Seminar on Open and Orderly Capital Movements

Does global co-operation matter?

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Remarks

I want to thank the OECD for this invitation; it is incredibly valuable for us to be able to present our perspective in this forum.

The central bank is not the lead discussant in the access process to the Codes, but we are a key player in the subject since we define some of the macroprudential policies that have been discussed during the day. On the other hand, when the process began I was Head of Financial Regulation and then Deputy Minister of Finance, and therefore responsible for another set of these policies. What I will share here is my personal view of how the adherence process has advanced for Colombia, having been both on the side of the government and now as part of the Board of the Central Bank.

I will divide my remarks in 3 parts:

1. Countercyclicality
   It would be my understanding that the code allows for the space that the regulatory and policy framework in emerging markets might require in order to introduce macroprudential measures; that was the case for Colombia. However, it might be useful to more formally introduce language that allows for *preemptive* countercyclical measures, which give the capacity to local regulators to increase the marginal cost of some inflows when push factors might be fostering excessive balance sheet expansions and/or asset price valuation processes. The language in article 7 describes more corrective procedures and that would not be optimal if these processes threaten to deviate the economy from a sustainable trend of liberalization. In the long term I would depict the liberalization process as a trend towards a more open equilibrium, but one that allows for countercyclical reactions that protect the process from crises that would harm the long term goal. These preemptive measures can work for a more consistent and resilient process.
   Our experience in adhering is that the codes provided space for such measures but as I say I think it would be convenient to incorporate the “ex-ante logic” in increasing temporarily the marginal cost of certain flows. The nature of these flows may be difficult to differentiate and therefore it is hard to affect only the portfolio debt flows shown in the morning as to be the ones most harmful, which means, among other things, that the

unintended consequences that Mr. Cowan described earlier will be taken into account when taking the decision of imposing them or not.

If a country is committed to a long term process of liberalization, it will be evident that increasingly, the costs of imposing such measures will be higher than the benefits, precisely because the economy gains resilience along with the strengthening of the regulatory and policy framework. The Chilean example is a good illustration in that sense. However, it is imprudent to lose the *capacity* of being able to use the measures, ahead of time.

In the case of Colombia we have retained the faculty to react counterciclically to certain flows, but, looking at recent history it is also evident that resiliency has increased and that we haven't used them in a long period of time. As chile, we have also witnessed some stabilizing effects of foreign asset holdings of local institutional investors; there is an endogenous reaction of currency mismatches to the volatility of the floating exchange rate; and the framework in general has changed the conditions under we have adjusted to the very strong negative terms of trade shock that the economy has lived through. We experienced very heavy inflows of portfolio investment in the first three quarters of 2014, and then, the extremely strong shock I mention in terms of trade, at the end of that same year. Along the inflow period, we increased our international reserves accumulation and strengthened our buffers; put in place some internal macroprudential policies too (probably even before this juncture), but we imposed no capital movement measures. Once the shock hit us, we allowed the exchange rate to absorb it, with a sharp depreciation, which from trough to peak reached levels short of 85%. Fluctuations of this sort without any major disturbance among corporate and financial institutions are new to our history and speak about the resilience the economy has gained.

Authorities internalize the costs of any capital flow measure in the face of market reaction, as well as rating agencies, and I don't believe that they will be used unless there is a real threat to sustainability, in which case I think they will go in as a protection to the long term liberalization process.

2. Currency risk and liquidity risk in foreign currency

   This is the second issue in which I believe there is need for some space within the codes, and we need more collective work on the subject. There is still the need to better understand the effects of currency risk and liquidity risk in foreign currency in financial balance sheets; I would concur with what was said earlier in the sense that Basle III may not gather these risks in the magnitude that is relevant, at least for emerging markets.

3. New advances

   Finally I want to deviate, substantially I fear, from what we are discussing today, but it seems a pertinent remark to make in the middle of a review process of the codes. The technological advances, all the digital innovations that we are witnessing, from *crowdfunding*, to *criptocurrencies* will change, are changing rather, the way financial services are provided. Many of these new technologies will create flows that will fall out of the current categories. Residency, place of origination, frontiers in general, will grow blurry with this progress. It will be interesting for this group to elaborate on the challenges of all that is been called fintech, in the discussion of the codes.

Thank you very much.