



MACROPRUDENTIAL POLICIES: SOME LESSONS FROM THE ASIAN EXPERIENCE

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PURPOSE OF MACROPRUDENTIAL POLICIES

RISKS

- Excessive domestic credit growth especially directed to non-tradeable sectors
- Exchange rate volatility
- Surge of short-term inflows, including carry trade
- Sudden and sharp capital outflows
- Sharp changes in asset prices
- Fragility of domestic banking sector
- External commercial borrowings and debt crisis.

FEATURES

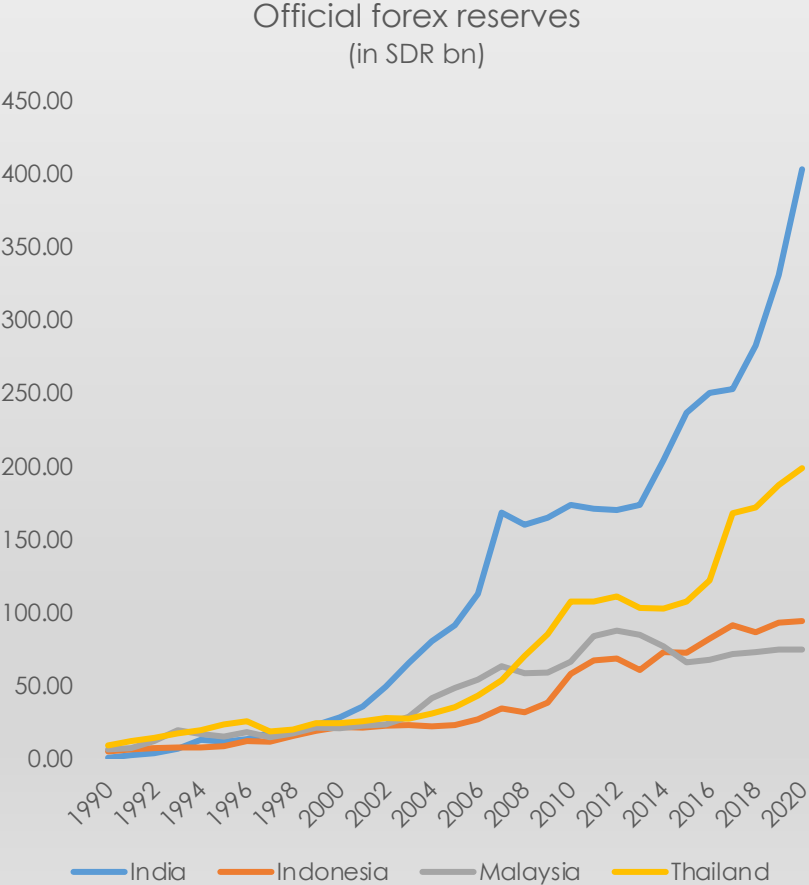
- Identify early indicators of weakness
- Pre-empt and limit build up of such risks
- Create buffers against pro-cyclical feedbacks of financial instability
- Measures can cover both domestic and external financial markets
- Capital management policies as subset of macroprudential policies

INDIA, INDONESIA, MALAYSIA, THAILAND

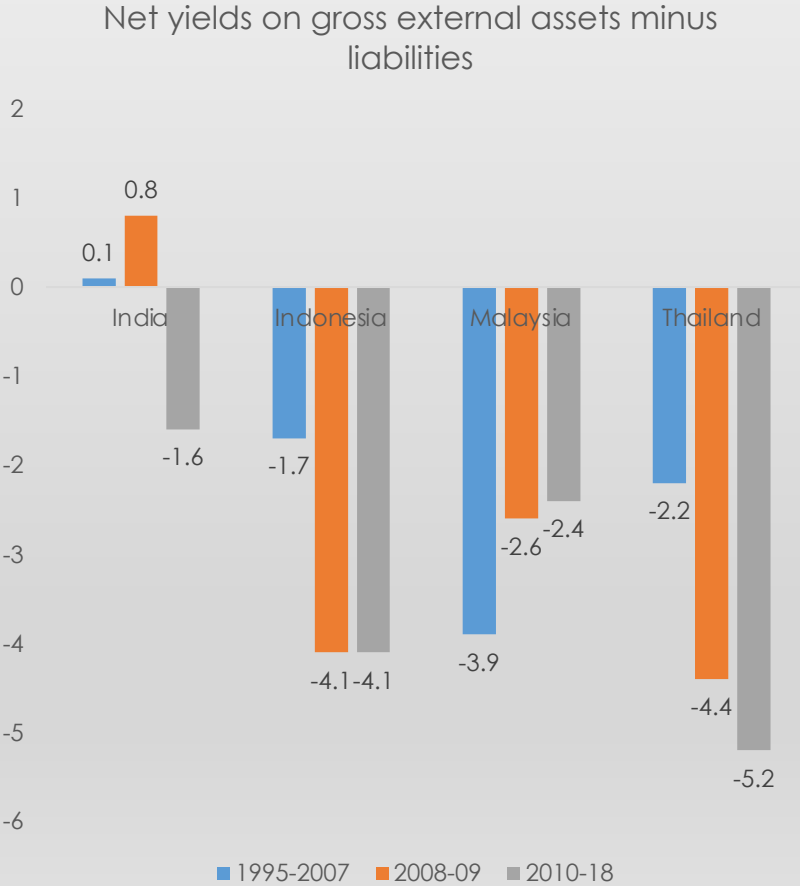
- Two recent episodes of heightened external vulnerability:
 - Global Financial Crisis, 2008-2010
 - Before and after Taper Tantrum, 2011- 2014.
- Asian Crisis 1997-98 was watershed, esp for divergence between savings and investment rates in Indonesia, Malaysia and Thailand.
- Shift from administrative to market-based and more “prudential” controls, in context of liberalised framework for capital flows
- Large increases in gross capital flows, strongly influenced by global economic forces
- Macroprudential measures have focused on exchange rate management, domestic asset price inflation and bank resilience
- Here I will look at exchange rate management.

FOREX RESERVES AS SELF-INSURANCE

FOREX RESERVE HOLDING GREW FROM 2000 AND THEN FROM 2012

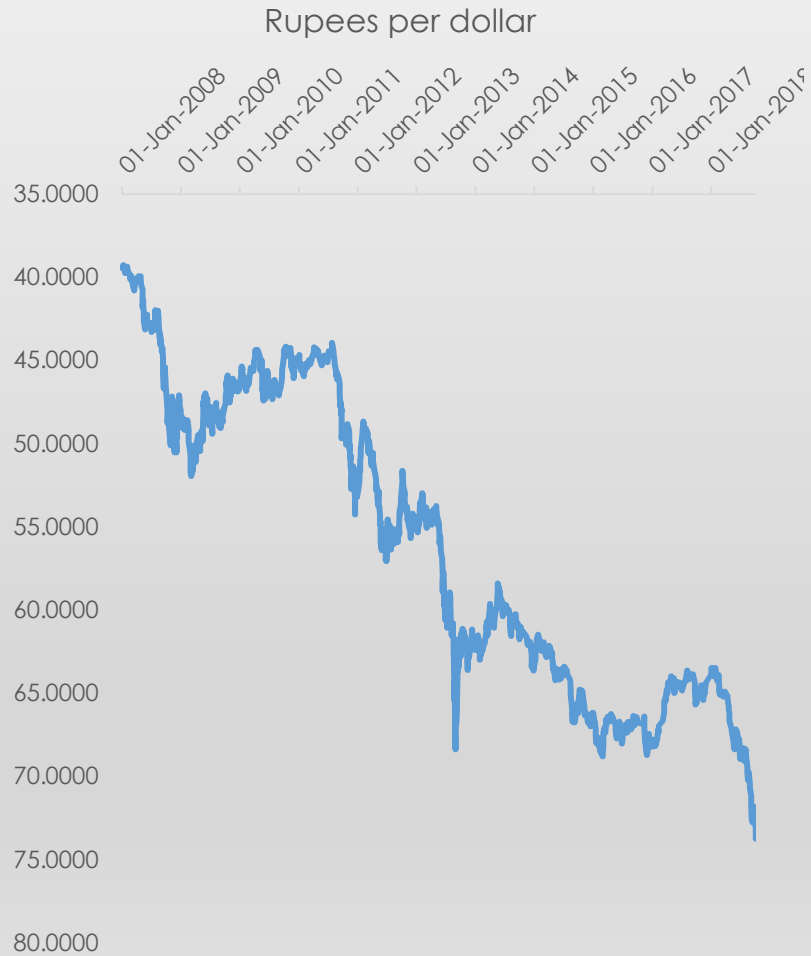


SEIGNOURAGE LOSSES ADDED TO NET NEGATIVE RETURNS

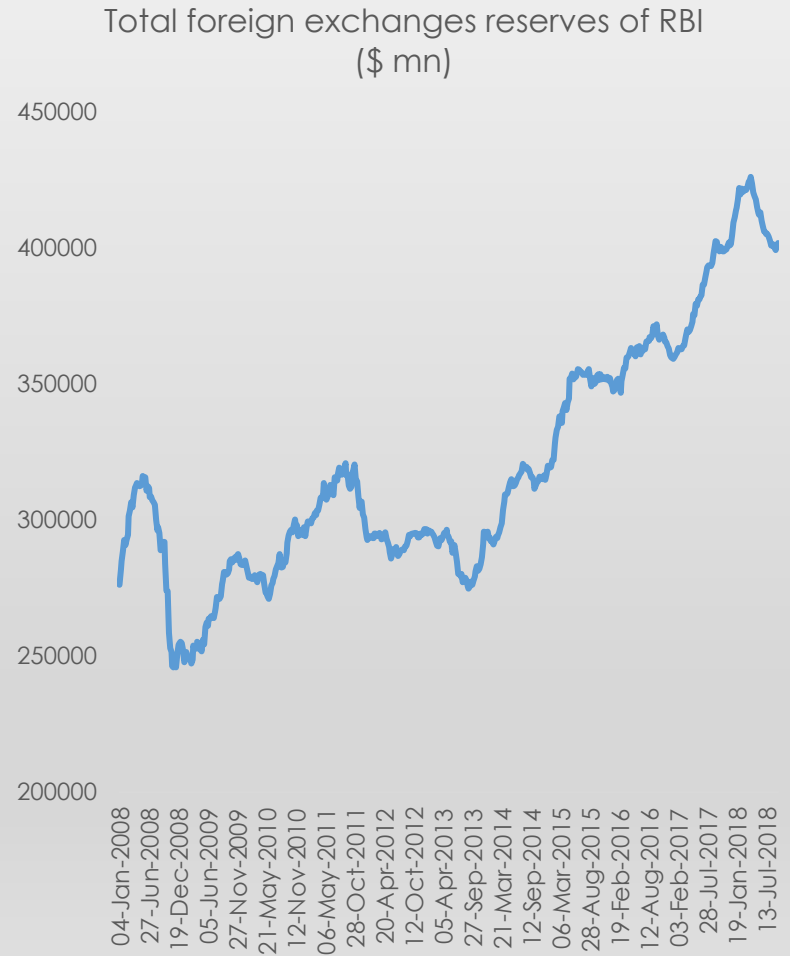


INDIA: EXCHANGE RATE MANAGEMENT

DECLINING RUPEE



RISING FOREX RESERVES

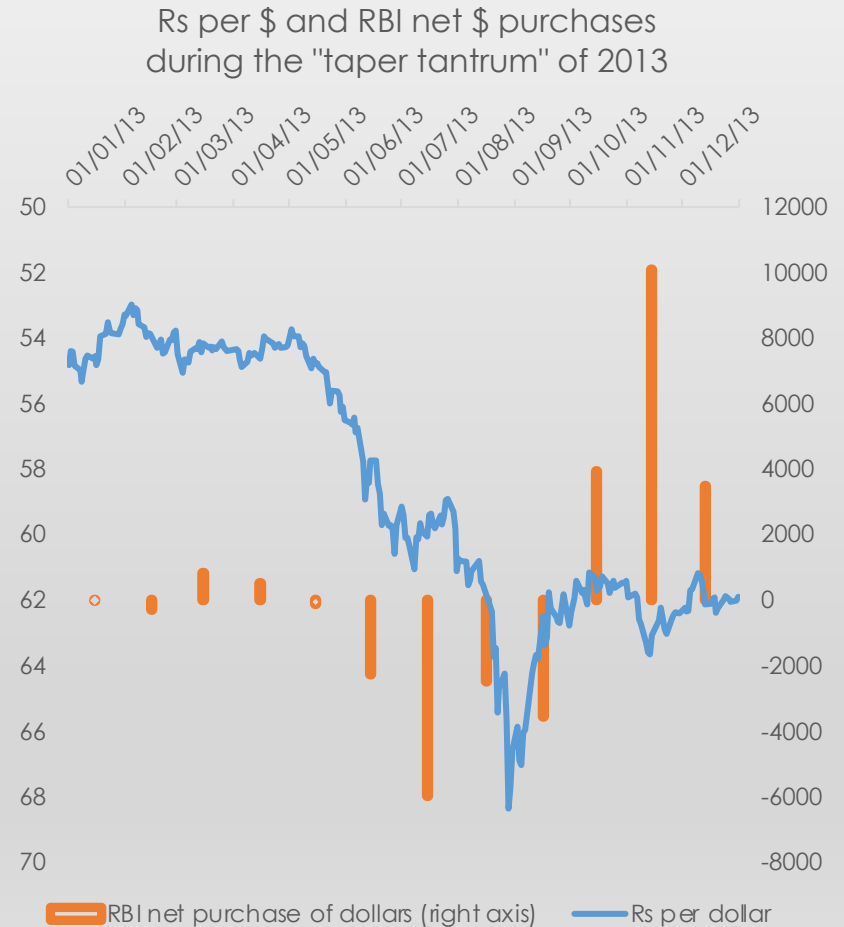


DID RBI'S OPEN MARKET OPERATIONS WORK?

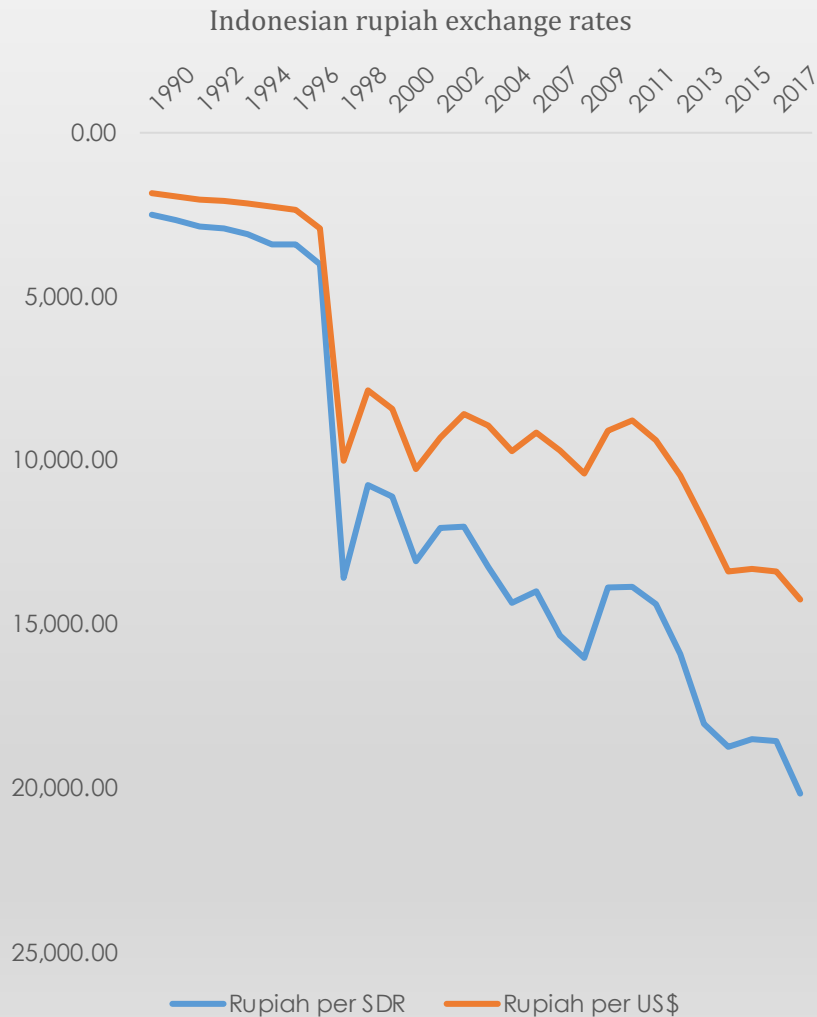
GLOBAL FINANCIAL CRISIS



TAPER TANTRUM

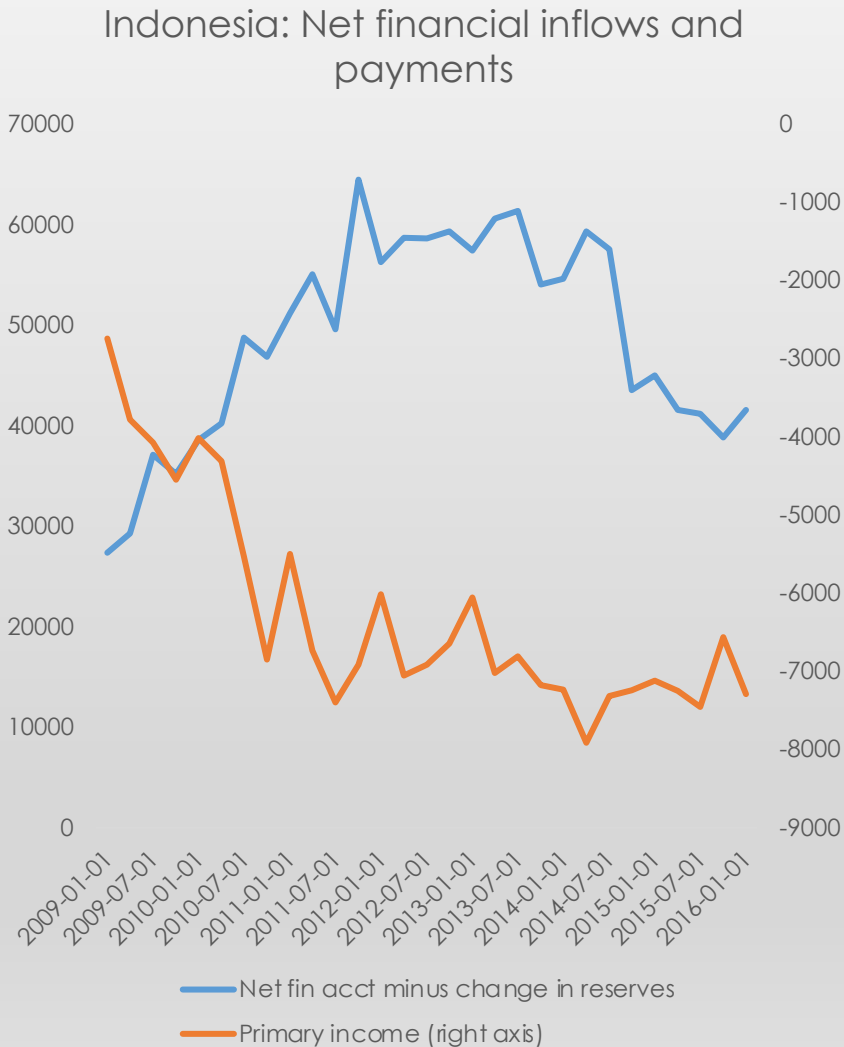


INDONESIA EXCHANGE RATE MANAGEMENT HAS FOCUSED ON OFFSHORE MARKET IN RUPIAH



- 2001: Rupiah transfers by Indonesian banks to non-residents prohibited.
- Restrictions imposed on derivatives transactions not supported by underlying real transactions.
- Maximum derivatives transactions with forex sales by domestic banks to non-residents reduced from \$ 5 mn to \$ 3 mn
- 2005: Limits on net open forex positions of banks, to reduce speculate in the swap market.
- Higher reserve requirements on forex bank deposit accounts
- Short term borrowing by banks limited to 20 percent of bank capital

INDONESIA: TRYING TO DEAL WITH SURGES IN INFLOWS AND OUTFLOWS OF PRIMARY INCOME



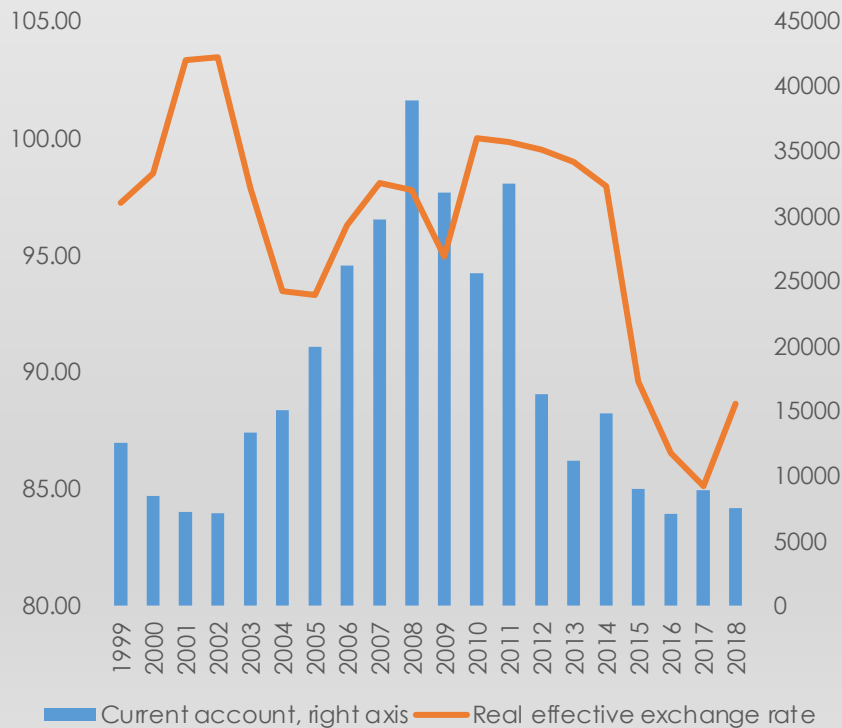
- 2010: Incentives for foreigners to hold longer-maturity assets
- Controls on short-term forex debt held by banks and non-banks to control currency mismatch
- Ceiling of 30% on short term forex debt
- 2011: Forex reserve requirement ratio increased from 1% to 5% to 8%.
- Loan to deposit and loan to value ratios increased.
- 2013: Hedging, liquidity and credit rating requirements for corporate forex borrowers
- These had some limited effect on containing forex outflows of primary income.

MALAYSIA: GRADUAL REDUCTION OF CAPITAL AND PRUDENTIAL CONTROLS FROM 2002, ALSO FOR OFFSHORE CURRENCY AND CREDIT MARKETS

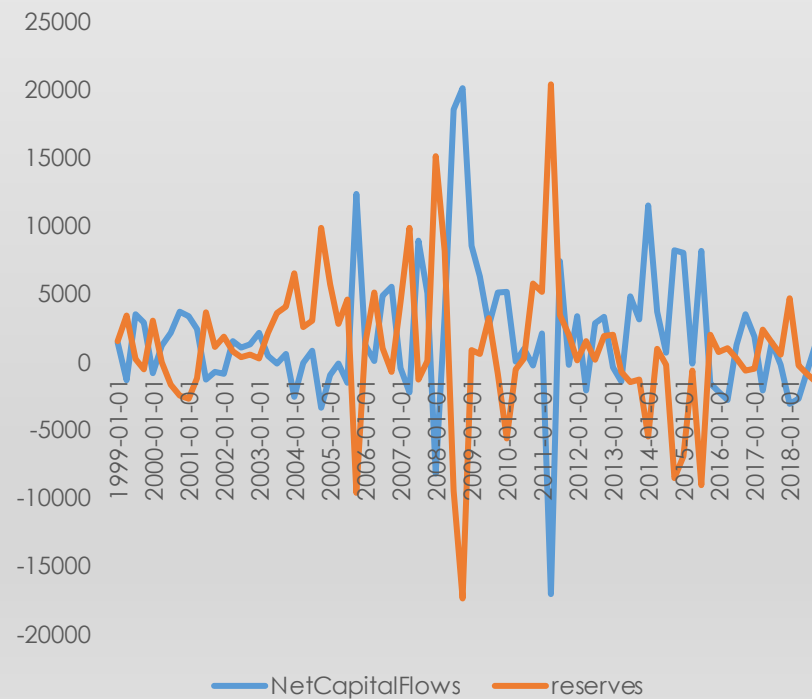
RINGGIT DEPRECIATION DESPITE CURRENT ACCOUNT SURPLUSES

VOLATILE CAPITAL FLOWS DROVE CURRENCY VOLATILITY DESPITE RESERVE CHANGES

Current account and real exchange rate



Net capital flows and reserves change

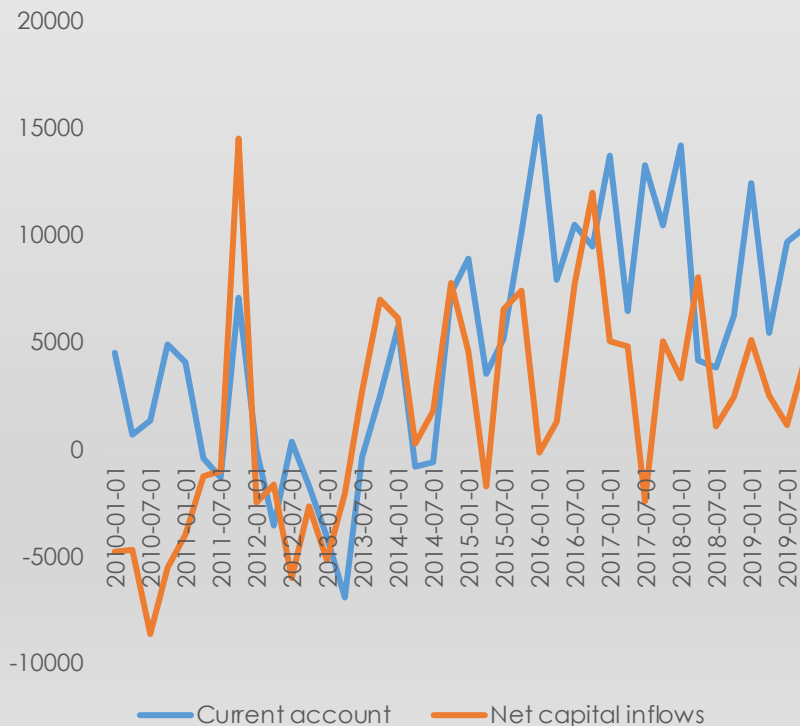


THAILAND: TRYING TO PREVENT BAHT APPRECIATION WITHOUT MUCH SUCCESS

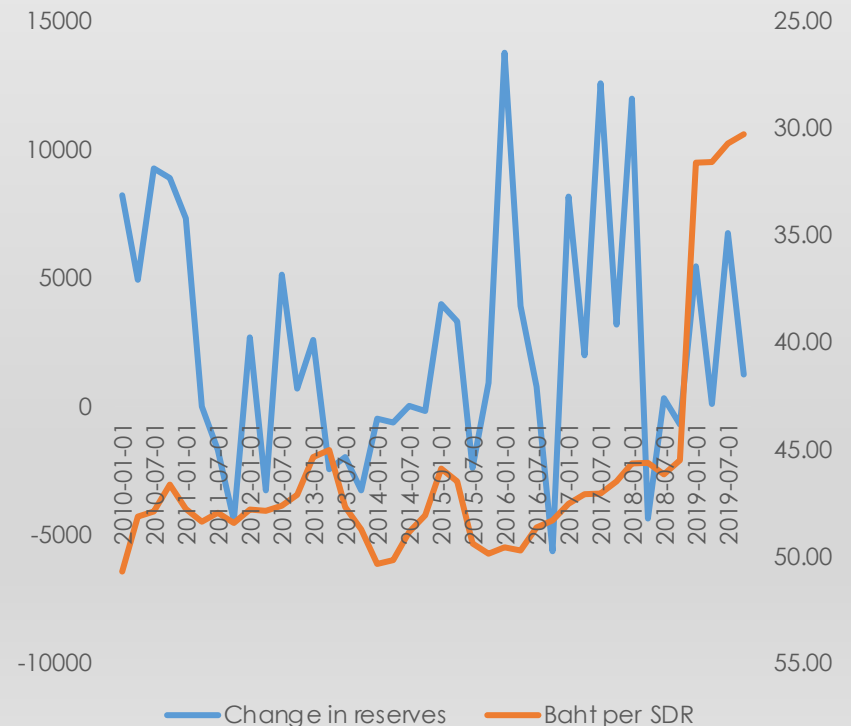
BOP SURPLUSES PUT UPWARD PRESSURE ON BAHT; 15% TAX ON CAPITAL INCOME IN OCT 2010 HAD TEMPORARY EFFECT

CENTRAL BANK KEPT ADDING TO RESERVES BUT HAD LIMITED IMPACT ON EXCHANGE RATE

Thailand: Current account and Net capital inflows



Change in forex reserves and exchange rate



SOME LESSONS- 1

- Deregulation of capital flows associated with higher volatility, financial instability and now external debt vulnerability in private bond markets, without necessarily resulting in better economic performance.
- Tendency to overestimate resilience of financial system and therefore allow excessive risk-taking, loose underwriting standards and overvaluation of assets.
- Procyclicality of external ratings can be made worse by some macroprudential moves.
- Exchange rate management now very complicated and goals have not been achieved either by Open Market Operations of central banks or specific prudential measures.

SOME LESSONS- 2

- Individual prudential regulations are less effective as they can simply lead to asset-switching or moves to different sectoral markets.
- Incentive structures for private players have to be constantly assessed and altered within broad framework of regulatory practices.
- Macroprudential regulations must be set in medium-term macroeconomic framework to reduce cyclicalities and mitigate macroeconomic risk.
- They must also encourage real investment, especially for employment generation and meeting social and climate goals – ideally as part of broader plan.