

DISCUSSION OF
**Are Capital Inflows Expansionary or
Contractionary?**
Theory, Policy Implications, and Some Evidence
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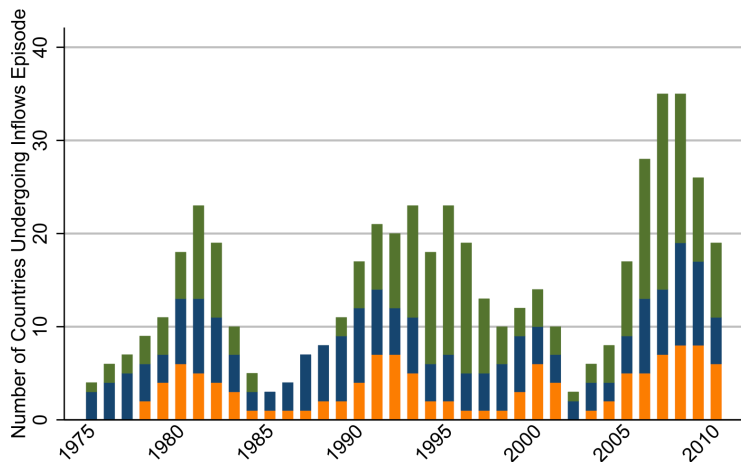
IMF-SNB-IMFER Conference
Zurich, June 2016

INTRODUCTION

- Are capital inflows expansionary or contractionary ?
 - ▶ Policymakers' eyes: expansionary
 - ▶ Mundell-Fleming: contractionary (holding constant the policy rate)
 - ▶ Blanchard et al. (2016): it depends on type of inflows (bond vs. non-bonds)

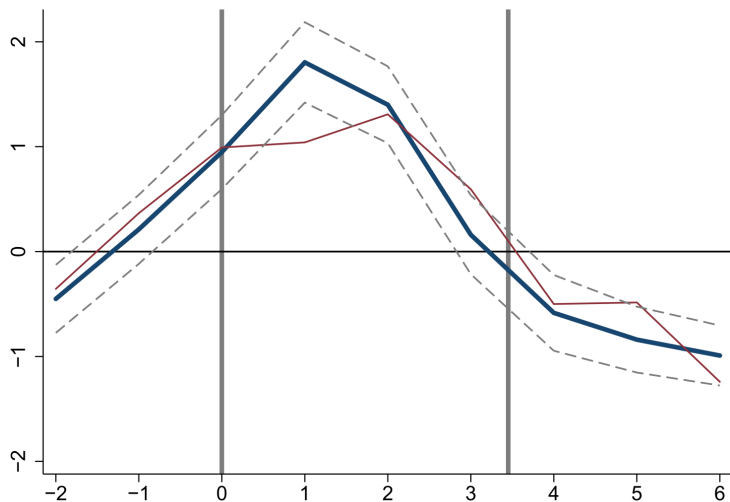
- My discussion
 1. Some empirical evidence
 2. A simple model
 3. Comments on the paper

EPISODES OF LARGE CAPITAL INFLOWS



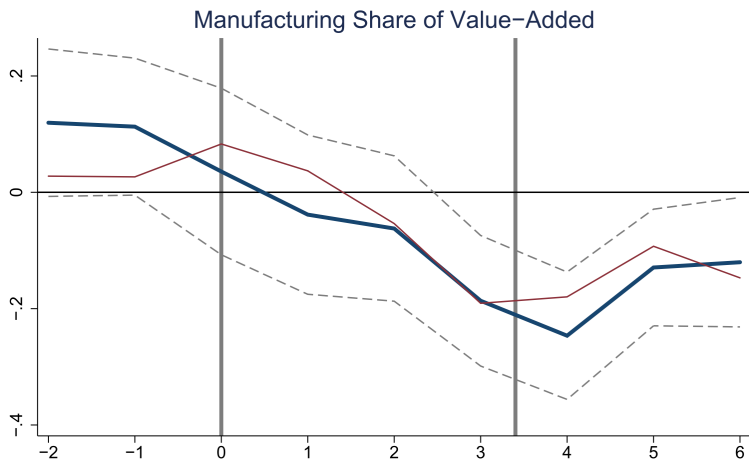
Benigno, Converse and Fornaro (2015, JIMF)

GDP



Benigno, Converse and Fornaro (2015, JIMF)

SHARE OF MANUFACTURING IN VALUE ADDED



Benigno, Converse and Fornaro (2015, JIMF)

A SIMPLE FRAMEWORK: AGGREGATE DEMAND

- Small open economy

$$C_t = (C_t^T)^\omega (C_t^N)^{1-\omega}$$

- Demand for non-tradables

$$C_t^N = \frac{1-\omega}{\omega} \frac{P_t^T}{P_t^N} C_t^T \quad (\text{AD})$$

A SIMPLE FRAMEWORK: AGGREGATE DEMAND

- Small open economy

$$C_t = (C_t^T)^\omega (C_t^N)^{1-\omega}$$

- Demand for non-tradables + law of one price ($P_t^T = E_t$)

$$C_t^N = \frac{1-\omega}{\omega} \frac{E_t}{P_t^N} C_t^T \quad (\text{AD})$$

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$$C_t^N = \frac{1-\omega}{\omega} \frac{E_t}{P_t^N} C_t^T \quad (\text{AD})$$

- World interest rate: R
- Interest rate charged to borrowers: $R(1 + \psi)$

$$\downarrow R(1 + \psi) \rightarrow \uparrow \text{foreign borrowing} \rightarrow \uparrow C_t^T$$

AGGREGATE SUPPLY

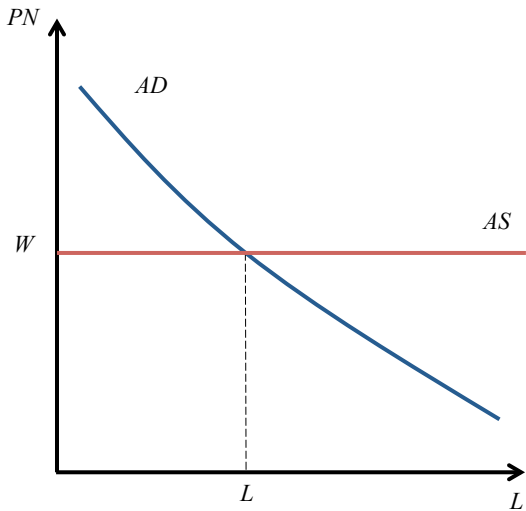
- Endowment of tradables
- Non-tradable good produced using labor

$$L_t = Y_t^N = C_t^N$$

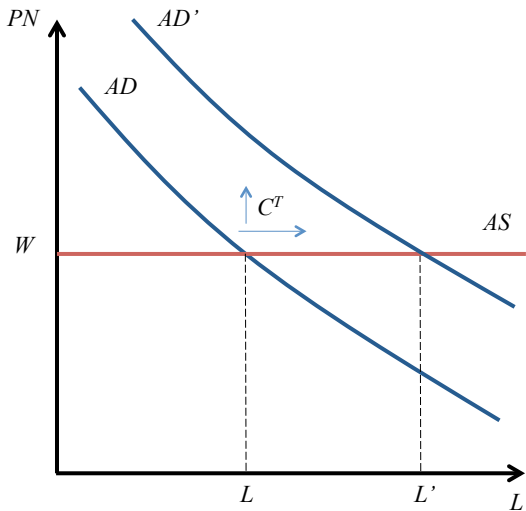
- Zero profit condition + sticky wages

$$P_t^N = W_t = \bar{W} \quad (\text{AS})$$

EQUILIBRIUM ON MARKET FOR NT



RESPONSE TO $\downarrow R(1 + \psi)$



MONETARY POLICY

- Domestic nominal bond

$$R_t^n(1 + \psi) = R(1 + \psi)\frac{E_{t+1}}{E_t} \quad (\text{UIP})$$

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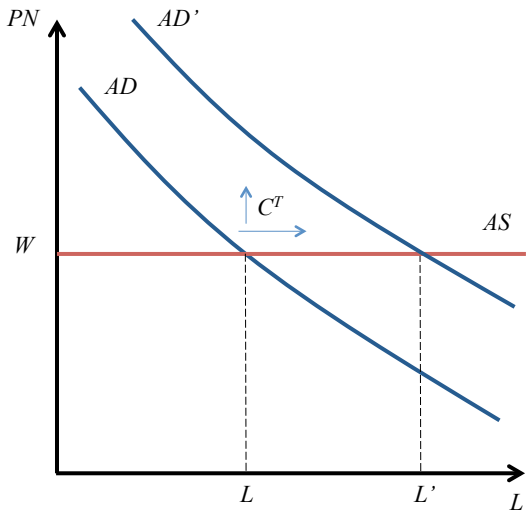
MONETARY POLICY

- Domestic nominal bond

$$R_t^n = R \frac{E_{t+1}}{E_t} \quad (\text{UIP})$$

- For given R_t^n , capital flows driven by:
 - ▶ Relaxation of credit constraints ($\downarrow \psi$) are expansionary

RESPONSE TO $\downarrow \psi$ - ($\Delta R^n = 0$)



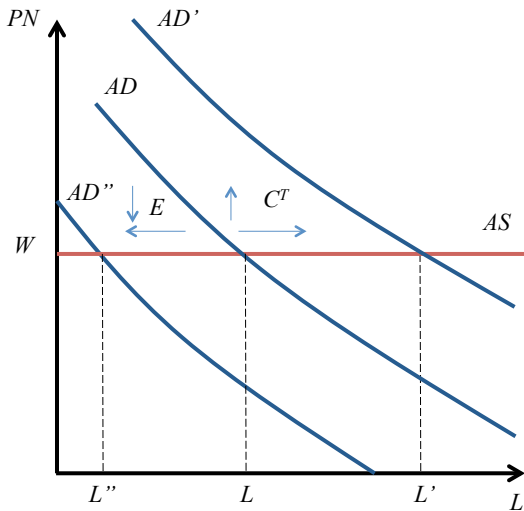
MONETARY POLICY

- Domestic nominal bond

$$R_t^n = R \frac{E_{t+1}}{E_t} \quad (\text{UIP})$$

- For given R_t^n , capital flows driven by:
 - ▶ Relaxation of credit constraints ($\downarrow \psi$) are expansionary
 - ▶ Low world rate ($\downarrow R$) have ambiguous impact on output

RESPONSE TO $\downarrow R$ - ($\Delta R^n = 0$)



INTERPRETING EPISODES OF LARGE INFLOWS

- Episodes of large capital inflows driven by
 - ▶ $\downarrow \psi$: emerging countries during the 1990s, Euro area periphery and Eastern Europe pre-2008
 - ▶ $\downarrow R$: emerging countries and Switzerland post-2008
- Even in the latter case, capital flows are expansionary if central bank pegs the exchange rate or targets CPI inflation
- Zero lower bound might explain why capital inflows in Switzerland post-2008 are perceived to be contractionary
- But even expansionary capital inflows might need to be regulated (aggregate demand externalities, financial risk, financial resource curse)

COMMENTS ON BLANCHARD ET AL. (2016)

- Can I think of ψ as the spread between bonds and non-bonds (return on savings vs. borrowing cost)?
- Why focus on bonds vs. non-bonds?
 - ▶ Why not include bank lending in the bond category?
 - ▶ What about public vs. private assets?
- Imperfect substitutability opens the door to interesting new effects
 - ▶ $\uparrow R^n \rightarrow \downarrow \psi$?

COMMENTS ON EMPIRICAL ANALYSIS

- More nuanced view of the results?
- Some avenues to explore
 - ▶ How important are bond capital inflows during the sample period?
 - ▶ Time dimension (pre-2008: mainly bank flows, post-2008: increased importance of bond flows)
- More intuition about policy instruments

CONCLUSION

- Very interesting paper on topical research question
- Opens the door to exciting new research avenues