

Capital Flows and Exchange Rates: A Look Back and a Look Ahead

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Pre-crisis



- Easy financial market conditions globally
- Appreciating currencies in many debtor countries
- Widening global imbalances—including deficits in “peripheral Europe”
- Large two-way debt flows among advanced economies

The crisis

- Global risk aversion shock
- Collapse in global capital flows
- Flight-to-safety on currencies (through March 09)
 - and US\$ up, virtually everybody else down
- Sharp reduction in imbalances (recessions plus lower oil prices)

What has happened since March 2009?



- Capital flows to and from advanced economies remain weak
- Recovery in capital flows to emerging markets
- Rebound/appreciation in EM currencies
- **Still unsettled financial market conditions**

Capital flows and exchange rates looking ahead (I)



- Global rebalancing
 - Adjustment so far primarily through expenditure compression in deficit countries
 - ...but need for expenditure-switching over the medium term
 - Scope for real appreciation in surplus countries, particularly in emerging Asia
 - Euro weakening since the beginning of the year helpful for external adjustment in peripheral Europe

Capital flows and exchange rates looking ahead (II)

- Picture for other emerging markets more differentiated
 - ▣ Latin America: substantial exchange rate adjustment already, challenge is how to deal with large capital inflows
 - ▣ Emerging Europe: heterogeneous picture. In several countries need to reduce vulnerabilities and macro imbalances (risk of capital-flow reversals, for domestic or external reasons).

Overall....

- Good “baseline” prospects for K-flows to EMs
- Exchange rates have adjusted with the crisis, but more needed to facilitate rebalancing
- Still pervasive uncertainty:
 - ▣ Pace of the recovery in advanced economies
 - ▣ External adjustment in the pipeline (e.g. US, China)
 - ▣ Potential output, particularly in crisis-hit countries
 - ▣ Implementation of ‘exit strategies’
 - ▣ Financial market conditions

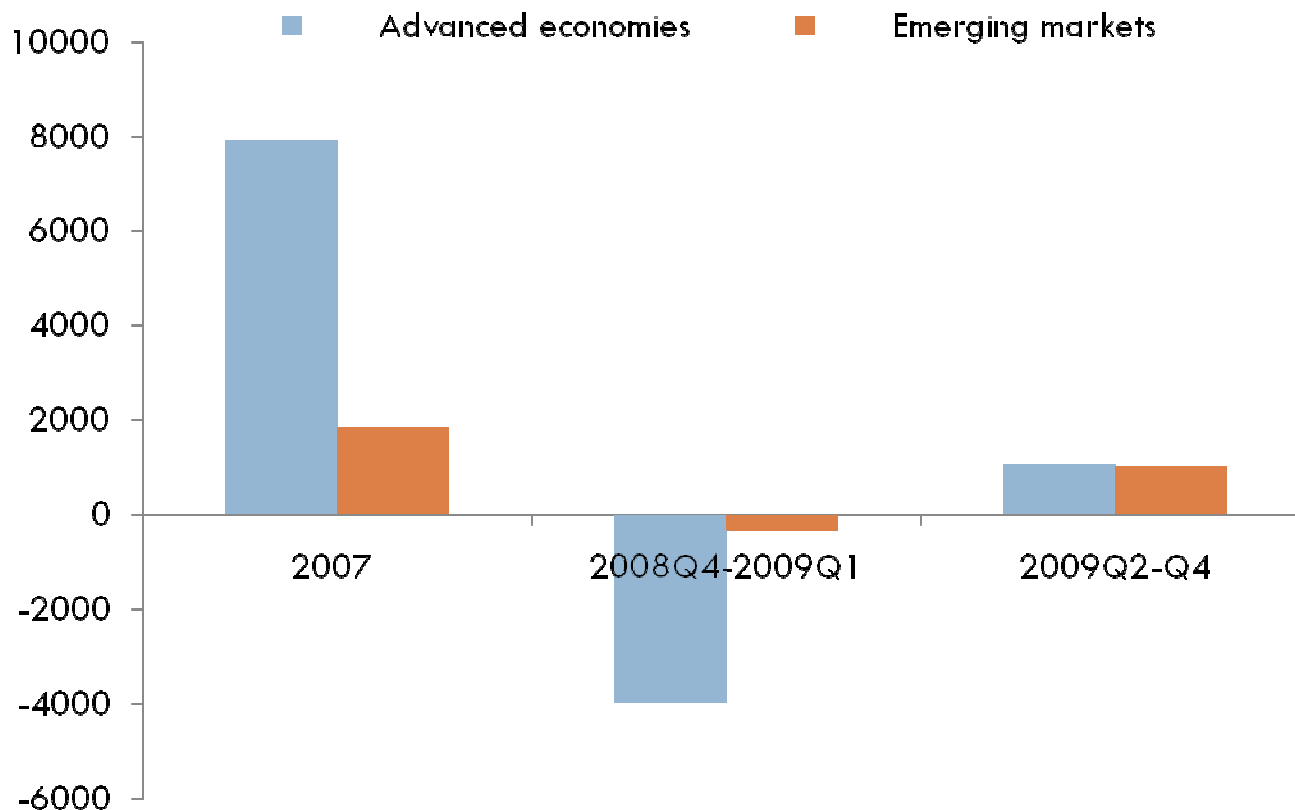
Background slides



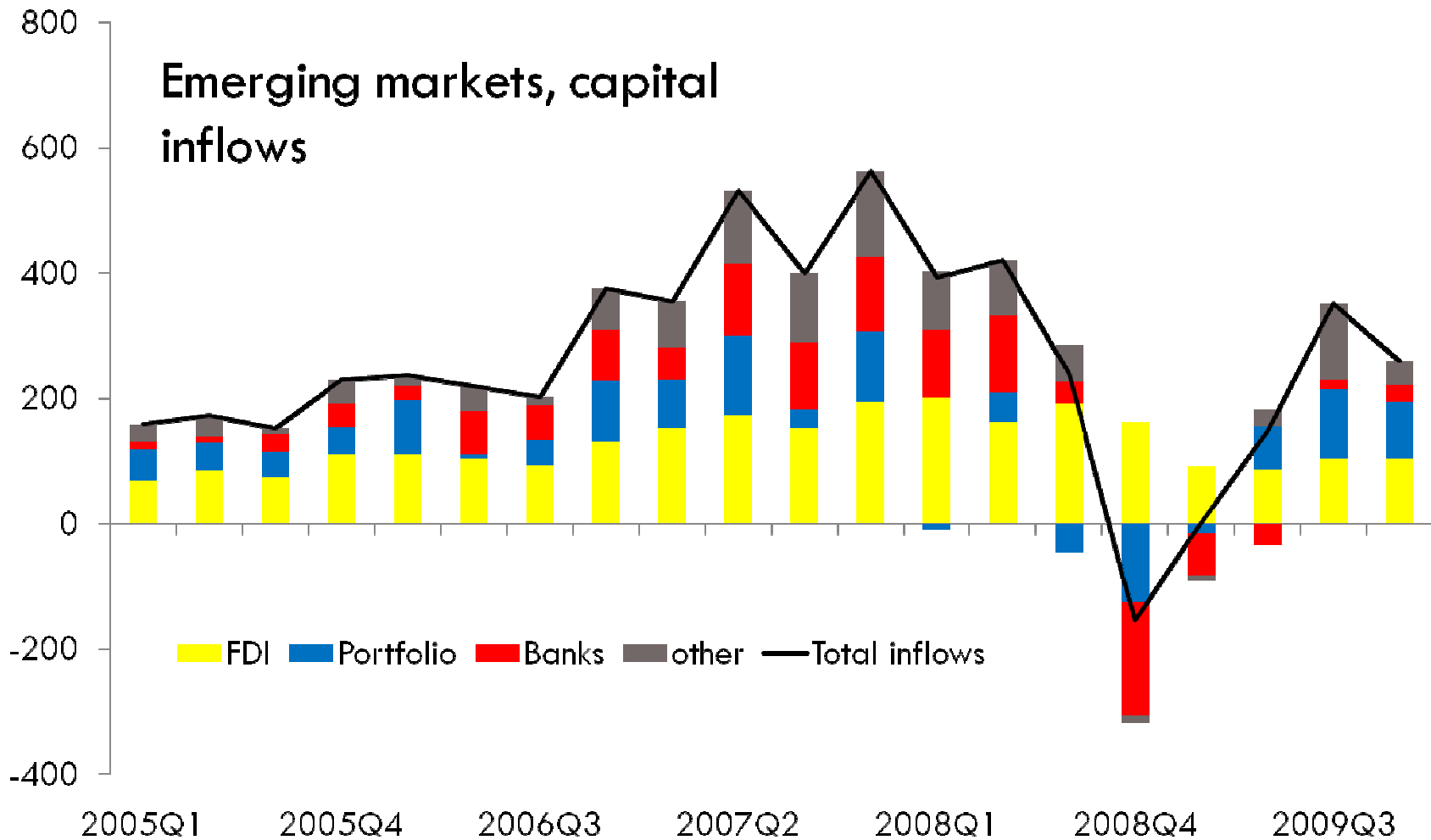
Change in the pattern of capital flows:

larger decline and shallower recovery for advanced economies

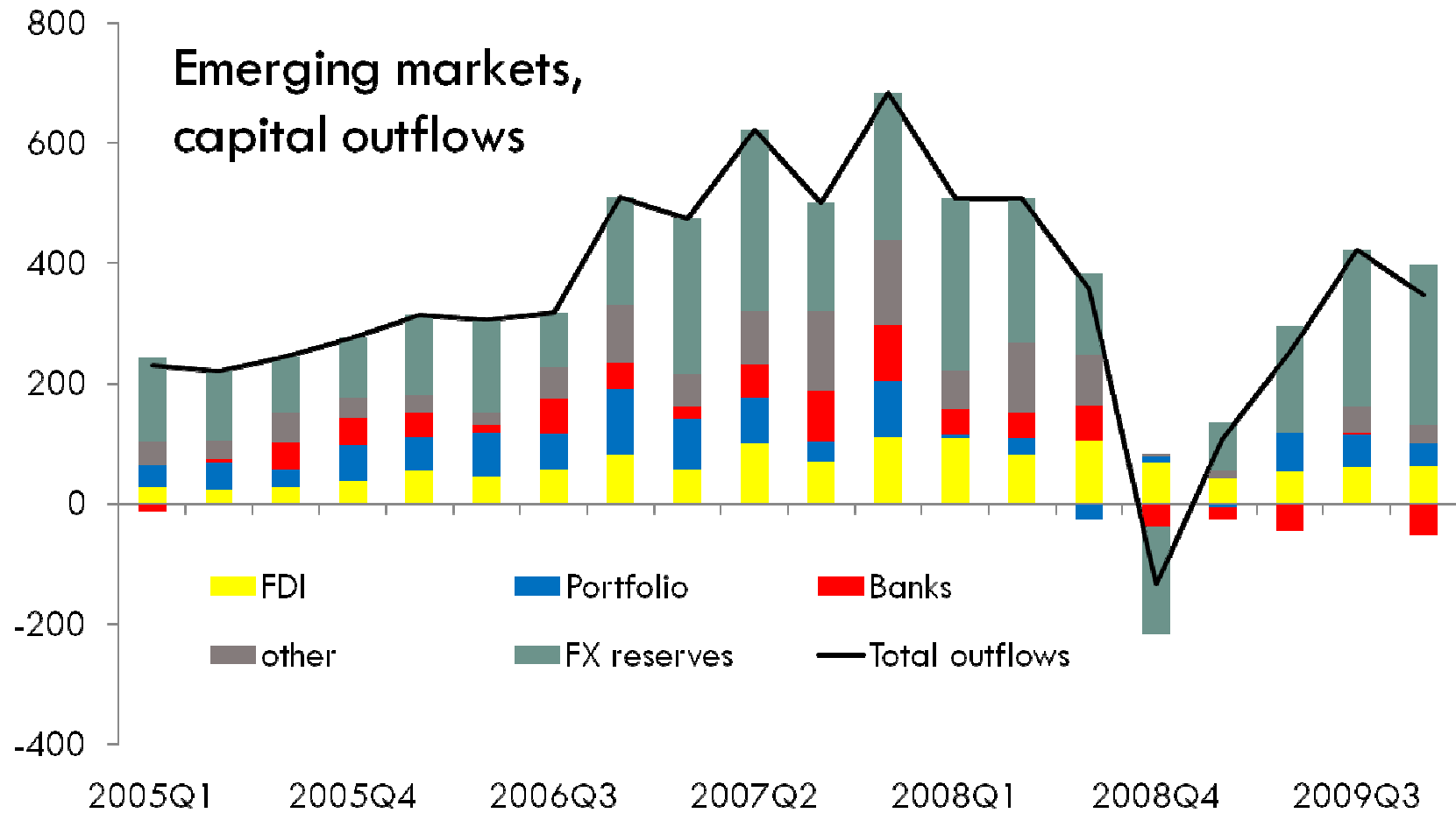
World capital inflows (annualized rates, billions USD)



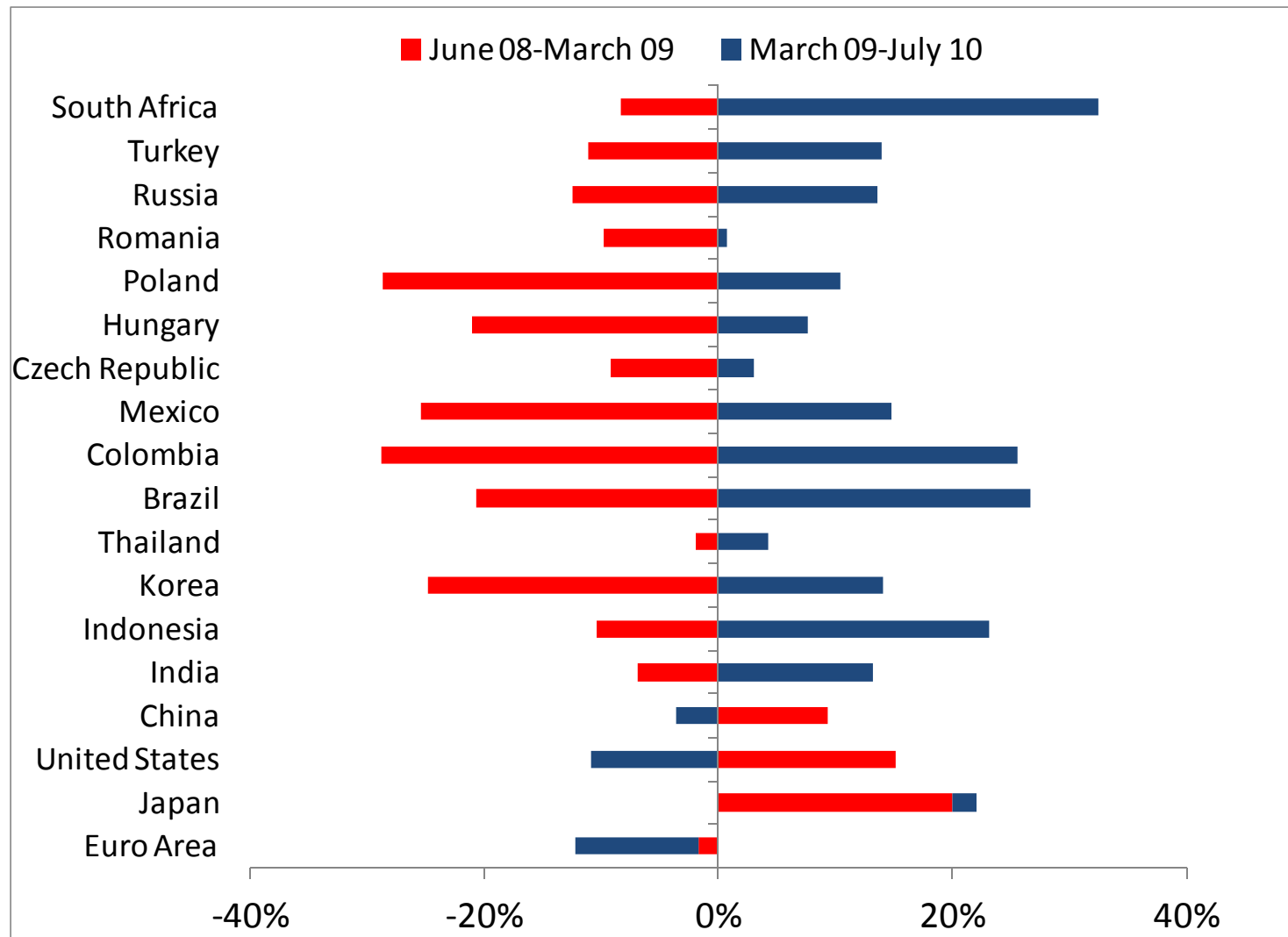
Flows to emerging markets have recovered...



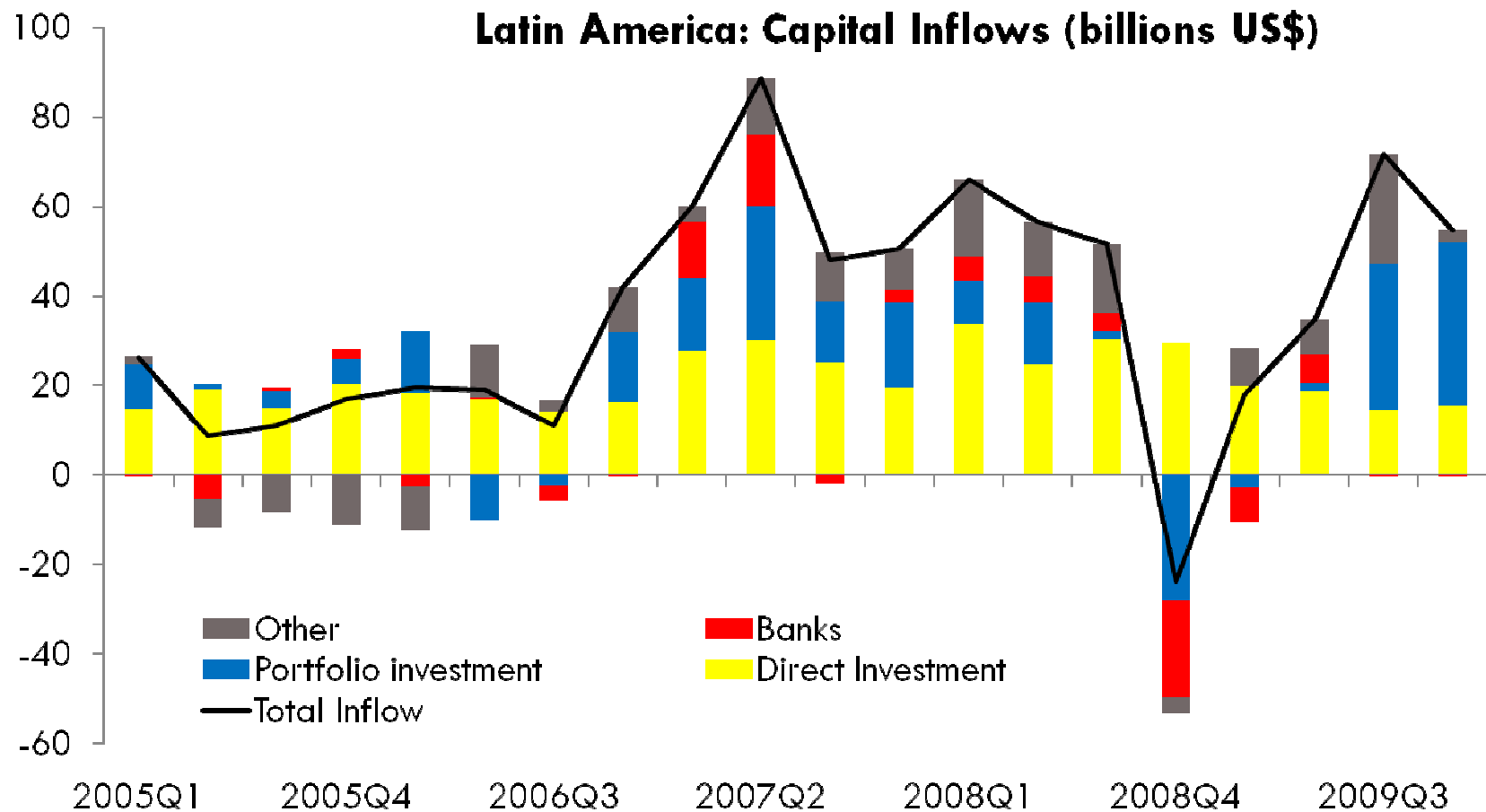
...offset by renewed accumulation of reserves



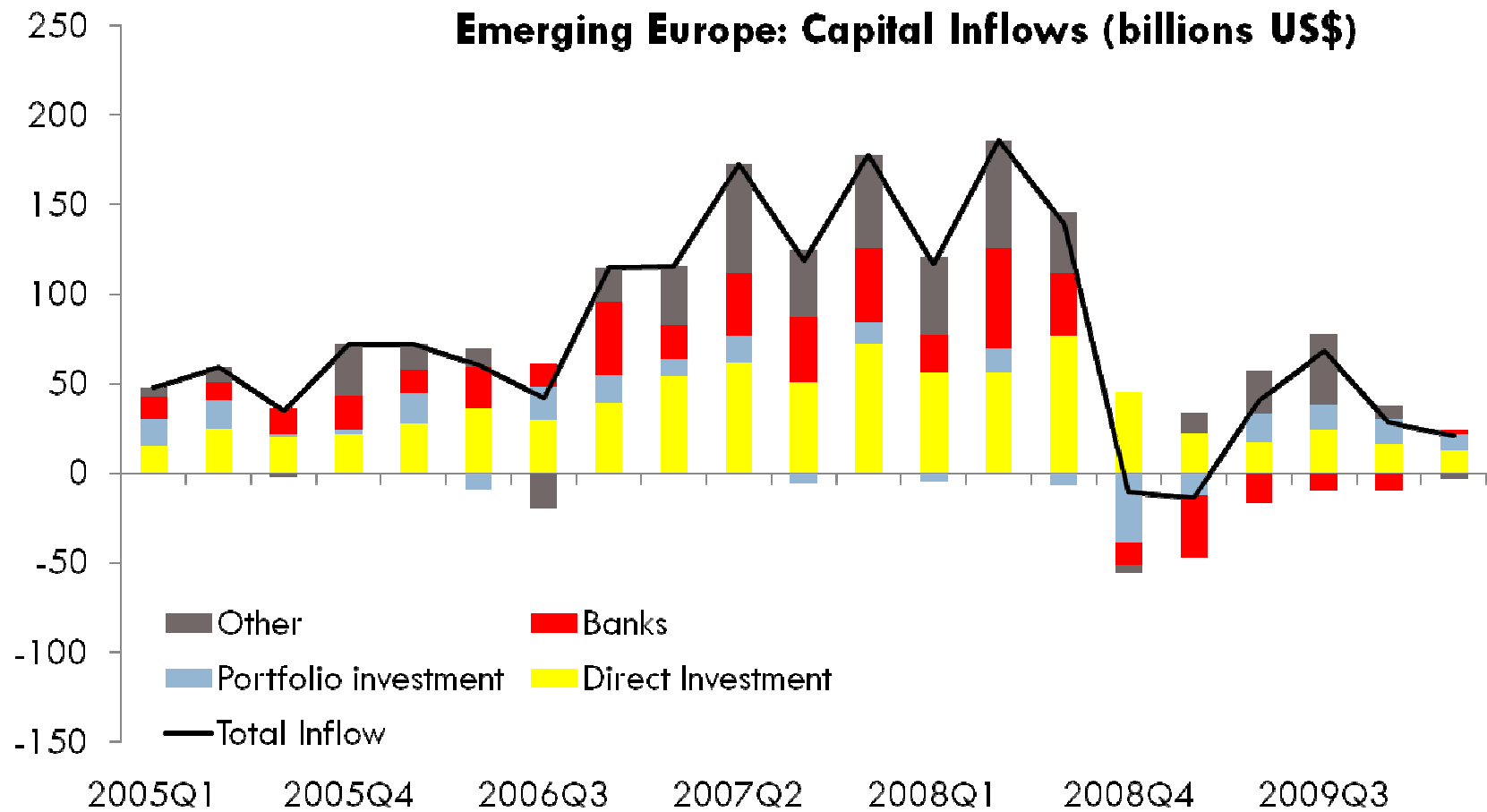
Real exchange rate changes



Capital flows to Latin America



Capital flows to emerging Europe remain weak...



Capital flows to emerging Asia

