Comments on:

IMF Advice on Capital Flows to Latin America

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Hernando Vargas H.*
Banco de la República
Colombia

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* Technical Deputy Governor. The comments and opinions expressed in this presentation are my own and do not necessarily reflect those of Banco de la República or its Board of Directors

1. Comments on the general assessment
2. Specific comments on the assessment for Colombia
3. The Colombian policy approach to capital flow management policy

1. Comments on the general assessment

- Fair and complete evaluation of IMF's advice and policy dialog with the authorities of the region regarding capital flows and capital flow management

- Generally positive and fruitful interaction with the IMF on this and other issues

- Comment # 1: The report correctly points out that the *preemptive* application of CFM and macroprudential policies in the region between 2006 and 2014 came from painful lessons learned by the countries in the past, rather than from IMF advice,...

- ... and that the IMF had a humble and respectful attitude to listen and learn from our experience

- Comment # 2: The report states that *“Latin American countries have adopted a range of policy frameworks, reflecting in part different attitudes to how to handle volatile capital flows”*

- It is important to remember that these *“different attitudes”* resulted from varying history and legacy

- For example, financial dollarization in Peru and other economies stemmed from traumatic inflationary experiences,...

- ... while Brazil, Chile and Colombia resorted to indexation...

- ... with remarkably different consequences on financial structures and *“attitudes”* (institutions? Policy tools? Regulation?) toward financial integration and CFM policies

- Comment # 3: A positive role the IMF has played in the region that deserves mention in the report has been that of a “conduct” of knowledge, advice and practices between countries in the region

- For example, BCRP has been an important source of advice and guidance to other countries in the region with dollarized economies in their transition to more flexible monetary regimes like IT through the participation of its staff in IMF sponsored or coordinated missions

- A similar positive effect on the Colombian monetary policy framework came earlier from IMF-sponsored missions from the Czech Repubkic

2. Specific comments on the assessment for Colombia

- Correct assessment of the positive relationship between the IMF and authorities:
  - Productive policy dialog regarding the outlook and risks of the economy... Increasing quality of the interaction over time
  - Open and respectful discussion of policy frameworks and responses
  - The FCL has been very valuable since its inception

- Comment # 1: Non-resident **portfolio** investors have been generally sources of stability rather than instability throughout several shocks that have hit the Colombian economy

- For example, during the “Taper Tantrum” in 2013, foreign portfolio investors offset outflows from nervous residents

- During the sharp fall in oil prices in 2014-2016 and the huge depreciation of the COP (that reached almost 90% at its peak), foreign portfolio investors kept coming

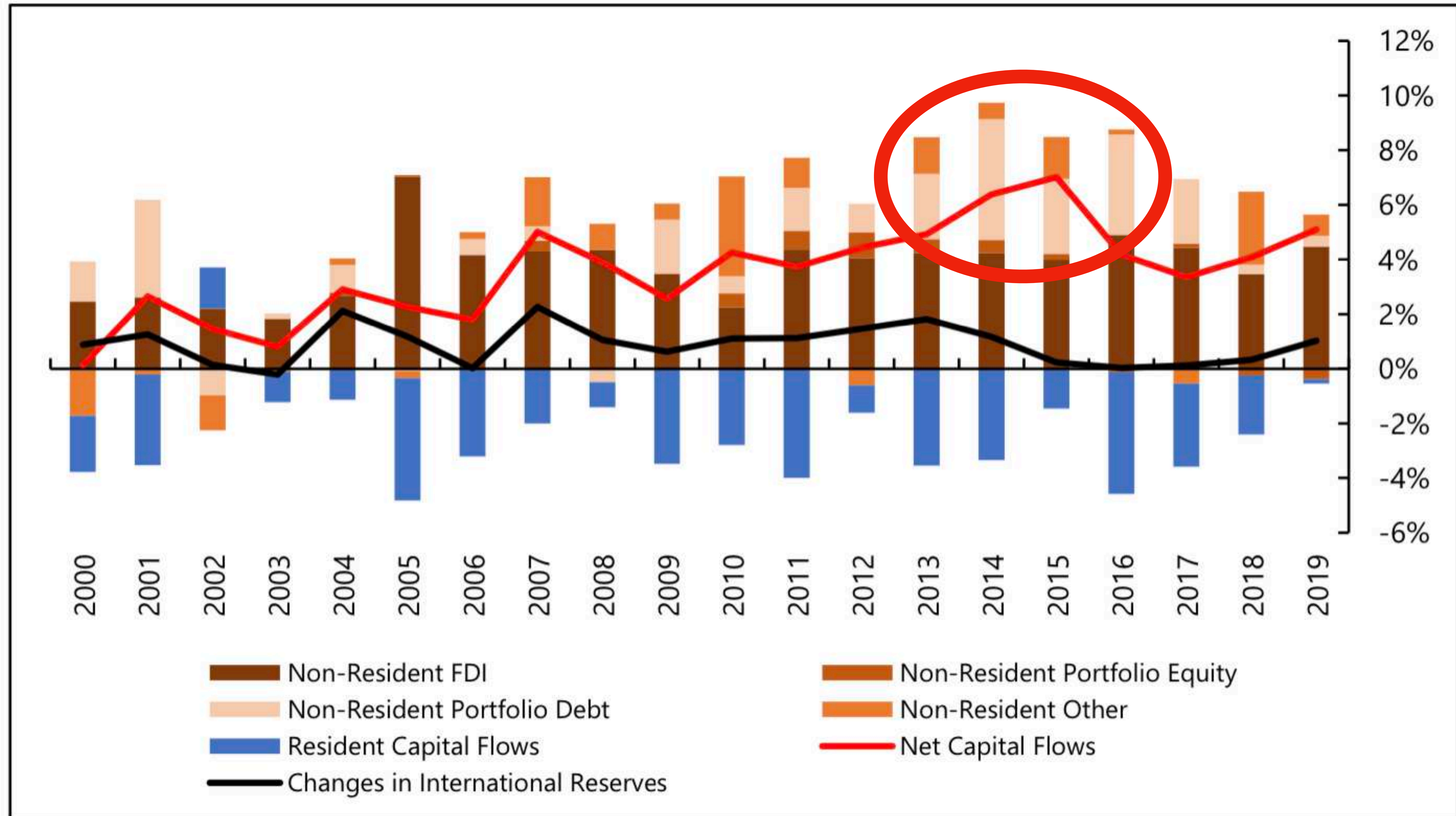
Figure 9. Colombia: Net Capital Flows, 2000–2019
(In percent of GDP)
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
Non-Resident FDI
Non-Resident Portfolio Equity
Non-Resident Portfolio Debt
Non-Resident Other
Resident Capital Flows
Net Capital Flows
Changes in International Reserves
Sources: Institute of International Finance; April 2020 WEO database.

- Comment # 2: Some useful clarifications on the Colombian experience:

- Banco de la República and the Colombian Government strengthened and adapted the currency risk, FX liquidity risk, and Conglomerate regulation and surveillance of Colombian banks expanding overseas ***before*** the IMF discussed in detail those issues with the authorities ... parts of that regulation did not even exist in the Basel guidelines (South - South expansion)

- Foreign portfolio investment increased markedly since 2014, after the inclusion of Colombian local bonds in EM bond indices... However, that followed a reduction and a clarification of taxes on its returns... I.e. there was a previous opening of the financial account for those flows

  - ... By the way, the substantial reduction of “original sin” and potential for currency mismatches that resulted from those phenomena should be highlighted in the report

- The URR increase on foreign indebtedness and portfolio investment between 2007 and 2008 is presented in the report as a measure to confront the appreciation of the COP...

  ... But this is an incomplete representation of the facts... Domestic credit supply had skyrocketed since 2006 in spite of increases in the policy interest rate... Hence, *domestic* reserve requirements were raised and the URR rise was the natural complement to contain a credit boom and possible currency mismatches in the real sector ...

  ... We viewed it more as a macroprudential measure than as a purely FX policy measure

- Similarly, FX intervention is generally presented as a tool to contain currency movements or volatility... This was (totally or partially) the case on several occasions...

  ... But there were other motives for FX intervention (increase International Reserves or support market liquidity and stability, for example)... This is key to understand the timing and mode of FX intervention

- The purchases of public and private bonds by Banco de la República after the Covid-19 shock are understood as *“the first case of so-called ‘quantitative easing’ in the region”...*

  ... This is not accurate. Those purchases were made to stabilize key markets under heavy stress, not to achieve particular values of the long term interest rates in response to inflation or output gaps...

  ... Actually, those purchases were made when policy interest rates were well above zero, and they were suspended once liquidity indicators of the relevant markets (e.g. bid-ask spreads) began to normalize

3. The Colombian policy approach to capital flow management policy

- Three-pronged approach to macro and financial stability in Colombia: IT with ER flexibility + Fiscal Sustainability + Sound Financial Intermediaries and ample macro and micro liquidity/solvency buffers
  - For this to work, a key element is the containment of currency and FX liquidity mismatches: it facilitates ER flexibility and Sound Financial Intermediaries (with feedback)
  - That is why financial dollarization is not permitted and currency mismatches are closely monitored

- In the other hand, there is a view that an open capital account has plenty of static (cost of funds, risk diversification) and dynamic (financial development) benefits

- The Colombian "solution" to possible tradeoffs that may appear is a system that combines permanent financial regulation (e.g. currency and FX liquidity mismatches) with occasional implementation of "counter cyclical" measures (e.g. movements in URR)

- The latter are sparsely used (as tools of last resort), in light of their uncertain effectiveness and the hidden risks that may result from circumvention

- Looking ahead, this framework would face challenges, as financial development is likely to weaken the power or effectiveness of some of the regulatory and countercyclical measures

Gracias