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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)

EMERGING

FRONTIER

CHINA

year

• 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 FMFs

### FDI inflows

<table>
<thead>
<tr>
<th>Equity inflows</th>
<th>RESTRICTED</th>
<th>OPEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>RESTRICTED</td>
<td>AGO, BGD, CIV, GHA, HND, KEN, MOZ, MUS, TZA, VNM</td>
<td>MNG, PRY</td>
</tr>
<tr>
<td>OPEN</td>
<td>LKA</td>
<td>BOL, NGA, PNG, RWA, SEN, UGA, ZMB</td>
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</tbody>
</table>

### Bond inflows

<table>
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</table>

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.
<table>
<thead>
<tr>
<th>Policy</th>
<th>Instruments</th>
<th>Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary policy</td>
<td>Interest rate</td>
<td>( F(\text{inflation,employment}) )</td>
</tr>
<tr>
<td>Macroprudential policy</td>
<td>Many</td>
<td>Factors of systemic risk</td>
</tr>
<tr>
<td>Capital flow (exchange rate?)</td>
<td>Sterilized forex interventions</td>
<td>Exchange rate</td>
</tr>
<tr>
<td>management</td>
<td>Capital controls</td>
<td></td>
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</tbody>
</table>
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
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%