

Capital Flows and Monetary Coordination

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Capital Flows: Historical Overview

- Pre-WW I
 - Debt flows, mostly long-term
 - Gold standard – stable exchange rates
 - Financial openness – comparable to modern era
- WW I – WW II
 - Breakdown of IMS
- WW II – 1971 (Bretton Woods)
 - Mostly fixed exchange rates
 - Trade liberalization
 - Capital accounts mostly closed/controlled, incl. advanced economies
- 1971 onwards (especially 1980s onwards)
 - Floating exchange rates
 - Opening of capital accounts
 - Oil prices hikes – petro dollars recycling
 - Large capital flows to EDEs – both push and pull factors

Incidence of Crises

(Number of crises per year)

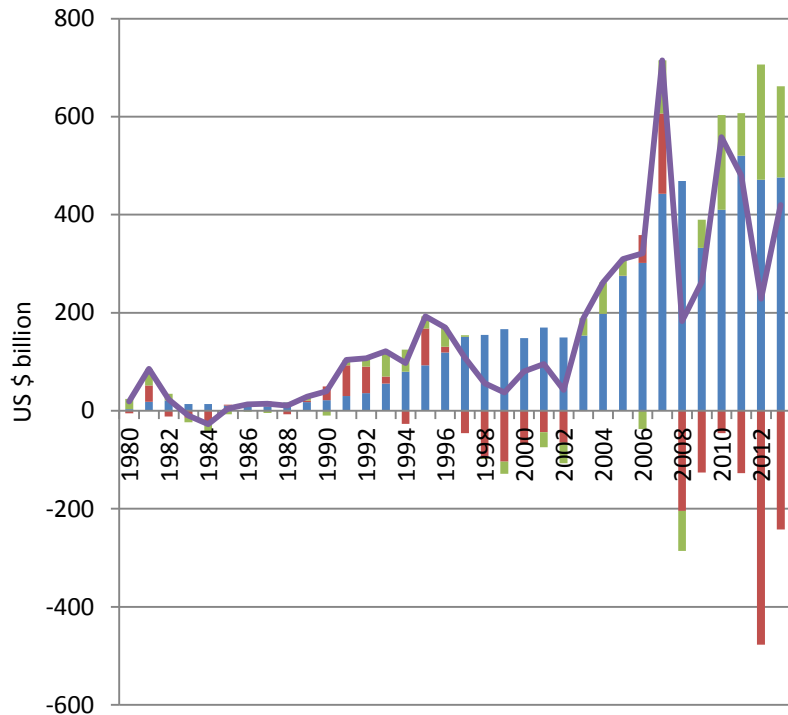
Period	Banking Crisis	Currency Crisis	External Default
Gold Standard (1870-1913)	1.3	0.6	0.9
Interwar Period (1925-1939)	2.1	1.7	1.5
Bretton Woods (1948-1972)	0.1	1.7	0.7
a) 1948-1958	0.0	1.4	0.3
b) 1959-1972	0.1	1.9	1.1
Post-Bretton Woods (1973-2010)	2.6	3.7	1.3
a) 1973-1989	2.2	5.4	1.8
b) 1990-2010	3.0	2.4	0.8

Source: Bush, Farrant and Wright (2011) [Table A, p,7].

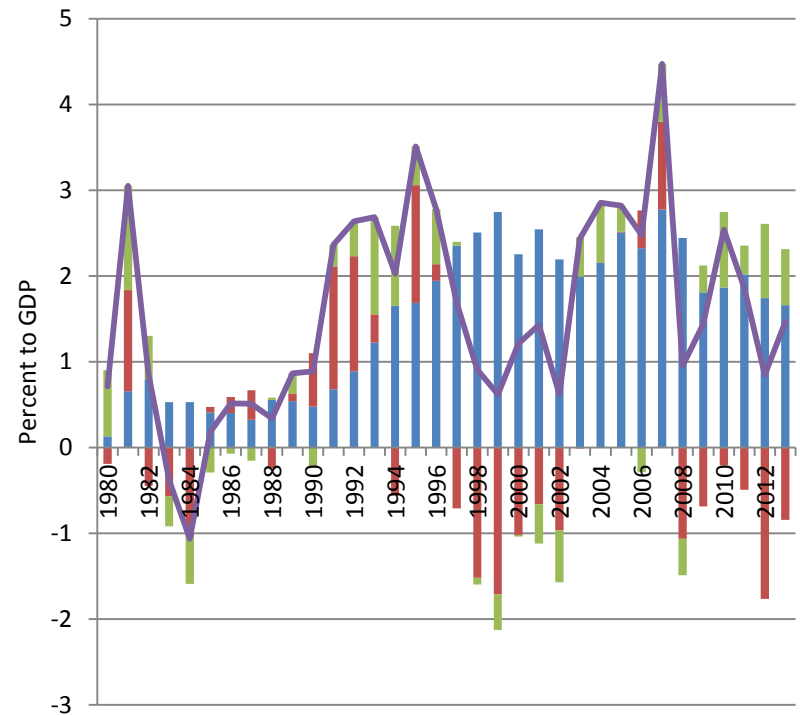
Increased frequency of financial crises in the post-BW system of open capital accounts

Capital Flows to EDEs (1)

Net Private Flows



- Direct investment, net
- Other private financial flows, net
- Private portfolio flows, net
- Total private financial flows, net



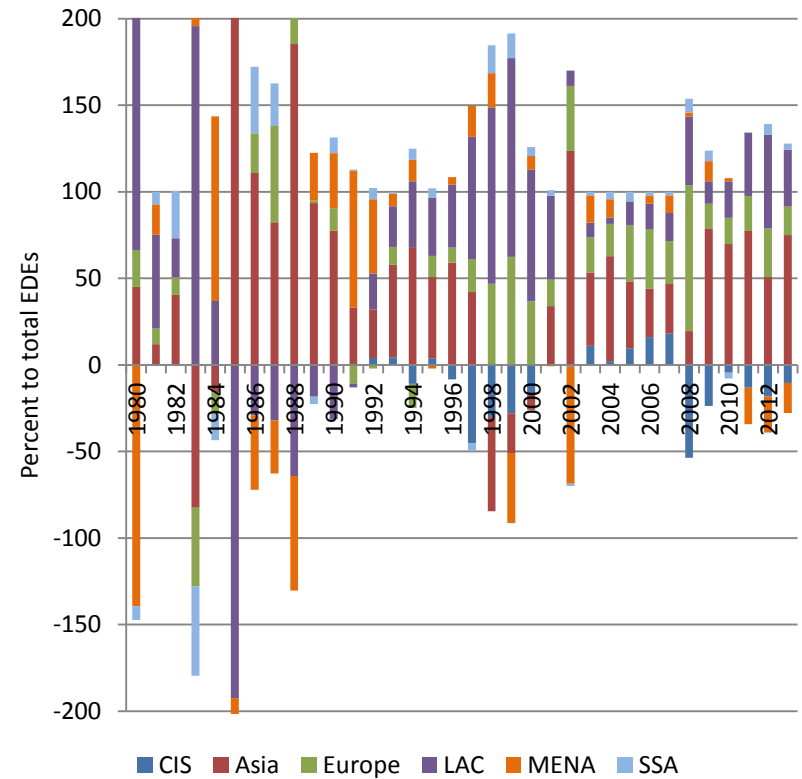
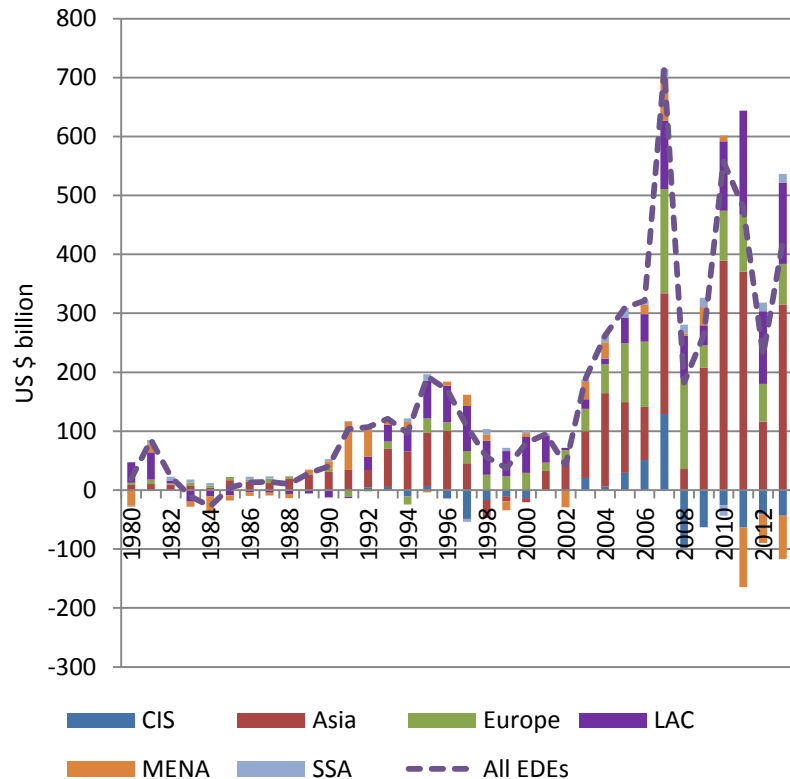
- Direct investment, net
- Other private financial flows, net
- Private portfolio flows, net
- Total private financial flows, net

Continued volatility in capital flows to EMDEs

Source: IMF

Capital Flows to EDEs (2)

Net Private Flows – region-wise



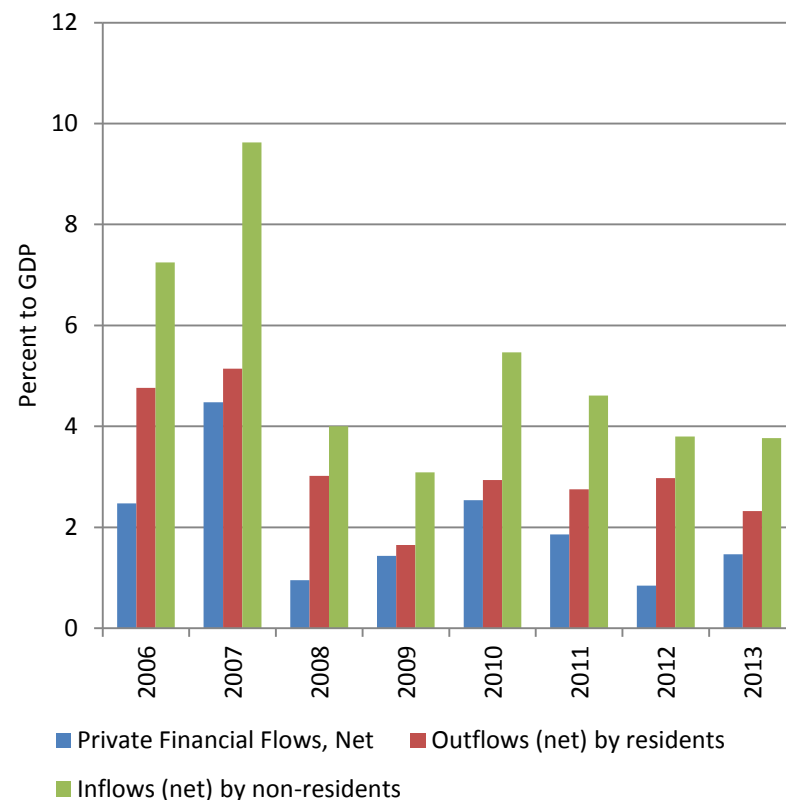
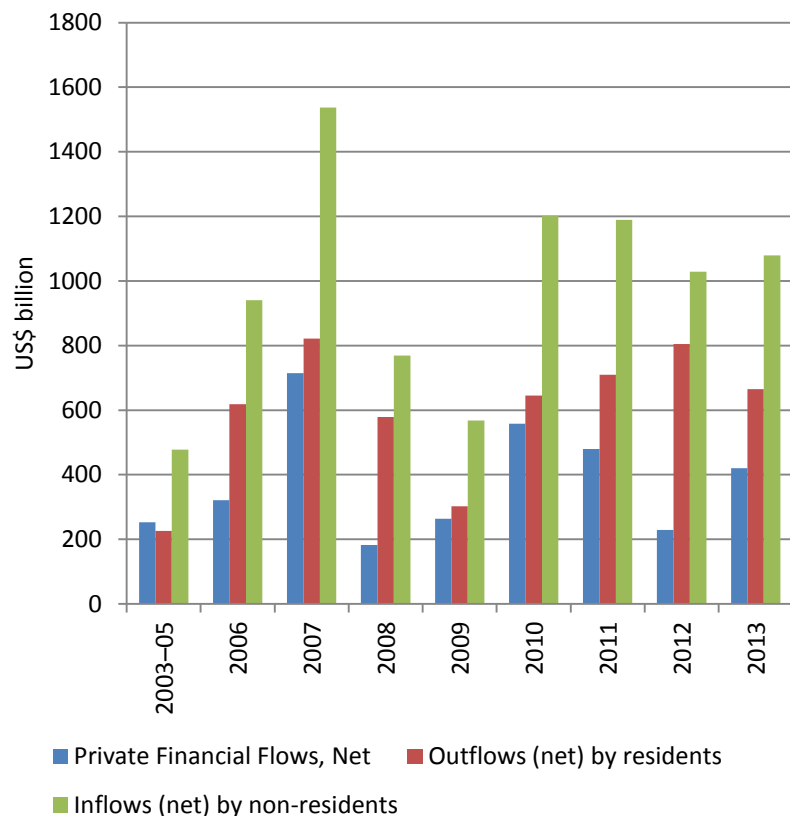
Large capital flows to LAC (early 1980s), Asia (mid-1980s to mid-1990s); and Europe (2000s) – associated with subsequent crisis episodes.

Source: IMF

CIS: Commonwealth of Independent States; LAC = Latin America and the Caribbean;
 MENA = Middle East, North Africa, Afghanistan, and Pakistan ; SSA = Sub-Saharan Africa

Capital Flows to EDEs (3)

Inflows (from non-residents) and Outflows (by residents)



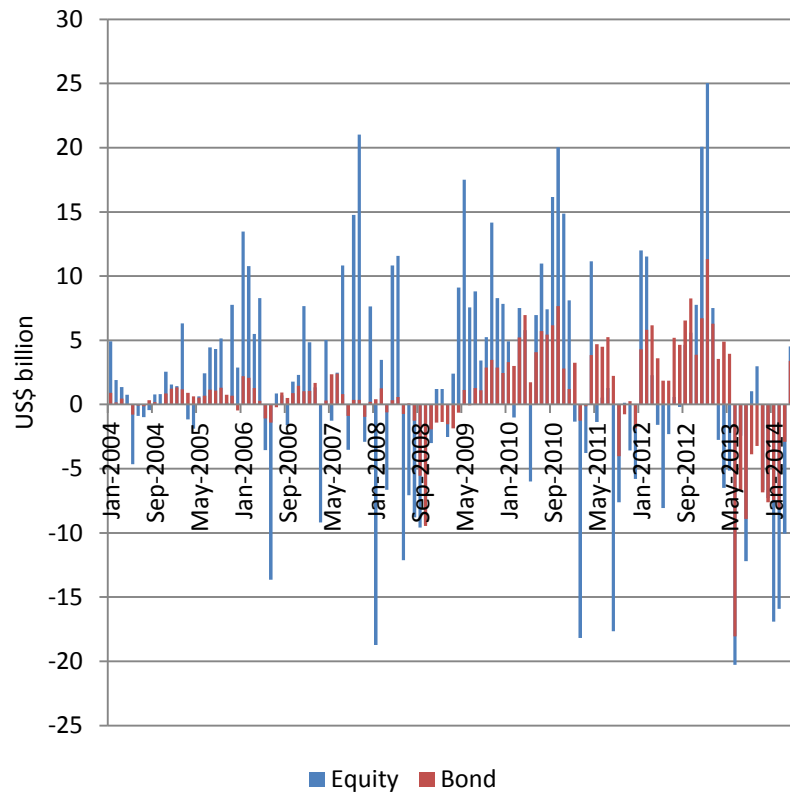
Underlying capital inflows and capital outflows are multiples of net flows, and also more volatile.

Source: IMF.

Capital Flows to EDEs (4)

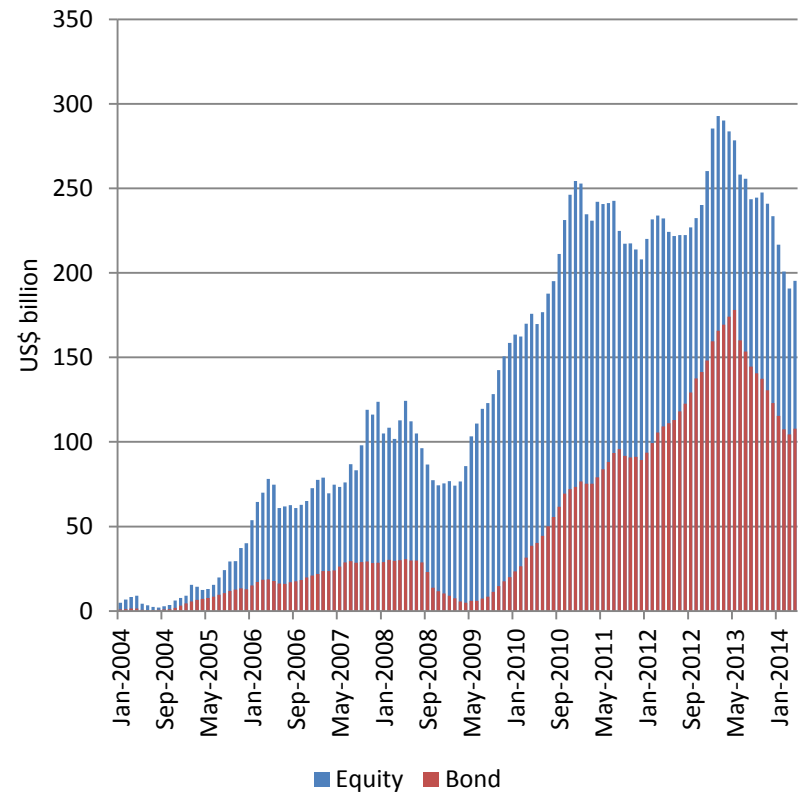
Institutional and Individual Investor Flows and Fund Manager Allocations

EPFR Flows: Monthly



Bond flows more volatile than equity flows

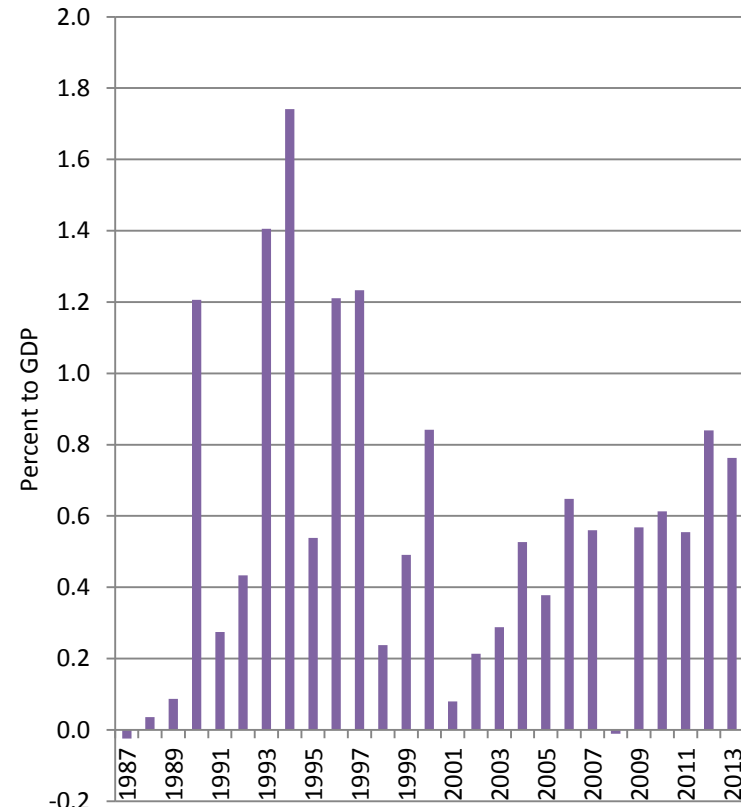
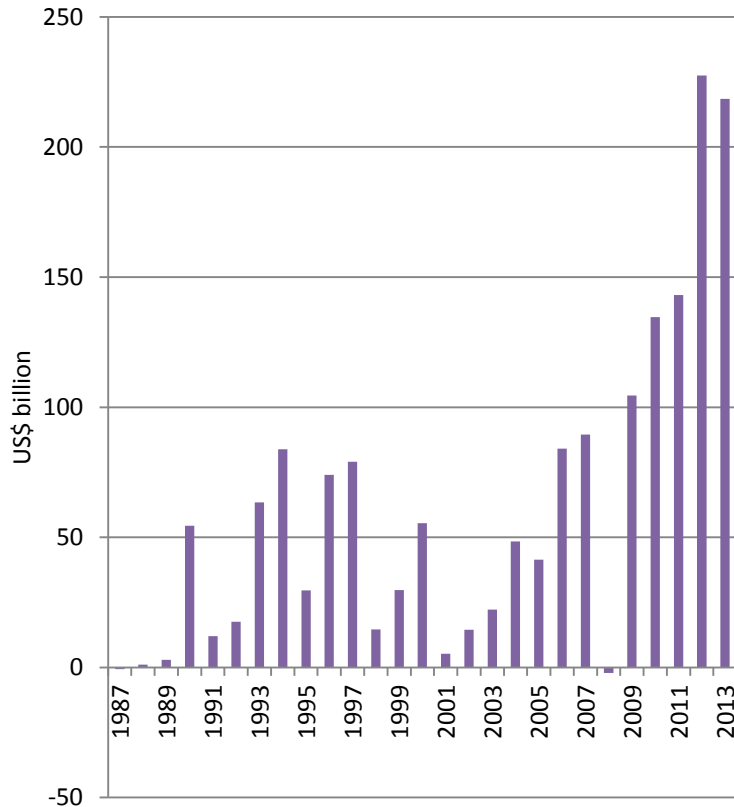
EPFR Flows: Cumulative (since Jan 2004)



Source: EPFR, Haver Analytics.

Capital Flows to EDEs (5)

Net International Debt Issuances by EDEs

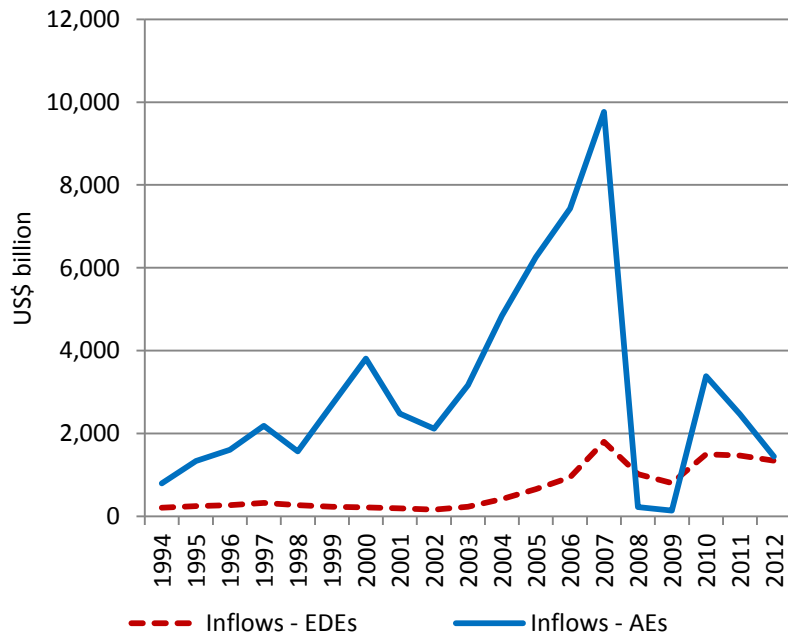


Sharp jump in debt issuances by EDEs since 2009: impact of highly accommodative MP in AEs?
(Source: BIS)

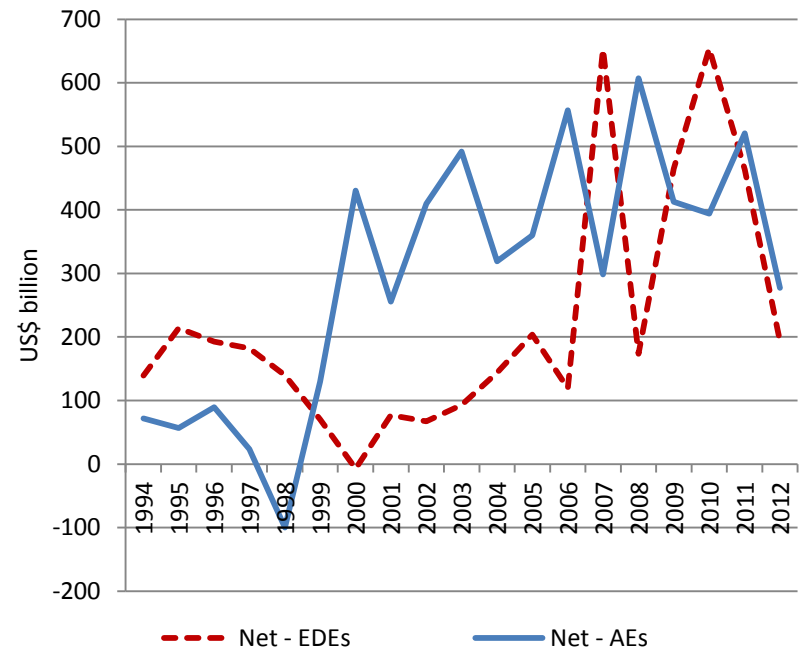
Capital Flows to EDEs (6)

EDEs v/s AEs (US \$ billion)

Gross Inflows



Net Inflows



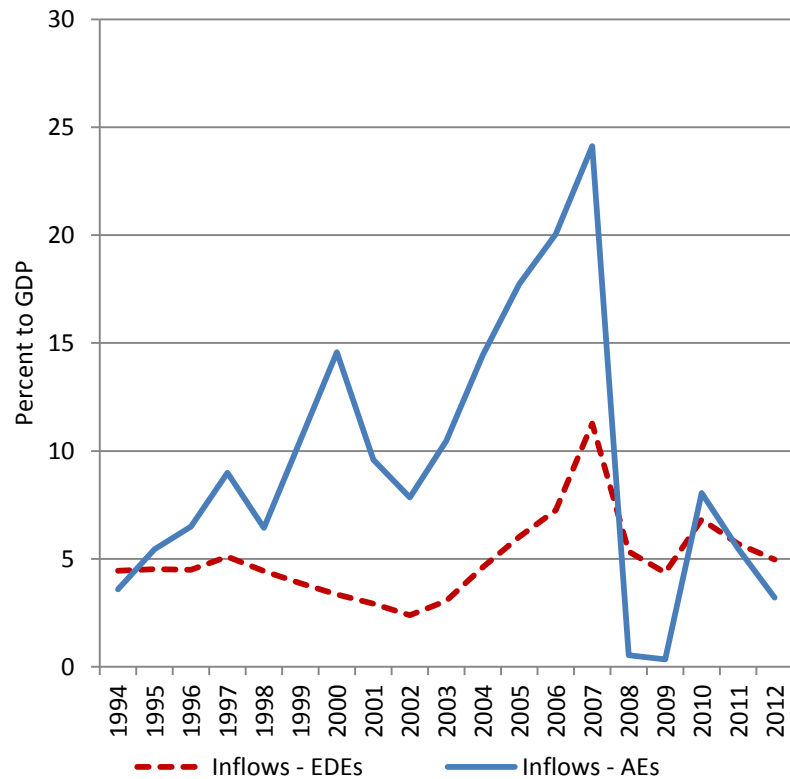
Capital inflows and outflows in AEs are multiples of EDE flows, although net flows are comparable. AEs equally vulnerable to volatile capital flows.

Source: IMF.

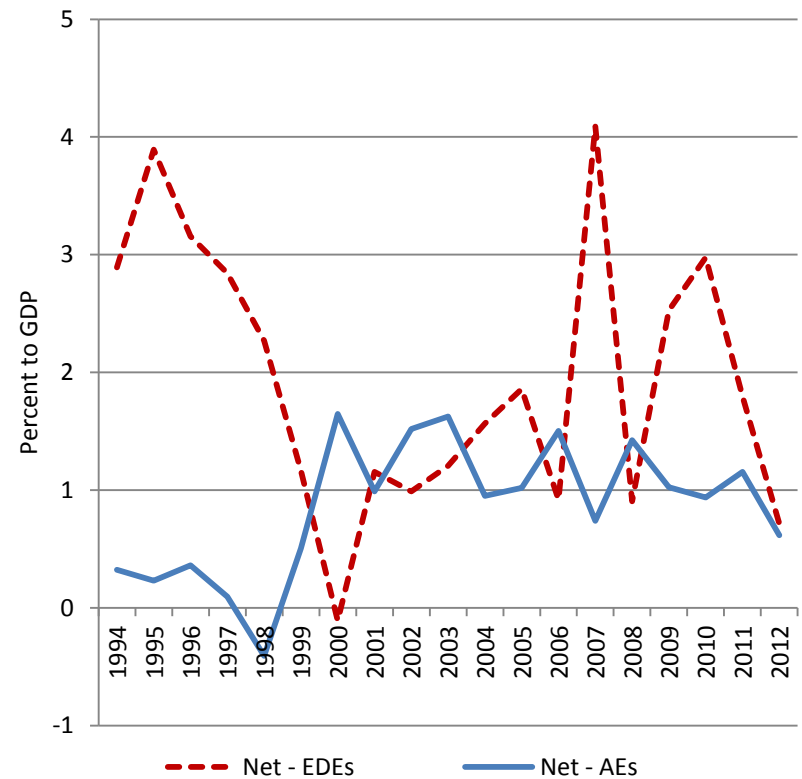
Capital Flows to EDEs (7)

EDEs v/s AEs (% to GDP)

Gross Inflows

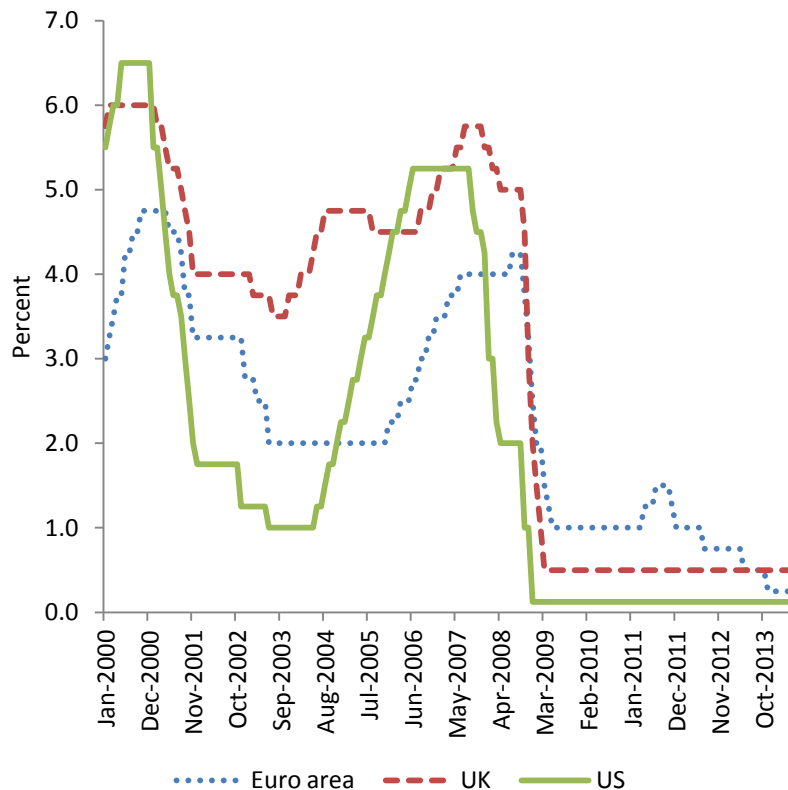


Net Inflows

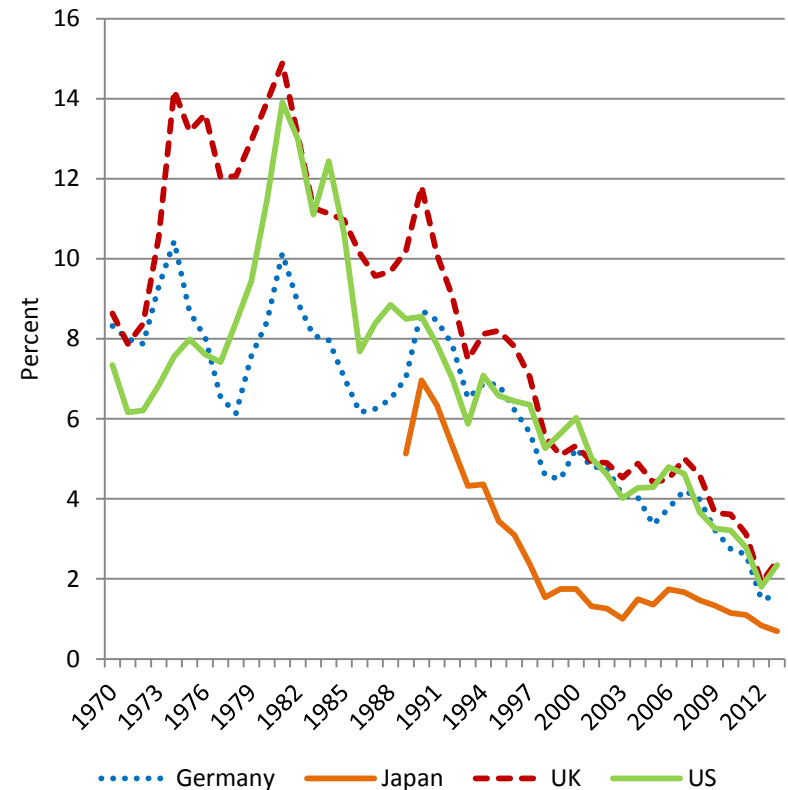


Monetary Policy: AEs (1)

Policy Rates



Long-term (10-year) bond yields

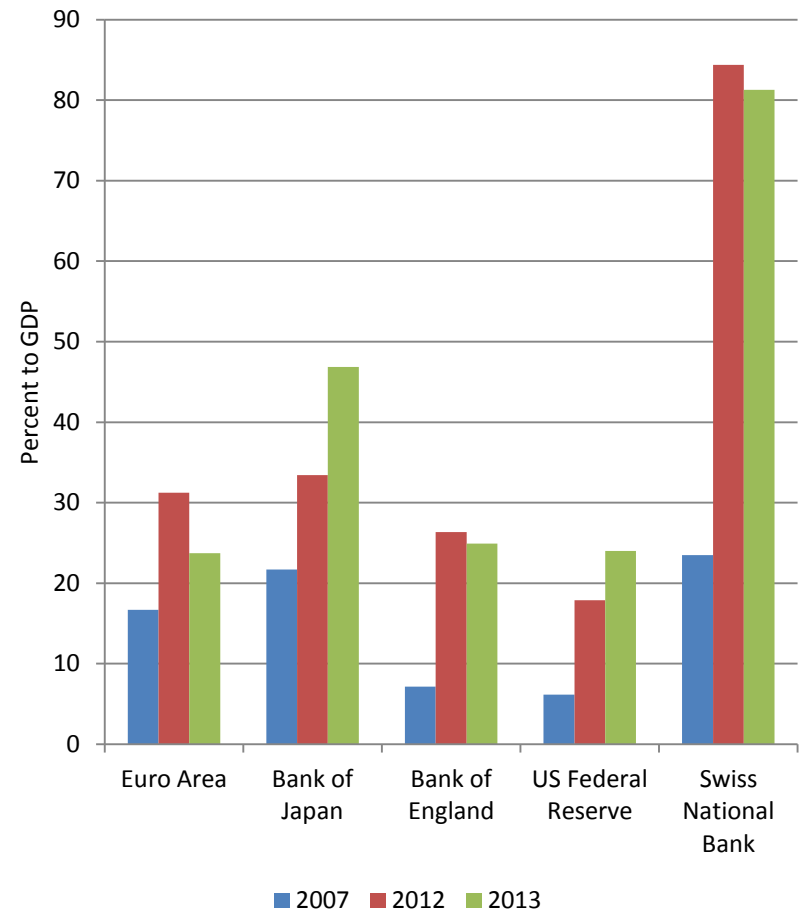
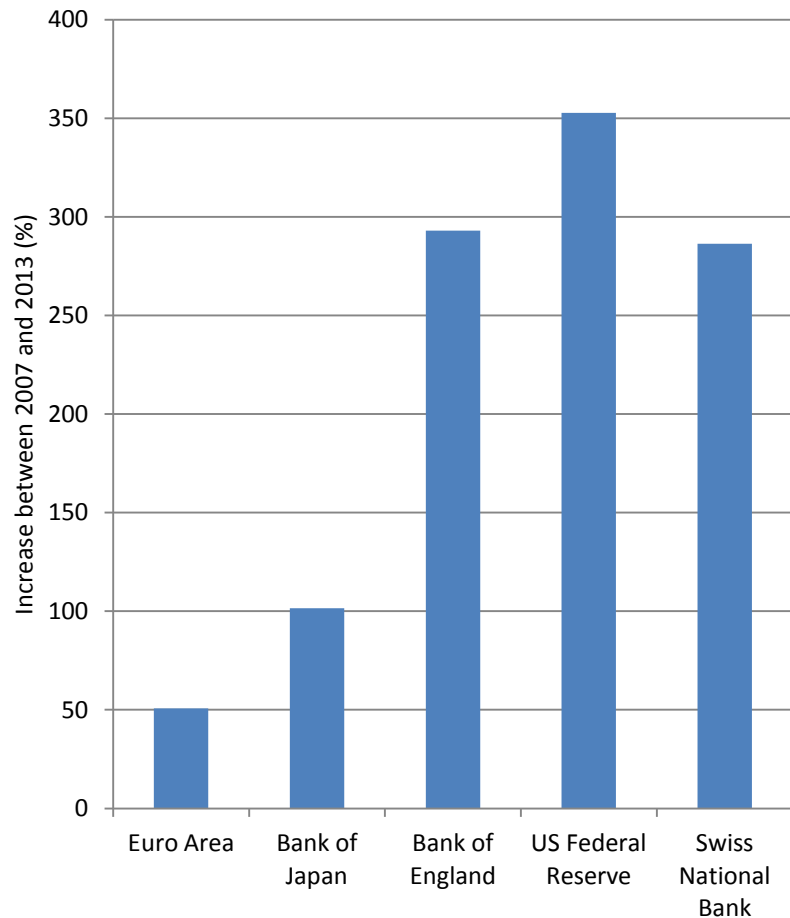


Monetary policy cycle in AEs a key source of capital flows (push factor) and the volatility; pull factors (domestic EDE factors) also important.

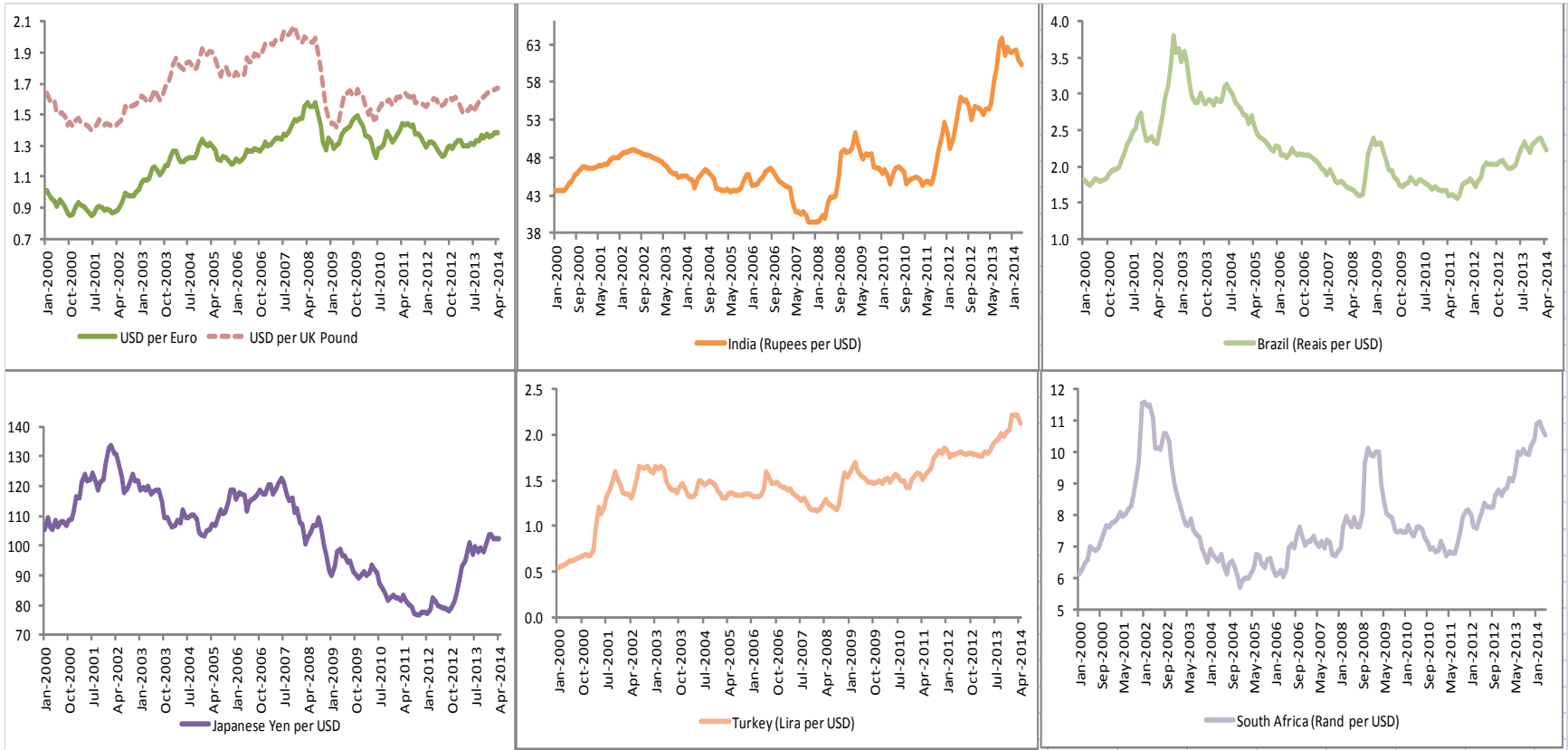
Source: IMF, OECD

Monetary Policy: AEs (2)

Central Bank Balance Sheets



Exchange Rates



Volatile capital flows lead to volatility in exchange rates – adverse implication for the real economy.

Current Account Balances

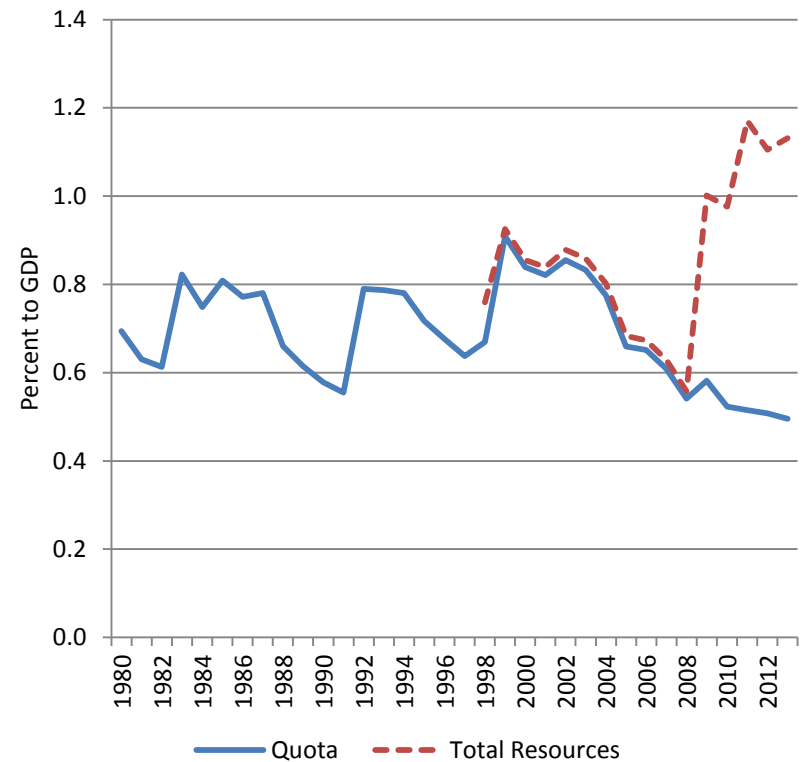
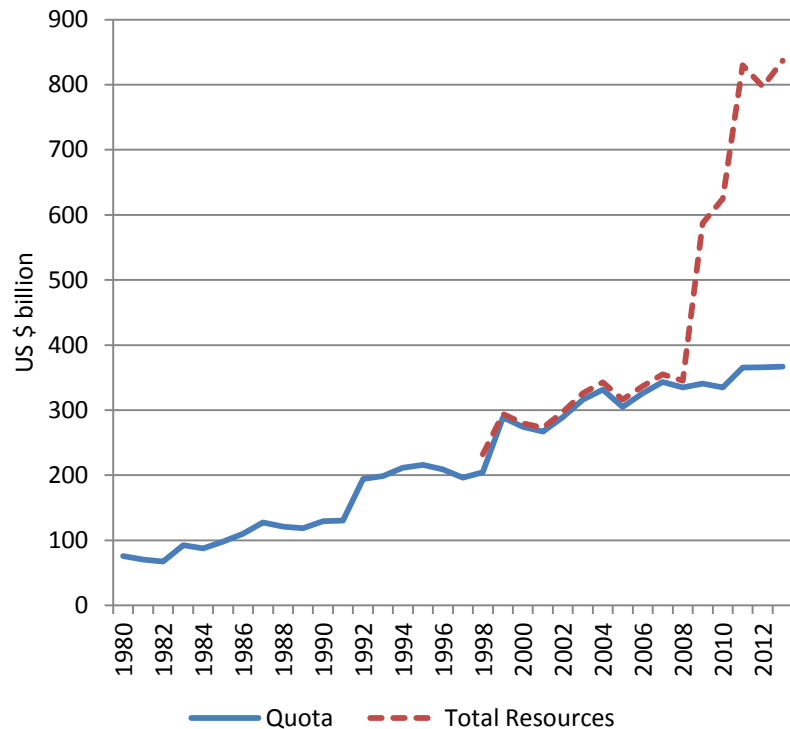
(Percent to GDP)

	1980-90	1991-97	1998-2002	2003-07	2008-09	2010-12	2013
Advanced economies							
Germany	2.1	-1.0	-0.4	5.1	6.1	6.9	7.5
Japan	2.0	2.3	2.6	3.9	3.1	2.3	0.7
United States	-1.6	-1.2	-3.5	-5.2	-3.6	-2.9	-2.3
Emerging and developing economies							
Brazil	-2.8	-1.1	-3.5	1.1	-1.6	-2.2	-3.6
China	0.0	1.3	2.0	6.1	7.1	2.7	2.1
India	-1.9	-1.0	-0.1	-0.3	-2.5	-3.9	-2.0
Indonesia	-2.7	-2.5	4.3	2.0	1.0	-0.6	-3.3
South Africa	0.9	0.1	-0.3	-4.0	-5.6	-3.2	-5.8
Turkey	-1.2	-1.1	-0.3	-4.5	-3.7	-7.4	-7.9

Widening of CADs in major EMEs since the NAFC

Source: IMF

International Monetary System: IMF Resources



IMF quota resources not keeping pace with the growth in the global economy and capital flows – limits IMF's capacity to respond to volatility in the IMS - heavy reliance on borrowed resources.

Source: IMF.

Managing the International Spillovers (1)

- **AE central bank interest rate actions –**
 - Largely uncoordinated
 - Except October 8, 2008 - the immediate aftermath of the Lehman collapse – a coordinated reduction of 25-50 basis points in policy interest rates by six AE CBs to ease “global monetary conditions”.
 - *“By showing that policymakers around the globe were working closely together, had a similar view of global economic conditions, and were willing to take strong actions to address those conditions, coordinated action could help to bolster consumer and business confidence and so yield greater economic benefits than unilateral action”* (Board of Governors of the Federal Reserve System, 2008b).
- **Liquidity swaps**
 - Well coordinated, but largely restricted.
- **Earlier occasions of coordinated actions:**
 - interest cut and liquidity provision by G-7 in response to the 1987 stock market crash in the US
 - Exchange rate interventions: Plaza and Louvre accords

Managing the International Spillovers (2)

- Spillovers to EMDEs
 - EME policymakers
 - Complaints about UMPs
 - Capital flow volatility
 - exchange rates,
 - domestic liquidity conditions,
 - asset prices,
 - credit and monetary aggregates,
 - CAB
 - Financial stability and growth implications

Managing the International Spillovers (3)

- AE policymakers:
 - Agnostic about spillovers,
 - UMPs are net positive for EMDEs
 - ... *It is true that interest rate differentials associated with differences in national monetary policies can promote cross-border capital flows as investors seek higher returns. But my reading of recent research makes me skeptical that these policy differences are the dominant force behind capital flows to emerging market economies; differences in growth prospects across countries and swings in investor risk sentiment seem to have played a larger role (Bernanke, 2013).*
- Need to factor in financial stability implications of volatile capital flows

Managing the International Spillovers (4)

- International Monetary Policy Committee (Eichengreen and others)
- Capital account management
- Regional financial arrangements
 - CMIM, BRICS, ESFS/ESM,..
- Currency swap lines by major AE central banks
 - Risk mitigation for AE central banks
 - EME reserve holdings

THANKS