

Capital Flows and the Crisis: The 'system' isn't working



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Outline

This time was (somewhat) different: Many EMDs regulated capital flows AND the West didn't clamp down.

The 'system' still isn't working: Despite a more inclusive G-20 arrangement and movement at the IMF, there is a lack of coordination on macroeconomic policy and financial reform that would reduce the risks associated with capital flows.

Need stronger effort at 'both ends': EMDs need to craft more permanent and stronger regulations and the West needs to channel its monetary policy better and coordinate on financial reform.

The Kindleberger 5

1. Maintaining open markets
2. Lender of Last Resort
3. Providing counter-cyclical lending
4. Policing a relatively stable exchange rate system
5. Ensuring macroeconomic coordination

LOLR: Swap Lines from FED, ECB, PBOC

<u>Country</u>	<u>USFED</u>	<u>ECB</u> (USbillions)	<u>PBOC</u>
Argentina			70
Australia	30		
Brazil	30		
Belarus			20
Canada	30		
Denmark	15	15	
ECB	240		
Hong Kong			200
Hungary		5	
Iceland		1.5	
Indonesia			100
Japan	120		
Korea	30		180
Mexico	30		
Malaysia			80
Norway	15		
New Zealand	15		
Poland		10	
Sweden	30		
Singapore	30		
Switzerland	60		
UK	80		
Sub-totals	755	31.5	650
			EMD total
			685
			TOTAL
			1,437

Little Counter-cyclical Lending in US

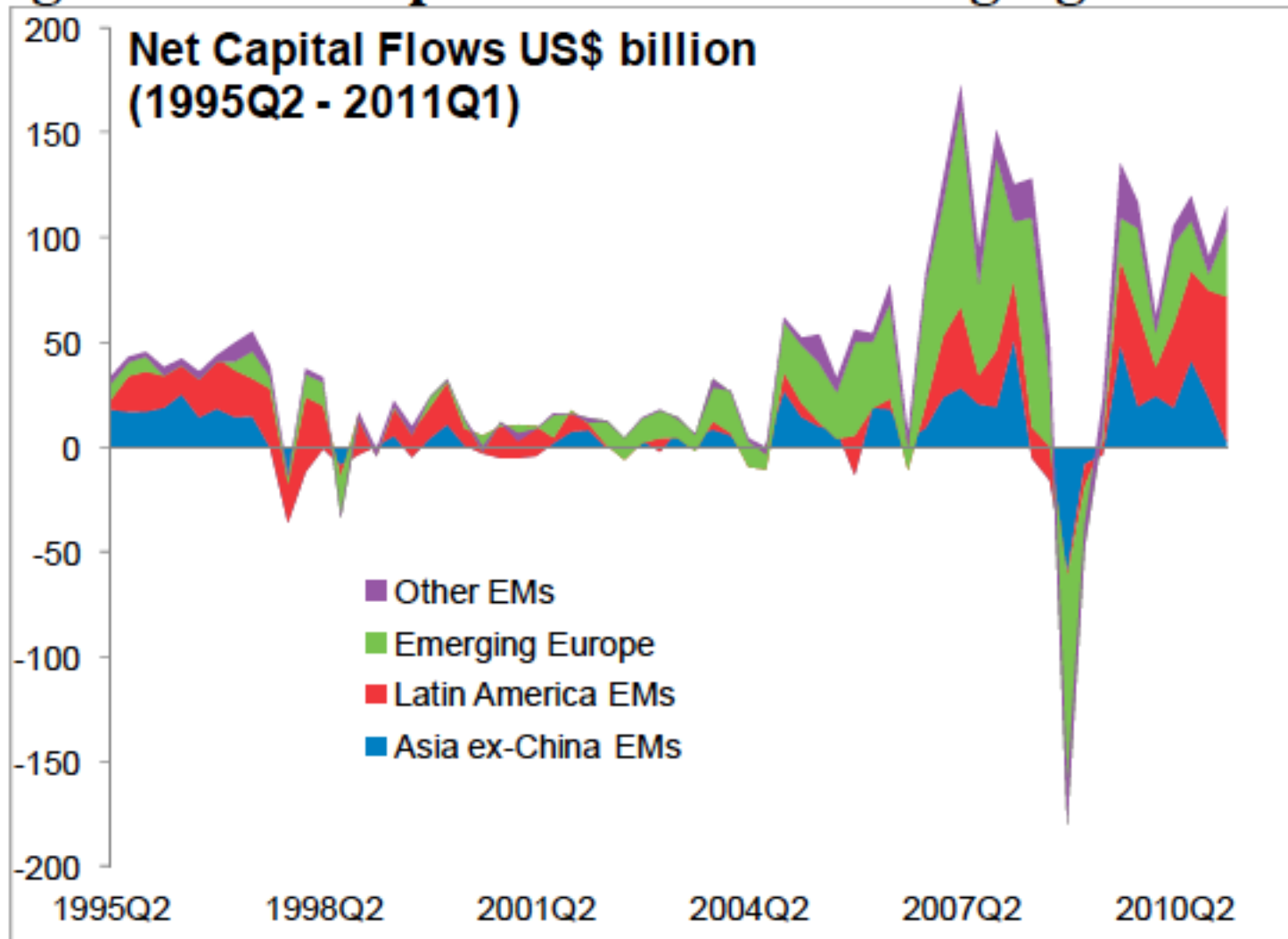
Table 1 US commercial bank cash reserves relative to bank liabilities and GDP during six economic recovery periods

	Commercial bank reserves (billions \$)	Reserves as pct of bank liabilities	Reserves as pct of GDP
1973 following 11/70 recession trough	27.1	3.6%	1.9%
1977 following 3/75 recession trough	26.9	2.9%	1.3%
1985 following 11/82 recession trough	28.6	1.4%	0.7%
1993 following 3/91 recession trough	35.0	1.2%	0.5%
2004 following 11/01 recession trough	24.0	0.4%	0.2%
2011 following 6/09 recession trough	1595.9	15.3%	10.5%

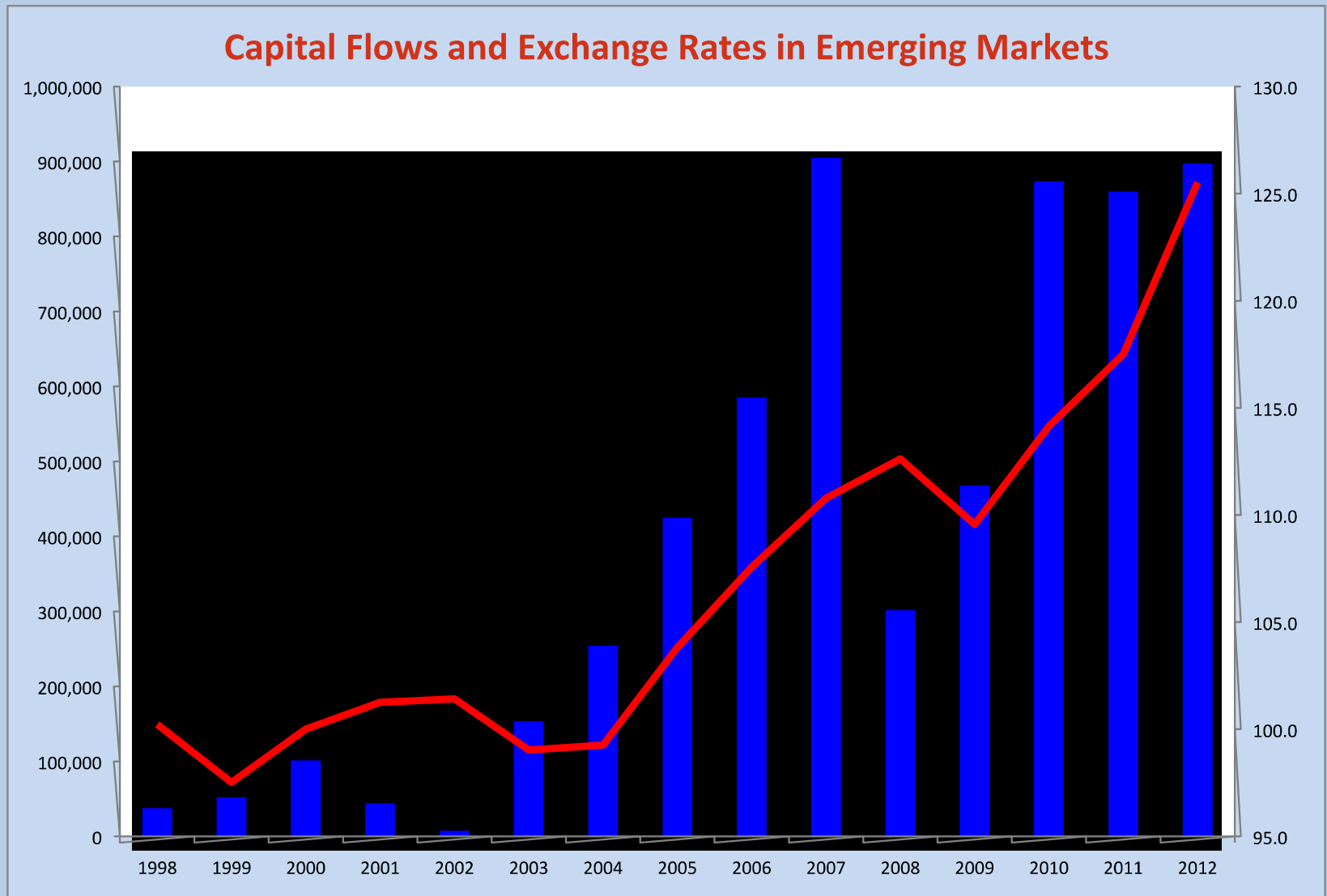
Note: Figures are for two years into economic recoveries.

Source: Flow of Funds Accounts of Federal Reserve System.

Counter-cyclical lending for South?

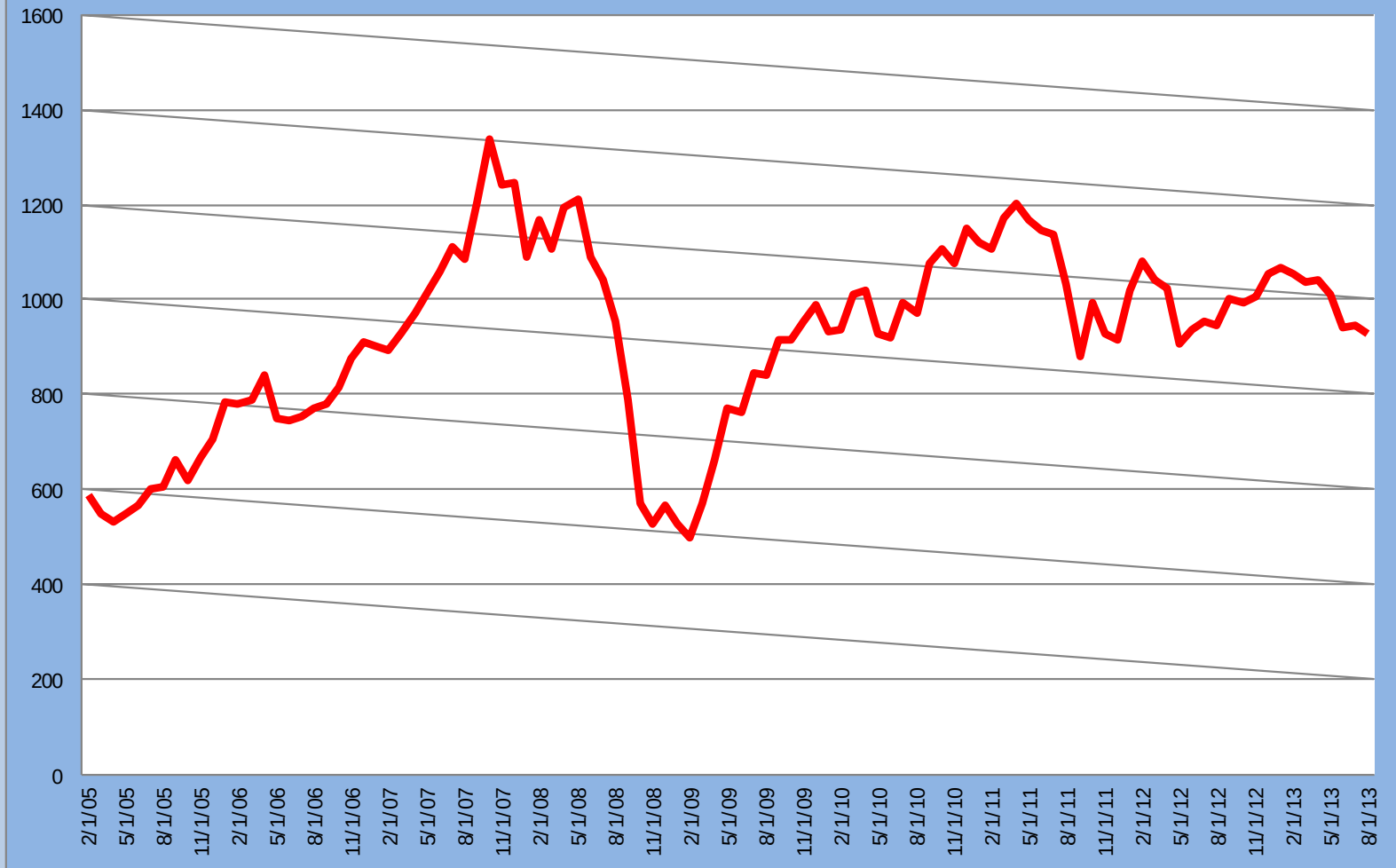


Exchange Rate Stability?



(Nominal) Exchange Rate Stability?

Emerging Market Currencies



Macro-coord: G-20, they are talking

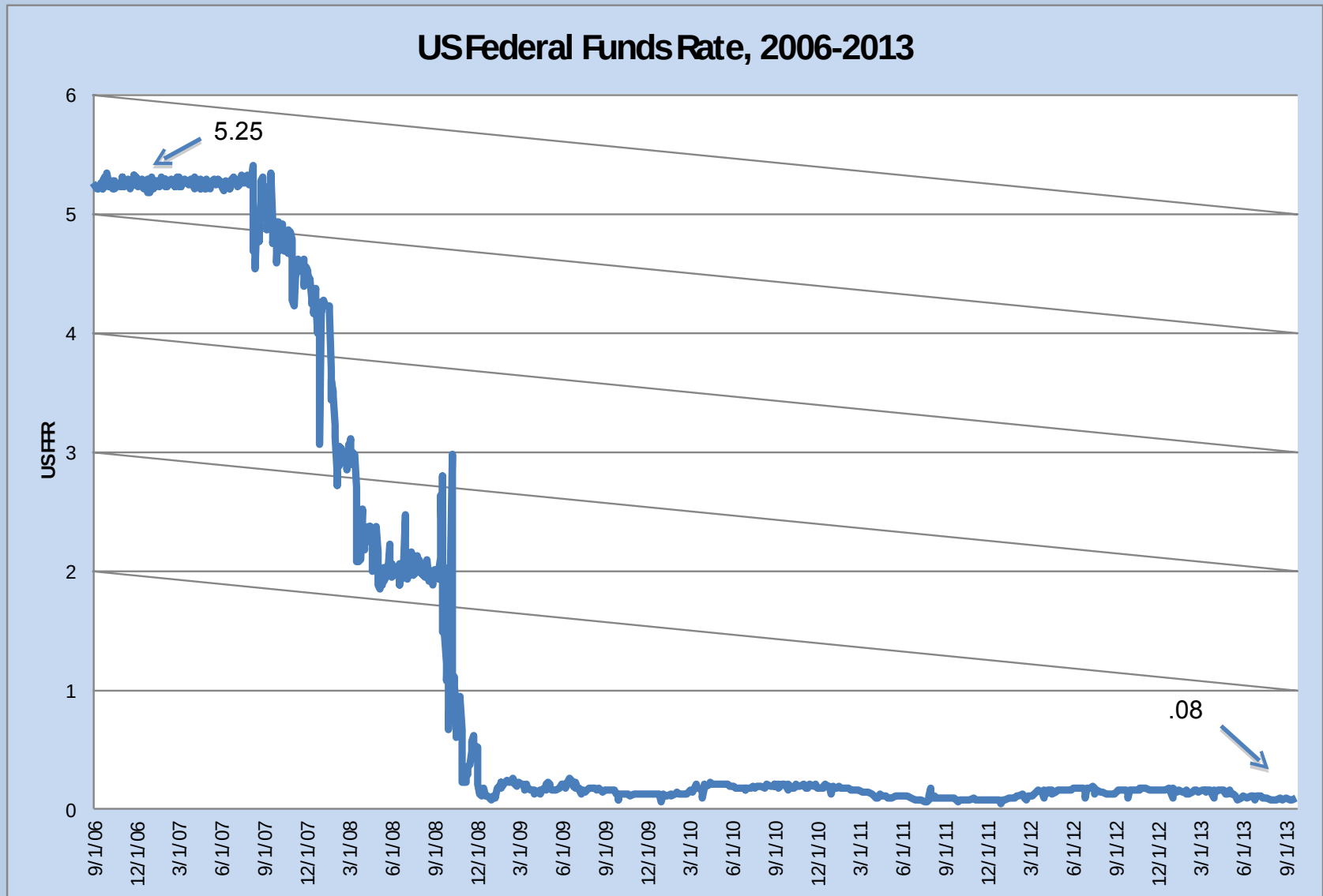
G-7/G-8, 2013

- “We, the G7 Ministers and Governors, reaffirm our longstanding commitment to market determined exchange rates and to consult closely in regard to actions in foreign exchange markets. We reaffirm that our fiscal and monetary policies have been and will remain oriented towards meeting our respective domestic objectives using domestic instruments, and that we will not target exchange rates.”

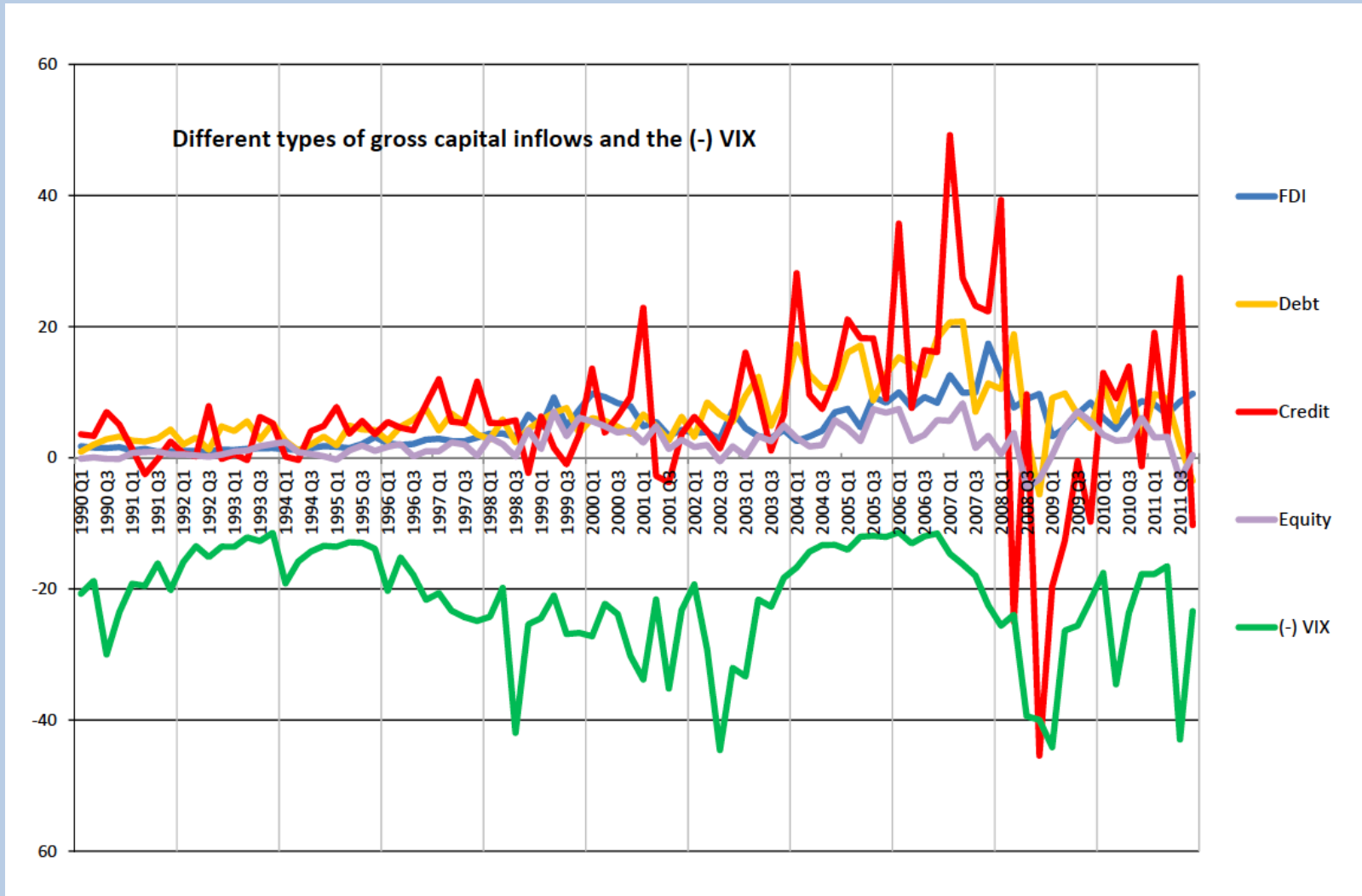
G-20, 2013

- “We commit to monitor and minimize the **negative spillovers on other countries** of policies implemented for domestic purposes.”

But not walking the talk...

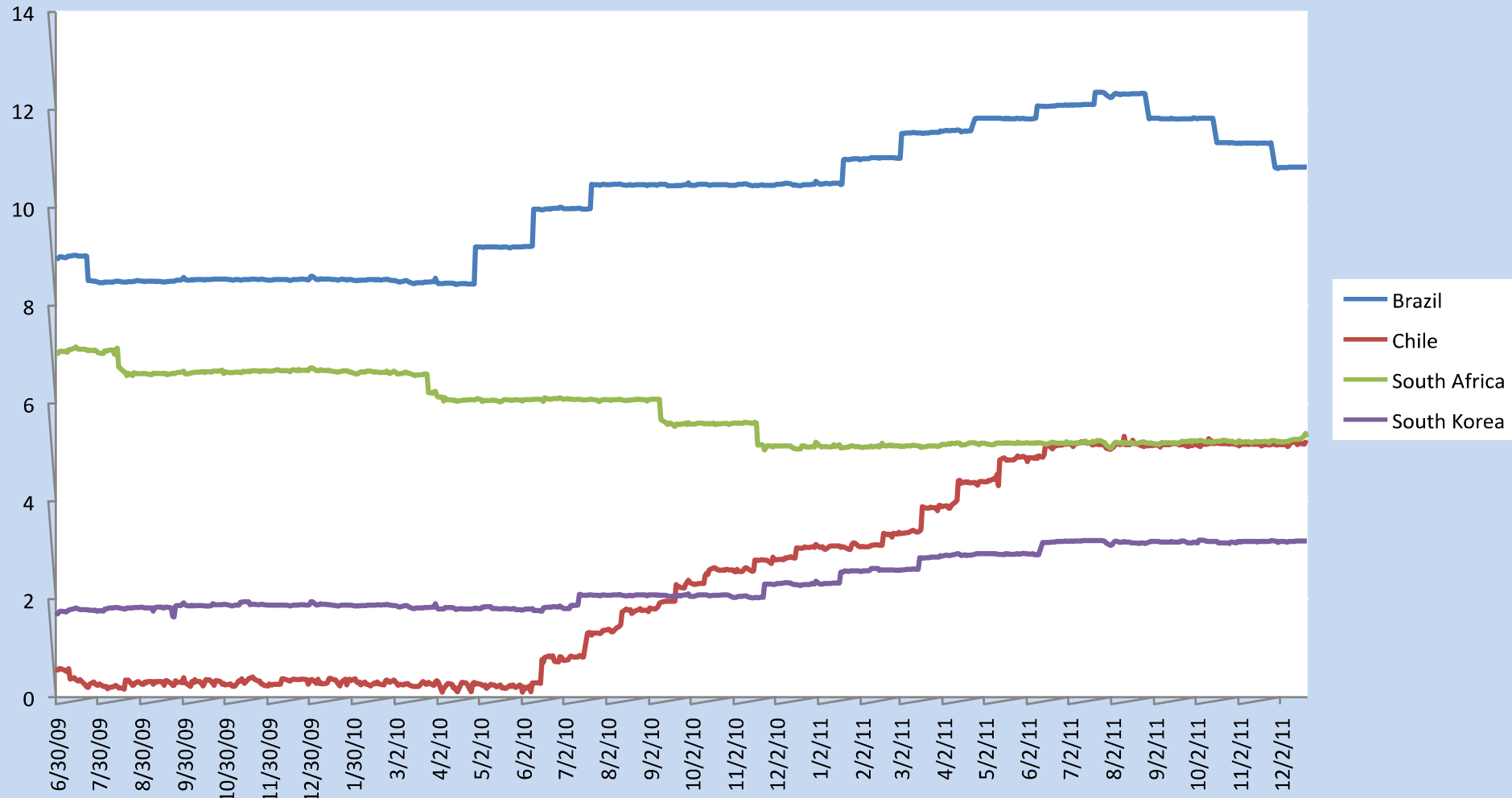


But not walking the talk..



Source: Helene Rey (2013) "Dilemma not Trilemma" Jackson Hole Symposium

Interest Rate Differentials



Macro-Coord: G-20 'Coherent Conclusions'

“Capital flow management measures may constitute part of a broader approach to protect economies from shocks. In circumstances of high and volatile capital flows, capital flow management measures can complement and be employed alongside, rather than substitute for, appropriate monetary, exchange rate, foreign reserve management and prudential policies.”

Weak Coordination on Financial Reform

- **G-20:**
 - margin requirements
 - leverage limits
 - position limits
- **Dodd-Frank**
 - Exempts FX derivatives
 - No cross-border application
 - Volcker rule under fire
- **TPP**
 - No exceptions for inflows regs or BOP crises

Toward a More Coordinated Approach

- **EMDs:** stronger and institutionalized capital flow management strategies
 - Cloak in ‘macro-prudential framework’
 - Make them ‘automatic’ to certain debt thresholds?
 - Focus on FX derivatives: Leverage ratios, margin, and position limits
- **Industrialized nations:** internalize negative spillovers abroad
 - Channel monetary policy toward domestic (productive) investment Signal clearly and coordinate beforehand
 - Vocal support for EMD efforts
- **International Institutions:** coordinate on equal ground
 - Substantial IMF quota reform and alternative institutions
 - Assist in enforcement and coordination of CARs
 - IMF surveillance on industrialized spillovers
 - IMF/FSB/US vocal support for EMD measures
 - IMF/FSB/US support for enforcement and capabilities enhancement

MARCH 2012

PARDEE CENTER TASK FORCE REPORT

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Regulating Global
Capital Flows for
Long-Run Development

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Capital Account Regulations
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A Compatibility Review

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