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**Statement by Mr. Jin and Mr. Zhang on Independent Evaluation Office – IMF Advice on  
Capital Flows  
(Preliminary)  
Executive Board Meeting  
September 18, 2020**

We thank the Independent Evaluation Office (IEO) for the comprehensive set of reports and the Managing Director for her Buff statement. Amidst the COVID-19 crisis, many countries have launched stimulus packages, including extensive monetary easing. As the economy recovers, these policies need to normalize too. In turn, emerging markets and developing economies (EMDEs) may face another round of capital flow volatility. The IEO reports are timely and relevant, allowing us to draw lessons from countries of various financial and institutional settings.

At the outset, we wish to point out that, where feasible, exchange rate flexibility should still be the primary absorber of capital flows. The need for timely exchange rate adjustments in the face of capital reversals should not be understated. The adjustments would be smoother and more orderly if supported by prudent macroeconomic policies, efficient financial markets, and sound regulatory and supervisory oversight. In particular, it is important to develop a well-functioning financial system that can provide effective tools for hedging and prudent management of exposure to short-term foreign currency-denominated debt and the risk of currency mismatch. That said, under certain circumstances, capital flow management measures (CFMs) may have a role to play in addressing challenges posed by capital flow volatility. In this regard, the Fund's Institutional View on The Liberalization and Management of Capital Flows (IV) has provided a structured framework for guiding Fund advice on policies for managing some of these challenges.

To ensure the IV remains timely and relevant, we support revisiting the IV based on recent experience and research. The IEO has identified a number of emerging issues which we

agree would merit further consideration, and we would like to comment on a few specific issues as follows:

### **On more pre-emptive use of CFMs**

Despite the huge asymmetry, there is a regularity in the up-and-down swings of capital flows. It should be anticipated ahead of time that outflows would occur some day following abnormal massive inflows. So, unless inflows were effectively managed in the first place, when outflow pressures eventually emerge, the usefulness of imposing CFMs to stop outflows may be limited when the reversal of sentiment is strong and there are opportunities for circumvention. We therefore encourage the Fund to consider allowing for more flexibility for preemptive and more long-lasting use of CFMs in some circumstances, drawing from recent theoretical work and empirical results.

### **On cross-border issues**

Capital flows to EMDEs continue to be driven by developments in AEs. Therefore, we encourage staff to keep addressing the push factors behind volatile capital flows, including by enhancing monitoring spillovers from AEs. Through its multilateral and bilateral surveillance work, the Fund should continue to shed light on the potential benefits of coordinated action to mitigate possible negative side effects of domestic policies on others. In the meantime, there has been growing attention on the increasing capital flows among EMDEs, including the rising outflows from China since the launch of the Belt and Road Initiative. In analyzing these capital flows, it is important to recognize the substantial and long-term benefits through greater integration, improvement in infrastructure and increased trade.

From a broader perspective, large-scale cross-border capital flows may impact macroeconomic and financial stability and expand systemic financial risks. We encourage staff to continue to strengthen monitoring of capital flows, enhance early warning of cross-border risks, and increase transparency of capital flow data.

### **On housing-related issues**

We appreciate the IEO's dedicated Background Paper on housing-related issues in AEs. As noted from the IEO paper, the application of the IV in this area has been a subject of some debate, both between authorities and IMF staff and also within the Fund. The experience suggests there may be room for improvement. We believe some of the time spent on addressing the labeling of measures could have been used for more constructive discussion on whether measures were effective in tackling housing market concerns and/or possible

alternative measures that do not discriminate between residents and non-residents. To this end, we welcome the recent shift observed by the IEO, where IMF staff paid less attention to labeling and focused more on policy effectiveness, with assessments of measures under the IV often moved to a footnote.

We also support greater consideration to be given to the broader social goals of housing measures, and how these measures fit into the authorities' overall strategy of tackling housing market challenges. As pointed out in the IEO paper, housing measures often did not intend to focus on limiting capital flows. While there may not be a lot of flexibility in the designation of these measures as CFMs, there may be room to give the measures' main underlying objectives more recognition. We also encourage IMF staff to consider the potential impact on the housing market and broader financial stability if existing measures were removed and take this into account when discussing their policy recommendations with the authorities.

### **On increasing traction of Fund advice**

We support further efforts to increase traction of Fund advice on capital flows. IMF staff should continue to avoid mechanistic application of the IV and be cognizant of country-specific circumstances. Prejudging the effectiveness of new measures should be avoided, and greater evenhandedness in the application of the IV is encouraged. IMF staff should strive to have timely and in-depth engagement with the authorities. To support this engagement, more analysis on the long-term benefits of CFMs and MPMs, especially regarding the impact on market development would be helpful. We also encourage staff to consider ways to further reduce the stigma of CFMs, drawing from cases where CFMs were used appropriately.

We look forward to a deeper analysis on the above issues in the forthcoming review of the IV scheduled for 2021. The 2021 review should carefully consider how best to adapt the IV based on lessons learned so far, taking into account the insights from this IEO report and other analytical work at the Fund (including work on the Integrated Policy Framework). Any changes arising from the forthcoming review should be based on thorough consultation with the Board and the authorities, and should be carefully communicated prior to implementation.