

Managing Capital Flows: Lessons from Emerging Markets for Frontier Economies

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March 2, 2015, Mauritius

Introduction

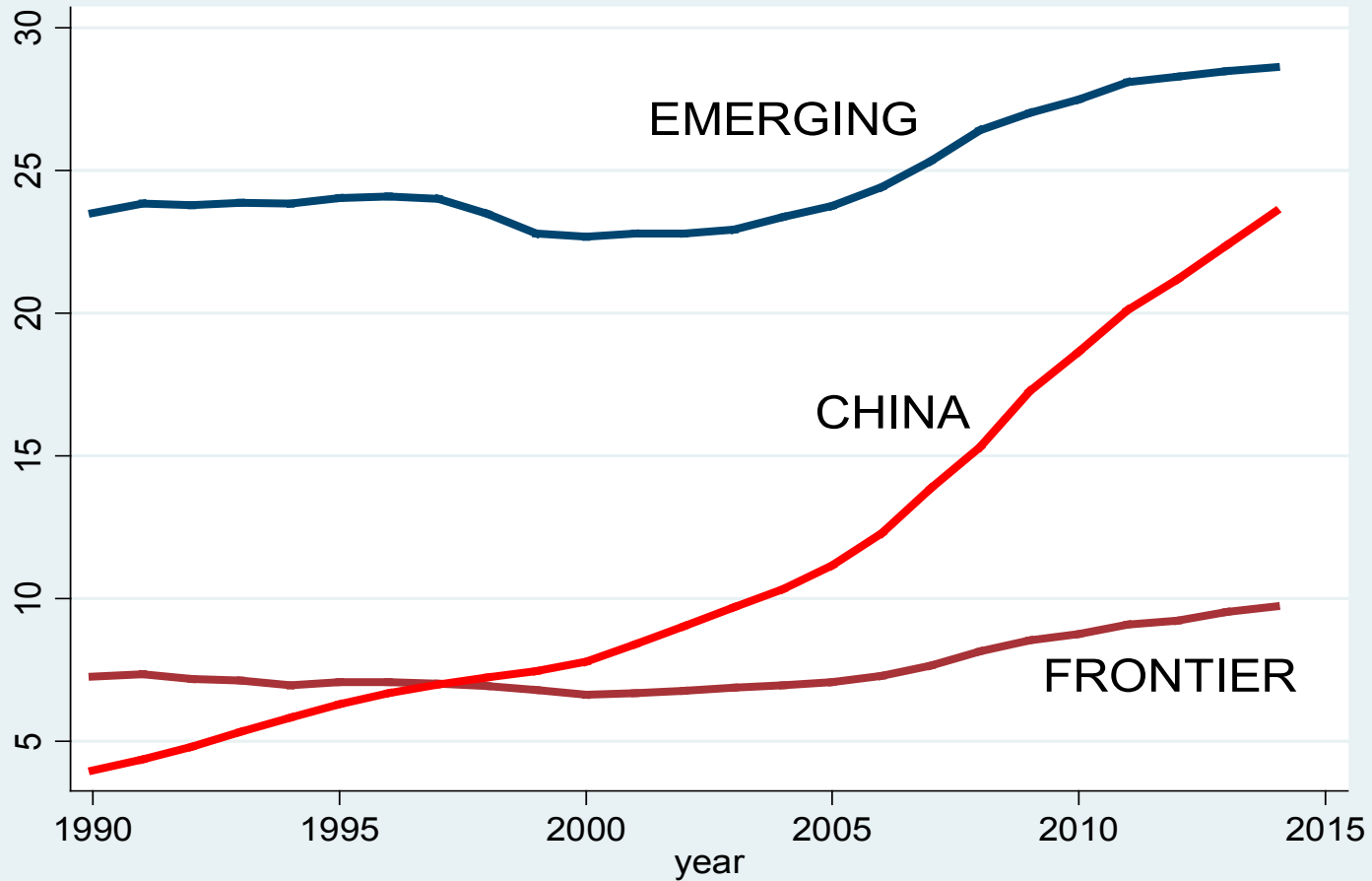
Structure

1. Capital account opening for low-income countries
2. Capital flow management, macroprudential policy and the exchange rate
3. The instruments of capital flow management

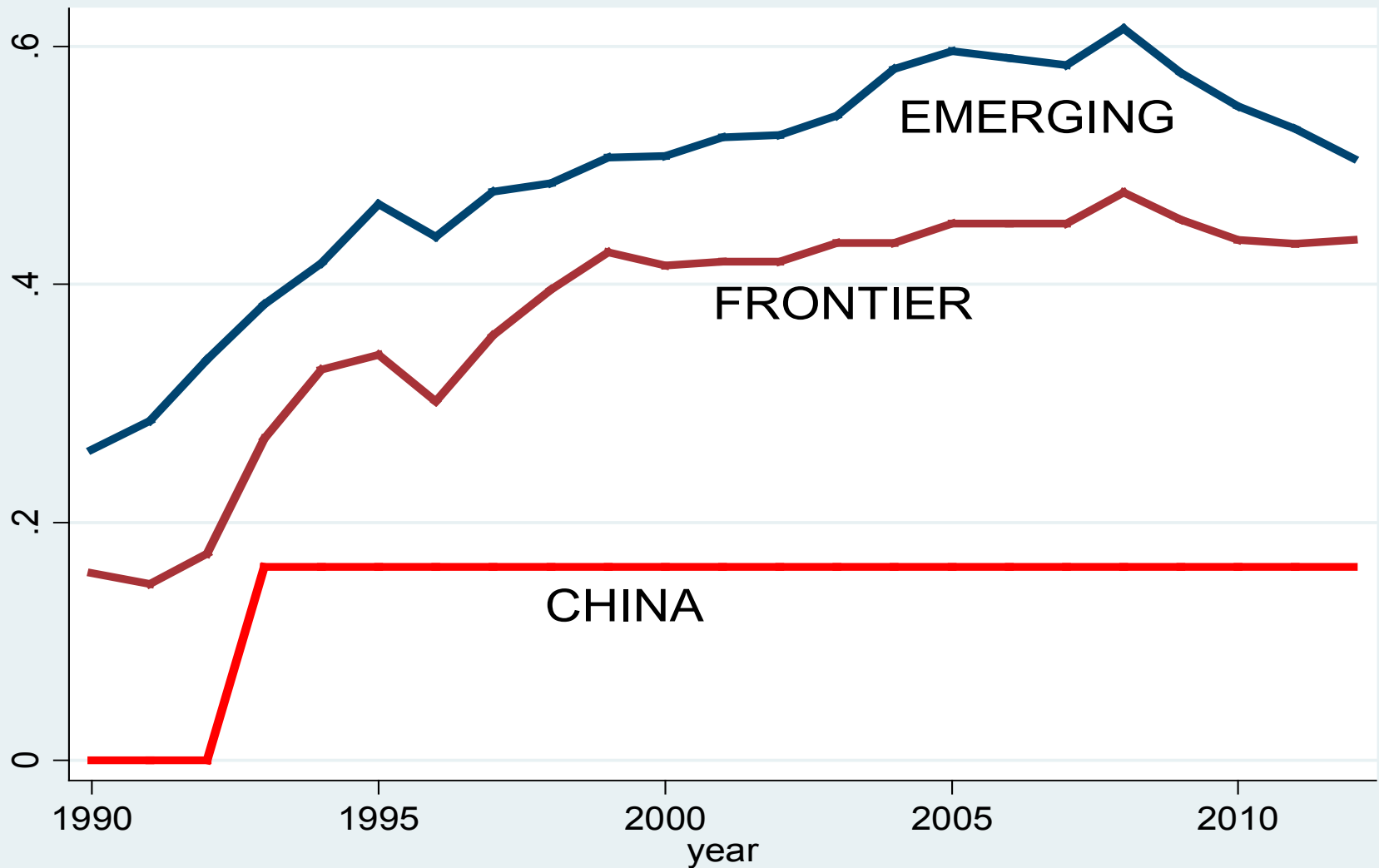
1. Capital account opening for low-income countries

- Half of Frontier Markets are low-income countries
- For LICs, one key objective is to “graduate” to middle-income status
- Which emerging market economies have graduated in the past?
 - which EM economies had GDP per capita < 10% of US level in 1990 and > 20% of US level now?

GDP per capita, share of US level in % (PPP-adjusted)



Chinn-Ito index of capital account liberalization (1990-2012)



- China has limited its integration to global financial markets
 - more generally, literature does not find that international financial integration increases growth (Jeanne, Subramanian and Williamson, 2012)
- There is a tension between
 - “development-appropriate” exchange rate
 - “financial equilibrium” exchange rate(Rodrik, 2008)
- Appropriate sequencing:
FDI → equity flows → bond flows

Sequencing in FMs

FDI inflows

Equity
inflows

	RESTRICTED	OPEN
RESTRICTED	AGO, BGD , CIV, GHA , HND, KEN , MOZ , MUS, TZA , VNM	MNG, PRY
OPEN	LKA	BOL, NGA, PNG, RWA , SEN , UGA , ZMB

FDI inflows

Bond
inflows

	RESTRICTED	OPEN
RESTRICTED	AGO, BGD , GHA , HND, LKA, MOZ , TZA	MNG, NGA
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Source: Jahan and Wang (2015), low-income countries in bold

2. Capital flow management, macroprudential policy and the exchange rate

- Capital flow management (CFM) is about managing the effects of **fluctuations in foreign demand for domestic assets**
 - global financial cycle
- Two main instruments:
 - sterilized forex interventions
 - market-based capital controls

Macroprudential motive

- High foreign demand for domestic assets may contribute to buildup in systemic risk
- This calls for **macroprudential policy**
- Macroprudential policy relies on instruments that are (mostly) not those of capital flow management

Exchange rate motive

- The instruments of capital flow management can be used to control the exchange rate without sacrificing monetary autonomy
(Ostry, Ghosh and Chamon, 2012)
- This is what these instruments seem to be used mostly for in practice.

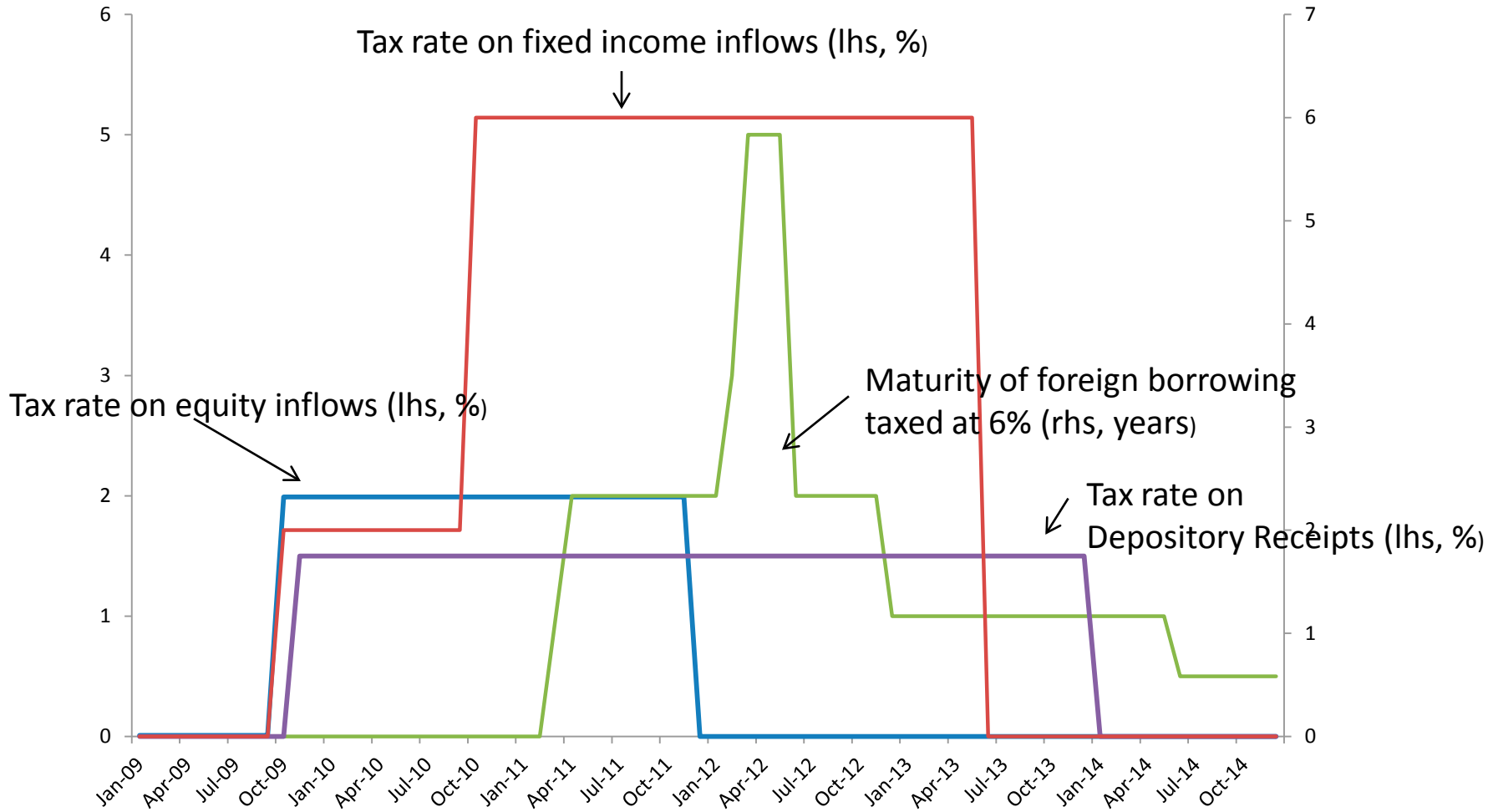
Policy targets and instruments

Policy	Instruments	Targets
Monetary policy	Interest rate	F(inflation, employment)
Macroprudential policy	Many	Factors of systemic risk
Capital flow (exchange rate?) management	Sterilized forex interventions Capital controls	Exchange rate

3. The instruments of capital flow (exchange rate) management

- How to resist appreciation induced by increase in foreign demand for domestic assets?
 - **increase supply**: sterilized forex intervention
 - **tax foreign demand**: the Brazilian experiment

Brazilian capital controls



Lessons for FM?

- The tax had a (limited) impact on the exchange rate (Chamon and Garcia, 2014)
- Sterilized forex interventions seem a more simple and robust way of resisting appreciation
 - Blanchard, Adler and Carvalho Filho (2015) find that a sterilized forex intervention amounting to 1% of GDP depreciates the exchange rate by 1%