Global Financial Flows after the Great Recession: Prospects and Policies

Peterson Institute for International Economics

Kristin Forbes
MIT-Sloan School of Management

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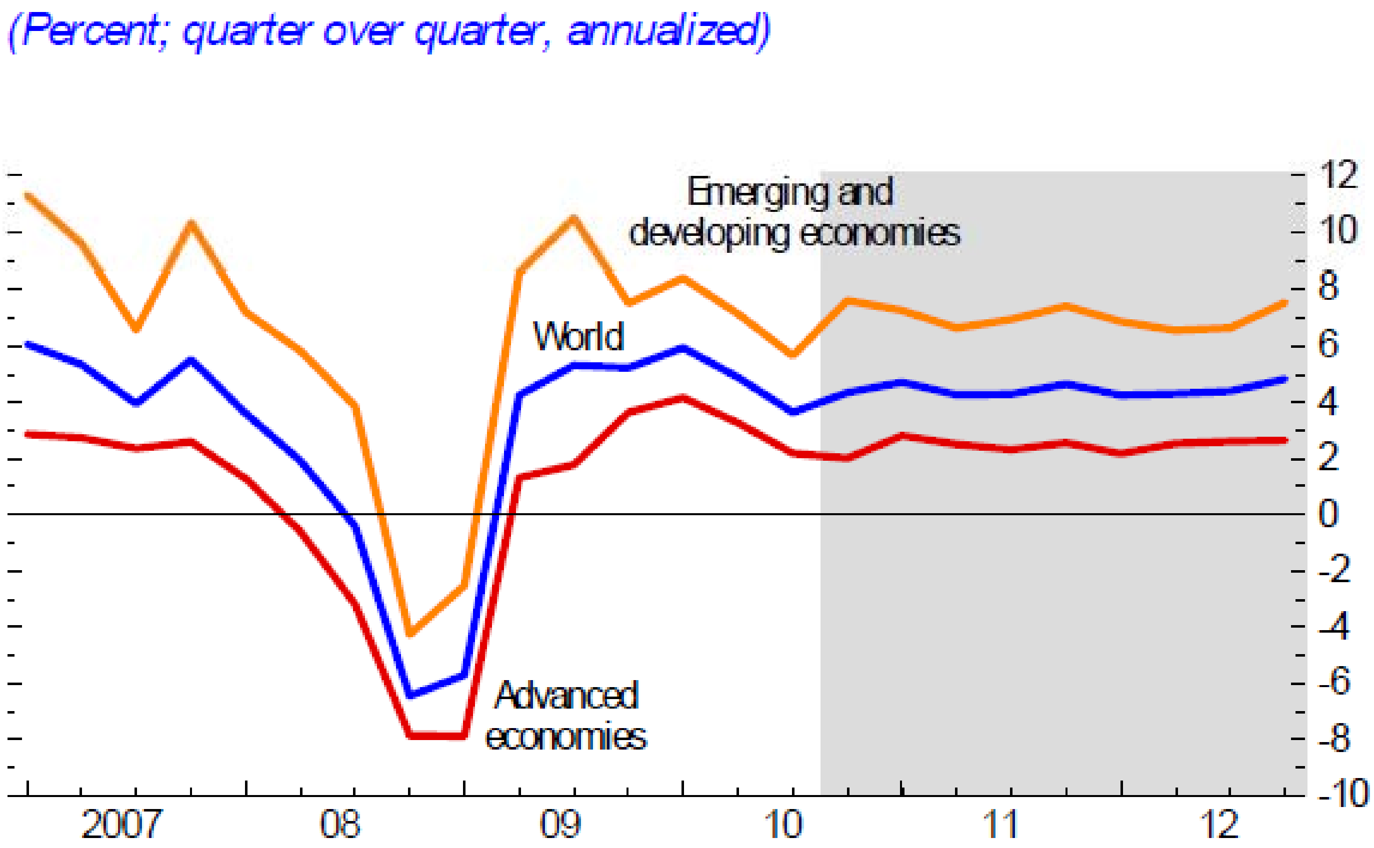
Comments

I. Tying it all together
   – Link to recent IMF work

II. What's Missing?

Global GDP Growth



Source: IMF WEO update, 01/11

World Upside Down

Source, *Economist* cover, 09/11/10

Options for Emerging Markets?

- Lower interest rates → inflation, bubbles
- Tighter fiscal policy → political challenges, lower investment & growth in future (?)
- Exchange rate appreciation → reduce competitiveness
- Accumulate reserves → increasing cost
- Encourage capital outflows → often limited impact
- What's left?
  - Capital controls focused on capital inflows?
  - Better risk management and macro-prudential regulation?

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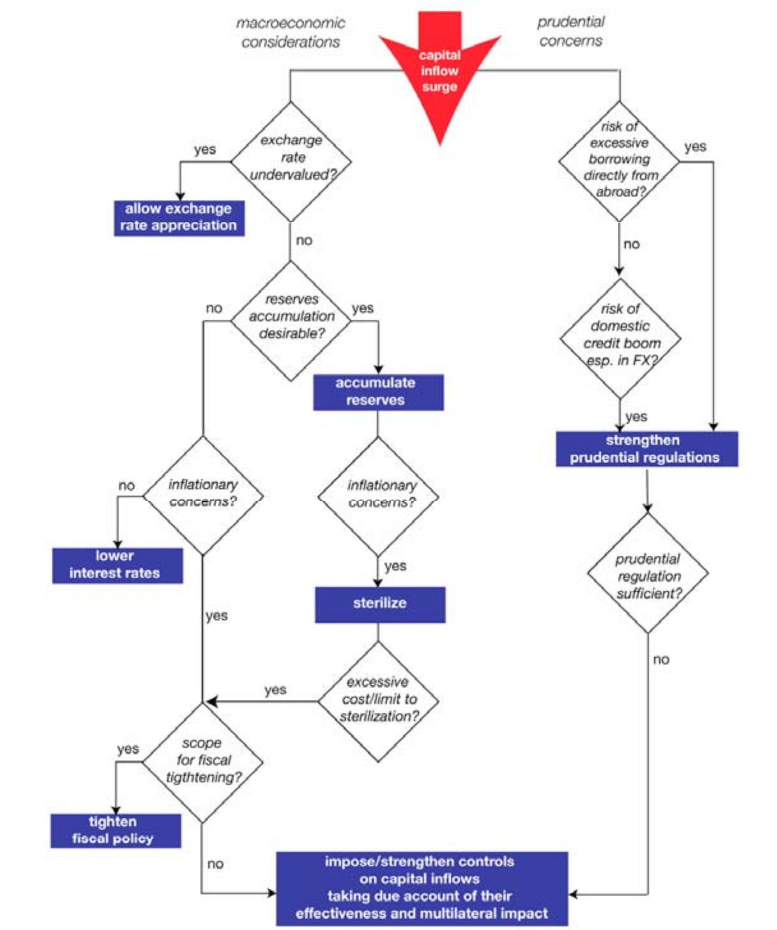
Capital Controls: New Support from IMF

Figure 1. Coping with Surges in Capital Inflows: Macroeconomic and Prudential Considerations 1/



1/ From the perspective of an individual country, without taking account of multilateral considerations; on the effectiveness of controls, see Section III.

Capital Inflows: The Role of Controls, 2010, by Ostry, Ghosh, Habermeier, Chamon, Qureshi and Reinhardt

Key criteria to possibly use controls on inflows, either:

- Concerns about overborrowing & credit booms but prudential regulations insufficient
- Exchange rate overvalued, reserve accumulation undesirable, inflation concerns, but fiscal policy insufficient

A Start, but…

- Only viable as a **TEMPORARY** response to a **TEMPORARY** surge in inflows
  - Lawson shows this is not the case today
- Develops theoretical scenarios when controls could make sense, but does not analyze relative costs and benefits
  - Cline analysis fills this gap
  - One of only attempts to quantify costs and benefits
  - Results: the costs to growth of reducing financial globalization do not outweigh the benefit of reduced risk of crises
- Strongest case for controls is to shift borrowing structure away from riskier liabilities, but why can't this be accomplished through macro-prudential regulation?
  - Rust presents one approach

What's Missing?

Role of Domestic Investors

Gross versus Net Capital Flows

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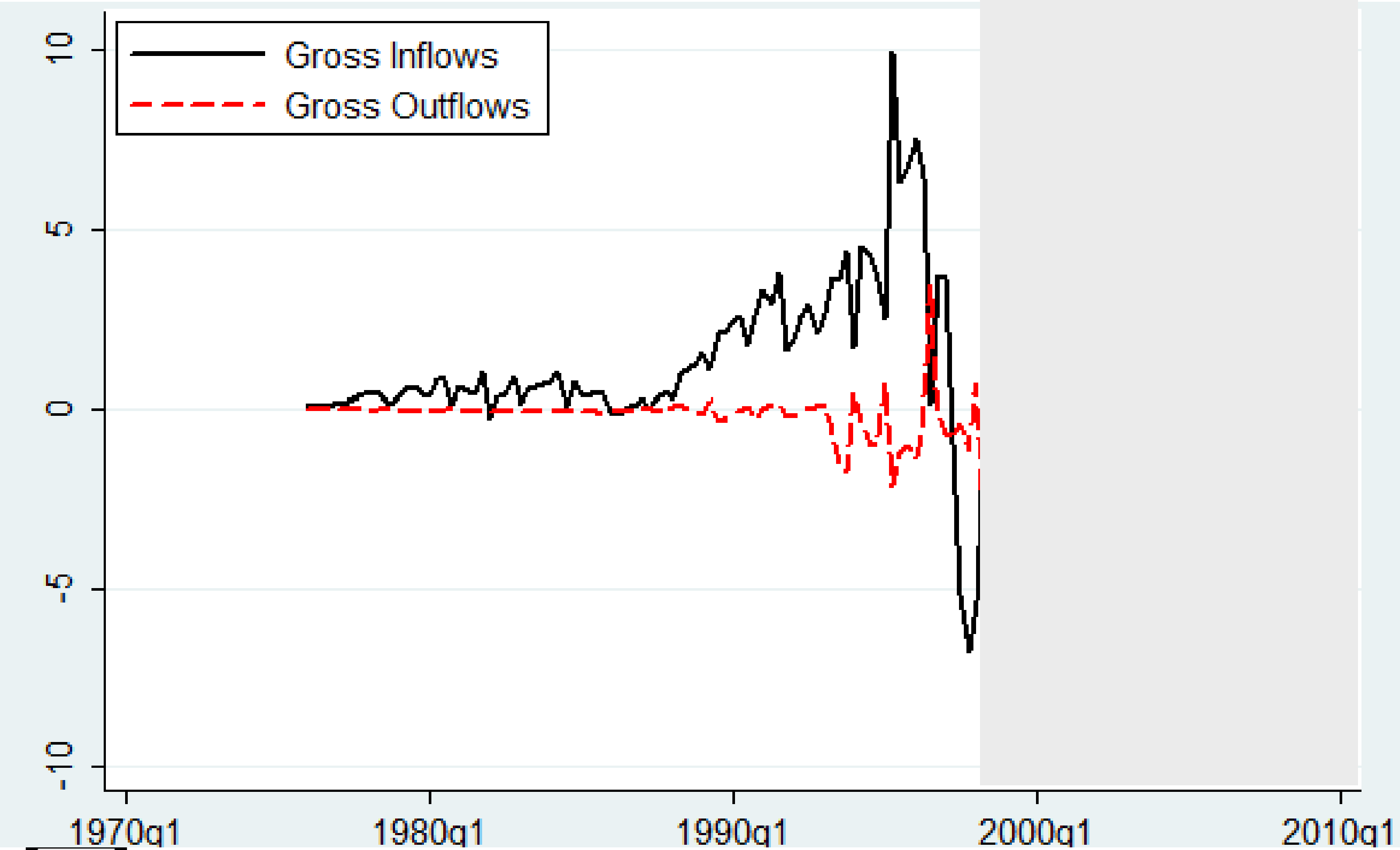
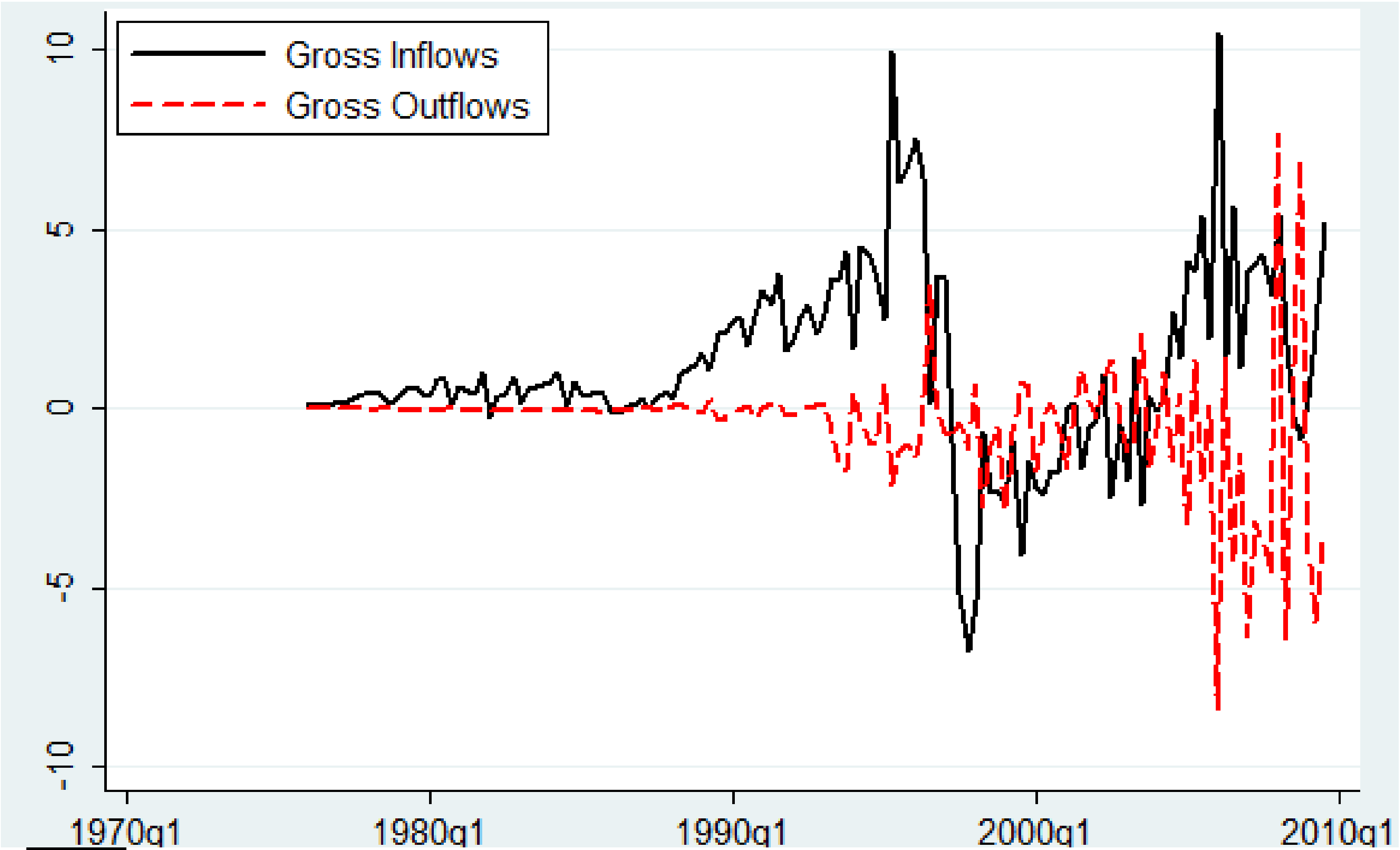
Thailand: Gross Inflows & Outflows



Source: Forbes & Warnock, 2011

Thailand: Gross Inflows & Outflows



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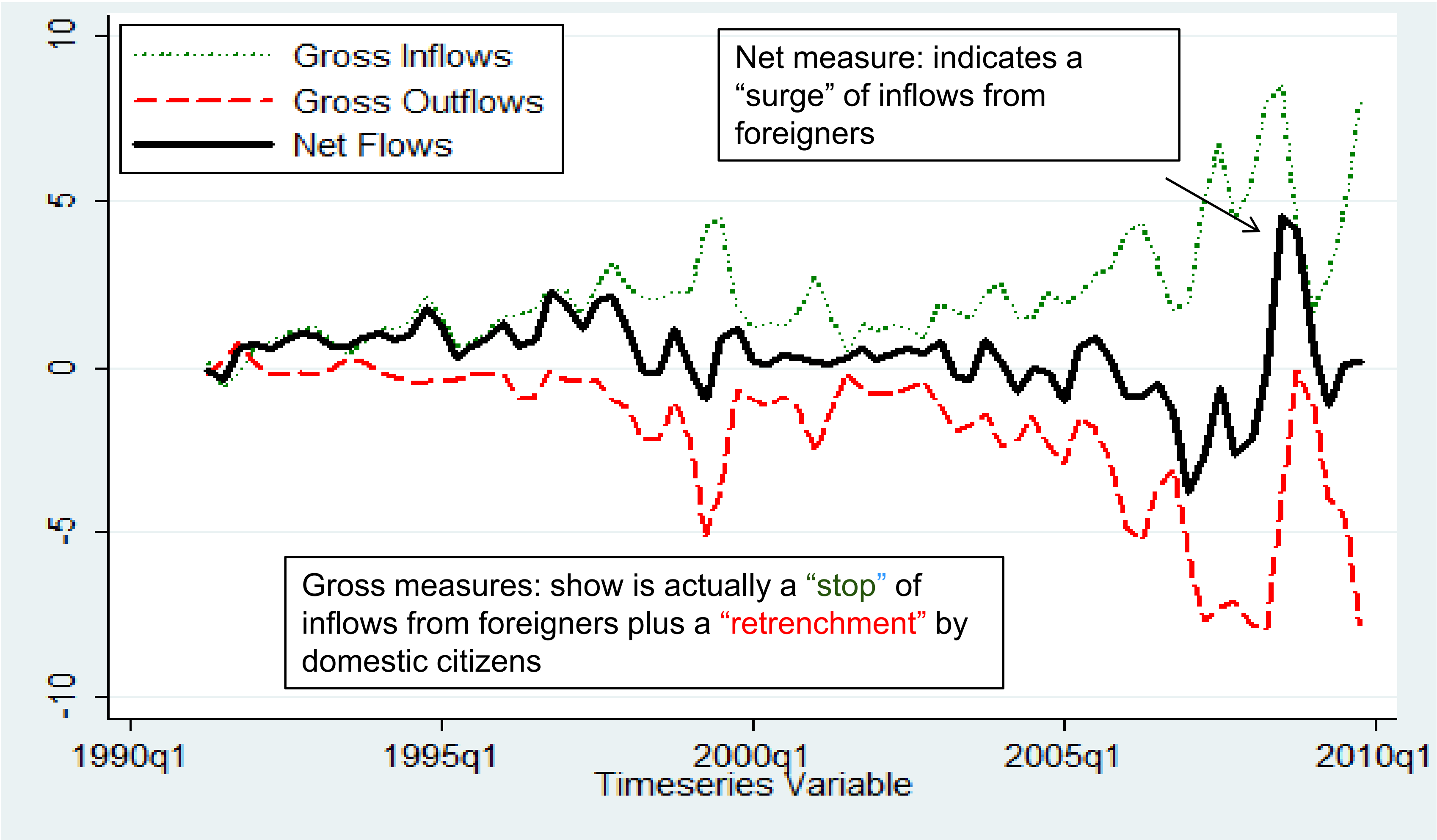
Source: Forbes & Warnock, 2011

Chile: Net and Gross Capital Flows



Source: Forbes & Warnock, 2011

Final Thoughts

- Global economy undergoing major transformation in patterns of capital flows
  - This is a permanent shift
  - Policies aimed at temporary relief will not be satisfactory
- Emerging economies must choose between difficult options
  - Criteria to justify controls on capital inflows are lengthy
    - And then still unclear if benefits outweigh costs
  - Most benefits of capital controls can be achieved more efficiently through prudential regulations (without additional costs)
- Discussion needs to be extended to consider different role and policy implications for capital flows by foreigners versus domestic citizens

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