VAKIFBANK GLOBAL ECONOMY WEEKLY

New Approaches by IMF Against to Increasing Capital Inflows …

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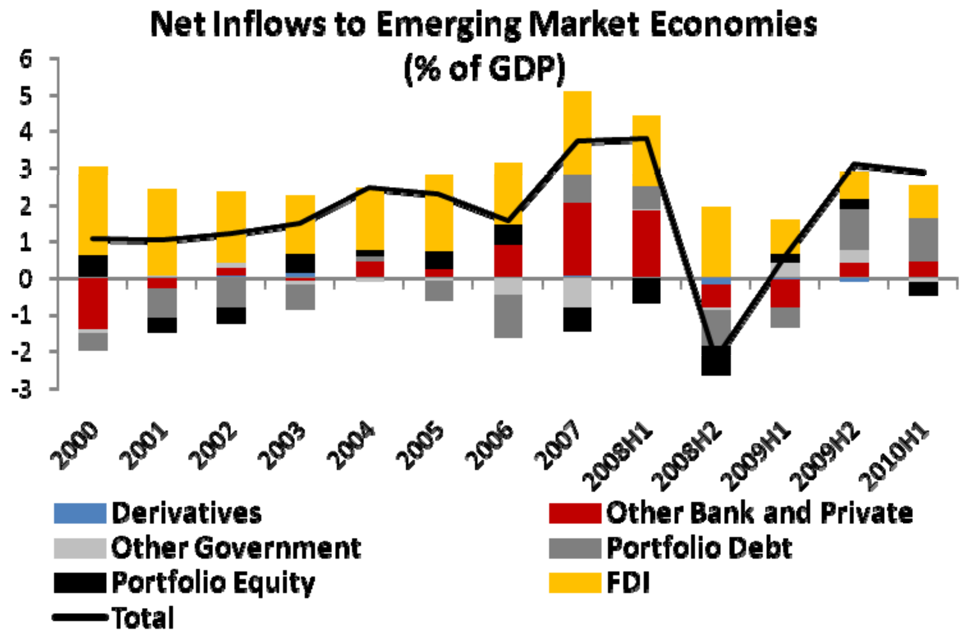
Capital inflows to emerging economies have increased recently…



Source: IMF

- After crisis period, capital inflows to emerging market economies (EM) have increased as a result of expansionary monetary policies and ample global liquidity in advanced economies. Positive growth outlook of EM, their relatively high interest rates and decreasing risks can be defined as other factors that increase capital inflows to EMs.

- Moreover decoupling which shows that recovery rate between advanced economies and EM encourage capital inflows to EMs.

- Although advanced economies are expected to maintain their expansionary monetary policies for a long time, EM such as China, Brazil and Chile have started to increase policy rates. Hence through short-term portfolio investments so-called hot money have increased capital inflows in these economies.

- Capital inflows to EMs have increased since 2009 and IIF estimates that capital flows to EMs will increase in 2011.

- In this situation may cause asset price bubbles and risks for financial system. Hence, EM have taken some measures against increasing capital inflows.

IMF analyzed the measures taken by countries against the capital inflows...

Structural Measures	Secondary Measures	After Other Options Exhausted
• Loan to Value Ratios (Korea, Thailand, Turkey) • Reserve Requirements for local currency deposits (Brazil, Indonesia, Turkey) • Levy on interest from consumer loans (Turkey) • Limits on banks’ net open FX positions (Peru) • Limits on ratio of banks FX loans (Korea) • Capital requirements for specific loans (Brazil) • Capital requirements for FX loans (Peru)	• Limits on banks’ FX derivative positions in percent of bank capital (Korea) • Reserve requirements on short dollar positions (Brazil) • Reserve requirements on FX deposits (Indonesia, Peru, Turkey) • Minimum holding period on investments in central bank bills (Indonesia) • Levy on banks’ non-deposit foreign liabilities (Korea) • Withholding tax on public sector bonds (Korea, Thailand)	• Fee on nonresidents’ purchases of central bank paper (Peru) • Reserve requirements on nonresident deposits (Peru) • Tax on equity and bond inflows (Brazil)

- Countries aimed to prevent the short term inflows from abroad and to reduce the volatility of the inflows. At the same time, measures were taken to limit the liquidity usage of residents.

IMF’s key elements of a possible policy framework for managing capital inflows…

- Allow the exchange rate to appreciate when it is undervalued on a multilateral basis.

- Purchase foreign exchange reserves—sterilizing the impact when inflation is a concern—if reserves are not more than adequate from a precautionary perspective.

- Lower policy rates, or tighten fiscal policy to allow space for monetary easing, consistent with inflation objectives and when overheating is not a concern.

- Use capital flow management measures if;

  (a) the exchange rate is not undervalued,

  (b) reserves are in excess of adequate prudential levels or sterilization costs are too high,

  (c) the economy is overheating, precluding monetary policy easing, and there is no scope to tighten fiscal policy.

- Conversely, do not deploy CFMs if the exchange rate is undervalued or as a substitute for necessary policy adjustments, such as addressing procyclicality in fiscal policy. However, CFMs could be used to complement fiscal tightening plans already in place, in light of the lags associated with the macroeconomic impact of fiscal consolidation.

- Give precedence to CFMs that do not discriminate on the basis of residency (e.g., currency-based prudential measures) over residency-based CFMs.
- Ensure the intensity of CFMs, whether or not residency-based, is commensurate to the specific macroeconomic or financial stability concern at hand. Lift CFMs when the risks they were designed to address recede, as CFMs are most appropriate to handle inflows driven by temporary or cyclical factors.
- In designing CFMs, consider country-specific circumstances and effectiveness/efficiency criteria (e.g., whether inflows are intermediated through regulated institutions).
- Strengthen the institutional framework on an ongoing basis. Prudential and structural measures that do not differentiate on the basis of residency or, typically, currency and are designed to strengthen the ability of the financial sector to cope with financial stability risks and the capacity of the economy to absorb capital inflows can be used at any time and before the necessary macroeconomic policy adjustments have been undertaken, provided they are not assessed to have been designed to influence inflows.

Source: IMF

Turkey in Policy Framework…

- Turkey has been attracting increasing capital inflow although uncertainty in Europe and the Middle East remains.

- Reduced political uncertainty, near term strong growth, and less leveraged household are supporting inflows.

- The composition of capital inflows in post crisis period is skewed towards short term maturities and potentially volatile portfolio assets

- Short term capital inflows lead to robust domestic demand and widening current account deficit

- Debt creating flows has increasing significantly, through banks and real sectors.

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