

Managing Capital Flows: What is the Right Policy Mix?

April 12, 2019

12:30 p.m. to 1:30 p.m.

HQ1 Atrium, HQ1-1-700

Moderator: David Lipton, First Deputy Managing Director, IMF

Panelists:

Mark Carney, Governor, Bank of England

Stanley Fischer, former Vice Chairman of the US Federal Reserve

Elvira Nabiullina, Governor of the Central Bank of Russia

Raghuram Rajan, Professor of Finance, University of Chicago Booth School of Business

Nor Shamsiah Mohd Yunus, Governor, Bank Negara Malaysia

Panelists shared their views on challenges to policy managers of macroeconomic management brought by capital flows, and a possible policy framework to manage flows going forward.

Key Points:

- **Foreign exchange intervention.** *Fischer* commented on his experience as Governor of the Bank of Israel during the Great Financial Crisis and the positive use of foreign exchange market intervention to deal with major capital inflows episodes in a low interest rate scenario. *Yunus* highlighted that the policy mix may be adversely influenced by capital flows and, thus, capital controls may help policy makers in rebalancing the policy mix. *Fischer* suggested that while it is may be possible to refrain from interventions for large countries, interventions may be needed to manage capital flows in small countries which are more exposed to these flows.
- **Building resilience against shocks.** *Rajan* noted that capital inflows may lead to an increase in corporate sector leverage in the inflow countries. In this context, *Nabiullina*, noted the importance of building resilience against shocks and the importance of establishing adequate preventive measures, such as measures to strengthen debt sustainability and macroprudential policies to deal with corporate leverage.
- **Policy mix and central bank credibility.** *Yunus* highlighted that transparency was essential when using capital control measures. *Nabiullina* stressed that controls on capital outflows tended to undermine central bank credibility. Panelists, in general, underscored the key role of central bank credibility in managing macroprudential policies.
- **Spillovers and international responsibility.** *Rajan* noted the major changes on the policy mix in advanced and emerging markets economies and wondered whether international spillovers should be included in the central banks' reaction function.
- **Framework and IMF's contribution.** *Carney* highlighted the three buckets of factors that influence capital flows: push factors (basically, the global financial cycle), pipes (international market structures and the nature of the flows), and pull factors (linked to domestic factors, including fiscal policy, central bank credibility, and macroprudential policy). He highlighted the IMF's unique position in leading the discussions on these factors.

Quotes:

“When we say to ‘getting the right policy mix’, we have to consider other policy areas, how monetary policy, foreign exchange intervention policies, macroprudential policy and capital flow management policy may all fit together, what are the right mix, and what are the trade-offs.” **David Lipton**

“We could have lost control of the exchange rate. We didn’t, but we had to scramble from time to time and it worked.” **Stanley Fischer**

“By now the market is not especially volatile and the central bank continues to intervene (...). So, it must certainly be what the Fund doesn’t approve of and, again, you have to say, ‘if you are doing the wrong thing what is the damage?’. And I must confess I can’t’ actually figure out what the big damage is.” **Stanley Fischer**

“Increasingly, we are asking the question: are the benefits domestically of higher growth and then spillovers of this higher growth to the rest of the world, do they outweigh the cost of this spillovers effects through capital flows and the raising leverage in other countries, which then needs to be counteracted and then could create problems.” **Raghuram Rajan**

“I think that what the Fund can do is to try to pull all this together and dimension these various factors – it is an ambitious task, but it is in the core of its mandate.” **Mark Carney**

Contributor: Daniela Alcantara