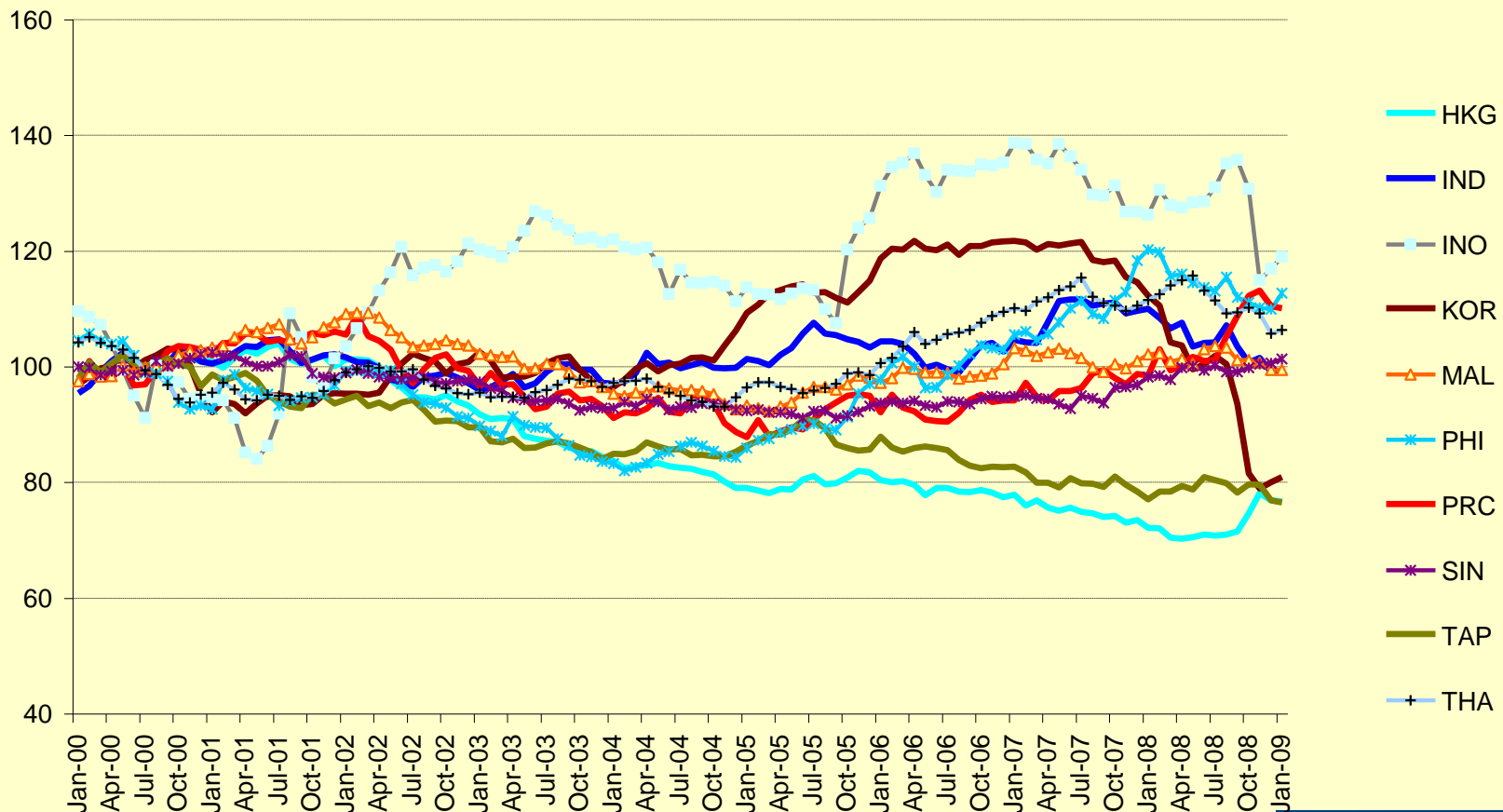
Rapid accumulation of foreign exchange reserves

Foreign Exchange Reserve Accumulation (in billion US\$): 1990-2008



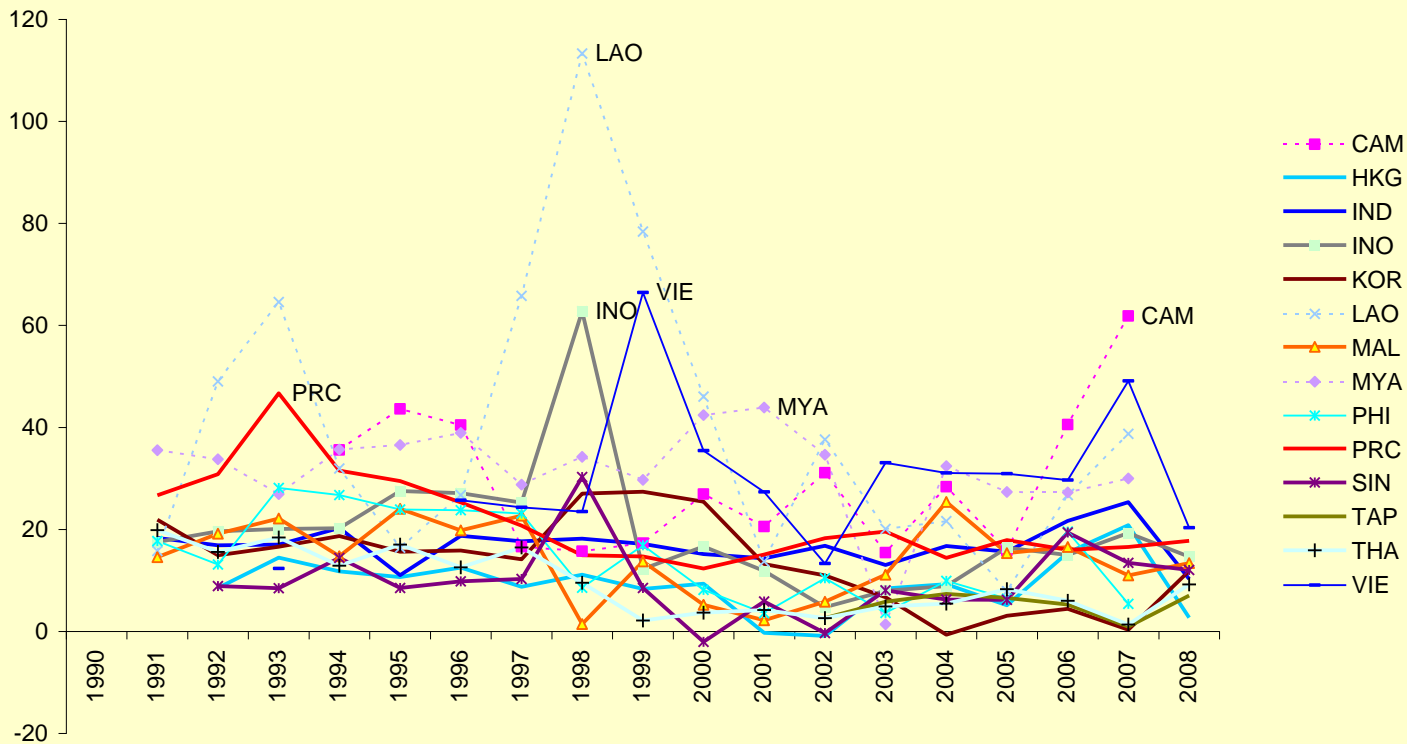
Most currencies in the region had appreciated in real terms, up until the global credit crunch, and showed some rebound in recent months for most countries....

Real Effective Exchange Rates (Jan. 2000 = 100)



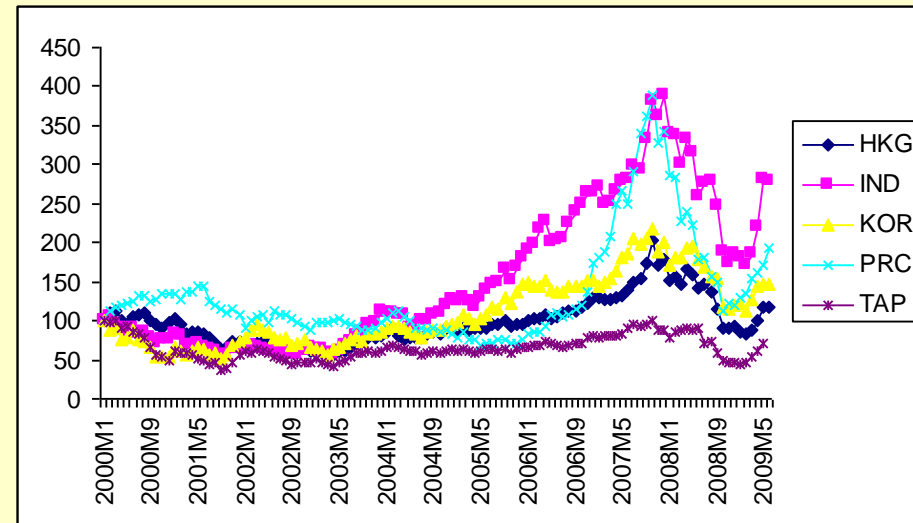
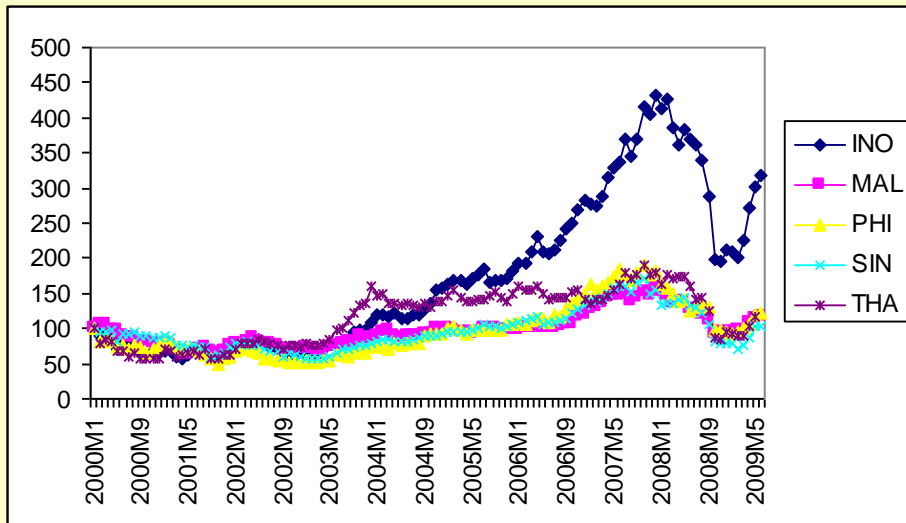
Money supply growth rates had been generally low and stable after the financial crisis, but tended to rise in most recent years...

Figure 16: Growth Rates of Money Supply (%)



Equity prices increased markedly since 2003 up until recently as foreign portfolio investors made substantial withdrawal of their funds due to the deepening of the subprime loan crisis and risk increases in global equity markets, but have rebounded in recent months ...

Equity Prices, Jan 2000-August 2008

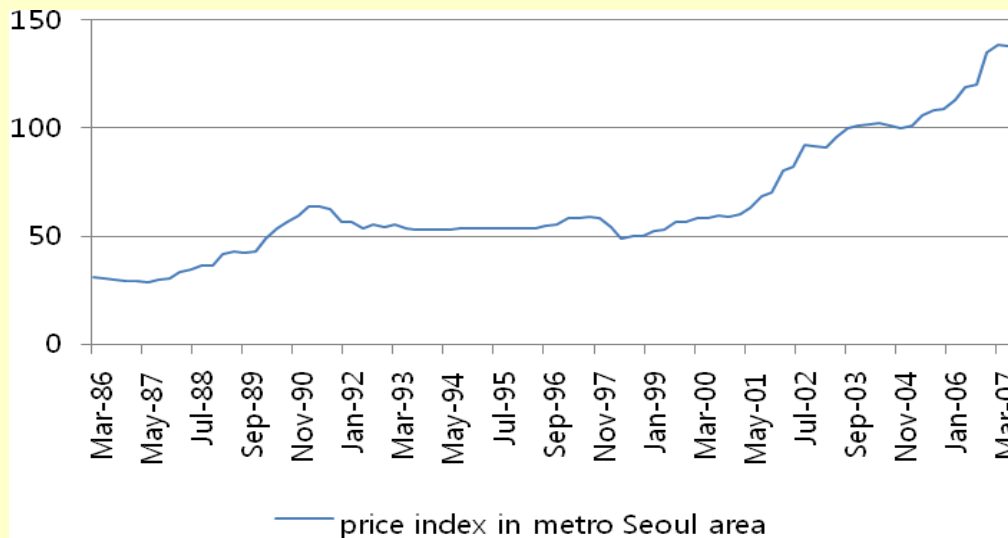


Real estate prices rising rapidly during surges in capital inflow...

(Note: hard to get data on real estate prices)

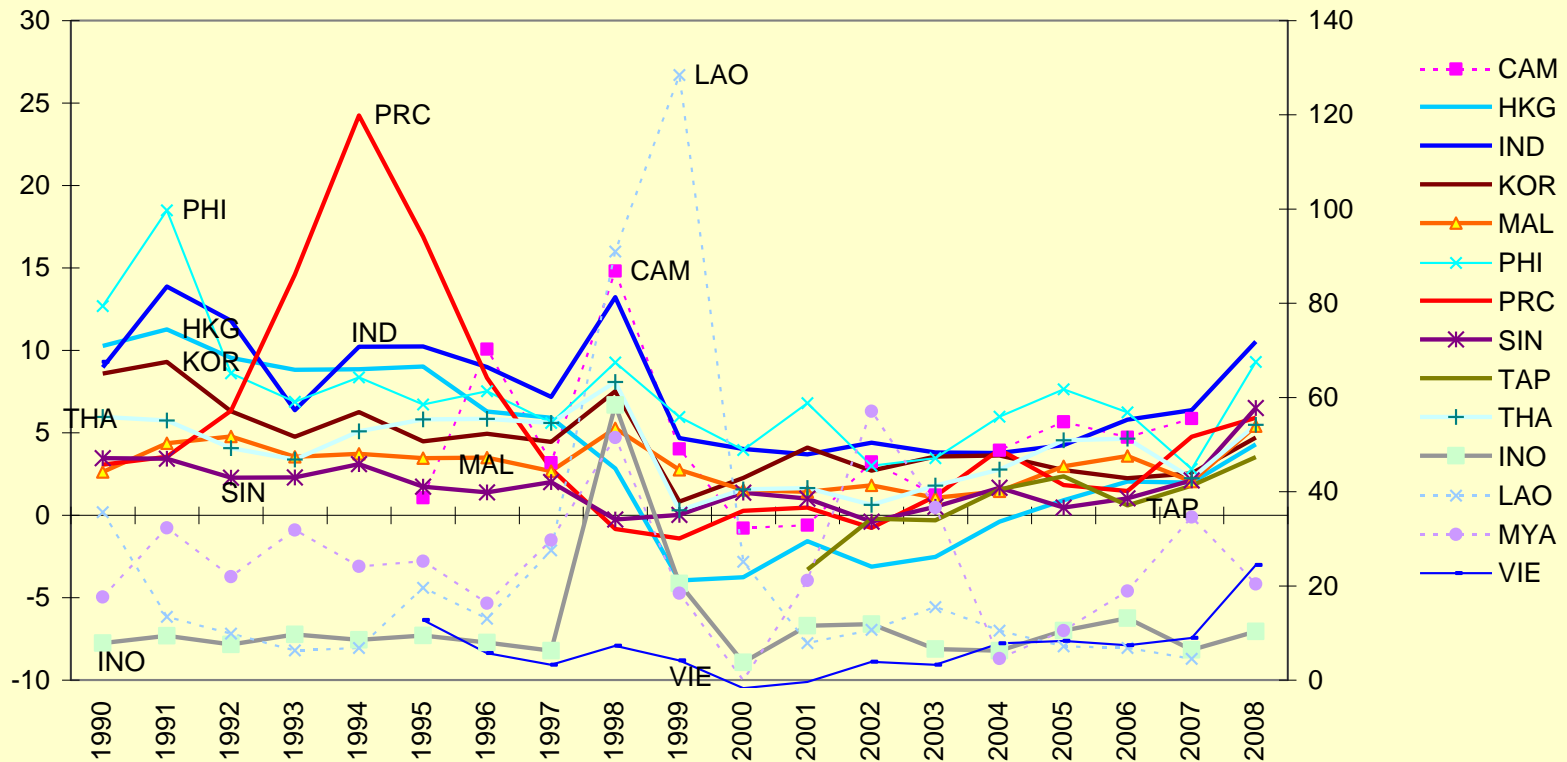


Land Price Index of Seoul Metro Area



Inflation rates were generally low after the Asian financial crisis but have tended to rise for some countries in recent years up until 2008...

Inflation Rates



6. Policy Responses of Asian Economies during Surges in Capital Inflows

6.1. Intervention in the Forex Markets.....

<u>Countries</u>	<u>Sterilized Forex Market Intervention: Instruments</u>
PRC	PBC initially sold T-bonds and later replaced them with its own Central Bank Bills (CBB). Adjusts reserve requirement ratio
India	RBI sells regular government bonds and special bonds under the Market Stabilization Scheme. Adjusts reserve requirement ratio.
Indonesia	BI sells government bonds and central bank certificates.
Korea	BOK uses Monetary Stabilization Bonds while the Ministry of Finance issues treasury bills and deposits proceeds with the BOK.
Malaysia	BNM Sells securities in the conduct of its open market operation.
Philippines	BSP sells government securities and has opened a special deposit accounts facility. Adjusts reserve requirement ratios.
Singapore	MAS carries out intervention in the foreign exchange market to directly influence the value of the currency and defend the band.
Thailand	BOT sells government bonds. Recently sold US dollars in the forward market.
Viet Nam	SBV sells T-bills and central bank bills. Adjusts reserve requirement ratios.

6.2. Capital Controls

- imposition of new (fine-tuning) capital controls to slow down inflows
- but general tendency – liberalization of the capital account
- easing of controls on outflows

Observations: speculative capital inflows slipped through different legitimate channels such as trade accounts, FDI and investment account as well as illegitimate channels.

7. Policy Issues

- The question: In the post-crisis period, will Asia face again a surge in capital inflows? [liquidity from further monetary easing in US and Europe]
 - Asia is currently leading the economic recovery
 - Emerging economies in CEE still facing huge task of stabilizing their economies and repairing their financial systems
- Policy Issues:
 - Of the measures tried before, which can be applied again?
 - What other domestic policy options should be tried?
 - Is there scope for global solutions?
 - What is the role of regional cooperation?

7.1. Doing More of what has been tried before

- Sterilized intervention and reserve accumulation:
 - even though there is no optimal level of reserves, the current forex reserves in Asia seem to have exceeded the level needed for mitigating abrupt capital reversals or external financing crisis
 - scope for reserve-sharing arrangement

- Strengthening national financial markets– need to accelerate regulatory and supervisory reforms
- Controls on capital inflows:
 - recent trends - moving away from administrative controls to market-based controls (e.g., tax on inflows)
 - evidence on effectiveness of controls on inflows is mixed
 - For countries that have already substantially liberalized capital account, administrative controls are no longer a viable option
 - For countries that have still substantially closed capital account, properly sequenced liberalization is called for

7.2. Exploring other options

- Fiscal policy – automatic stabilizer function of the budget
- Rebalancing growth – stimulating domestic private investment in some countries and private consumption in other countries
- Easing restrictions on capital outflows
 - effectiveness in the short run
 - could attract more capital inflows

7.3. Scope for Collective Actions

Global solutions:

- So far, mainly focused on transparency as a way to minimize volatility of capital (e.g., ROSC, SDDS)
- Another view: incidence of crises has not declined despite the increase in transparency
- Possibility of including countercyclical element in the regulation of financial intermediation and capital flows

Role of Regional Cooperation:

- Exchange rate cooperation
- Regional financial market surveillance and integration – “Asian Financial Stability Dialogue”
- Effective regional reserve pooling arrangement (CMIM)
- Capacity building: ensures a supply of well-trained regulators and bankers

Thank you very much!

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